THE GEN Z MONEY MANUAL

Mastering Our New Economy

MARK BOLTON

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CREDIT CARD DEBT

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High interest credit card debt will fuck you up big time. No doubt about that. But the debt is ultimately a symptom of a more dangerous underlying cause – you're spending more than you earn. And this is the disease that you must heal from to become financially well. But let's deal with the credit card debt first and directly.

The Problem with High Interest Debt

We'll start with the definition of a credit card. A credit card is a little piece of plastic that acts as a token and gateway to an account where some bank or financial services company will lend you money for a period of time and allow you to hold an open balance from month to month. American Express and Diners Club mostly offer charge cards which must be paid off in full at each statement date (monthly). They grant you a few weeks credit only. If you spent $3,000 on it last month, you're going to send them $3,000 of your hard earned a few days after you receive the monthly statement.

But what we're talking about in this chapter is any type of 'revolving' credit that you can push over from month to month. So that's credit cards issued under the Visa or MasterCard or other logos. It also includes store cards or affinity cards attached to particular stores or brands where you can run up balances and pay over multiple months. We're also including online payment products where you have a revolving credit account that you can use to buy more stuff and then pay it down slowly over time like Affirm. Most of them are defined as having “high” interest rates. At the time of writing, interest rates have already moved upwards from 2020-22 where they were around 5-10% on retail credit and store cards. Now that we’re seeing 5% on government bonds means that credit card and revolving credit interest rates have gone through the roof. Apart from special balance transfer deals at around about 12% (which we’ll discuss, as teasers are designed to suck you in) they can be anywhere from 24% - 35% annual interest. Rates this high are extremely dangerous and corrosive to your financial welfare. The compounding effect that applies in a positive way to interest or dividends that you earn on investments applies in reverse when you owe money at painfully high interest rates. You can do the math for yourself in our spreadsheet tool or use a calculator like this one: https://www.bankrate.com/finance/credit-cards/credit-card-payoff-calculator/

Take $1,000 and then assume that you get an 8% annual return which is similar to what you get from the stock market. And just allow that to compound over a decade and see how much money that turns into. Now take that $1,000 and multiply it by your typical high end credit card 28% interest and roll that forward over a decade making minimum payments. See the difference? That’s the problem. High interest debt is extremely corrosive to your financial wellbeing.

Credit Score Impact

Almost as harmful to your financial wellbeing, holding high credit card balances for extended periods of time will damage your credit score. I’ve written a chapter specific to this topic but for quick reference purposes: a low credit score can negatively impact your career, increase your insurance costs and healthcare costs and make it way more difficult and expensive to get future credit. In modern America, your credit score (FICO score) is king and the one of the worst things you can do is run high credit card balances. These have a very significant impact on your month-to-month, week-to-week credit score. What do I mean by high balance? Anything over 20%. If you’ve got three cards that give you a total of $25,000 of credit line (amount you’d have if you maxed them all out) then you should avoid running a month end-to-month end balance of more than $5,000 which is 20% of that total. Yes, you can use the cards heavily intra-month but you should aim to pay enough of the card statement balance at each month end to reduce the remaining balance below 20%.

Juggling multiple credit cards is a time-consuming pain in the ass that inevitably leads to a screw up where you forget to make a payment or max one out or do some combination of these. While it's good to have two credit cards – giving you flexibility and building your credit score, having 10 cards is asking for trouble. So, simplify your life. How do you do that? Pay down all of your credit cards balances to $0 apart from one and use that for every transaction. Put the rest in a drawer out of sight and mind. Usually, you'll pick the card with the best deal. Best points. The lowest fees. Lowest interest rate. Check out one of many search tools here: https://www.bankrate.com/finance/credit-cards/. Use your one card for buying everything. Do not cut up, close or send back the other credit cards as this will negatively affect your credit score. Instead, lock them away somewhere that you never see them. Never carry them in your purse, wallet, pocket or phone wallet. Just keep only the one credit card that you use for everything and manage it really well.

Using Tools

I'm a big advocate of using smart tools to help you gain and keep control over all of your finances. I'll repeatedly give links – which of course will become out of date over time so I'll update them in new versions of the book. But do your own research and read what people are saying on social media. I like tools that connect all my accounts in one place and give you an overview of everything that you owe, everything that you own and all of your income and expenses. Mint from Intuit (https://mint.intuit.com/) is a simple, easy, free starter product to get going. It has a series of upgrade opportunities as well if you want to make use of those. The point is - you need information. You need to understand what your balances are. What Mint won't do, right now anyway, is to give you sufficient level of analytical detail on your credit cards and for that unfortunately, you're going to have to go to a spreadsheet and so we've included one with this chapter as an example. It's on the website (https://mark-bolton.com/). That's the information you need to capture. So, make sure you've got all of that because you're going to use it to help understand where to focus first.

