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**Let The Snow Melt**

This newsletter is about the issue of whether or not one should do a debt snowball, a debt avalanche or something else to pay off their debts. So... first let me explain (for those who don't know) what Debt snowballing and Debt avalanching really mean.

Debt snowballing is when you pay off your debts from smallest balance to the largest balance. So if you had an extra 100 dollars per month, rather than pay for example 20 extra on 5 different debts, you would put all 100 dollars on the smallest debt and then once it is paid off roll it over onto the next smallest debt until you pay everything off and become debt free.

Doing a debt avalanche is very similar. Except instead of putting the \$100 on the smallest debt, you would put it on the debt with the highest interest rate (regardless of debt size) and once it is paid off roll it over onto the second highest interest rate etc etc.

Now, while both of these methods work much better than haphazardly paying off your debts, the question is... which one works better?

Well.... let us find out! Let's do an illustration.

Let us say that you are fresh out of college, so to join the middle class matrix, you decide to go out and buy a new house and car to go with the debt that you have accumulated. Now that you are in deep debt, it is time to make your game plan to get out of this debt and plan for retirement. Here are your current debts.

Mortgage = \$165,000. Interest rate = 7%, Monthly Payment = 1097.75  
Car = \$15,000. Interest rate = 12%, Monthly Payment = 498.21  
Credit Card#1 = \$10000. Interest rate = 11%, Monthly Payment = 200.00  
Credit Card#2 = \$5000. Interest rate = 17%, Monthly Payment = 100.00  
Credit Card#3 = \$2000. Interest rate = 10%, Monthly Payment = 50.00

Now... In this illustration we will say that you are able to scrounge up an extra \$200.00 per month to work towards paying off your debt and going into retirement. This gives you a total of \$2,145.96 to work with per month. And after you get done paying off your debt, you will then put your money into an investment vehicle that pays 9%. This illustration will start this September 09.

Now if you didn't do anything at all and just paid the minimum on all of these debts (which is what a lot of people do) it will take you 354 months to pay off the debt. So... your debt would be paid off in February of 2039. That is almost 30 years (if there is NO reborrowing or charging, which is

unlikely), and at that point most people start to think about planning for retirement. So we will use the 360 months (30 years) for this illustration.

The Following Website is what I used to do the calculating in this debt illustration.  
<http://www.whatsthecost.com/snowball.aspx>

The following website was used for the investment illustration.  
<http://golfgeek.org/investments.htm> (Only works in IE)

Let us first check out the Debt snowball method.

Using the Debt snowball method, you will pay off the debts from smallest balance (CC#3) to largest balance (Mortgage) by first putting the extra \$200.00 on the smallest debt and rolling it up to the top.

If you do it this way, you will be out of debt in 134 months on Oct 2020 with your last payment being \$235.31. That will leave \$1910.65 in the 134th month. So let's say you put that into an investment paying 9% for the remaining 226 months. If you invest the \$2145.96 for the remaining time, then after 30 years you will have \$1,272,825.48

WOW! That is a big difference.

Now let us check out the Debt avalanche method.

Using the Debt avalanche method, you will pay off the debts from smallest interest (Mortgage) to largest interest (CC#3, which is the smallest debt) by first putting the extra \$200.00 on the highest interest and rolling it over to the debt with the lowest interest.

If you do it this way, you will be out of debt in 133 months on Sept 2020 with your last payment being 1976.95. That will leave 169.01 in the 133rd month. So let's say you put that into an investment paying 9% for the remaining 227 months. If you invest the 2145.96 for the remaining time, then after 30 years you will have \$1,275,020.64.

That is one month earlier of being debt free and approximately \$2,000 in extra cash at the end using the Debt Avalanche.

Now in this particular instance, the debt avalanche won (But not by much at all). Generally speaking, Debt avalanche will always win. But it certainly won't be by a huge margin. So... mathematically, the quickest way to pay off your debt is from the highest interest to the lowest. But, if this is really the case, then why do so many people subscribe to debt snowballing? Well, there are those that say that debt snowballing provides quick victories. So, if you pay your smallest debt off quickly, it will make you feel good and give you more motivation to move on. I can completely understand this, especially considering that there is not a big difference between doing the two.

With that being said, I am not one to do a financial plan based on how disciplined I think most people are. That is a slippery slope that many financial advisors choose to go down. That way they can (for example) sell someone a jacked up whole life insurance policy and justify it by saying, "yes, there is a more economical way, but my client is not disciplined enough to follow through on it" In most cases, I just analyze and give the numbers.

But there is a method that has not been explored yet. And if you are reading this newsletter, you should feel lucky because you are one of the first to be exposed to this brand new revolutionary way to pay off your debt. It's called the "let the snow melt" method.

Now let us check out the "Let the snow melt" method. In this method you will not pay down your debts from the smallest to the largest balance. You will also not pay down your debts from the largest to the smallest interest rate. In this particular method, you will not pay the debt off early at all! You will take the \$200.00 and start your investment right away, and just pay the minimum on all your debts. Now, when each debt gets paid off, take that extra money and invest it rather than rolling it over to the next debt.

If you do this... at the end of 30 years your total will be \$1,422,098.01. Now that is about \$147,077.37 over the nearest competitor!

You see ladies and gentlemen, sometimes getting out of debt is just flat out overrated. That is why I don't believe in paying ones house off early. But this also applies to almost any situation. The pay yourself first principle truly does work.

Now, do I normally recommend for people not to pay ANY debt off at all and just start investing? No... Not really. Why? Well... first, in a lot of cases Credit Cards will charge a minimum balance which is a percentage of the total debt, which means that paying the minimum will NEVER get you out (or maybe in 100 years or so). But even with that you would have more money. And of course the second reason is that, it would take EXTREME discipline to do such thing.

So... I guess I just contradicted myself. Oh well.

But... the most important thing to remember about this whole thing is that it doesn't matter what method you choose IF YOU DON'T FOLLOW THROUGH ON IT! Sadly enough, most people don't have the discipline to do 1, 2 or 3 (while sitting there arguing about it). One can have an 8 hour debate on what plan is the best, but the truth is that WE MUST ALL HAVE ONE. And we must be disciplined to follow through on it. I talk about these things in Financial Freedom Boulevard and Don't Do a Budget.

Now, while I would clearly choose #3 (Let the Snow Melt Method) to be my end result, options one and two are both good enough aren't they? Either way you would be better off than most. So make a plan that is customized for YOU! And then DO it! Because doing the plan is more important than the plan! Understand?

So until next time,

Free Your Mind... Online

Matt Mason

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