"Should I Pay Off My Mortgage Early?"

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"No, you shouldn't!" say the invest-rather-than-be-debt-free crowd.

Here's the argument:

"Well, staying in the market for the long term earns you 6-8% while your mortgage is only costing you 3-4%. That's a wealth building advantage of 3-4%."

"Besides," they'll say, "depending on your tax bracket, as much as 30+% of all the mortgage interest could come right back into your pocket. That means your wealth building advantage could be as high as 5.4% just by keeping your mortgage and investing what you would have put into paying off the mortgage early."

This is a pretty convincing argument. If you think, and the evidence is clear, that remaining invested over 30 years (the typical mortgage) builds wealth quite powerfully, the argument is drop-dead great.

What counter-argument could be equally as convincing? Hands down, let's keep our mortgages and invest the money we would have put into paying down that mortgage into a prudent market portfolio.

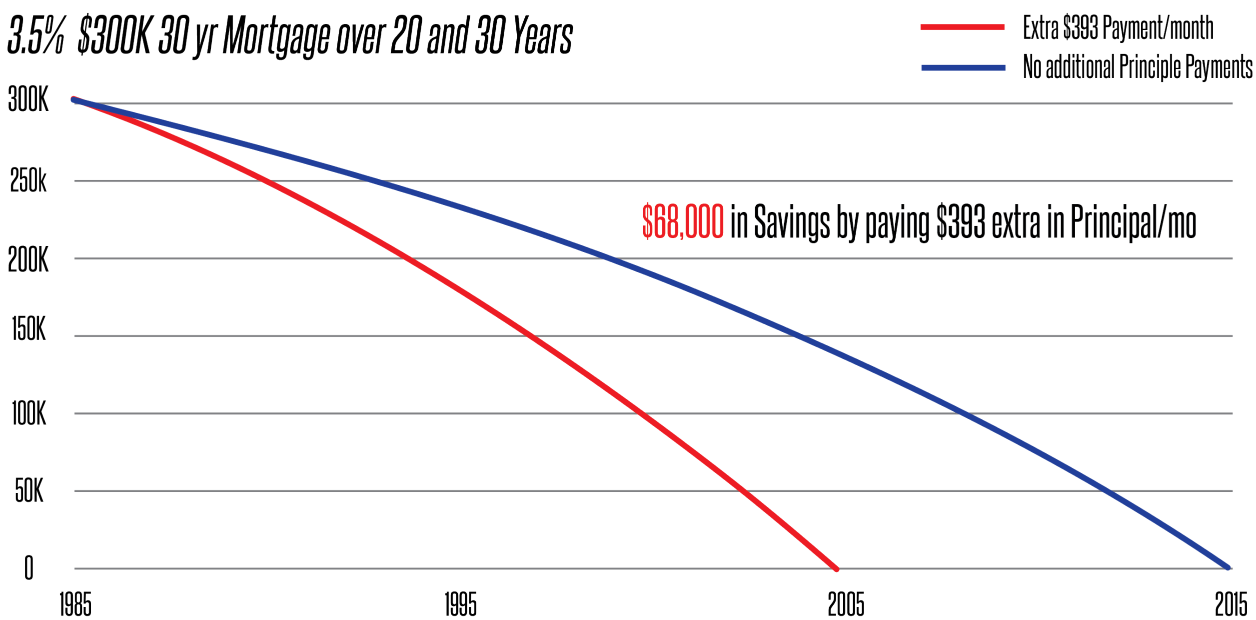
Here are the best and worst returns over 20 rolling year periods if your money was only in the Dow Jones stocks:

- Start investing in 1941: 15% annual return over 20 years
- Start investing in 1979: 18% annual return over 20 years

