BURKE
FINANCIAL STRATEGIES
99 Wood Avenue South, Suite 102
Iselin, NJ 08830
732-744-1200
john.burke@burkefinancialstrategies
steven.criscuolo@burkefinancialstrategies.com
christopher.trainor@burkefinancialstrategies.com
melissa.montalvo@burkefinancialstrategies.com

JOHN B. BURKE, MS, CFP®
Financial Advisor

STEVEN CRISCUOLO, CPA
Financial Advisor

CHRISTOPHER M. TRAINOR, CFP®
Financial Advisor

MELISSA MONTALVO, CFP®
Financial Advisor

financial $UCCESS

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To reach us during office hours, please call 732-744-1200

Pension Plans vs. 401(k) Plans

A pension plan has become exceedingly rare, or at least that's the conventional wisdom. But that doesn't mean pensions are not still an important retirement planning tool for many people. While it's true that few private sector employers offer pension benefits for new hires, they are still common for people who work in the public sector. Many older people also have some pension benefits, perhaps from a previous employer. So, although pensions aren't available to everyone, they are still an important part of the retirement planning mix for millions of Americans.

Whether you have a pension, a 401(k) plan, or a combination of the two, you may be wondering which is better. The answer is it depends.

The Difference Between Pensions and 401(k) Plans

What separates a pension plan from a 401(k) plan? A pension is a defined benefit retirement plan. Your employer contributes money throughout your working years in a pot with all other employees' money. The money is then invested on behalf of you and your coworkers. When you retire, you receive a predetermined monthly benefit based on your length of service, salary, and age. Your benefit is guaranteed, but you don't have any control over how the money is invested.

With a defined contribution plan, like a 401(k) plan, you (and your employer if they offer matching contributions) set aside money in a special account. You can then invest that money in options available in the plan. Unlike a pension, the amount you receive when you retire depends on the amount you save and the investment returns you receive.

Pros and Cons: Pensions

At first glance, pensions seem

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Do You Have Too Much Debt?

If you are worried about your debt levels, look for these signs that your debt level may be getting too high:

✔ **You have no money left over at the end of the month.** If you have nothing left to save after paying your bills every month, your debt may be too high.

✔ **You've reached your maximum credit limit.** If you've maxed out your credit card limits or are considering obtaining new cards for additional credit, your debt may be getting out of hand.

✔ **You're only making minimum payments.** Minimum payments on credit card debt are so low that it can take decades to pay off the debt.

✔ **You don't have an emergency fund.** Ideally, you should set aside three to six months of living expenses in case of emergencies, such as a job loss or major home or car repair.

✔ **You're not comfortable.** The ultimate test of whether your debt level is too high is your comfort with that debt and the payments that must be made. ❍❍❍

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Pension Plans

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superior to defined contribution plans. After all, you get a guaranteed benefit that lasts for the rest of your life after you stop working. A pension eliminates the risk of outliving your money or losing all your savings because of a market crash or an investing mistake. Overall, pensions also have slightly better returns over time than 401(k) plans.

But pensions have their downsides too. One of the biggest is that you can't control the investments. That means that if you're a savvy or aggressive investor, you could be missing out on possible gains. Another drawback? If you leave your employer before a certain time (called your vesting period), you lose access to all or a portion of your benefit. Finally, if your employer runs into financial distress or goes out of business, your benefit may be far less than you anticipated.

Pros and Cons: 401(k) Plans

Employers love 401(k) plans since they take the responsibility for managing employees' retirement off of the employer and put it onto the workers. Many employees like 401(k) plans too, since they can control how much they save for retirement and how it is invested. And the money you contribute is yours — you won't lose it if you change jobs (although you may lose matching contributions, depending on how long you've worked for your employer) or face the possibility of reduced benefits if your employer goes bankrupt. Finally, you can pass on any money left in your 401(k) plan to your heirs. That's not the case with a pension, where the benefits end after the pensioner or the pensioner's spouse dies.

But 401(k) plans have their disadvantages as well. First, you need to be motivated enough to set aside money from your paycheck — money you could be spending today — for retirement. Many people struggle with this, either putting off saving or not saving enough. Another problem? Many people don't take enough risk with their retirement savings. If you stick with cash or low-interest bonds, your returns likely won't be high enough to generate the income you need in retirement.

