3 Personal Finance Pillars to Protect Your Personal Balance Sheet

Description

Individuals, like corporations, have balance sheets. However, individuals may not look at key components of their personal balance sheet as often as they should.

In this article, I am going to discuss three pillars of every investors' balance sheet that should be assessed and monitored. After all, investors judge a company based on its cash base, debt level, and ability to survive this economic shock. Similarly, investors should think about how a bank will look at their personal balance sheet when the time comes.

Debt level

All sorts of debt are near all-time highs in Canada right now. Oil players such as **Baytex Energy** are being plagued by discussions about their balance sheets. Similarly, one's personal balance sheet strength or weakness has become amplified during these times of economic stress. Some have accumulated cheap consumer debt during the recent bull market. For these investors, this period of economic uncertainty may make it more difficult to deleverage. The revenue one receives may become more unreliable or simply be cut or suspended due to mass layoffs nationwide.

The good news is that as long as one is able to maintain employment during this recession, borrowing costs have dropped due to a zero-interest rate policy in North America. This provides investors with potentially lower financing costs. Thus, this will cushion the burden of this crisis somewhat. For those who have let personal debt loads get out of control, it has become imperative (in my view) to correct course and pay down debt as soon as possible.

Build up a rainy-day fund

Building on my previous commentary about debt repayment, one can potentially use an unused portion of a line of credit as a rainy-day fund as last resort. For those investors who are scrupulous and pay down their credit cards every month and do not carry any non-mortgage-related debt, I have a suggestion: start putting aside a higher percentage of your income in a rainy-day fund.

This can come in many forms. My personal favourite choice is to use a Tax-Free Savings Account (TFSA) to build savings. This will act as a form of worst-case-savings-scenario insurance. Most financial planners suggest having at least six months to one year of income set aside in such a fund in case one loses their job. This can seem like a daunting task. However, if one sets aside 10% of their gross income into such a fund, a year’s worth of salary can be put aside in less than a year.

Reduce discretionary spending

The easiest way to pay down debt and/or set up a rainy-day fund is to “go lean” on non-essential spending. Step one is avoiding that triple chocolate mocha and pastry in the morning. One easy way to save money, especially in the COVID world, is by saving money previously spent on gas/insurance from one’s previous commute.

By following these tips, one may notice that essential and non-essential spending cuts may be easier in this post-COVID world than before. Investors should take advantage of not being able to easily eat out or grab that coffee. They should instead redirect those funds towards debt repayment. Further, they could work on building up a cash stockpile to wait out the recession.

If one can supplement such discretionary purchase reductions with additional income, such a strategy can be undertaken much more quickly. I would encourage all investors to continue to work on personal balance sheet improvements before economic conditions potentially turn very sour, should this COVID-19 pandemic indeed turn into a depression of multi-generational proportions.

Stay Foolish, my friends.

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