Prudential Investment Managers

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When to invest or pay off your debt

You’re paying off your car. You still owe a ton of money on your bond, and because you just couldn’t help yourself you’ve just “maxed out” your credit card on the winter sales. So when your financial adviser starts talking to you about investments, it’s only natural to think that the best way to spend your extra cash is to pay off your debt as quickly as possible. But can you invest and become debt-free at the same time? And when, if ever, is it better to invest instead of accelerating your debt repayments?

You’ve probably heard the statement before, that the best “investment” you can make is to pay off your debt as quickly as possible. The theory behind this is simple: the money you save on interest by repaying your debt is likely to be more than the return you would get from investing your money.

While this makes sense in theory, there are certain instances when it doesn’t make sense. The key to figuring which option is best for you is to start by looking at the respective interest rates for each option (i.e. the interest rate charged for servicing your debt, compared to the potential rate of return on your investment). If the interest on your debt is more than the potential return on your investment, then you might consider paying off your debt first (and vice versa).

But before you make your decision, it's important to know where you are in your debt cycle and how your debt repayments have been structured. It's usually the case that debt repayments are designed so that the interest amount gets paid off first (during the first half of the term), and the loan amount (also referred to as the capital amount) gets paid off second. So if you are close to the end of your repayment term, it's likely that you would have already paid off most of your interest. This means that even if the interest rate on your debt is greater than the potential return on your investment, choosing to invest your extra cash may be the better option compared to accelerating your debt repayments.

Remember, though, that there are no absolute guarantees when it comes to investing. There is always an element of risk, but the good news is that you get to decide how much risk you're prepared to take. At Prudential, we have a range of different unit trusts with different risk profiles. To find out which one best suits you, visit the Fund Selector tool on our website.

Sit with your financial adviser and run the numbers. Investing when you have a mountain of debt to pay off might sound like a crazy idea, but it's all about working wisely with your money and investing it in the right places.

To find out more, contact your financial adviser or our Client Services Team on **0860 105 775** or email us at query@prudential.co.za.