Defined benefit and defined contribution plans each have their pros and cons. Whatever type of retirement plan you have access to, it's essential to understand how it works and what your responsibilities and options are. Please call if you'd like to discuss this in more detail. ❍❍❍

Control Your Spending

Do you feel as though you live paycheck to paycheck? Are you frustrated that you earn a reasonable income but never seem to have anything to show for it? If so, you may need to take active steps to control your spending so you will have funds available to save for long-term goals. The following tips may help:

✔ **Track current spending.** Most people have no idea where their money is spent. To make intelligent choices about where to spend your money, you need to first analyze how you are currently spending your income. Canceled checks, credit card receipts, and tax returns will provide much of the needed information. If you are unable to account for large sums of money, you may want to keep a journal of all expenditures for at least a month.

✔ **Identify spending problems.** Overindulging can cause serious financial problems. Review each expenditure carefully, ranking it as important, moderately important, or unimportant. Eliminate, or at least reduce, unimportant expenditures, allocating those sums to your savings.

✔ **Develop long-term savings goals.** To modify your spending habits, you need short- or long-term goals that will motivate you to save rather than spend.

✔ **Make saving automatic.** Find ways to make saving as automatic as possible, perhaps through payroll deductions or monthly checks to an investment account.

✔ **Give yourself rewards.** Just because you are trying to control your spending doesn't mean you must live an austere life. You may need to cut back on some discretionary spending, but you should still allow yourself a personal allowance to spend freely. ❍❍❍

How to Improve Your Credit Rating

Credit scores are important because they determine your ability to get a loan. Credit scores also impact the interest rate and fees you will pay on that loan. Additionally, it can affect whether a landlord will rent to you, an employer will hire you, an insurance company will cover you, and utility companies will turn on services. While you need credit to get credit, having healthy credit is a balancing act.

What Is a Good Credit Score?

While creditors use different credit scoring models, the following provides a good example of score ranges:

750 and above	Excellent
700–749	Good
650–699	Fair
550–649	Poor
550 and below	Bad

The scoring models use five key factors in determining your credit score, including:

- **Payment history** determines how much of a risk you are to creditors in your ability to make timely payments.
- **Amount of debt** shows how much credit you have available and how much you are using. If you are holding a lot of debt, creditors worry about your ability to take on more.
- **Age of accounts** provides creditors with a good understanding of how you manage debt.
- **Account mix** shows lenders how you handle different types of credit.
- **History of credit applications** shows how often you are applying for credit and if you are overextending yourself.

If your credit score falls into the fair, poor, or bad range, it's time to work on improving that score.

Look at Your Credit Report

The first step to improve your credit score is to review your credit reports from all three of the major credit bureaus: Experian, Equifax, and TransUnion. Since your credit score is based on the information in your credit reports, you need to make sure they are accurate. Here is a list of things to look for:

- Is your personal information accurate, including your full name, address, Social Security number, and birthdate?
- Are all of your credit accounts on the report?
- Are there late or missed payments that are inaccurate?
- Are there accounts or credit applications you don't recognize?
- Are there items from more than a decade ago that are still on your report?

If you find inaccuracies on any of your reports, contact the bureau to find out their process for disputes and resolution. If your credit reports are accurate and your score is suffering, the following steps can help bring your score into the healthy range:

Pay on Time, Every Time

This is one of the most important factors that impacts your score. If you are late or missing payments, you need to set up a plan to make sure your payments are made on time. You may want to set up payment alerts so that you remember to make the payments, or even easier, you can have payments automatically deducted from your checking account.

Ask for Forgiveness

If you are late with a payment, call your credit card issuer or lender to see if they will forgive the late payment. If you have a consistent track record of on-time payments, they will most likely work with you.

Consider Your Credit Mix

If you only have one type of credit, it will impact your score. If you've never had a credit card, it may be time to get one. Just make sure you pay your balance off on a monthly basis or make on-time payments. If your poor credit score is preventing you from getting a credit card, see if you can get a secured credit card from your financial institution.

Not Too Many Cards

Don't go overboard, because the more credit you apply for in a short period of time, the greater damage it will do to your credit report. When you apply for credit, it is considered a hard inquiry, which will impact your score regardless if you get approved or not. So if your score is in between tiers, too much credit can put you in a lower tier.

Watch How Much You Use

Your score will suffer if every month your credit card balances are more than 30% of your limit. Even if you pay off your balance each month, a higher utilization rate will negatively impact you. If you know your balance is going to be above 30% in a month, prepay some of the balance so you are in the safe zone.

Please call to discuss this in more detail.

GOOD NEWS!

The headline above is one you will seldom see in the newspapers or hear from the talking heads. As we celebrate our July 4th holiday, let me remind you that the holiday commemorates the year 1776. Yet 1776 was a very difficult year. General George Washington was on the verge of being fired as the leader of the revolution, for most of the year, after losing New York to the British and, in general, celebrating "masterful" retreats and not victories. In the final days of the year, Washington scored victories in Trenton and Princeton to begin 1777 with good news.

