MIKE CHADWICK'S

MONEY MATTERS

ADVISING, EDUCATING & INSPIRING YOU TO A BETTER LIFE

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Credit Cards, Master or Servant

These items we call charge cards, like anything else in the financial world are just tools. If you use them responsibly and with control, they can be quite lucrative. Yes, I actually just said credit cards can be lucrative. ☺ You must have discipline, the slightest slip ups and the banks will suddenly own you. That isn't a position you'd like to be in, owned by the banks. We all should be disciplined when it comes to our finances otherwise it'll be very hard if not impossible to get ahead in the world economically.

Here is the deal with credit cards. If you use them for your purchases starting with a zero balance (critical first step) and pay off the entire balance in full by the specified due date on your statement it will not cost you anything to use or own the credit card (unless they carry an annual fee). In fact, if you have a card that has some type of reward for using it, such as cash back or airline miles, you can actually make money by making all of your purchases with credit cards providing you're paying the balance off in full each month and never paying any interest. This really is a good deal if used properly. We use our card for everything throughout the month. We charge our gasoline, groceries, cell phone bills, house supplies, repairs, etc. If we made a charge on May 1st, and didn't get our bill until June 8th and our due date was June 30th we could use the banks money on this purchase for 2 full months, interest free and fee free. Not only that, we use a cash back card (Chase Sapphire $95/yr. fee) and at the end of each year have a few thousand dollars in cash back points we can spend as we wish. Even after the fee, it makes a lot of sense for us to use this card. I spent many years working with no fee cards, but if you spend enough, and pay it all off each month in full of course, it can make sense to pay an annual fee for a credit card 53.3% of the population is disciplined with cards as we are. Congrats if you are too!

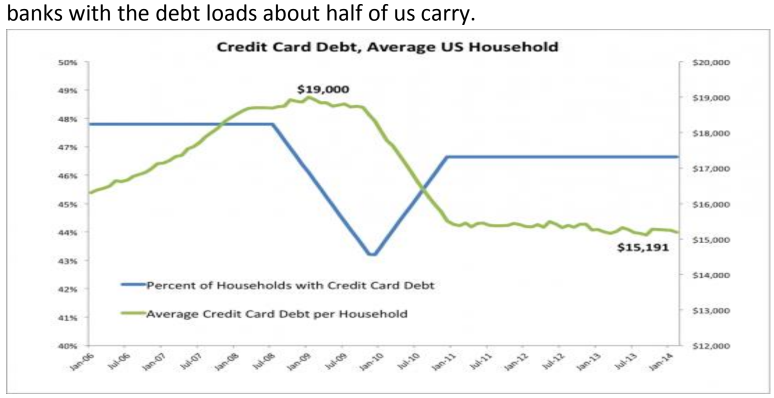
The other 46.7% of the population isn't so disciplined and they use the cards just as much, if not more, but lose in one key area, they don't pay off the balance in full each month. This is where the fine print can really hurt you, I mean really hurt! If you have a balance on your card of $1.00 from the previous month and make a purchase this month, interest, and possibly fee's, begin accruing from the second you make the purchase until the recent purchase is paid off in full. Interest rates on credit cards are not very

INSIDE THIS ISSUE

Debts and Leashes

There are good debts and there are bad debts. We try to get people to get rid of bad debts such as credit cards, high rate personal loans, etc. Good debt is low rate, fixed rate tax deductible debt. Some debts that are low rate and fixed need not be tax deductible to be considered good debt. The mustard test is if you can earn more on the money you have than the rate you're paying on debt then the debt makes sense to keep. If you have a mortgage at 4% and it's deductible to you while you're in the 33% income tax bracket, the net cost of that debt to you is only 2.67%. If you're earning a 5-10% average return on your money then by all means, don't pay off that debt. If you've got an 18% credit card and savings paying you 0.01%, then pay off the debt, it's a no brainer.

Think of debt as a leash, if you have too much of it you're bound by the terms of your debt load. In America, we're addicted to debt in bad ways. Look at the credit card complex and how we've got ourselves essentially enslaved to the banks with the debt loads about half of us carry.