Making Minimum Monthly Payments

If you're making your credit card minimum payment (around 3% of the month-end balance), then you will barely move the dial on paying down the debt. Minimum payments are set by the credit card company for three reasons.

- The first reason is that it sets a level of payment that covers the monthly interest.
- Second, it enables you to show that you're making the effort and paying something.
- Third, it will very slowly bring down the balance on your credit card. But if you project outwards, it will take years and here's a link to a site that allows you to play with some projection with the credit cards: https://www.calculator.net/credit-card-calculator.html.

However, to prevent the problems caused by a missed payment I recommend that all your cards are set to Autopay the Minimum Payment each month. If the balance is $0 then nothing will come out of your bank account.

High Debt Needs Good Strategies

So, now that you understand the problem and its implications and what you need to do, how are we going to tackle it? Well, in a couple of different ways; the Debt Avalanche Method and the Debt Snowball Method. I've also included a hybrid method. Use our spreadsheet (https://mark-bolton.com/) to help you with this section.

Debt Avalanche Method

In this method, you prioritize your debts by interest rates. So, the higher the rate that you're paying, (and by the way, you may have to go and look at your physical or PDF statements to find this number) the higher you prioritize paying it down because they're costing you the most over time. In the spreadsheet, sort by the Interest Rate column. If you have a credit card with two different interest rates - perhaps some balance is at 0% from a balance transfer and the rest at 29.95% - you will create two rows in the spreadsheet. One row shows the 0% interest balance and the other is the regular interest rate balance. When you sort the spreadsheet in descending order of Interest Rate you can prioritize to pay off the high interest rate balance ahead of the 0% rate balance.

Special Tip: when banks and financial services companies offer you teaser rate deals that last for a specific period of time, they are almost always contingent on you fully repaying the balance before the end date. What typically happens if you don't – even if you pay back, say 95% of the promotional balance – is that they'll levy interest at their full normal rate on the entire balance right back from the day that you borrowed it. I once got caught in this trap and challenged the policy of the lender with the CFPB: https://www.consumerfinance.gov/ and eventually got the dispute resolved in my favor. But it's way better not to get into this situation in the first place.

Debt Snowball Method

In this method, you prioritize the debt by balance and focus on paying off the smallest balances first. You sort the Balance column from the lowest to the highest and then simply work through paying them off. You've already put the cards away in a locked drawer, right? So now just pay down each balance to $0. The nice thing about this approach is that it can get rid of several small cards really quickly and that makes you feel good about your progress. It also quickly simplifies life and enables you to focus on the smaller number of big balance cards.

Hybrid Method

In the Hybrid Method I recommend using the Debt Snowball first to cut your smaller debts and gain some momentum and psychological traction. Then apply the Debt Avalanche to the remaining debts to tackle them in total cost order.

In my spreadsheet (https://mark-bolton.com/), you can achieve this by sorting on the Balance column first ascending. Then sort on the interest rate column descending.

So, if you have two cards, both at 29.95% one's has a balance of $50 and the other has a balance of $3,000 you're immediately going to pay down the card with the $50 balance and make sure you don't spend a penny more on that card. If you pay down a card that still incurs fees such as a membership and you're no longer using it and never plan to again then in these limited circumstances it may make sense to consider closing the account. But again, avoid doing that unnecessarily because the more open lines of credit you have that are not being used, the better it will be for your credit score. Paying down your high interest revolving credit as quickly as possible to get your overall balance below 20% should cause your FICO score to improve by anything from 10 to 30 points a month. So that means in 3-4 months, you could potentially go from being a 650 to a 750 FIO score. To check all of this you should be watching your FICO score for free on a weekly basis. Many banks and credit card firms are now offering this for free and Mint also does it.

Cut Overall Debt

Use Earnings / Income

The best way to get out of debt is to use your earnings. If you have to cut some costs elsewhere to free up income to get rid of high interest revolving credit, then look first at your discretionary spending. That's where you need to squeeze first. I'm not a fan of making life miserable and there are books about saving $5 a day on a cup of coffee that's not going to move the dial financially but will turn you into one pissed off grouch. But that $250 dinner that you're planning for Saturday. Well, time to replan it or reschedule it. Find a cheaper restaurant or perhaps eat at home first then head to a bar or club. Do whatever you can to cut back on discretionary expenses.

Debt Consolidation Loan

A debt consolidation loan can be used along with other strategies – but on its own it's a 'whack-a-mole' tactical move that does not solve the underlying problem that you're probably spending more than you earn. In this option you'll consolidate one or more credit card balances into a single loan at a lower interest rate and with lower payments. When you do this, you must lock away all the cards that you paid off and never touch them again. Otherwise, you'll be right back to credit card debt and another loan before you know it.

