The 3 Most Important Financial Lessons of All Time

Description

Surviving in the financial world is never easy. There are numerous pitfalls, challenges and wrong-turns which all individuals experience during their lives. Similarly, there is a huge amount of good advice on offer on how to boost your portfolio returns, retire early and enjoy financial freedom in your later years. However, it is easy to become overwhelmed with good ideas on how to manage your money. Therefore, here are what could be the three most important financial lessons of all time.

Debt is a gift and a curse

For most people, debt is a part of life. It is necessary in order to buy a house, car or even to start up a new business venture. Therefore, debt can be a good thing on the one hand, since it provides opportunities for people who do not have financial capital available today. And with the cost of debt being low in many of the world's developed economies, it could be argued that there has never been a better time to borrow.

However, debt can also be a curse as well as a gift. Debts are nearly always secured against some asset or another, and for most personal loans or mortgages this will be in the form of an individual's house. Therefore, an inability to pay could mean a loss of home and potentially even bankruptcy. As such, it is imperative to ensure that any borrowings are affordable and that a higher interest rate and/or lower returns are factored in over the medium term.

Cash is King

Although many companies focus on their sales, operating profit or even net profit, the only thing which matters in investing in cash flow. That's because the currency of the world is not revenue or profit, but cash. As such, it is not possible for a company to pay salaries or suppliers in anything but cash, so it is important to focus on a company's cash resources before buying a slice of it.

In fact, the same idea can be applied to an individual's financial outlook. Although a high salary is always appealing, if it is matched by a high cost of living brought on by an extravagant lifestyle, the end result could be negative cash flow. In extreme circumstances, an individual could be earning an above average salary but have a small or even zero net worth.

The power of compounding

The average annual return on shares of 8% may not sound like a great deal. However, over a period of time the power of compounding can have a huge impact on even a fairly modest return. For example, 8% per annum over a period of 30 years will mean that an investment is worth around ten times its original value.

As such, it seems logical to chase more modest annual returns which offer consistency and reliability, rather than focus on making big gains in a short space of time on riskier investments. In other words, lower risk investments can prove to be more rewarding than higher risk ones over a long period of time due to the impact of compounding.

CATEGORY

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