

## Evaluating Credit Card Reward Programs

Consumers are using credit cards more than ever. The good news is that smart consumers can turn their spending into rewards. Credit card companies offer cash back, hotel points and airline miles for everyday spending, but there are various formulas used to calculate the reward to the consumer. How can you determine the best credit card reward program for you?

The first point to consider is that reward credit cards are not for everyone. Credit cards that offer rewards tend to charge higher interest rates, for example. If you carry a balance, a reward credit card is not a good choice as you lose lower interest rate financing. The benefits of a lower interest rate to someone carrying a balance is much bigger than receiving rewards from the same credit card.

Keep your circumstances in mind as you consider the variety of credit cards available:

- **Balance transfer cards** – for those that want to pay off their credit card balance without high interest rates. These cards usually charge a fee to transfer your balance but offer 0% financing for a defined time period.
- **Introductory 0% APR** – if you do not want to pay off your balance immediately. This card offers 0% interest on purchases and your transfer balances for a defined period, generally 12-18 months.
- **Secured** – designed for individuals with poor or limited credit. A “secured” credit card is backed by a cash deposit, usually equal to the credit limit. They sound like a pre-paid card but you still have to make payments and card activity is reported to the credit bureaus. Secured credit cards are a good way to help those with poor credit improve their credit score.
- **Rewards** – Reward cards are best if you pay off your balance each month. Incentive cards offer cash, points or miles remuneration based on your spending. Often, these cards will offer a sign-up bonus: receive a bonus once you reach a required spending amount within a specific amount of time.

### Credit Card Fees

In general, it's best to avoid credit card fees. However, since some reward cards charge an annual fee, it could make sense to pay the fee to receive rewards. It is important to understand the fees associated with your credit card so you can determine if the rewards outweigh the fees charged.

- **Annual fee** – assessed once a year, a card with an annual fee usually offers better reward structures. Sometimes credit card companies that charge an annual fee offer a larger sign-up bonus compared to cards that do not charge an annual fee.
- **Foreign transaction fee** – a percentage-based fee, typically 3-4%, on charges made internationally. Consider a foreign transaction fee card if you plan to travel overseas. Some annual fees cover the expense of foreign transaction fees. This is an instance where paying an annual fee eliminates fees associated with international charges.
- **Late payment fee** – You can avoid a late payment fee by making your payments on time. Currently, the average late fee is \$35. It is a good idea to set up automatic payments if you are concerned about forgetting payments.

- **Cash advance fee** – several credit cards allow you to take cash advances from your card from an ATM or at a bank branch. The credit card company charges a fee to advance the cash and a higher APR than normal. Typically, they do not offer a grace period, so interest will start to accrue immediately. Only use the cash advance feature as a last resort. Keep emergency funds on hand for instances that you need cash.

### When Is an Annual Fee Worth It?

Credit cards are available with or without an annual fee, so it is a good idea to compare offers. To illustrate, here is a comparison of hypothetical credit card offers from the same company. One of the credit cards charges an annual fee. At what point does the higher annual fee of Card X overtake the higher sign-up bonus?

Card X: \$95 annual fee, 2 points for every dollar spent

Card Y: No annual fee, 1 point for every dollar spent

Card X =  $0.02x - 95$

Card Y =  $0.01x$

$0.01x = 0.02x - 95$

$x = \$9,500$

It is worth the annual fee of \$95 if you spend more than \$9,500 a year on that credit card. If you do not, it is more beneficial to select the card with no annual fee.<sup>1</sup>

### Credit Card Reward Programs

Credit card rewards can be redeemed for cash, travel, gift cards, tickets to events such as concerts and sporting events, merchandise, charitable contributions—and

the list goes on. They are a great way to pay for trips by accumulating points or to offset typical spending by collecting cash back.

However, it's always good to remember: If you carry a balance, credit cards with rewards charge higher interest rates than those that do not.

Reward credit cards may offer different reward rates based on purchased items. Determining where you spend the bulk of your money will help you select the best reward program for your goals. Consider finding a card that offers more reward points for your most prevalent spending categories, such as groceries or travel.

### Strategies to Maximize Your Reward Programs

The goal in carrying a cash back credit card is to maximize the cash back for dollars spent. It is easy to calculate the return on a fixed percentage cash back credit card. If the cash back percentage changes depending on the category or merchants, the calculation can get more challenging. Some credit cards even put limits on the amount spent that is eligible for additional cash back incentives.

One option to maximize cash back is to carry multiple cards based on what card gives you the most cash back based on merchant/category. However, it can be overwhelming to remember which card provides the maximum benefit depending on the purchase.

There are also multiple options to redeem your “cash back” rewards. Different credit cards may offer different options, such as a statement credit, direct deposit to your banking account or a gift certificate for various businesses.

## Travel Reward Cards

It can be challenging to calculate the rewards when it comes to cards that offer points or miles related to travel. For example, a credit card company provides two miles earned per dollar spent. Miles can be redeemed for one cent each as a statement credit against any travel expense. Therefore, cardholders receive the equivalent of 2% back in rewards value for each dollar spent.<sup>2</sup>

Airlines and hotel brands offer co-branded reward credit cards. This is a popular option if you like to travel, but calculating the benefit also presents a challenge.

Case in point, holders of an airline credit card who receive the standard one mile per dollar spent will not benefit much if they have to use 25,000 – 50,000 miles for a “standard” domestic airline ticket. If the cost of the airfare is \$500, the cardholder is only going to receive 1-2% back on their purchases. However, if they can use 100,000 miles for a “business class” ticket for international travel, the award will probably be worth several thousand dollars. The individual has realized four to eight cents per dollar spent using the credit card. If the same individual selected the cash back option on a card that returned 2% on airline travel, they would receive \$2,000.

Using miles for first or business class air travel internationally provides the biggest reward, as these airline tickets cost far more than an economy class ticket. The upgrade costs relatively few miles compared to the benefit.

Additional benefits to consider: Most credit cards offer a host of benefits, including shopping and travel protection. Shopping benefits may include purchase and price

protection. These programs reimburse you if covered items are damaged or stolen or go down in price within a specified amount of time. Travel benefits may include trip cancellation and interruption protection, car rental insurance and lost baggage protection. Review the benefits to be sure the protection benefits offered match the list of benefits that are important to you.

## Summary

Reward credit cards are not for everyone, so it pays to follow a smart strategy.

Utilizing your credit card for everyday expenses will deliver points, but it's best to pay for only what you can afford and pay the credit card balance off, in full, each month. Since reward credit cards charge higher interest rates on card balances, strive to pay off your credit card debt and limit spending to what you are able to pay off monthly.

Choose a card that offers the highest rebate. If you are doing home improvement, look for a card that rewards spending at home improvement and hardware type stores. Some of the cards offer allow you to use points in various capacity such as cash back or airline tickets. If you're uncertain as to what is the best reward for you, this option may be your best bet.

In any case, choose your reward credit cards wisely. Seek to limit fees, match rewards to your spending patterns and keep your balances in line with your budget.

<sup>2</sup> <https://www.moneycrashers.com/compare-best-credit-card-rewards-programs/>

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