Retirement: Escape the enticing embrace of debt

JUST because "everyone" is doing something doesn't make it right. The sooner we learn that life lesson, the quicker we can take charge of the trajectory of our lives.

Most people around the world consider owing money on a range of outstanding debts like mortgages, car loans, personal loans and unpaid rolling credit card balances as normal behaviour.

Let me just say, in this case, normal is unwise.

Since we Homo sapiens usually find it far too easy to bend to the group-think of mobs, I alerted readers of this Money Thoughts column last week to the dangers of doing so when I wrote about the cloying clutches of debt and introduced the hypothetical fraternal twins named Average Andy and Astute Andrea.

Throughout their whole active working lives, they both earned the same amount of active income prior to retirement but did markedly different things with their money. If you missed last week's column, you'll find it (and many others) here: www.nst.com.my/authors/rajen-devadason.

Long story short: For a life that aims to minimise financial stress, escape debt's enticing embrace ASAP. At the very least, aim to repay all your debts in honourable fashion BEFORE you retire, whenever that might be.

You see, regardless of what age you aim to retire at, eliminating your debts as early as possible during your active earning cycle will give your retirement funding initiatives a massive boost.

So, if eliminating all personal debts is your goal, I recommend you follow one of two different debt eradication strategies I call "High-to-Low" and "Small-to-Big".

"High-to-Low" is mathematically more efficient while "Small-to-Big" is emotionally more effective.

American financial guru Dave Ramsey refers to Small-to-Big as the Debt Snowball. I love his snappy term and readily admit it's way cooler than my clunkier "Small-to-Big". For now, though, I'll stick to my original names because they'll make it easier for you to understand the differences of both useful debt eradication strategies:

MONEY THOUGHTS

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HIGH-TO-LOW

List all your debts and then re-order them from highest APR — or annualised percentage rate — to lowest. Then squeeze out excess cash flow from your budget by making proactive short-term sacrifices.

Pay all minimum payments on all your loans, ideally a few days before each due date.

Then use your freshly liberated excess cash flow and allocate all of it to pay down the loan carrying the highest APR. Stay focused on doing so each month until you've paid it off in full.

After that, channel its minimum payment plus the excess payment made possible by your wise sacrifices and add that amount to the minimum payment on your second most expensive loan, the one with the second highest APR.

Keep attacking your debts until you've paid off every last one. This is a wonderful strategy that makes excellent mathematical sense. Oddly, though, our next strategy is even better.

SMALL-TO-BIG

List all your debts and re-order them from smallest in absolute size to largest. Make all your scheduled minimum payments a few days early so that you steadily improve your standing with your creditors and, far more importantly, your innate sense of self-respect. You see, otherwise honourable people floundering in debt gradually lose a part of their self-worth each time they miss a payment on one of their loans.

Of course, there are always flaky deadbeats whose consciences are so seared that they feel no remorse when they intentionally withhold money they owe other people or institutions. I'm not writing this column for those losers. Instead, I hope to shine a light that helps future winners come to grips with their debilitating debts.

So, as I was saying, make all your minimum payments early.

BANISH DEBTS

Then, as in the earlier explanation, squeeze excess cash flow by tightening your belt. Allocate all of that extra money toward the debt at the top of this "Small-to-Big" or Debt Snowball stack. As it is the smallest of all your loans, you will pay it off very quickly.

It might be just RM50 you owe a co-worker who advanced you some cash before payday or RM200 on an unpaid credit card or RM1,000 in an easy payment scheme for a television you bought earlier this year.

As the smallest loan is paid off, pat yourself on the back, figure out a cheap way to celebrate this victory — ideally without digging yourself deeper in debt — and then shift your focus and your energy on repaying your second smallest loan.

This strategy is not as mathematically efficient as "High-to-Low" but it is a profoundly powerful plan that resonates with the human spirit because we all need a series of initial tiny wins to prepare us for bigger battles ahead. I recommend you try whichever debt eradication strategy makes better sense to you. My preferred option, though, is the debt snowballing "Small-to-Big".

Regardless of which option you choose to try out first, arrange your affairs so you may continue working for an active income long after you've eliminated every last lingering debt. You owe it to your family and yourself to battle and defeat this world's wealth-stealing debt demons and to banish them forever.

Next week we'll explore four types of passive income that will raise your odds of enjoying an incrementally better quality of life every passing year — both before and after your retirement.

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