Should You Pay Off Debt or Invest? | Finance Dad Podcast

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SUMMARY

Investing in the S&P 500 is highly recommended, but it's crucial to prioritize paying off certain types of debt first. Credit card debt, with its high interest rates, should be eliminated before considering stock market investments, followed by student loans. Mortgages and car leases can be managed while investing in the stock market.

- *Prioritize paying off credit card debt before investing in the S&P 500 due to high interest rates (around 20%).*
- *Even successful stock market investments may not outpace the compounding nature of credit card debt.*
- *Student loans should be paid off before investing, as their interest rates can be significant, especially for private loans.*
- *401(k) contributions can continue while managing debt, as they are pre-tax and not accessible for debt repayment.*
- *Mortgages and car leases are considered manageable debts that can coexist with stock market investments.*
- *Reducing consumption can help pay off debts, particularly credit card debt, more effectively.*
- *Personalized financial consulting is available for tailored advice on managing debts and investments.*

Every time I've talked about investing, I've talked about investing in the S&P 500. Consistently, that's the one investment I've talked about every time because I really believe that everyone should be invested in the S&P 500. But, what if you have any kind of debt? What kind of debt should take precedence before you make your investment in the S&P 500? Let's talk about that today. Hi, this is Shalabh Garg, Finance Dad. I'm a Wall Street veteran. I've had jobs at a bank, at a hedge fund. I currently run my own hedge funds. I know all things investing. I'm a big believer in the S&P 500. I I believe that everyone and at all age groups should have an investment in the S&P 500, but there are certain kinds of debt that should take precedence before When I say precedence, I mean should be paid off before you make your investment in the S&P 500.

The first and foremost amongst it is the credit card debt. You cannot have credit card debt and use the proceeds of that debt effectively and say that I'm invested in the S&P 500. A typical credit card, no matter how attractive your credit may be, charges you 20% a year. Nothing in the world can make you 20% a year to make it worthwhile to have that debt outstanding and still have an investment in the S&P 500. In fact, one of my clients showed me their balance sheet and she said that I have done so well on my investment in the S&P 500 over the course of last four or five years, um that I don't even want to pay off this hundred grand that I have outstanding credit card debt because I I'm rather just keep it in the stock market. And I went through the numbers with her and it turned out that despite doing as well as she has, ultimately the credit card has debt has grown more on a percentage basis than her stock market investment has. And she immediately liquidated the S&P 500 investment and paid off the credit card and I'm so happy she did that. Simply because you cannot keep up with the compounding of 20% debt. 20% is just too much. The average return of the S&P 500 over the last hundred years has been about nine or 10% a year. At nine or 10% a year on a compounded basis, as even the S&P 500 cannot beat the credit card debt. It is just too too unattractive and too high in interest rate to have any amount of credit card debt outstanding. MasterCard and Visa, the two big oligopolies that exist in the country, their stock has done fantastically well over the course of the time that they've been around.

You know why? Because this debt payments that they get is just way too attractive for them and they will just keep extending you more and more and more credit card debt because it's the in their interest to do it and you know, ultimately some of some people will default, but the percentage defaults are so small in relation to the amount of interest that they make on these credit card debts, it just doesn't make any sense. Please, please, please, I beg you, if you can, do not keep credit card debt outstanding. It's not worth it.

It's the worst kind of debt that you can have. In fact, in in many countries, it's only a very recent development that credit card debt has become popular. In India, for example, when I was growing up, it was entirely a cash economy. Credit cards weren't even as popular. People would pay in cash. And I understand in the modern economy, having credit cards is convenient. You go to a restaurant, you want to be able to pay via credit card even though you do have a debit card option, but I understand that that's in European developed countries, in many European developed countries, even today, people will often use the debit card for the convenience as opposed to use a credit card to pay off a restaurant bill or anything like that. Um I feel like over time, uh avenues like Zelle and Venmo are becoming more and more popular and I hope they keep becoming more and more popular and these credit cards companies go bankrupt. I just hate them. And the reason I hate them is because I don't think an average person really really appreciates how cumbersome and horrible the interest interest rates are on this credit card debt and how quickly it grows and compounds against you if you keep that balance outstanding. So, please don't keep a credit card debt outstanding before you invest in the stock market. As much as I I'm a huge proponent of making an investment in the S&P 500, not against a credit card debt.

