

Put all your eggs in one basket

The cost of debt diversification

In the Fall of 2005, Manulife Bank conducted a survey of Canadian homeowners (through Maritz Research*) to find out if homeowners had ever applied the strategy of consolidation to managing their debts and, if not, they wanted to understand why.

In addition, Manulife Bank commissioned a study by Moshe Milevsky, Associate Professor of Finance at the Schulich School of Business, York University, to investigate the financial advantages of Canadians consolidating their debt. Here's what they learned:

Maritz Research Survey

- over 1/2 of all Canadian homeowners polled have some form of household debt (e.g. mortgage, credit card, line of credit, etc.)
- 1/3rd of those are just servicing their debts, that is, only making the required payments
- even though 2/3rds of homeowners with debt polled indicated they have a plan in place to reduce their debts faster, 2/3rds have never tried consolidating their debt
- among those who haven't consolidated their debt (besides those who felt their debt was not large enough to consolidate), the top two reasons for not doing so are:
 - they prefer to keep their debts separate (45%)
 - they see no advantage to consolidating (39%)

Milevsky Study

- concluded that Canadians have a preference to keep their debts separate
- coined this practice as "debt diversification" and determined there were two types:
 - "space" diversification (spreading debts over different products each with different terms and interest rates)
 - "time" diversification (not using their savings and income to pay down debts as quickly as possible)
- the study noted that debt diversification is harmful and recommends that Canadians:
 - consolidate their debts at the lowest rate possible
 - use short-term assets to reduce those debts with the option to borrow back when they need to
 - manage their debts in the most tax-effective manner possible – reducing their taxable interest earnings by paying down their non-deductible debt
- using financial simulation techniques, it calculated that the average Canadian homeowner could probably save money each year just by optimally managing their debts and short-term assets

Conclusion

While the survey identifies a problem, the study offers a solution. To save money, Canadians should consolidate their debts at one low interest rate in a line of credit and use their short-term assets – including their income – to pay down those debts.

And there is no better account in Canada to do this than Manulife One. With access to up to 90% of the value of your home (based on your individual circumstances), you can easily consolidate most, if not all, of your debt into a single account. Then, because it operates as a line of credit, you can deposit your savings and chequing account balances and your income into the account to pay down that debt – and take the money back out as you need it. Manulife One, Canada's best basket for all your financial eggs.

* The survey by Maritz Research conducted between September 15 – 21, 2005 of Canadian homeowners has a margin of error of +/-2.73 per cent, 19 times out of 20. The number of Canadian homeowners surveyed was 1,261.