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Tax refund burning a hole in your pocket?

Smart money management can pay off later

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Medill News

If you're getting a tax refund this year, odds are strong that your mind is still spinning with 1040s and W-2s. So the thought of dealing with more money management is less than appealing. You've earned a fancy dinner out (or a vacation or a flat-screen television), you tell yourself. After all, it's money that you weren't expecting. It's almost like it's a gift.

Hold on, Daddy Warbucks. Before you blow that refund on a bit of self-indulgence, keep in mind that this money is no gift.

"Let's stop kidding ourselves -- what you did is you gave the government an interest-free loan," said Lynnette Khalfani, author of the book "Zero Debt for College Grads."

In other words, that fat paycheck that lands in your mailbox is still the result of hours you spent hard at work. So you can take that refund and splurge on a weekend trip to the beach right now or you can plunk that dough into a long-term investment that may eventually earn you enough to buy a retirement house by the sea.

Pay down looming debt: If you're not able to wipe out all your credit card debt with the refund, paying off even a small chunk is still putting your money to good use. Not only are you reducing the amount that you owe the credit card company, you're reducing the interest you'd pay. And a big-time payment of $500 may kick-start your motivation to get out from underneath that plastic all together.

Those eager to start trading stocks should "pay off debt and read up on investing strategies," said Rob Bennett, the author of "Passion Saving: The Path to Plentiful Free Time and Soul-Satisfying Work," who considers the market currently lackluster for new investors. Though paying off old debts may not be as much fun in the short-term, it means "you will be positioned to earn solid, long-term returns and will not have the deadweight of interest payments on old loans holding you down" in the future, Bennett said.

Open a savings account with some muscle behind it: We all know we should have an emergency fund to cover expenses like a broken car or unexpected unemployment, but sitting on a savings account with a wimpy interest rate makes no sense.

Upgrade to an online savings account and you can generally bump the annual yield you're earning, with 4 to 5.5 percent not uncommon. These online accounts tend to piggyback on existing checking accounts and most have no minimum fees or minimum balances. The best part is, unlike a CD, you're earning a beefy return without getting penalized for withdrawals.

Invest in your far-off future: Unless you don't mind the thought of a retirement laced with ramen noodle dinners, it's wise to start thinking about retirement sooner rather than later. If your employer offers a matching contribution for 401(k)s, strongly consider signing up and using your refund to offset the deduction.

"The most important reason young people should sock away some money now into their retirement plan is because you have the opportunity to literally get free money from your employer," said Khalfani. It's money that you wouldn't be able to tap into otherwise.

Go on, play the stock market: OK, so pumping a few benjamins into the market isn't going to make you a millionaire, but it can yield a return and if you're planning on investing larger sums later it can also introduce you to the volatility of the market.

"Before anyone starts investing, they really need to find out what their risk tolerance is, whether they're aggressive or conservative," said Lisa James, a financial advisor for Merrill Lynch Co. Inc.

Though most larger firms have minimum investment criteria, James points out that many Web sites let Internet-savvy investors get involved in the market for less, and most sites provide free surveys to help newcomers assess their risk tolerance.

When all else fails, ask the experts: Don't know the difference between a money market account and a mutual fund? Luckily, there are plenty of people to ask and a bevy of online sites to browse.

Head to Investopedia.com for some easily digestible help with understanding the stock market or give large firms like Fidelity a call. Even if you're not a customer (or don't have the dough to make the minimum investments), phone operators can help you navigate the difference between types of accounts.

And, of course, bookstores are bursting with how-to guides to get out of debt, into the market and onto a great retirement.

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