“Apply even some of this book’s teachings and you’ll owe its author a debt of gratitude. And that’s smart debt!”
Dave Chilton, “The Wealthy Barber”

The Smart Debt Coach

$1,000 BENEFIT GUARANTEED OR MONEY BACK

Secrets of the Rich to Increase *Your* Wealth and Security

Talbot Stevens

Book Excerpt

To make it easier to quickly learn and benefit from one or two concepts, this document contains a small part of *The Smart Debt Coach: Secrets of the Rich to Increase Your Wealth and Security*. The entire publication, as well as other brief excerpts, is also available.

For more information, or to get more ideas to help you increase your wealth and security, please contact

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> *"Apply even some of this book's teachings and you'll owe its author a debt of gratitude. And that's smart debt!"*
>
> *- David Chilton, "The Wealthy Barber"*

"Help a Friend"

Since we're not taught about money, let alone more powerful strategies used by the rich, you're probably not the only one who could benefit from the ideas in *The Smart Debt Coach*. **If you find some of these concepts valuable, please *"Help a Friend"* and spread the word, giving them a copy of this document.**

If a friend knew of a way that you could benefit significantly, and they didn't tell you about it, how would you feel?

Please share this content with those you care about: your friends, relatives, and co-workers. Helping a 'friend' learn how to create their own financial independence might be the most valuable thing you do for them.

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As everyone's situation is different, these ideas are not, and should not be construed as advice. Readers should use their own judgment and/or consult a financial expert for specific applications to their individual situations.

About Advisor Name

This page explains WHY someone should choose you as their financial advisor, instead of their current advisor.

You might identify your target market and your Ideal Client Profile, so you only attract clients you want to work with.

You would clearly outline your USP, or Unique Selling Proposition. That might include the fact that you don't sell, you serve. Your focus is working with a limited number of client families to deliver the highest value in two critical areas.

Wealth Strategies. You can't benefit from powerful ideas until you're aware of them. You specialize in untaught concepts to increase wealth and security, like the rich do.

Behavioural Coaching. More important than knowledge is the ability to execute strategies effectively, managing the biggest threat to clients' financial success: behaviour. Your clients refer their friends because of your ability to help them understand and stick to the financial plan that is best for them.

You might include a personal anecdote about your family or community involvement, to show your human side.

You would close with a Call to Action, perhaps including a hook or free offer to entice a prospect to meet with you.

The Keys to the Debt vs. RRSP Dilemma

"NEED TO STOCKPILE NUTS TO SURVIVE THE WINTER, AND SOMETIMES THE SUMMER"

"I understand why you keep coming back to that," Bruce said. "It's an excellent question and an increasingly important one. More and more people are dealing with high debt levels and falling behind on retirement savings.

"While lower-income taxpayers are generally better off saving for retirement using TFSAs, for most middle- and upper-income Canadians, the tax savings and tax deferral of an RRSP make it the vehicle of choice. As a result, the debt-versus-RRSP question is one of the annual dilemmas that investors face every winter.

"But let me turn it around for a second. What have you two heard about whether it's better to pay down debt, such as a mortgage, versus contributing to an RRSP?"

"As you've learned, we know little about finances," I acknowledged. "But I think I remember hearing something about putting your money in an RRSP first, then using your refund to pay down your mortgage."

"That's what I heard," Michelle seconded.

"You're right," Bruce announced. "Doing both – RRSPs first and paying down debt with the refund – is the answer most often given. But before I offer what I think is the key to assessing what's best for you, let me ask another question. If I came to you to find out if Option A was better than Option B, and you told me to do both, did you really tell me which was better?"

Michelle's eyebrows shot up. "I suppose not!"

"My point is that if the RRSP is the best strategy for your money initially, then why would you want to put the refund into the second-best strategy?

"Don't get me wrong. They're both good strategies, but if one is twice as good as the other, don't you want to know which is better? There is real merit to diversifying into more than one strategy, as we'll see later. But in my opinion, **the do-both response to the RRSP-versus-debt dilemma is a convenient non-answer**."

"So what's better, RRSPs or paying down debt?"

"Well, Joe, the short answer is that … it depends. There are a number of parameters that are important for assessing what's best for your unique situation. In addition, there are other considerations that might completely override which strategy is mathematically best."

