Money Matters 2025

Understanding index funds

Investing is a skill that some people develop over time. When just starting out, novice investors might not be comfortable choosing individual stocks. In these instances, options like index funds merit consideration.

Investopedia advises that an index fund is a type of mutual or exchange-traded fund (ETF) that tracks the performance of a market index like the S&P 500 or the Russell 2000. The index fund holds the same stocks or bonds as the index, or a representative sample of them. Some index funds track specific sectors, company sizes or additional qualifying parameters.

Index funds do not change very often, and will only do so when the makeup of the index they are tracking changes. Index funds are popular investment vehicles for many reasons. Here's a look at why it can be advantageous to invest in index funds.

• **Lower costs:** Because index funds do not have fund managers who actively buy and sell assets regularly, they typically have lower fees in the form of expense ratios, which are the costs of running the fund.

• **Passive investing:** Index funds are a long-term strategy that utilizes passive investing so that an investor doesn't have to pick securities or time their choices to the market.

• **Diversification:** Index funds enable investors to enjoy broad market exposure across various sectors and asset classes according to the benchmark indices they follow.

• **Reduced bias or error:** According to Fidelity, professional investment managers may make mistakes during stressful market conditions. Index funds don't require a manager to make decisions beyond tracking the index.

• **Reduced taxes:** People who invest in actively managed funds that sell frequently tend to owe more taxes than investors in funds that sell less often. Index funds tend to not sell often.

Although there are many perks to index funds, there are some detriments as well. Some funds put a lower limit on how much an investor needs to invest. And while index funds are low-cost, they aren't always no-cost. A fund's expense ratio needs to be examined to ensure that the smallest cut of returns goes to the fund manager. Investors choosing index funds may earn a lower return than if they had chosen their own best-performing stocks. Index funds include both high- and low-performing stocks and bonds.

Index funds merit consideration by investors who want investment vehicles that are relatively easy to manage.

Tips to avoid falling into debt

Avoiding debt is a key to long-term financial stability. However, data from the Federal Reserve Bank of New York indicates households throughout the United States began 2024 with a record high of $17.3 trillion of debt. Debt also is a problem in Canada, where a recent survey from NerdWallet found that 55% of Canadians had credit card debt, which marked a 12% increase from the previous year. Perhaps even more telling is that 51% of survey respondents indicated they expect it will take them six months or more to pay off their credit card debt.

Debt may seem unavoidable in a time marked by high inflation, when the cost of everything from groceries to entertainment has increased significantly. Thankfully, various strategies can help individuals avoid falling into debt.

• Prioritize an emergency fund. Unforeseen expenses, whether it's major auto repairs or unexpected medical bills, can quickly land consumers in financial hot water. In fact, a recent survey from the Kaiser Family Foundation found that more than half of all adults in the United States report going into debt in the previous five years due to medical or dental bills. Roughly one in five respondents indicate they don't ever anticipate paying off such debts. One way to avoid such a fate is to prioritize building an emergency fund that can be accessed whenever sizable, unforeseen expenses threaten to derail your finances. Resist any temptation to tap into an emergency fund during non-emergencies, and continue to grow the fund with routine contributions each month.

• Utilize automatic transfers via your bank. Banks enable account holders to set up automatic transfers, which make it easier than ever to save money and thus avoid debt. Consumers can examine their finances and determine how much from each paycheck they can automatically transfer into a savings or retirement account. Once that number is determined, set up the transfers so you are not tempted to spend the money come payday.

• Build and maintain a good credit rating. A strong credit rating is advantageous for many reasons, not the least of which is the cost savings associated with such a reputation. When borrowing money for big-ticket items like homes and vehicles, individuals with high credit scores generally receive better lending terms, including lower interest rates. Over time, the money saved by earning a lower interest rate on a mortgage can equal tens of thousands of dollars, and those cost savings can help consumers avoid utilizing credit cards to pay for unforeseen expenses like home repairs or medical bills.

• Become a disciplined consumer. Online shopping has made it easier than ever to spend beyond one's means. A new wardrobe and expensive concert tickets are only a few mouse clicks away, and that accessibility can tempt consumers to spend beyond their means and accrue a substantial amount of debt. By resolving to remain a disciplined, savings-first consumer, individuals can avoid the pitfalls of debt.

Debt can have both short- and long-term consequences. A few simple strategies can decrease the chances individuals join the debt-riddled masses even during a time when cost of living is especially high.

What distinguishes three popular retirement accounts from one another

Financial security in retirement is a goal worth pursuing, but it's one that a significant percentage of individuals feel is out of reach. According to a February 2024 report from the National Institute on Retirement Security, 55% of Americans are concerned they cannot achieve financial security in retirement.

Saving for retirement is an integral component of securing long-term financial security. There are many ways to save for retirement, and individual retirement accounts (IRAs) and employer-sponsored 401(k) plans are among the more popular ways investors build a nest egg for their golden years. IRAs and 401(k) plans differ in some notable ways, and recognition of what distinguishes these types of accounts can help people choose the right vehicle for them. When considering these vehicles, it's important to point out that contribution limits can change from year to year, so individuals can expect to increase their contributions in future years if they hope to maximize the allowable amounts. The following breakdown, courtesy of US Bank®, notes some key differences between a traditional IRA, a Roth IRA and a 401(k).

Traditional IRA

Eligibility: Anyone with earned income is eligible to open a traditional IRA.

Funding: A traditional IRA can be funded with after-tax dollars or as tax-deductible contributions.