Second after that that I think that should take precedence over the S&P 500 are student loans. If you have student loans outstanding, I would pay the student loan before I would put money in the stock market. Student loans are also very they're not as high in interest rate, particularly if they're federal. If they're federal interest rates, then the interest rate loan can actually be very low. But, it's unlikely that a federal interest rate amount already has satiated your need for a student loan.

So, most likely, if you have gone through the federal route, you also have some private loans like the Sallie Mae or any other. And even those, they're much much better than than the credit card debt. I'll give you that. Their interest rates are between 10 and 12%. Pretty much in line with on average what you'll make in the stock market. I still think that those loans are paid off should be paid off before someone makes an investment into the stock market because they're still very high interest rates. Stock market returns are not guarantees while the debt on student loans has to be paid. Student loan is the only kind of debt that even God forbid something happens to the child or the other or the young adult, if they pass away, that student loan doesn't go away. The co-signer or the parent has to keep paying it thereafter as well. So, it's a loan that's worth paying out. I do not believe it's it's it should be take precedence at parri passu or below the stock market. So, the one question that will come up is that means that I can't invest for a few years because I'm just not at the point. That means to me, the way I would answer that question is that that's okay then. Then don't invest. You should only invest in the stock market once your credit card debt is paid off and your student loans are paid off because what is the point of making random investments in a stock market when these debt that you're paying such high interest rates are still around? Then I would wait. I would wait before you Now, you can still keep with your 401k. I would say that even with those debts, your 401k should still be invested in the S&P 500 cuz that's pre-tax and it's money that you're saving away and it's not money you will have access to to pay off these loans anyway, right? Because you have to pay a fine if you do that before 65. So, outside of your 401k, I would continue to pay down these debts before you pay uh put your money after-tax money in the in the stock market investment. One question comes up is how can I pay it off? I would say that before you took these debts is when that discussion should be happening. There's no real reason. Student loans can be unavoidable. I get it. But, the credit card debt is a consumption thing, right?

You took some main major consumption-based patterns uh to undertake that debt to start with. This has come out of nowhere. So, I would say if there's no easy way to pay it off, but I would say that if you pay a little principal off every month, over time you will be able to pay it off and reduce your consumption. I would say reduce your consumption until those debts are paid off, uh particularly the credit card debt. There's no reason to keep stacking up the credit card debt to keep up with certain amount of consumption pattern uh to keep up with your friends or your uh neighbors or any such thing. Reduce your credit card to zero today. The only kind of debt that I would say uh or just going two kinds of debt that I would say can be debts um that can be sub to the stock market investment. One is your mortgage against the house. It's secured debt. Interest rates are in the five even right even having risen and then now it's trying to fall again, they're still five to six percent. So, in my opinion, that is a kind of debt that is worth investing in the stock market before you pay it off. Um we had a mortgage and I believe that in terms of keeping that mortgage because of the tax advantages, I've covered this before. I think it's the kind of debt it's worth keeping before you pay off uh before you start investing uh in the stock market.

And the second one uh which is kind of a neutral, but I still think it's worth keeping is your car leases or the debt against your car. I believe a lot of people take um lease a car instead of buying a car outright. I think that's I understand why because every three years there's a new car that comes up or and people want to own different kinds of cars and have a new car and all of that.

It's kind of like an iPhone or an iPad that you have to renew every few years and people take a lease instead of um buying a car outright. I understand it and that's okay as well to keep as opposed to paying off uh before you make an investment in the stock market. So, those would be my recommendations. I do offer a consulting hour. If you want personalized advice on what loans to keep, what loans to pay off specific to your personal financial circumstances, please don't hesitate to reach out. I'm really enjoying these doing these uh Finance Dad consulting and all my clients are enjoying them. Many of them are coming back for it. With that, it's Finance Dad signing off. See you next time.

>> [music] >> Bye.