San Diego finance pros offer tips on making the most of high interest rates

By Roxana Popescu

If you've carried a credit card balance this year, or applied for a car loan, or run the numbers for a new mortgage, you've felt it: the burn of high interest rates.

Some people — perhaps those who have lived through the 1970s or 1980s, or who recently lived in Argentina, where the central benchmark rate is 75 percent — might shrug and say, "Could be worse."

But by raising its policy rate another half-point on Wednesday — to a range of 4.25 percent to 4.5 percent, from near zero at the start of this year — the Federal Reserve has made it harder for hard working people to buy a house or car, or borrow the money that helps them cover ballooning expenses in a period of record-high inflation.

Both can be true.

Whichever view you have, there are better or worse ways to react if you're looking to curb the sting of high rates and even take advantage of what they can offer. Analysts expect rates aren't going away soon — indeed, Fed officials signaled more increases are coming — so now is still a good time to make these changes. A Bank of America outlook for 2023 predicts that rates will stay high for now and are expected to decline by the end of next year.

The Union-Tribune asked a panel of San Diego finance professionals for their best pointers about how borrowers and investors can make the most of high interest rates.

Q. What prompts a bank to raise its deposit account rates? And is there usually a predictable time lag between when the Federal Reserve changes the rate and banks change theirs, or does it vary broadly?

Anthony Valeri, investment management director of wealth and fiduciary services at California Bank & Trust: This is usually an internal decision based on a bank's internal strategy. There may, or may not, be a lag and, yes, it varies broadly. The decision to raise deposit rates depends on multiple factors.

First and foremost a bank must decide what spread, or interest rate differential, they are seeking between the loans they offer and customer deposits. A bank flush with deposits may have little desire to raise deposit rates, or may raise them less, as the Federal Reserve hikes the overnight rate. Conversely, a bank looking to attract deposits is likely to offer higher deposit yields.

There is a fine line to finding the right profitability for bank (rate between loans and deposits) while also risking clients taking their deposits elsewhere if rates are not competitive.

Q. Given today's high interest rates, which are mixed blessing do you have any pointers for what people should do, or not do, to maximize earnings or minimize losses?

Linda Rogers, owner of Planning Within Reach, a financial planning firm: Despite knowing about higher interest rates, I still see people holding their cash reserve in accounts earning essentially 0%. Cash reserves should be in a high-yield account earning closer to 3% based on current market rates. First, ask your bank if they have any high-yield options. If not, consider moving the reserve to an online bank such as Ally, Synchrony and CapitalOne, to name a few. Assuming you have a $50,000 cash reserve, that alone can generate an additional $1,500 per year.

Q. What should people do now, so they're in good shape to take advantage of lower rates once they do come down?

Rogers: Now is not a great time to refinance, but continue paying down debt to get yourself into a better position to refinance in the future when rates go down. If you are planning to make a big purchase such as a home, save aggressively. Having a larger down payment can often get you a lower rate and leave you with a smaller monthly payment. This period of higher rates can also prompt you to inventory all of your outstanding debt, verify the interest rates on the debt, and prioritize what should get paid off first. This is always an important strategy, but even more so now with rising rates.

Q. In this high rate environment, what moves if any should someone make who's saving for retirement or in retirement with their money in passively managed stock and bond index funds?

Rogers: There is not "one" move to make — rising interest rates can affect the economy in different ways. Stay focused on the financial plan that you have in place — any fund losses you see are only on paper until you sell. For those saving for retirement, keep saving and taking advantage of lower market prices. For those in retirement and presumably living off their investment portfolio, the focus should be on maintaining diversification, rebalancing as needed, and following the optimal withdrawal strategy given their cash flow and tax situation.

Q. I often hear "pay down high interest debt before saving or investing." That especially makes sense when credit card interest rates are so high. Wondering if there's any nuance to this. Is there ever any reason to go against the grain?

Mark Sutton, consumer region executive, Bank of America San Diego: Yes, absolutely. Focus on paying off high-interest rate cards first or cards with the smallest balances. When you pay more than the monthly minimum, you'll pay less interest overall.

But a great start is paying down the total balance on one card at a time with a focus on high-interest debt first. Another approach is what we call the snowball method, where you pay off the card with the smallest balance first and then take the money you were paying for that debt and use it to help pay down the next smallest balance. This is so important that we have an entire section of our free online Better Money Habits financial education site about strategies to pay off credit card debt.

Q. Are there other year-end financial strategies you recommend — especially in today's economy, with its mixed job market, anticipated recession, cooling housing market and high rates?

Valeri: In your investment portfolio, consider tax loss harvesting where appropriate. This is the first year in a long time that clients may be able to actively tax-loss harvest given the brutal year in financial markets. Tax-loss harvesting involves selling an investment whose market value is below its cost basis.

After selling the security that is at a loss, the investor buys a like security to maintain market exposure but also stay clear of wash-sale rules that would negate the tax loss harvest. After 30 days, you buy back the original security. Recognizing a loss can be used to offset capital gains on another investment. By doing so, an investor can lower their tax obligation and helps maintain investment tax efficiency. Please consult with your CPA or tax specialist, as everyone's situation is different.

Rogers: Focus on other aspects of your financial plan that can put more money in your pocket, such as:

- For employees who likely have one to two paychecks left in 2022, check the retirement savings contribution amount in the year-to-date column on your latest paystub. Many times people think they are maximizing their contribution but they aren't. Perhaps they miscalculated the max or a portion is being funded by a year-end bonus (which isn't happening this year or it is smaller than expected). If you are not in a position to maximize your retirement savings, at least ensure you are saving enough to get the employer match.

- For self-employed individuals that don't have a retirement plan in place yet and are considering a Solo-401k, this type of account has to be set up by Dec. 31 if you want to make elective deferrals. The Solo-401k providers are very busy right now so don't hesitate to get this going if it is something you are interested in.

- Get clarity on whether you will be itemizing your deductions in 2022 or taking the standard deduction. If you will be itemizing, you have until Dec. 31 to make charitable contributions that may be tax-deductible. You can also look at donor-advised funds to see if that would be of interest rather than giving directly.

- I-Bonds have gotten a lot of attention recently with the uptick in inflation. While purchases are limited to $10,000 in electronic bonds per person, per year, you can purchase another $5,000 in paper I-Bonds with your federal tax refund. Something to consider before year-end is to over-withhold your taxes in 2022, with the goal of purchasing additional I-Bonds with your refund. (I-bonds are inflation protected savings bonds that are bought directly from the U.S. Treasury. The interest rate is 6.89 percent, now through the end of April.)

- Take your required minimum distributions from IRAs and 401(k)s by Dec. 31 if applicable. Failure to do so will result in a tax penalty.

- Review your 2022 spending, set up a budget for 2023, and re-assess your cash reserve amount before going into the New Year.

Mark Kremers, managing director, Merrill Lynch Wealth Management: It can be hard to look beyond the present, but focusing solely on daily market fluctuations or interest rate hikes could mean missing near- and longer-term opportunities. Keep in mind that, historically, periods of market turmoil have been followed by economic revival. Merrill's Chief Investment Office finds reset periods like this generally produce some of the greatest investment opportunities.

As we close the year, we're working with clients on estate planning services, tax planning and retirement planning; and of course with each client's short- and long-term goals in mind, there's always consideration to rebalance asset allocation as needed in order to stay diversified and balanced.

Now is a good time to check in with your advisor on progress toward your goals and assess next steps. Ask questions such as: Where can I look for potential investment opportunities? How can I help offset the effects of higher inflation on my retirement portfolio? What can I consider doing to be better prepared for unexpected events?