The debt consolidation loan probably should come at an interest rate better than your cards - but probably not by much, because you've already shown yourself to be somewhat risky. But by taking this loan, making on-time monthly payments on-time and reducing your credit card use your credit score will probably rise significantly. And you'll find that 3 to 4 months later, you could well be offered similar types of loans at much lower interest rates. You can then refinance that loan and reduce the interest rate further by simply applying for a new loan and using the funds from the new one to pay off the old one. Now, you've added another perfect credit history to your credit score calculation by having a loan for three or four months on which you made payments and then satisfied in full. Don't do this more than 2 or 3 times in a year otherwise you risk looking like a credit junkie and that can start to work against your credit score. Remember, the aim here is not to be a smart-ass and game the system, it's to get out of the credit card debt hole and never get back in.

Secured Borrowing

The cheapest way to borrow money is against a big, fat asset like your house or a brokerage account. If you don't own a house or have an account stuffed full of stocks inherited from grandpa, then forget this section but if you do, read on. A HELOC (home equity line of credit) is one of the best products to access equity tied up in your home. A HELOC offers a lot of flexibility to borrow from $1 up to the account limit at a good interest rate similar to a mortgage. But beware, a HELOC behaves like a variable rate mortgage so as mortgage interest rates go up so will the interest rate on the HELOC. Most HELOCs require you to cover the interest monthly so be sure that you don't get caught out in a rising interest rate environment. The great news though is that you can draw on a HELOC as much or as little as you need and pay it back in full at any time or when you sell the house with no costs or penalties. But they're an expensive pain in the ass to set up so don't apply unless you plan to borrow more than $25,000 and you have plenty of home equity to cover the loan. If you need to do a HELOC, shop around. Your current mortgage lender (assuming you have one) will probably offer you the best deal because they'll offer you existing customer discounts. They will see your good payment history on your mortgage and that's where you'll likely get the best deal. Bear in mind that the process is as slow as it is expensive. We took a HELOC in 2022 that took many months to negotiate and was repeatedly ratcheted down in response to other changes in our credit history.

Balance Transfers

Balance Transfer transfers to other credit cards were mentioned before and fall into the 'whack-a-mole' category. Aside from reducing your immediate interest costs and payments they're really just kicking the can down the road and the debt is not being reduced. If you open a new credit card account to gain a 0% interest deal, then your overall credit utilization will fall and that's good for your credit score. For example, you have one maxed out credit card with a $5,000 balance – so your utilization is at 100% and this is crushing your FICO score. You get a new credit card with a credit limit of $10,000. Now you have two cards with a total credit limit of $15,000. The new credit card also comes with a balance transfer incentive at 0%. So, you transfer $3,000 from the old card to the new. You still owe $5,000 but the old card now has a balance of $2,000 – 40% utilization of the available credit. The new card has a balance of $3,000 - 30% of the available credit. You are paying much less interest as $3,000 is now interest free and your overall utilization has reduced to 33%. This is a lot better and will improve your credit score.

However, if the balance transfer were to another credit card that you already have then while you do reduce your interest costs your utilization won't budge.

But think carefully about all this. Because once again this is really a whack-a-mole tactic to help you juggle short term and doesn't improve your overall position very much. A balance transfer ultimately can lull you into a false sense of calm when you really need to address the underlying problem that you're spending more than you earn. And that now you've just made things potentially worse by creating more credit head-room to go shopping again.

Negotiate with Creditors

If you ever get to this stage, you're in the shit and really need to consider some lifestyle changes and possibly professional help. You're all out of home equity lines of credit. You'll be maxed out on loans, you're all out of 0% balance transfers and you're still deep underwater and sinking. You need to be talking with the people you owe money to figure out some kind of hardship deals. What do these look like? It can be anything from a stay of execution on the interest rates to a pause in the payments to an agreed minimum payment amount. All of these things will have an immediate positive impact on your cash flow. But they are absolutely not long-term solutions and will come back to bite you in the ass if you don't fix the underlying problem that you spend more than you earn. Negotiating a debt deal with a company to whom you owe a lot of money will probably ding your credit score pretty hard. That will make it more expensive and difficult to get credit in the future. And the balance is going nowhere. Short of government help or personal bankruptcy, you're not getting out from under that debt. You're simply kicking it down the road. So, you have to have a more fundamental strategy to fix what's going wrong in your income and expenses. And that's covered in other chapters.

Conclusion

High interest credit card debt is highly toxic, corrosive and to be avoided. Credit cards have a role to play but charge cards and debit cards are better. I paid every single revolving credit account down to zero and we now use only an American Express charge card for all of our spending. They have a generous points scheme. There are similar products on the market. It doesn't matter how you choose to do it. The principle is the same. Get out from under high interest revolving credit as fast as you can. Any strategy that doesn't fundamentally pay down the debt and get rid of it as quickly as possible is simply going to keep you in chains for longer. And as I've said, if you're in that position, then you need to do make changes to your income to grow it or make changes to your expenses to cut them. Or both.

Follow this link to access this chapter's Kanban planning template on Trello: https://mark-bolton.com/.