Contribution limits: $7,000 annual limit in 2024, though individuals age 50 or older can contribute an additional $1,000 if they choose to do so.

Employer match: None.

Investment selection: Account holders can choose their own investments.

Roth IRA

Eligibility: Individuals aspiring to open a Roth IRA are urged to speak with a financial planner or accountant, as certain contribution criteria and tax filing requirements must be fulfilled.

Funding: A Roth IRA is funded with after-tax dollars.

Contribution limits: $7,000 annual limit in 2024, though individuals age 50 or older can contribute an additional $1,000 if they choose to do so.

Employer match: None.

Investment selection: Account holders can choose their own investments.

401(k)

Eligibility: Individuals are urged to speak with human resources professionals at their place of employment, as US Banks notes most employers have certain qualifications their workers must meet in order for them to participate in these plans. Those qualifications can vary between firms.

Funding: A 401(k) is funded with pre-tax dollars deducted directly from participants' paychecks.

Contribution limits: The annual limit for 2024 is $23,000, though participants age 50 and older can contribute an additional $7,500.

Employer match: Some employers match employee contributions up to a certain percentage. Investopedia notes the average match was 4.5% in 2023.

Investment selection: Various portfolios may be offered, but those available are generally chosen by employers.

Individuals aspiring to create financial security in retirement are urged to consider investing via a 401(k) or a traditional or Roth IRA.

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Financial tips for young professionals

Young adults confront something of a juggling act once they begin their professional lives. For many, that challenge begins with landing and starting a first job, arranging a payment plan for student loans, finding a place to live, and determining savings and personal finance goals. Although entering the workforce and taking a big step toward financial independence can be exciting, it also comes with financial responsibility.

Setting a strong financial foundation as early as possible helps establish long-term financial security. These tips can help young professionals manage their money more effectively.

• **Take a money management course.** Young professionals may be tired of heading to class or making the grade at this point in life, but educating oneself about some of the basic rules of personal finance can help bridge knowledge gaps in this arena. Many young adults have never been taught the basics of applying for credit and staying out of debt. If you've been riding your parents' financial coattails throughout school, now is the time to learn more, whether it's through an online course or reading up on the subject.

• **Set SMART goals.** The acronym SMART stands for Specific, Measurable, Achievable, Relevant, and Time-bound, and can serve as a road map to achieving various goals, including those related to money. Develop a clear plan for your money, which can make it easier to budget and achieve savings-related goals.

• Minimize debt. The Education Data Initiative says university graduates owe an average of $28,244 on student loans after they leave school, with a monthly payment between $200 and $299. Some graduates have even more debt and higher payments. Managing debt is vital to anyone's finances. Create a debt repayment plan at the earliest opportunity. With a "snowball" strategy, borrowers pay off their smallest debts first. Once a debt is paid off, the payment amount for that debt is then applied to the next smallest debt, gaining momentum with each payment. The "avalanche" approach involves paying off the debt with the highest interest rate first.

• **Aim to pay with cash more often.** Unless you can afford to pay off the balance in full every month, using credit cards a lot can contribute to debt accumulation. LendingTree says that, as of September 2024, the average APR on all new card offers was 24.92%. Buying items with cash or debit will reduce the likelihood of spending what you don't have, offers Investopedia.

• **Set up an emergency fund.** It might be challenging to set aside a lot of money right now when you have an entry-level position and some debt. But setting aside as little as $1,000 for unexpected life events separate from your own personal savings can shield you from issues that arise from unexpected expenses.

• **Participate in employer benefit plans.** Look for the various ways that your employer can help you save money. This may include participating in retirement plans (including those with employer contribution matches), health spending accounts, gym memberships, and additional opportunities.

• **Start saving and investing now.** According to SmartAsset, if you start investing $150 a paycheck at age 25 and your investments have an average annualized return of 8%, after 40 years you'll have about $1.1 million in your account. Investing the same at age 35 means cutting nearly half of that total simply by procrastinating.

There are many ways young professionals can develop strong financial skills. Working with a certified financial planner also can help young professionals grow wealth over the course of their lives.

How long to hang on to your tax returns

As individuals attempt to more effectively organize their homes, they may come across a familiar pile of documents that they might hesitate to discard. Conventional wisdom has suggested taxpayers hold on to their tax returns for at least seven years. However, the Internal Revenue Service indicates that the seven-year timeline is not necessarily applicable to everyone. The IRS recommends taxpayers speak with their insurance company or creditors to see if they require account holders to hold on their tax records longer than the IRS. If they don't, individuals can follow these guidelines, courtesy of the IRS.

1. Keep records for 3 years if situations (4), (5), and (6) below do not apply to you.

2. Keep records for 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later, if you file a claim for credit or refund after you file your return.

3. Keep records for 7 years if you file a claim for a loss from worthless securities or bad debt deduction.

4. Keep records for 6 years if you do not report income that you should report, and it is more than 25% of the gross income shown on your return.

5. Keep records indefinitely if you do not file a return.

6. Keep records indefinitely if you file a fraudulent return.

7. Keep employment tax records for at least 4 years after the date that the tax becomes due or is paid, whichever is later.

These can serve as guidelines taxpayers can follow if they are attempting to declutter at home but don't want to discard tax returns they might someday need. Taxpayers also can consult with their accountants or tax preparers for advice on how long to keep their returns. In addition, those who want to keep their returns can scan relevant return documents and then store them digitally on an external hard drive. This frees up space in a home and can calm any fears about discarding returns taxpayers may have.