Thanks to our friends and Nerdwallet for the chart! It appears we're doing a much better job paying off our debts than we were just a few years ago, until we consider the fact that most debts have been reduced due to discharge (bankruptcy, forgiveness, negotiation, etc.) rather than the debtor hunkering down and paying off our debts. When we look at the auto loan complex we're seeing the resurgence of a word that was very popular just a few years ago, subprime. Subprime defines loans that are geared toward borrowers who are not considered "ideal" by any stretch of the imagination. These borrowers cannot qualify for prime credit so they use the subprime variation of the credit. In theory, the lower credit risk would pay a whole lot more interest for their debt than the prime borrower. In our world of artificially held down interest rates, nothing is quite what it seems and a subprime loan can come in at under 8%. The risks associated with these loans are large and they're real, but the current environment is one where risk is being grossly mispriced across the board. Here is a look at the current loan to value charts of automotive loans in the market today by type of lender.

Master or Slave! (Cont'd from Pg. 1)

low, they're often in the high teens or twenties, and I've even seen 30% + annual interest rates on credit card balances. This is nothing more than legalized loan sharking at those rates. Education and information continue to be the most valuable things in the world. Those who have the education and information are better armed to avoid a litany of pitfalls in any area of life. A large portion of the population has a balance on their credit cards but they pay either the minimum monthly payment (2-4% on most cards) or a bit more by rounding up to the nearest hundred dollar mark. If you have a 10k balance and the bank uses a 3% minimum payment method your monthly minimum payment would be $300.00. If your card charges 25% interest, the payment would be $250.00 in interest for the month and $50.00 would come off your principal. If you used the card at all that month, the purchases would be added to your balance. This is how many people operate on a month to month basis. Many people think having a credit card balance is no big deal and just keep rolling along in life with a balance and they continue to pay the minimum monthly payment.

Let's look at the actual math of using a credit card, carrying a balance and floating through a working career with that approximate balance. If you fit the example above and carried that 10k balance on your card throughout your working career how would it impact you? Of course there will be times when the balance is higher or lower based on how your life goes and what happens in it with your ability to pay and bills that come up, but the results will be very similar.

If your average balance is 10k and the card carries an 18% interest rate, the interest you'll pay on that 10k loan over a 40 year working career is $78,866.00. This is arguably the most expensive loan you can get. The only loans I'm aware of that are more expensive are refund anticipation loans from the tax return chains (H&R Block, Jackson Hewitt, etc.) or a loan from your local loan shark. The latter is completely illegal but they still exist on an amazingly grand scale. It's called the unbanked portion of our population or the hard money lenders, but the good old system of supply and demand continue to work where traditional banking leaves gaps behind. These may not be the most attractive venues for financing, but they still exist nonetheless. Not only do we need to worry about how much interest you paid on the loan, but we must factor in the opportunity cost of the loan. Some ask me what an opportunity cost is and I often say the most important thing about finances that people are unaware of. It's the opportunity you give up on your money of earning a return on it if you did something with it where you didn't get a return. The perfect example would be paying the bank 18% on your credit card, you not only paid the 18%, but lost the opportunity to earn interest on the money you used to pay the bank back.

To calculate the opportunity costs, we'll assume you paid off the credit card and then calculate how much you'd of accumulated with the payments you made to the bank on the credit card debt, in this example at an 8% rate of return. Hold your breath, the total you could have had, including opportunity costs, is $510,767.00. That's not a typo, this is the real deal and how much you could have had if you just knew more about how the banking side works and the mechanics of credit cards and discipline. The moral to the story is never, ever, under any circumstance, if you can possibly avoid it, carry a credit card balance, ever!

The Minimum Wage Battle

This topic remains a hot debate today between the economic front and the social front and various ideologies are in polar opposite camps on the issue. People are naturally loving and benevolent and want to help and this is a great way to do so, or is it? The economic argument seems to conclude people need to increase their skill levels to get out of a minimum wage job to support their family. Too high of a minimum wage puts far too much pressure on small companies while their larger brethren can comfortably afford higher costs. What the increased costs will do to product costs points to higher prices across the board. These jobs were never considered careers, but stepping stones to a better opportunity down the line. Peoples decisions and situations have put many in a place where they're stuck in a job like this for now, but nobody is holding them there we're all free to improve and grow as we wish and are duly motivated to do so. People all need to work and survive and some need help, so this remains a sticky situation.

Some organizations provide work to disabled folks and they earn very little, a fraction of the minimum wage, but they do provide a valuable service to the community and they do gain a sense of purpose and self-esteem for providing a value added to the society as a whole. Governments already subsidize non-profits and some businesses to make this happen today. This is great on every level, economic, social and societal but goes against the argument for minimum wages and somehow has found a caveat to the law.