"What do you mean?"

"Let's start with a mathematical comparison," Bruce commenced. "Two of the obvious parameters to account for are what your RRSP returns are, and the interest rate on your debt. The wide range of debt rates and returns is one of the reasons that a simple rule-of-thumb answer doesn't apply here."

Michelle nodded. "That makes sense. There's a big difference between paying down a mortgage at four or five percent and a credit card charging 20 to 30 percent."

"But there's another parameter that's almost always overlooked that can be more important than returns and debt rates. Can you guess what it is?"

I had no clue, but Michelle's insight reminded me that I married her for more than her good looks. "I don't know exactly, but since you've said several times how important behaviour is, and how your financial planning focus is based on behavioural coaching, I'd guess it has something to do with behaviour."

"Bingo. The key to doing a proper financial assessment of whether you should pay down debt or invest in RRSPs is your behaviour. Specifically, how disciplined a saver you are in two ways."

"What's the first?"

"We've already talked about the behavioural issue with RRSPs, and how spending the refund results in investing less than you start with."

"You said we should never put dry pasta in our RRSPs," Michelle recalled.

"You remembered," Bruce grinned, clearly satisfied with at least one of his coaching efforts. "Obviously, the behavioural factor of what investors do with their RRSP refunds – whether they're spent or grossed up to the equivalent before-tax amount – can make a difference of 25 to 85 percent, as we learned earlier."

"What's the other behavioural factor?" I asked, more determined to not be upstaged by my increasingly savvy wife.

"The other behavioural factor is what happens when the debt is paid off. **What portion of that 'new money' that used to go to mortgage payments actually gets invested**, now that it's available for savings? As David Chilton wisely points out in his book *The Wealthy Barber Returns*, merely investing all of the mortgage cash flow once the mortgage is gone isn't the right amount for an apples-to-apples comparison."

So much for my determination not to be upstaged. I looked at him blankly. "I don't understand."

"Let me give you a simple example. Let's say that Mary and Rob both have annual mortgage payments of $15,000. Each has an extra $5,000 a year that could be used to pay down their mortgages or invest in RRSPs. So they each have a total of $20,000 a year to direct towards their mortgage and perhaps RRSPs.

"Rob uses his $5,000 a year for RRSP contributions. Mary uses her additional cash flow to reduce her mortgage balance by $5,000 each year. That allows her to pay it off roughly five years earlier.

"To invest the same amount as Rob, how much should Mary invest in RRSPs during the five years after her mortgage is paid off?" Bruce tested.

After reflecting briefly, I thought I had the answer. "She needs to invest $20,000 a year, not just the $15,000 mortgage payment amount."

"That's correct, and too many don't realize that," Bruce confirmed. "A lot of mortgage-first thinkers feel that if they're disciplined enough to invest all of their mortgage payments when the mortgage is gone, they'll be on par with RRSP Rob's commitment level. But remember, they were both 'investing' $20,000 a year in total. Each allocated $15,000 for mortgage payments and $5,000 went to either RRSPs or to pay off the mortgage earlier, so there would be more cash flow to invest later."

Bruce leaned back, silent, as if waiting for us.

"I can't put my finger on it, but somehow I sense there's more to this," I ventured.

"Very perceptive!" Bruce smiled. "We still need to combine both behavioural issues to determine how much Mary should be putting in her RRSP once she's freed up her mortgage payments. Let me offer a clue: pasta."

"I think I know. All of the amounts in your example are after-tax dollars," I said, impressing myself. "The equivalent RRSP amounts – the larger, cooked pasta, as you call it – are more."

"Exactly! You two are really grasping the fundamentals well. If your implementation of wealth-building strategies is as good as your understanding of them, I'm confident you'll achieve all of your financial goals and more."

"That's great to hear," Michelle responded. "I'm sure we're not the fastest learners, but we're committed to being more effective with our money."

"I'm sure you will be," Bruce encouraged her. "So far, we've just discussed the basics. We haven't looked at how to reduce bad debt and free up more money to invest, both of which are guaranteed to increase your wealth. Later, we'll get into more powerful investment strategies used by the rich, including commonsense ways cautious investors can outperform the market.

