



Rodney's Take

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Give Yourself a Gift This Christmas... Cash

Every once in a while, I'm financially lazy. I don't pay as close of attention to our household finances as I should. I pay the bills on time, but I'm not always watching the expenses. Every so often I find that we're giving away cash.... I hate that. So, I decided to give myself a gift this Christmas, and you should, too. I'm giving myself the gift of cash.

We recently received an email at HS Dent from Linda E. asking about credit card interest rates. She noted that rates seem incredibly high, especially with overnight, Treasury bond, and even mortgage rates, so low. Linda, you're correct. Last year, the interest rates on credit cards reached their highest level since 1995, back when your great credit score got you a 7.75% mortgage and the overnight Fed Funds rate was about 5.5%. Today, solid borrowers can get a mortgage at 2.75%, less than half of the rate back then, and the overnight rate is near zero.

Credit card interest rates have dipped since they peaked last year, but they remain in the 15% to 25% range, which sounds outrageous. To answer Linda's question, rates are so high because, when it comes to credit cards, great borrowers subsidize bad actors.

When we borrow to buy a home or car, the asset is pledged against the loan. Lenders might lose a bit of money if they have to foreclose or repossess before the asset builds up equity, but at least an asset exists to help pay off the note. Credit cards are different. They're specifically unsecured borrowing, so lenders take a bath on most of what isn't paid. Since lenders (in this case, banks), aren't in the business of taking losses, they have to get the money from somewhere, so they charge all borrowers much higher fees than the borrowers would pay for secured loans.

This situation is especially out of whack, with interest rates the furthest from what they should be, for the best borrowers. If your credit score is over 800 and yet your credit card interest rate is more than 12%, then you're giving away cash. You are in the group most likely to pay your bills; the world knows this. Banks that issue credit cards rely on you to make good on your debt, including interest, through good times and bad, so that they can issue cards to marginal borrowers and still make a profit when those people don't pay.

I was surprised to find that the interest rate on my main credit card is 15.24%. I pay off my cards every month, so this doesn't affect me, but if I ever pay interest, I'll be subsidizing others. I use a Citibank card that pays 1% cash back for all purchases and another 1% back when the bill is paid. Because I carry no balance, effectively I earn 2% back on everything. I like that.

If I had balances, I'd be looking at my investments as a source of lending and becoming my own bank.

If you average \$5,000 on a credit card at 15% interest, that's \$750 per year in interest. Where can you consistently make 15% in the markets? It certainly isn't bonds, and, in normal years, it's not in equities, either. Consumers are much better off paying off their credit card debt than investing, because it's a guaranteed rate of return when you avoid those

high interest rates. If your credit card balance fluctuates during the year, consider creating a separate savings account that can be drawn down and replenished so that you never carry a credit card balance.

If you've got a big balance, you can usually get a personal loan at a much lower rate than for credit cards to pay it off, because the loan rate will be tailored to your personal situation.

And then there's refinancing your home, which is my current dilemma. I know I should. We moved just over a year ago and got a great rate of 3.99%. I can refinance today and save more than 1%. If I had credit card balances, I could take a little cash out and pay them off with much cheaper money. As it is, I can simply put the savings in my pocket. I need to get it done, and if you haven't done it, you do, too. It's almost free money.

For a little bit of paperwork and hassle, I can give myself a nice bundle of cash for Christmas. I just need to get started.

Rodney

Got a question or comment? You can contact us at info@hsdent.com.