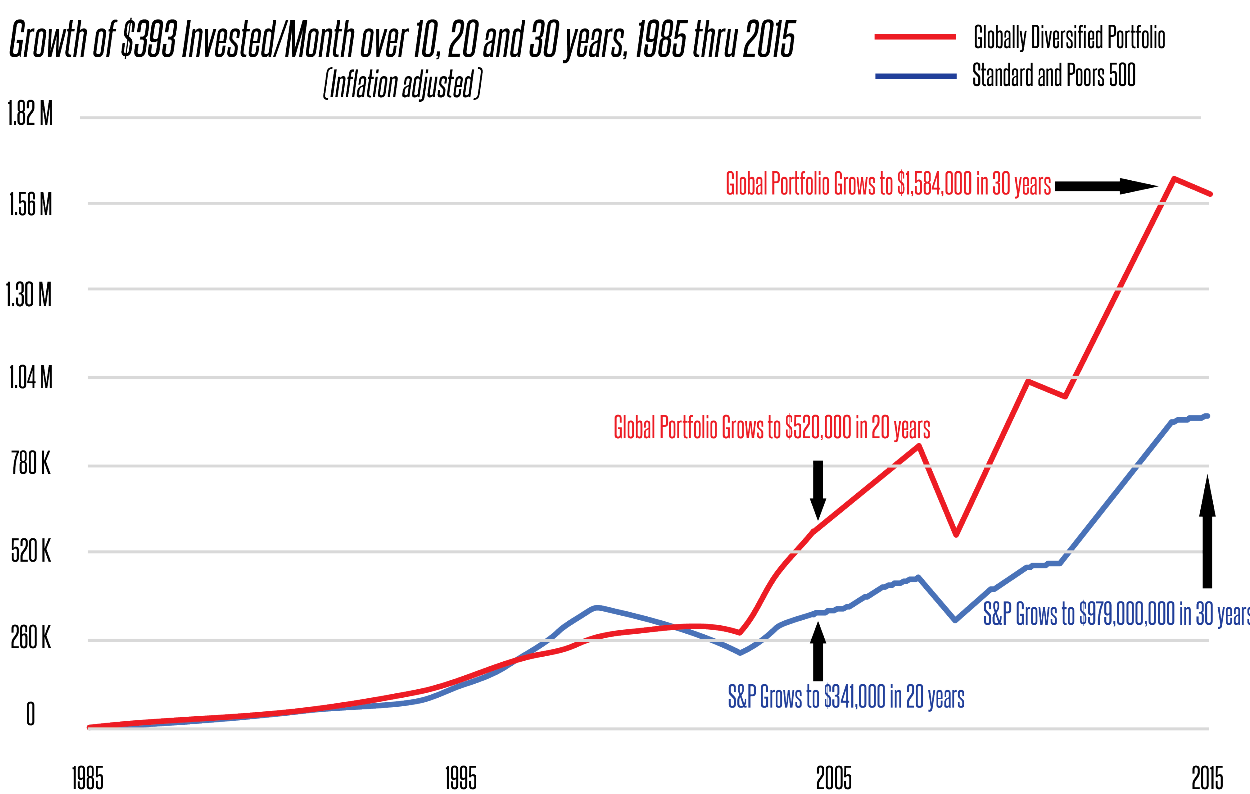
And the worst?

- Start investing in 1928: the return was about 2.5% for the next 20 years
- Start in 1958, 59 & 61: about 5-5.5% annual return[1]

