KATHMERE
CAPITAL MANAGEMENT

Deconstructing Debt

Debt is a common aspect of financial life for many Americans, with loans being a typical component. It's not uncommon for college graduates to carry student debt upon completing their education. As of December 31, 2023, the Federal Reserve Bank of New York's Center for Microeconomic Data reported that U.S. household debt had reached an all-time high.

While debt can be stressful, it can also be a useful financial tool. Here are some important considerations when thinking about taking on debt.

Assess Your Debt Capacity: It's generally advisable to take on only as much debt as you can comfortably repay. Knowing your disposable income each month—after covering all regular bills and necessities—can help you budget so you don't commit to debt payments that exceed this amount. A common guideline is to maintain an emergency fund with about 3-6 months of expenses to cover unexpected changes in your financial situation.

Distinguish Between "Good Debt" and "Bad Debt": Generally, bad debt tends to have high interest rates and is used for purchases that are not essential and are unlikely to retain value, such as the latest gadgets or designer clothes. Conversely, good debt usually has lower interest rates and is used for investments likely to appreciate or improve your financial standing, like buying a house, furthering your education, or purchasing a necessary vehicle.

Debt Consideration Checklist:

- The purchase is likely to grow in value or enhance your earning potential
- You can comfortably manage the monthly debt payments
- You have an emergency fund in place
- You are consistently saving for retirement
- You are not overpaying for the item
- You can secure a competitive interest rate for the loan

Credit Card Debt: Credit cards offer convenience but are usually not the best option for borrowing money due to high interest rates. Planning to pay off the balance each month can help avoid these high costs and build a strong credit history. A good credit score can qualify you for lower interest rates on major loans in the future.

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