Should You Pay Off Debts Or Invest?

Some financial decisions can be challenging — like whether to use your money to reduce your debt or to invest. If you already have a significant amount of debt and not a lot in savings or investments, it can be hard to figure out which issue should be a priority.

There's no simple answer, and everyone's situation is different, but here are a few suggestions for helping you make a good choice:

• *Evaluate your cash flow.* If you already have enough after-tax income to meet your monthly living expenses, you might lean toward investing any leftover cash, but if you are just getting by, possibly due to heavy debt payments, then you might be better off using your funds to reduce your debt load.

• *Build an emergency fund.* Paying off your debt as fast as possible may seem like the responsible thing to do, but not having an adequate emergency fund or saving for your future could leave your finances at a permanent disadvantage. It's a good move to have an emergency fund containing three to six months' worth of living expenses, with the money kept in a liquid, low-risk account. Once you have such a fund, you could use it, instead of going into debt — or adding to your debt — to pay for unexpected costs, such as a new furnace or a major car repair.

• *Evaluate your debts.* Some of your debts are actually more "expensive" to you than others. This expense level doesn't necessarily refer to the size of the debt, however. You might have a large mortgage, for instance, but because your interest payments are typically tax deductible, your "after-tax" interest rate may be relatively modest. Therefore, you might consider investing rather than paying down your mortgage. But if you have consumer loans or credit cards that carry a high interest rate and whose interest payments are not deductible, you might be better off paying down or refinancing this debt.

• *Take advantage of any employer match.* If your employer sponsors a retirement plan and offers a match, you will want to prioritize contributing at least what is required to receive the match. It's essentially free money. So, if your employer matches up to 3% of your contributions, for example, you should contribute at least 3% of your income to this retirement account. Additionally, some employers will match a portion of your contributions to a Health Savings Account. Eventually, you'll likely want to get to a point of saving more than just the match, but you'll have to weigh the benefit of additional contributions against the cost of any debt you're carrying.

• *Make it easier on yourself.* To make achieving these goals easier, automate as much as you can. For example, you can divert part of your paycheck into an emergency savings account or a retirement account through automatic payments for any debt reduction or savings needs.

While it may seem like a huge endeavor to pay off your debt while still saving for the future, it doesn't have to be. Taking small, incremental steps is key to helping you get to where you want to go.

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