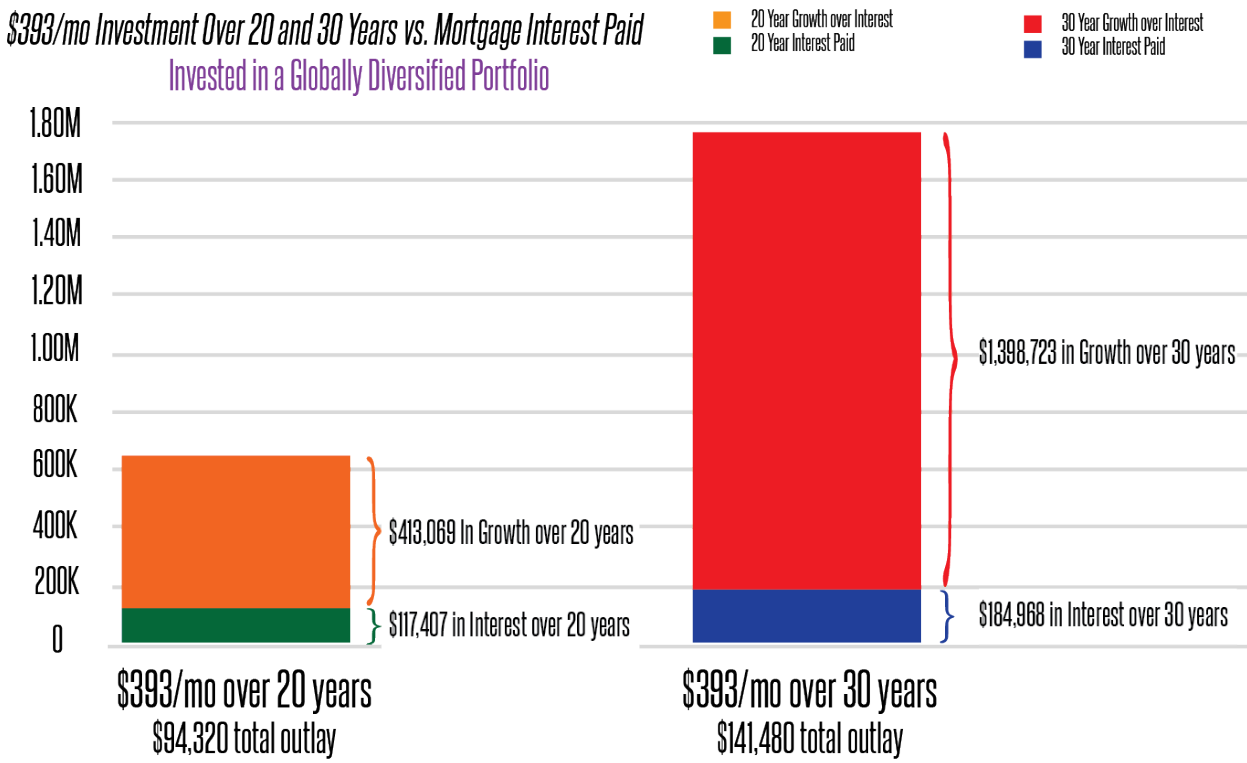
Let's think about this. A $300,000 30-year mortgage at 3.5% would cost you about $1347/mo. If you pay an extra $393/mo toward that mortgage you'll pay it off in 20 years and save $68,000 in mortgage interest. Here's what that would look like:



But suppose you invested that $393 in the market over the last 30 years. Let's compare two options, the Standard and Poors Index and a broad, Globally Diverse portfolio[2]:



Now of course the future may not look like the past and there's no guarantee that future will produce these returns. But the illustration is valid just to show how long term thinking (that is, ignoring at the daily, monthly or even yearly fluctuations) results in tremendous growth if you're disciplined and consistent. Here's how investing that $393 regularly would have looked over 20 and 30 years if you had been in a Globally Diversified Portfolio instead of paying down your mortgage early:



Your money could have grown, over the first 20 years, to $530,476 dollars. Subtract the $117,407 in mortgage interest over that 20 years, and you could have built your wealth by $413,069!

But suppose you continued to invest that money for the next 10 years until the end of your mortgage. In this kind of portfolio your money could have grown to $1.584 million dollars. Subtract the $184,968 in mortgage interest over that 30 years, and you could have built your wealth by $1.399 million!

(And suppose you got back a modest 15%/yr of that money from the mortgage tax deduction. $393 x 1.15 = $452, the monthly after tax money you have decided to invest. Imagine if you put the $452 into the market, what that might look like!)