"But for now, let's finish addressing whether it's better to focus on paying down debt or saving in RRSPs. To keep the numbers really simple, let's assume Mary and Rob are in a 50 percent tax bracket. Yes, the tax bracket for most middle-income Canadians is closer to 33 percent, but we'll see the critical point here doesn't require precise math.

"With our 50 percent tax bracket, it means that one dollar in an RRSP is worth fifty cents after cashing in and paying taxes. In other words, for Mary and Rob, an after-tax dollar to invest equates to how much in an RRSP?"

Michelle was on it. "Two dollars. If taxes are 50 percent, cooked pasta is twice as big as dry pasta."

"That's right. Now, let's apply the after-tax versus before-tax reality to Mary and Rob, so we can understand how much each should be putting in RRSPs for an apples-to-apples comparison.

"The $15,000 that went to mortgage payments and the extra $5,000 a year each had to invest – were they after-tax or before-tax dollars?"

"After-tax dollars. Generally, we only get to spend or save after-tax dollars," I replied confidently.

"So if Mary's putting an *after-tax* five thousand dollars against her mortgage each year, how much should Rob be putting into his RRSP to match Mary?"

"He needs to also invest $5,000 *after tax*," Michelle obliged.

"Which equates to an RRSP contribution of how much, with our 50 percent tax bracket?"

"Twice as much, or $10,000 a year. Using the Gross Up strategy, Rob's $5,000 of after-tax cash flow can become the equivalent $10,000 before tax."

"Excellent. And in the same way, after Mary pays off her mortgage, how much should she contribute to her RRSP to invest the same amount as Rob?"

I took this one. "They were each investing a total of $20,000 a year *after tax*. So Mary needs to continue to invest $20,000 after tax, which means contributing twice as much before tax. So for her RRSP, that's … $40,000 a year. Wow! That's a lot."

"It is. And based on my experience, a lot of people aren't aware of how much it should be. To keep up with her original commitment, and to match Rob's total after-tax investment, Mary needs to put not $15,000, not $20,000, but $40,000 a year in her RRSP after her mortgage is gone."

"We would have had no idea," I confessed. "The difference between after-tax and before-tax dollars – between dry pasta and cooked pasta – is a big deal in understanding finances."

"And identifying the most effective strategy," Bruce agreed. "That's why whenever the rich think about money, it's always in terms of net, after-tax dollars, whether they're buying something, using debt, or investing.

"Now that we've established how to properly evaluate the math of being a Mary or a Rob, let me be really clear about the behavioural factors involved.

"How many people are truly going to invest every penny of their $15,000 mortgage payments once they've finished their mortgage-burning celebrations? Wouldn't a lot feel justified in some enjoy-today rewards after years of sacrifice and discipline? Aren't some going to feel that bumping their RRSP savings from nothing to, say, two-thirds of their mortgage commitment, or $10,000 a year, will still put them ahead of most other people?"

"I would have," Michelle admitted.

"And beyond that, whether it's because of less-than-perfect discipline, or because they're not aware of the pasta message, how many Marys are really going to contribute the full $40,000 annually when their mortgage is gone?"

"I'd say slim to none."

"**Behavioural factors are key to our long-term success and one of the few things we can control**," Bruce declared. "My focus with clients is to help them understand the impact of behavioural choices and guide them towards their financial priorities.

"Even without a detailed analysis of what's best for an individual's unique situation, I think we can get to an answer that results in a larger retirement fund and, as a bonus, provides more short-term security – at least for the majority of people. I mean let's face it, few of us have machine-like discipline.

"Do you have squirrels in your neighbourhood?"

That was an abrupt change of topic. "Yes, of course. Doesn't everyone? I spend my summers chasing them away from my bird feeders," Michelle complained.

"And in the fall, what do they do?"

"Oh, the wretched pests start digging holes all over my gardens. They take walnuts from my neighbour's tree and bury them everywhere."

"Why do they do that?"

While Michelle fumed about the squirrels, I leapt in. "To store away food for the winter."

"And if they don't stockpile enough nuts, would they make it through the winter?"

"Wouldn't it be nice if they didn't," Michelle scoffed.

