Smart Spending

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My late parents had a simple plan for avoiding debt – they didn’t buy anything they couldn’t pay for in full at the time of purchase.  People who grew up during the depression learned that lesson the hard way, having lost most of their funds in the wake of the stock market crash and finding themselves penniless for years thereafter.  Many years ago financial responsibility was encouraged with what was known as Christmas Club accounts advertised by local banks.  People would put funds into these accounts every payday during the year so they had a nest egg saved by December to buy all of their presents.  In addition to avoiding debt, this process also placed a self-imposed limit on their spending which today is often lacking.

Along came my generation (the Boomers) who wanted everything under the sun and didn’t want to wait to get it.  The solution we developed was the credit card, issued by a bank to make purchasing easier and more convenient.  And, as long as the balance on the card was paid in full when by the due date, the cardholder incurred no interest cost.  So, the cardholder effectively received a no interest 30-day loan from the bank.  However, if the balance was not paid in full, then interest was charged on the outstanding balance at an extremely high rate.  In order to avoid high interest charges, banks created balance transfer programs where one could transfer an outstanding balance from one card to another for a modest fee (typically 3-4%) and not have any payments for a year.  That’s great, right?  Not quite.  First, if you didn’t retire the balance by the end of the year, then the ridiculous interest rates kicked in or you transferred the balance to yet another card.  For many folks, the situation snowballs out of control. Quickly!

Now enter the latest tool in the too-much-debt world – the personal loan.  Banks will provide a line of credit or personal loan backed by the equity in your house, pledging of investment and savings accounts or, in some cases, little collateral if any at all. The interest rates on these loans are not as egregious as the credit card companies charge but they are well above the rates the banks can earn holding government debt (current yield on a 1 year Treasury bill is hovering around 1.6%).  So, the banks are willing to take a chance of higher defaults in return for a 3+% interest rate differential. Americans are utilizing this latest borrowing opportunity in record numbers without, in many cases, any hesitation about the ever-increasing debt they are incurring.

What happens when the next downturn occurs?  You guessed it – this house of cards will collapse and crush many individuals and institutions when it does.  It is far too easy to overspend and our Black Friday mentality is so pervasive that overspending has become the norm.  Please don’t let this happen to you, particularly if assets you’ll need in retirement are securing your debt.  Experience tells us that it takes 6-9 years to recover from a downturn so a loss 5 years before retiring might require your delaying retirement for years.  If you lose your employment in the downturn as well as your savings, you’ll be in an even worse shape.

So, my advice is to a) never buy things you cannot pay for within 90 days of purchasing them (house and car excluded), b) make paying off consumer debt a priority and c) once debt free, try the old Christmas Club approach to spending, i.e., save the money before you buy rather than paying for things months or even years after you buy.

I’m not trying to be a Scrooge here, of course we want to buy gifts for loved ones this time of year. I’m just advocating that people do not go into credit card debt & end up paying high interest rates to do so. Everyone dreads January when all the Christmas bills are received.  Changing your spending habits now will make future Januarys far less stressful. Less stressful Januarys can surely only be a positive for our mental, physical & financial health.

Frederic “Ric” Schilling is a Florida native, born in Jacksonville, Fl. Ric is President of Senior Guardians of America, a local North Florida firm specializing in tax reduction, long term illness planning, asset protection, probate avoidance and life income planning. Ric is a National Speaker and Advocate on Senior Issues and has been featured by the Florida Times Union and WJXT, TV-4 in Jacksonville as an authority on Estate Planning and Retirement Issues. Senior Guardians has an A+ rating with the Better Business Bureau and is a member in excellent standing with the National Ethics Association. Contact Frederic: 904-371-3302 or 888-891-3381 Please visit: [www.seniorguardian.com](http://www.seniorguardian.com)

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