We too can celebrate how far we have come from a difficult year. On March 12 of last year, I was interviewed on Bloomberg Radio. Here is part of the transcript:

"Let's get back to John Burke. You know one of the things that people are trying to identify here, as the stock market rout deepens, is 'when is capitulation?' Do you even try to think about that, or is that just that falling knife thing is just too risky?"

(Sidenote — "don't catch a falling knife" is a long-held Wall Street adage that you should not buy when prices are declining quickly)

Responding, "Well, hey, Paul, you know, picking up on what I was saying before, I think it's time to buy. The reason being that the market going lower from here is to say that this pandemic will not be contained."

The Bloomberg interviewer responded somewhat incredulously, "talk about buying in a market like this! You have to talk time horizons, is this a longer-term bet that eventually we'll return to some sort of a bull market again, sometime in the future?"

It turns out I was a little early on my call to buy, as the market continued to decline over 10% before hitting a low nine days later on March 23. The S&P 500 is up 70% since March 12, and the reason is simply that the pandemic is nearly over, thanks to vaccines produced by pharmaceutical companies both here and abroad. That's good news.

Runners have a saying: If you don't know where the wind is, it is at your back. The point is that you don't realize the wind is at your back until you turn into it. And we should try to enjoy the wind when it is at our back. In a financial sense, the wind is now at our backs.

While we always worry, right now clients seem to be worried more than one would think, given all the good news. The pandemic is running its course, corporate earnings are the best we have ever seen, consumer debt is low, and interest rates remain at historically low levels (more on them shortly).

What's more, the economy, if anything, has yet to hit its stride. Supply chain constraints mean that you can't get furniture, bikes, pools, cars, and even new homes, to name a few consumer items on backlog. Some constraints are the result of a still-raging pandemic in supply countries like India and Brazil. The very strong pace of the economic recovery has semiconductor manufacturers, for one, struggling to keep up. Constraints are also being caused by a shortage of workers. Ships are waiting in port. Trucks are parked waiting for drivers. How hot will this economy be once these issues start to get resolved? Economic growth (GDP for example) is already at historically high rates.

We'd like to be invested in stocks when the constraints ease because stocks benefit from strong earnings, which derive from a strong economy.

Many of you, however, point out to us that all these supply shortages are going to result in higher inflation. We agree that is something to keep an eye on. In fact, higher inflation is already here. April's CPI increase (the key inflation reading) was 4.2%, one of the highest readings in many years. May's CPI increase, 5% over the past year, is the biggest 12-month inflation spike since 2008. This has caused interest rates to rise by about 1% since last August's low, but that was an all-time low. Rates are still well-below long-term averages. The much watched 10-year Treasury rate is at about 1.5%. It has traded between just over 3% and that 0.5% low over the past 10 years. In the 10 years before that, 3% was the low end of the range. In fact, at these rates, even though home prices have soared, homes are still affordable because mortgage rates are still low by historical measures.

Federal Reserve Chairman Jerome Powell says that inflation will only be high temporarily. It has been pointed out that Powell is not an economist, unusual for such an important economic position. Given rising inflation and supply chain issues, perhaps he is wrong about inflation.

The good news about inflation concerns is that we should receive a warning if it is going to impact the economy. Interest rates would likely head higher as bond investors demand higher rates to offset the effects of inflation. We think we'll be able to see the problem developing. We'd be worried if that 10-year Treasury rate gets near 3%.

We'd also be worried if it turns out the pandemic is not near its end. As with interest rates, we think we should see signs of that worsening as well, in the case counts.

Over the years, we've written quite a few of these newsletters and penned quite a few emails. Surely you've noticed that we don't like to see clients get in and out of the market. It doesn't work out well very often. In fact, let me conclude with the closing to that Bloomberg radio interview:

"John Burke, thanks so much for joining us. I really appreciate your thoughts there. John Burke, strategist and CEO at Burke Financial Strategies. Lisa, John was one of the, uh, I say relatively rare people we've heard over the last week or so saying, you know, here's a time to buy. Most people as they look at this taper, I think they're a little bit more inclined to kind of just stay on the sidelines here."

Now granted, not all of my markets calls have proved to be as prescient as the one from last March, and there is no way to know for sure what the markets will do. Inflation may hit us quicker than we think or the Covid virus may reassert itself, knocking stocks down. We can't say for sure. But we are more inclined to think that you should head off to enjoy your summer — with the wind at your back.

John B. Burke

John B. Burke, MS, CFP®
Financial Advisor

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