"Baby squirrels are born in the spring and mature quickly," Bruce continued. "Let's say they have 20 weeks as adults before winter hits, and they need 200 nuts to survive the winter. Now, let's pretend they get to choose how they stockpile those 200 nuts. They can stash 10 away each of the 20 weeks of the summer and early fall, or they can choose to wait and put 40 away each of the five weeks right before winter."

Michelle was following him. "The 'more-later' approach sounds a lot like Mary paying off her mortgage first, then needing to put $40,000 a year into RRSPs for five years."

"That might not be a coincidence," Bruce confessed. "Let's see if the squirrels can help you decide if you want to focus on debt or saving.

"First, consider which approach is more likely to produce the 200-nut stockpile needed to survive the winter. Assuming a 'more-later' squirrel correctly calculates that it needs 40 nuts each week – and most squirrels aren't great at long division – what if there aren't as many nuts available at that time? Or what if the squirrel wasn't able to gather *any* nuts, let alone four times as many as its cousins, because it had a debilitating run-in with a cat?"

"I like that cat," Michelle smiled.

I saw Bruce's point clearly. "So you're saying that even if Mary knew she needed to put $40,000 a year into her RRSP, the 'more-later' approach puts a lot of pressure on her. She has to be able to earn an income *and* have super discipline during those critical few years before retirement."

Our coach nodded. "It doesn't leave a lot of wiggle room for the possibility of income disruptions due to the economy or disability. And these days, does anyone – even people who work for the government – have job security?"

"Good point," I concurred. "We've both seen friends laid off, and some take a long time to find employment again."

"And even when they do, it's often at a reduced pay," Michelle added. "But on the flip side, let's say one of us loses our job. Isn't it better to pay off our mortgage as fast as we can, to reduce the risk of losing our house?"

"I'll let you answer that," replied Bruce. "Let's say the major bread earner loses their job. Which is going to allow the family to keep the house: having at least $50,000 in RRSPs or having a slightly smaller mortgage and no emergency-income buffer? In the event of a long-term income drought – due to the economy, change in technology, company merger, disability, whatever – which gives more peace of mind to weather the storm?"

Michelle had her answer ready. "I don't like debt. But I'm more concerned about doing what gives us more financial security, both short term and long term. For me, that means we should focus on stockpiling nuts to get through the long winter of retirement. More importantly, that would also protect against long job losses that can derail everything. Do you agree, Joe?"

"Completely. I see now that too many things have to go absolutely perfectly for the 'save-more-later' approach to be better in the long run. And it provides no additional income security in the short term. With no job security these days, you never know."

"Because your situation can sometimes turn upside down without any warning, you need to **first focus on stockpiling nuts to get through the summer**," Bruce suggested. "And there's another reason to bolster your financial reserves ahead of reducing your mortgage."

"What?"

"As comedian Bob Hope half joked," Bruce replied, "'a bank is a place that will lend you money if you can prove that you don't need it.'

"If you're in a tough spot financially and don't have a job, do you think you'd be able to get a loan to get through the crisis, especially if the crisis is widespread?"

"Probably not."

"And you can't really blame the banks. After all, they're businesses, not charities. In their spot, you'd probably do the same thing."

Bruce paused, checking for our understanding before continuing. "Just for a minute, I'd like you to forget how it makes sense to focus on savings to build an income buffer ahead of reducing a mortgage.

"Let's pretend that we're five years in the future. I'd like you to visualize how you would *feel* if you could look back and see that by focusing on stockpiling nuts and simply starting a 'Pay Yourself First and Inflate' plan, you were no longer concerned about money or the possibility of one of you losing your job. Instead, you're confidently on your way to financial independence and your retirement plan is on track to allow you to retire in the lifestyle you want, on your 40-foot boat, visited by your closest friends."

"I like that image," I confessed.

"So we have to save to take care of our own financial security," Michelle emphasized, "before any crap hits our fan."

"I'm not suggesting that RRSPs be your short-term emergency fund to handle temporary cash flow gaps," Bruce elaborated. "There are better ways to handle that.

