Build Real Wealth: Avoid 5 Real Risks of Money Management

Description

Managing your money is about a balance of spending and saving. Managing your investments is about balancing risk and return. And risk isn't volatility.

Generally speaking, you want to

- spend less than you make;
- keep cash on the side for near-term needs;
- allocate your safe-investment exposure appropriately;
- understand the real risk in investing; and
- potentially set up an automated plan of saving/investing if you prefer to take a passive approach.

Spending more than what you make

If you consistently spend more than what you earn, you're going to owe money and pay interest on it. Without savings, we won't even get to talk about investments. Therefore, aim to save a portion of every paycheque to get into the habit.

Probably the only debt that makes sense is a mortgage, because buying a home is too big of an expense to pay off immediately for most people.

It has become increasingly common to borrow to pay for things (such as a car) or even invest because interest rates are so low. People need to be careful how much debt they're taking on. Check if you're increasing your net worth over time by subtracting your debts from your assets at least once a year.

Not keeping cash for near-term needs

It's good practice to have an emergency fund of at least $1,000 but ideally three to six months of your living expenses. This way, when an emergency arises and you need something fixed, you won't need to resort to borrowing and having to pay interest that would increase your cost. Interest expenses might not make much difference now because interest rates are low, but you never know when interest rates will rise.

Remember to replenish your emergency fund as soon as possible after you have dipped into it.

On top of the emergency fund, you should have sufficient money in your chequing account to pay the bills at least for the upcoming month.

Having this short-term need for cash catered for, you ensure that you won’t need to tap into your long-term investments.

Staying in safe investments

It makes sense to put a percentage of your savings in safe investments, knowing that you’ll need the money in the short term. It’s probably not a good idea to put most or all of your savings in safe investments like GICs, money market funds, and savings accounts. You’ll end up generating small returns, thereby preventing you from reaching your financial goals, which could be making a big purchase like a car or down payment for a home, or even saving for retirement.

Mixing up volatility with risk

Volatility applies to the price of a security (stock, bond, ETF, etc.) going both ways — up or down. The volatility itself is not the risk. It’s how you react to volatility that could be risky.

Volatility will work in your favour if you aim to buy quality stocks like **Brookfield Asset Management** on corrections when they become more attractive. Volatility will work against you if you sell the stock of a good business during a market crash, because you needed the cash or you didn’t feel confident about the holding anymore.

The real risk of investing in securities is losing money or not achieving your long-term financial goals to live the lifestyle you want.

Not setting up an automated savings/investing plan

If you want to avoid your emotions getting in the way of staying invested and benefiting from long-term returns, set up an automatic plan to invest a set amount of dollars every month, quarter, or year, depending on your saving schedule.

This prevents you from investing excessive amounts when the market has gone up and you’re feeling good about it. Likewise, you wouldn’t be a seller in a down market, because your long-term plan is to invest regularly with eyes on gains in the long run. Here’s how to start investing.

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