Studies have been done to show what it takes to live in certain areas and that number obviously varies drastically depending on family size and geography. One study recently showed a person living in Minnesota would need to earn about $34/hr. to keep up with the cost of living there as a single parent with 4 kids. Should your wages depend on your family status and number of dependents? I cannot fathom a way to make that economically viable but socially it would be just great. Who would hire a man with 4 kids to do a job that must pay $35.00/hr. where a single man could do the same job for $15.00? Economically this holds no water.

The laws of supply and demand do not integrate at all with social thinking. We must balance these areas out as there are all types of people out there in our society. There is a thinking out there today and if we just help enough people we'll suddenly get a stronger economy and all will be well. We must remain optimistic and continue to innovate and invent, but we cannot bury our heads in the sand about basic economic tenants. The constant stimulus of the past 5 years have also adopted this thinking, has it worked? We're "growing" economically at a snails pace economically but we've managed to double our countries national debt in 5 years. I wouldn't consider that a blazing success, perhaps a dismal failure would be more appropriate. My thinking is rooted in economics and business as that is the world I live in and many of our clients own small companies so we see the daily struggles and issues. I too want to see everyone do well and have a big heart.

We also see plenty of regular folks who are just working to get ahead, retire, get by or move into the next stages of their lives. The issues surrounding this topic are many and complicated. Only time will tell how it plays out. The pendulum today favors doing the socially popular thing and ignoring fiscal reality. This works as long as it works and people buy into the kick the can theory. In the interim, keep improving and moving forward, never give up and don't rely on others, make it happen for yourself, the sky is the limit if you're so motivated.

Noteworthy News!!!

- Congratulation to Steve & Sue Schibi on the purchase of their new home! ☺
- Congratulations to Susan Boults on her new job! ☺
- Congratulations to Jared & Jamie Sauvron on the purchase of their new home! ☺
- Our condolences to the Fiori family on the passing of Dave, a wonderful man, husband, brother, uncle, son, man and friend.

Question & Answer

Ask any financial question you have and we'll address it here.

Q: I check my bank account online almost daily but rarely balance the account, is that sufficient?

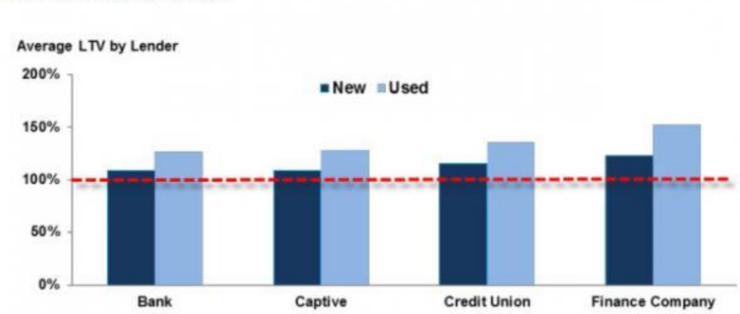
Not really! If you are checking it often you're of the impression you're not likely to be charged for something you did not purchase nor are you likely to bounce any checks or cause real chaos in your accounts. Not true, even when you balance your checkbook every month there comes times when errors come up and you may be off by a few cents or hundreds of dolars or you simply omit or double count certain entries. Not only that, you're missing a lot by not going through the balancing exercize. You will not know where your money is going, you will not cagtegorize it and put it in order and analyze it. Part of the monthly balancing task is to ensure your checks are cashed, deposits are made and nothing gets by the gatekeeper of the account.

This is an aggressive concept in theory, but we're not considering here the underwriting standards that banks must use to determine if people or businesses are a good credit risk. If banks had ample demand for loans with solid underwriting risks, they'd have already lent the money out to help grow their business. Banks don't want idle money on deposit iwht the ECB, they want it lend out as banks view loans as assets and deposits as liabilites. They're not doing it because there is a clear lack of quality creidt risks and they don't want to go right back into the crisis they just left. Banks today have been recovering from the period where loans were made with very laxed (some say downright stupid and I cannot disagree) lending standards over the past 4-5 years. Many banks are in much better shape than they were at the height of the crisis, but many more are still in trouble. European banks especially face certain risks as they're balance sheets are loaded with the paper (bills, bonds and notes) of the governemnts where they do business. In theory government paper is safe and "risk free" but in reality that is the furthest thing from the case. Yields are very low today, which on the surface makes one think this paper is safe, but it's not at all. The fact that the lower European block of countries can now borrow money at 3 or 4 or 5% proves the absolute dysfunction of the risk and reward system of government bonds today. Easy money has made it appear there is no longer any risk in the financiaal system. The reality is just the opposite, the risks of the system are higher than they've been in a long time, but they're masked. We can see very clearly through this façade.