"And while nuts owed to other squirrels must be repaid at some point, putting away enough nuts to get through the winter – or a long, dry summer – has to be the priority. Even if other squirrels are stealing some of your nuts – negative returns causing your stash to shrink instead of grow – you can still succeed and get through anything if you had the discipline to stockpile enough nuts.

"If there is such a thing as a perfectly disciplined investor, they might opt to focus on paying down debts first if the interest rate on the debt is higher than the return they expect to earn in their RRSP. They recognize that paying down debts is a guaranteed return, and investing in equities never is.

"But unless you're a perfectly disciplined saver, **I recommend paying off any debt charging double-digit rates, such as credit cards, and then building up an RRSP, first as an income buffer to protect against long-term job loss**, and second, for retirement. For most people, the peace of mind is more important than the math.

"After that, if you're keen on knowing whether it's mathematically better to pay down debt or invest for your unique situation, we'll look at it then. Does that sound like a game plan?"

"Sounds like a good one to me," I confirmed.

Bruce started gathering up his notes. "I've kept you long enough today, and I've got another appointment shortly. So to recap briefly, my role in the Coaching Agreement is to serve, by understanding, educating, and coaching you towards your top priorities. Do you remember your role in your financial success?"

"Our role is to prioritize our financial goals, learn openly, do, and Teach Two," Michelle recited dutifully. "We pre-commit to act on the strategy that we feel is best, even before we determine exactly what it is."

"Excellent. You said your top priorities were to reduce debt, build RESPs, and save for retirement. When I suggested that half of financial success is possible by simply paying yourself first, you wondered how you could save ten percent when you're not covering all of your expenses now. I introduced the Painless Pay-Yourself-First approach …"

"Where we start small and increase slowly, inflating monthly deposits automatically each year," I recalled.

Bruce was clearly pleased. "And while you liked the stealth approach that required saving an unnoticeable five or even three percent of your income initially to get the habit started, you wondered if it was better to pay down debts first."

"Expensive debts like credit cards should always be paid off first," Michelle said as she picked up her purse. "But after that, because of the behavioural factors and short-term security benefits of building RRSP funds, we decided it would be better to focus on saving before paying down other debts."

"Joe, at one of the games, you said your truck lease is expiring soon. You wondered how you might do better in this area."

"Yeah, and shortly after that, our mortgage is up for renewal," I replied. "I was hoping you might have some ideas with that as well."

"Those are significant, ongoing costs, and there are a number of things that can make a big difference in reducing debts and freeing up more money for savings," Bruce replied. "Maybe we'll have a chance to talk about them while we're at the Christmas tournament."

"That'd be great," Michelle said. "And I'm sure that Kim would like to be part of the discussions as well. Even though she's in a higher income category than we are, she appreciates learning about the secrets of the rich and your Smart Debt concepts."

"That's good to hear," Bruce beamed. "I'm looking forward to the tournament. And to seeing Kim."

"Well, see you next week," I said as we made our exit. "After the tournament, I think we're ready to start putting some of these ideas into action."

"Then we're moving in the right direction," Bruce smiled in encouragement. "Have a great Christmas."

As we drove home, I was feeling much better about our finances. We hadn't acted on anything yet, but we had taken the first steps to get clear on our priorities and some of the fundamentals. I was looking forward to our Smart Debt Coach helping us improve our vehicle and mortgage situation.

And then, we'd be ready to learn how to invest and build wealth like the rich do.

About The Author

Talbot Stevens' true passion is helping people benefit from effective financial strategies and behavioural solutions. Confessing to be one of those weirdos who likes math, he has degrees in engineering and computer science. But he's committed to not letting that handicap him. His previous books, *Financial Freedom Without Sacrifice* and *Dispelling the Myths of Borrowing to Invest*, have sold almost a quarter of a million copies.

Whether speaking to the public, corporate staff, or the financial industry, Talbot's focus is to educate, entertain, and inspire others towards what financial success means for them. He has started a "*Help a Friend*" campaign to encourage everyone to share valuable ideas with others. He grew up on a small farm, and currently lives in London, Ontario, with his wife, Theresa, and their three wonderful but patience-testing kids, Derek, Ryan, and Kristin.

To learn more about how Talbot's speaking, books, or consulting can help increase your wealth and security, visit www.TalbotStevens.com.