

Independent Investor

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Eliminate Debt *and* Save Money? It's All About Getting a Plan

With widespread concern about the value of homes, rising health care costs and the general outlook for the economy, now more than ever, Americans need to set a new course with regard to managing their household finances.

Debt Facts & Figures

There are two stories of debt in this country.

One describes an America that is knee-deep and sinking:

- Today U.S. consumers are carrying more than \$900 billion in credit card balances.¹
- The average credit card debt load is \$9,659 per household.²
- Of cardholders carrying debt, more than one in 10 say they carry credit card balances in excess of \$25,000.²

The other describes an America that is facing reality and trying to do better:

- Half of Americans confess to being "concerned" or "extremely concerned" about the amount of credit card debt they have.²
- Most U.S. households have no credit card debt; about 25% have no credit cards and an additional 30% of households pay off their balances every month.¹
- Three out of four Americans (74%) envision themselves being completely debt free at some point in their lives.²

If you are ready to face up to your own financial realities and set a plan of action, the time to act is now. With a measure of self-discipline and a positive attitude, your financial picture can potentially change for the better in about six months.

The following three-part strategy may help you control your cash flow, pay off debt and encourage saving so you can handle the unexpected expenses that may have gotten you into debt in the first place.

Part One: Track Spending

As a first step, keep track of your typical expenses for one month or so to find out where your money is going. Also figure your unexpected expenses for a year's time—auto and home repairs, gifts, vacations, etc.—and divide that number by 12. Once you have a record of your spending, compare your monthly outlay to your monthly income. If you have a surplus, this is the amount you can apply each month to paying down debt and building savings. If you have a shortfall, you'll need to cut expenses.

Part Two: Build Savings

A key to establishing good saving habits is to make saving even easier than spending. Here are some tips.

Set up three savings accounts with goals attached to them, and then ask your bank about linking them to your checking account via an ATM card. Accounts may be labeled similar to the following:

1. "cushion" for emergency cash
2. "expenses" for unexpected bills
3. "investments" for investing

Whether you have direct deposit of your paycheck or you receive your paycheck in hand, keep only what you need to live on for one month (or two weeks, if you get paid every two weeks) in your checking account. If you leave more in checking, you'll probably spend it. If

you can, put money equivalent to one month's expenses into your "expenses" account for unexpected bills. The idea is to build at least a small stash so you're less likely to use your credit card if your car needs a new tire.

Begin building your emergency cushion by depositing a portion of each paycheck into your "cushion" savings account. If your goal is to have three months' living expenses, you could reach your goal in 30 months by saving 10% of each month's pay-or in 15 months by saving 20%.

Put whatever is left into your "investments" account, including found money such as birthday and holiday checks, bonuses or money made from a garage sale. If you get a raise, put the difference into this account on a regular basis.

Step Three: Reduce Debt

Paying off debt is easier once you stop using your cards. Pay off your highest interest credit card debt first, making sure you avoid the "minimum balance trap." Because credit card companies make their money from interest payments, they purposely set those payments low so it will take you years to pay off the balance. Paying more than the minimum can make a big difference.

- Assume you have a balance of \$5,000 at an interest rate of 15% and you make the minimum monthly payments of 2.5% of the balance or \$25, whichever is greater. It would take you 183 months to pay off the debt and cost you \$4,395 in interest. However, if you were to pay an extra \$150 each month, you would pay only \$845 in interest over 27 months. *This is a hypothetical example for illustrative purposes only.*

Consolidate your debt by transferring outstanding balances to lower-rate cards. If you don't want to transfer your balances, chances are that your current credit card company will match the interest rate of a competitor. Just be aware that some of the low rates available are "teaser rates," which only apply during the first 6 to 12 months you have the card. Cancel your old cards

so you won't be tempted to use them again or leave them at home unless you really need them.

Set up a realistic payment timetable and stick with it. If you need to readjust your timetable, do so. If you have trouble, talk to a professional. The counselors at the nonprofit National Foundation for Credit Counseling can develop a more structured plan for you, if needed. To find the nearest location, call 1-800-388-2227, or log on to www.nfcc.org.

Put Time on Your Side

You may not be able to solve your debt problem overnight, but you can solve it over time. Not only will a combined debt reduction and saving strategy begin to lighten the load now, it will help you feel better about your future.

¹Source: The Federal Reserve

²Source: CardTrak.com

This article is not intended to provide specific investment or tax advice for any individual. Consult your financial advisor, your tax advisor or me if you have any questions.

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