What's the counter-argument? The raw joy some folks get from receiving that mortgage cancellation notice in the mail. These people have spent 20 years paying off that 30-year mortgage **10 years early** and nothing makes them feel as great as not having that debt.

That's not a bad argument at all. Market returns and wealth building arguments are rather weak when you're looking forward to getting that notice from your mortgage company.

So what is the bottom line? Should you pay down your mortgage early?

You have to ask yourself, "How am I 'built'? What's my temperament?" If having that debt keeps you up at night, I don't think the arguments for 'keep-the-mortgage-and-invest-the-rest' will convince you. On the other hand, if you like the good odds for long term returns in a Globally Diversified portfolio over 30 years, you might sleep just fine with that mortgage. And you might sleep really well having that extra wealth you've built.

Next time we'll look at how you can make systematic investments in this kind of a portfolio. They aren't easy to find but at Eaton-Cambridge we know were to look to find such an investment at low cost.

But we'll also look at how to create your own mortgage accelerator if your 'makeup' is such that you just want to get that mortgage paid off. You don't have to hire a service to accelerate your mortgage and we'll give you some tips for doing that yourself.

Stay tuned.

[1] http://observationsandnotes.blogspot.com/2009/04/best-worst-20-years-in-stock-market.html

[2] This assumes the all equity portfolio shown below. Market return illustrations are hypothetical. Hypothetical and/or actual historical returns contained in this presentation are for education and information only purposes. They are not offers, solicitations, or recommendations. Please note the following about these illustrations and assumptions:

Real Estate Strategy weighting allocated evenly between US Small Cap and US Small Cap Value prior to January 1978 data inception.

International Value weighting allocated to Fama/French International Value Index prior to January 1994 data inception, and evenly between International Small Cap and MSCI EAFE Index (net dividends) prior to January 1975 data inception. International Small Cap Value weighting allocated to International Small Cap prior to July 1981 data inception.

Emerging Markets weighting allocated to MSCI Emerging Markets Index (gross dividends) prior to January 1994 data inception, and evenly between International Small Cap and International Value prior to January 1988 data inception.
Five-Year Global weighting allocated to Five-Year Government prior to January 1985 data inception.

For illustrative purposes only. The balanced strategies are not recommendations for an actual allocation.

Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is no guarantee of future results.

Assumes all strategies have been rebalanced monthly. Highest and lowest one-year and three-year returns are calculated from periods overlapping monthly. Annualized standard deviation is calculated from monthly data.

All performance results of the balanced strategies are based on performance of indices with model/back-tested asset allocations; the performance was achieved with the benefit of hindsight; it does not represent actual investment strategies. The model's performance does not reflect advisory fees or other expenses associated with the management of an actual portfolio. There are limitations inherent in model allocations. In particular, model performance may not reflect the impact that economic and market factors may have had on the advisor's decision-making if the advisor were actually managing client money.

Inflation adjusted data calculated Morningstar Data, 2013, based on the Ibbotson SBBI Yearbook by Roger G. Ibbotson and Rex Sinquefield.

S&P 500 Index provided by Standard & Poor's Index Group.

Past performance is no guarantee of future results.

US Stocks	70%
S&P 500 INDEX	20.00%
DIMNESIONAL US LARGE CAP VALUE INDEX	20.00%
DIMENSIONAL US SMALL CAP INDEX	10.00%
DIMENSIONAL US SMALL CAP VALUE INDEX	10.00%
DOW JONE US SELECT REIT INDEX	10.00%
Non-US Stocks	
DIMENSIONAL INTERNATIONAL VALUE INDEX	10.00%
DIMENSIONAL INTERNATIONAL SMALL CAP INDEX	5.00%
DIMENSIONAL INTERNATIONAL SMALL CAP VALUE INDEX	5.00%
DIMENSIONAL EMERGING MARKETS INDEX	3.00%
DIMENSIONAL EMERGING MARKETS VALUE INDEX	3.00%
DIMENSIONAL EMERGING MARKETS SMALL CAP INDEX	4.00%