Debts and Leashes

(cont'd from page 1)

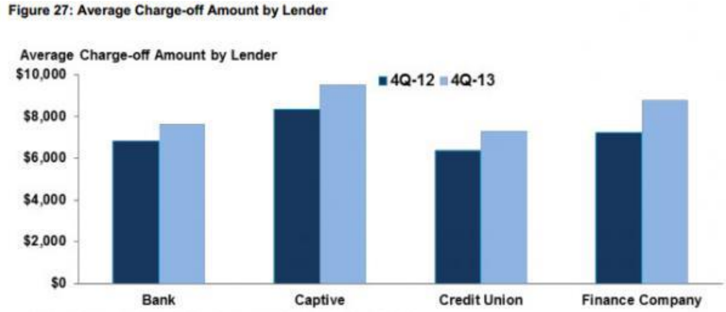
Figure 26: Average LTV by Lender



Source: Experian, *State of the Automotive Finance Market* 4Q2013

It's quite interesting how we're lending people over 100% of the value of the car in the form of a loan. That sounds eerily familiar to what was happening to homes in 2005 & 2006! We also must consider skin in the game, if the borrower has no skin in the game, that is a sizable down payment, (s)he is less inclined to behave properly as the cost of walking away from such a loan is simply a ding to credit, no immediate financial loss.

Figure 27: Average Charge-off Amount by Lender



Source: Experian, *State of the Automotive Finance Market* 4Q2013

Look at how the amount lenders are charging off (this means they're not getting paid and hiring the repo man you see on TV to go and find and confiscate the car) in the past two quarters. All forms of lenders are seeing repo's increase by double digit amounts in just one year. Subprime is called that for a reason, they're not all going to pay off the loans. Cars have seen price increases at close to double digits for some time and consumer income is stagnant. The solution is to water down the credit requirements, lend more money over a longer time horizon. While we're seeing record car sales by many auto companies, we must ask ourselves the question of sustainability and how much channel stuffing can be actually performed. This doesn't seem very sustainable to anyone who can perform simple math.

The bottom line here is don't take on too much debt in any form. If you do, you'll be beholden to the debt holder until that debt is paid off. We find through experience that those who keep it simple and never borrow beyond their means can do fine and work through the tough times when they come. Those who end up taking on too much debt have a hard time surviving tough times that are more difficult and end up having to walk away from debt in some form. These people end up with bad credit because they're late on payments or sometimes they have their credit cards turned off, cars repo' d or even their homes foreclosed. You're in control of how you do this so go slowly and well thought out. Never borrow beyond your means and don't try to keep up with the package society is selling. Simple is often better! ☺

Money Quiz

This month's challenge is to tell us about the age of cars we drive in America, on average. The average vehicle on the road today was purchased during what quarter of what year? Last month's quiz was won by Linda St. Pierre, Warren Buffet's annual meeting was host to only 12 people in 1981 vs the 40,000 that came this year. ☺ Winner goes to Ruby Tuesday on us!

06:30:14 - 10

New IRA Rules

The IRS is planning to implement new IRA rollover rules as early as January of 2015. The new rules, proposed as Announcement 2014-15 will limit IRA rollovers to one per 12 month period, regardless of the number of IRA's one may own. Right now you can roll IRA's as often as you'd like. Some people that come to us have dozens of IRA's and want to consolidate them in to one account. If you do your IRA business with a bank they're notorious for opening a new account for every deposit made, especially if they're in CD's. With this new rule, you can continue to make as many IRA rollovers as you'd like as long as they're trustee to trustee rollovers. A trustee to trustee rollover is one where you never get your hot little hands on the money and it goes directly from company one as trustee of your IRA to company two as trustee of your new IRA. Let's say you have an IRA at the bank and want to roll it over to Fidelity. If the paperwork is filled out as a trustee to trustee rollover and the bank sends the check directly to Fidelity that is considered a trustee to trustee rollover. Note you never had what they refer to as "constructive receipt" of the cash and never could have used or enjoyed it.

You can roll over IRA's and act as the middleman if you'd like, these are not considered trustee to trustee rollovers. In the same example if you took your IRA out of the bank, cashed the check, put it into your checking account and then sent it to Fidelity that would not count as a trustee to trustee rollover and this is what the IRS is proposing to limit. In 20 years I've only seen one IRA rollover go this way and it was just recently. An important note is that you do not need to put the IRA back with the same institution you withdrew it from, you can go from one company to the next, as long as it's done in the 60 day window and no taxes will be due. It'll be a bit more complicated from a tax perspective, but as long as it's reported correctly on the tax return you're good. Before doing such a maneuver I would consult with your CPA and consider doing the trustee rollover first, but this does work. I was under the impression that the money had to go back into the IRA it was removed from when doing such a transaction, but that isn't the case.

