Get your financial affairs in order early

Most Canadian adults would agree their high school educations failed to teach them basic financial literacy.

I firmly believe it is our responsibility to ensure that we educate youth on the importance of learning the basics of managing their own financial affairs.

When a person is 16 years old, it is difficult to imagine being 25, let alone 40. To be 40 feels like 1,000 years away.

As someone who is still a few years away, believe me, it's not nearly as distant as you think. That means that the earlier you learn to reconcile your financial affairs, the better. The most important financial concept for every young person to understand is the near-magical powers of compound interest. It may sound boring but it's truly miraculous and most people fail to grasp its concept until it is too late. The best way to describe it is with an illustration.

Consider two people, Beth and Jason. Beth puts $200 per month into a retirement account with an estimated 6 per cent average annual rate of return starting at the age of 25. Jason does the same but starts when he's 35, only 10 years after Beth started saving. Both continued to add $200 per month until they retire at age 65.

By that time, Beth will have contributed $96,000 and Jason $72,000. Yet, Beth will have amassed a nest egg of $400,000 while Jason just over $200,000.

The same goes for debt. Those who carry outsized credit card and other consumer debt find it hard to dig out because they have to pay not just the principal of their loans but interest upon it. And, as most people know, the amount a bank charges you interest is much higher than it is willing to pay you for the same sized credit. Credit cards are even worse, charging typically 12 to 19 per cent on debt owned and nothing on credit balances.

Canadians today are, on average, more indebted than Americans were before the recent credit crisis. It's unbelievable but true. While most of it is mortgage debt, younger people are especially susceptible to digging themselves into consumer debt early. This is the worst sort of debt because it's the mark of a person trying to live a standard of living they can't afford.

For people who are employed yet find themselves not paying off credit cards each month, let alone saving some money, it's a very clear sign that they are doing something wrong. The more debt you pile on, the more uncontrollable it threatens to get. And aside from health problems, there is probably no bigger threat to one's wellbeing and happiness than a crippling, out-of-control debt burden.

Young people who love the "high life" of restaurants, shopping and fancy cars spend more time thinking about how to earn more money. It's cash flow that affords those things, not credit. Acquiring lavish "wants" on credit is a recipe for disaster. Maybe not today, but tomorrow.

"Compound interest is the eighth wonder of the world," Albert Einstein once said. "He who understands it, earns it. He who doesn't, pays it."

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