Investor Insights

Smart Ways to Get Smarter About Money

It would be too dangerous to get behind the wheel of a car without knowing the rules of the road or even where the gas and brake pedals are. Yet that's the way many Canadians "steer" their personal finances, with no real understanding of how money works or how to get it to work for them. Adding to the challenge is that they often don't recognize their blind spots. An IPSOS poll of over a thousand adult Canadians asked them 15 questions to gauge their financial literacy. Although 78% of Canadians surveyed rated themselves as financially literate, more than half (57%) failed the literacy test[1].

Gaining a handle on the five basics of saving, spending, debt and credit management, and investing better empowers you to build a nest egg, control how much you owe, and ultimately achieve your desired lifestyle. Here are some tried-and-true approaches for focusing on these five money essentials to develop your financial literacy.

Spotlight saving

Having savings is integral to your well-being, financially and otherwise. Besides being able to cover unforeseen expenses that can pop up regularly, saving enough for big milestones like retirement requires starting in time. If you wait until the last minute, you're more likely to fall short of your goals or worse – find yourself in financial hot water.

A proven and straightforward approach to saving is to "pay yourself first" through automated transfers to your bank account that coincide with paycheque deposits. Your savings then become just another bill, but one that you'll benefit from in the future.

Monitor and control spending

It's easier to prioritize saving when you know how much money you have to begin with. Track where your money goes in order to identify your spending habits and find saving opportunities. You can then create a budget based on allocating your money between your must-haves and nice-to-haves. There are countless user-friendly online resources you can turn to for support. The convenience of accessing many of these applications from your smartphone can help you keep your budget top of mind. Even simple changes like packing your lunch and using cash instead of credit whenever possible can help keep your spending in check.

Manage debt effectively

Like your spending, it's important to have a clear picture of exactly what you owe. That's because interest can work both for you and against you. You can borrow a small amount of money and end up owing much more than you need to over time as the interest piles on.

With borrowing costs at historical lows, it's tempting to rely on debt to fund your lifestyle, but that's neither economical nor sustainable. Living within your means is most effective for managing debt. In other words, you need to spend less money (or make more of it) to lighten your debt load. One of the first steps in managing debt is to tackle the amounts you owe that are incurring the most interest. Don't be afraid to negotiate with creditors for reduced rates – every little bit counts and can shave off substantial time and money from your repayment plan.

Use credit responsibly

When you pay off your credit card on time, all the time, it functions as a handy, interest-free loan that's more secure than carrying around the same amount in cash. When you only pay the minimum monthly balance, month after month, it becomes an expensive means of buying things. It's important to understand what you're getting into, from the interest rate you're being charged and fees that may apply to what your credit limit is. That way you can appreciate the true cost of your credit card purchases. A general rule of thumb is to never borrow more than 20% of your annual income outside of your mortgage. That said, even if your credit is out of hand, take heart – it's possible to recover by having a concrete plan for repaying the debt and sticking to it.

Investing 101

The point of investing is to grow your money so that you have more in the future than you have today. How you choose to put your money to work is contingent on your personal situation, including your goals, time horizon and risk tolerance.

Investment choices available to you typically fall into three main categories: cash and cash equivalents (think T-bills and money market mutual funds), fixed-income products like Guaranteed Investment Certificates (GICs) and government bonds, and equities (stocks). In general, the higher the expected return on an investment, the more risk you'll need to take to achieve that return. Cash and GICs are typically on the lower end of the risk continuum, while equities are on the higher end.

Lessons to last a lifetime

In today's increasingly complex world of money, financial literacy is more relevant than ever. Dealing with personal debt, planning for longer life expectancy and navigating a growing range of sophisticated financial products all become more manageable when you grasp the fundamentals. Mastering these concepts takes time, but with practice provides a lifetime of benefits.

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[1] https://www.lowestrates.ca/reports/lr-financial-literacy-canada-report.pdf

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