IRA's are a great tool to plan for your future and retirement but the rules surrounding them are very complicated. We're here to help with any IRA or related financial questions you may have. We too learn all the time and the rules of the game are constantly changing. IRA's were born in 1974 as a result of the ERISA (Employee Retirement Income Security Act) rules to help workers retire comfortably.

Interesting Facts

Trivial pursuit knowledge for sure, these tidbits could be useful in other ways and they're very likely to make you smile! ☺

- You can't breathe and swallow at the same time
- The girlfriend of the man who founded match.com left him for a man she met on match.com that's a testimonial!
- German is the 2nd most spoken language in North Dakota
- The official state vegetable of Oklahoma is the watermelon!
- A day on Venus is longer than a year on Venus
- A TI-83 computer has 600% more processing power than the computer that put the Apollo 11 on the moon
- Cambridge University is older than the Aztec and Inca empires
- Harvard University was founded before calculus was derived
- George Washington was 48 when Beethoven was born
- Horses cannot breathe through their mouths
- Light road coffees have more caffeine than dark roasts
- There is a basketball court on the top floor of the U.S. Supreme court Building, it's known as the "highest court in the land"
- NYC is further south than Rome
- Scotland is as far north as Alaska
- Reno, NV is west of LA as are six other state capitals
- Leave Detroit and walk south, the first thing you'll hit is Canada
- A Butt Load is an actual unit of measurement, equivalent to 126 gallons
- France is the country with the most time zones in the world
- Africa is larger than the US, Chile, India, Spain, and France – combined!
- Butterflies taste with their feet
- A jiffy is an actual unit of time not just an expression, it represents 33.3564 picoseconds.
- The lint that collects in the bottom of your pocket is called a gnurr.
- A cubic inch of bone is 4 times stronger than concrete
- There are more lakes in Canada than in the rest of the world, combined!
- You can get a rough temperature estimate by counting the number of times a cricket chirps in 15 seconds and adding 37 to it.
- The feeling you get when something is so cute you can't help but want to squeeze it is called "cute aggression"
- The voices of Yoda & Ms. Piggy were done by the same person
- AOL still earns more than $100 million every few months from dial up subscribers – Wow!
- There are more tigers living in Texas than in the rest of the world.
- Astronauts are on average 2" taller in space
- There are some trees alive today that were alive before the great pyramids were built
- When you yawn and stretch at the same time you're "pandiculating"
- There is enough iron in your body to make a 2" nail.
- One million seconds is 11 days. One billion seconds is 33 years.
- Wombat poop is square
- The brain named itself!

Inspirational Quotes

- Everything you are against weakens you. Everything you are for empowers you, author unknown.
- There will be many surprises: unexpected gains are likely, author unknown
- Your life does not get better by chance, it gets better by change.
- Wealth is not in making money, but in making the man while he is making money, author unknown
- Playing it safe is the riskiest choice we can ever make, Sarah Ban Breathnach
- Honesty is the first chapter in the book of wisdom, Thomas Jefferson
- It is literally true that you can succeed best and quickest by helping others to succeed, Napoleon
- Promise yourself to be so strong that nothing can disturb your peace of mind, Christian Larson
- A pessimist sees the difficulty in every opportunity; an optimist see the opportunity in every difficulty, Winston Churchill

We can piece the puzzle together and make your money work for you!

Don't make excuses; make things happen; make changes; make history!

Kids Korner

Who is the boss of the house? Clearly we as the adults are the ones who are supposed to be in charge. Many of today's youth have it too easy, they're not pushed to make it happen on their own as they know we'll bail them out if they don't do what they need to do. It's imperative we do not allow the kids to think that for one millisecond they're the ones ruling the roost. If your child is not motivated to do what you ask him/her to do, doesn't have a job in high school, whines when asked to help around the house or is generally exhibiting an entitled attitude and behavior set it's time to hit this problem head on. Make the kids know in no uncertain terms that you are the boss and they will do what is expected of them and be useful members of your family and society in general. Should they be sleeping till noon on the weekends and during the summer? I don't subscribe to that theory but they should get some down time after they've done what you expect of them as far as jobs, chores and responsibilities. Keep them responsible young, it's hard to change in adulthood!

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- Required Minimum Distributions
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- Settlement option analysis
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