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9 Financial Concepts Every Functioning Adult Should Know

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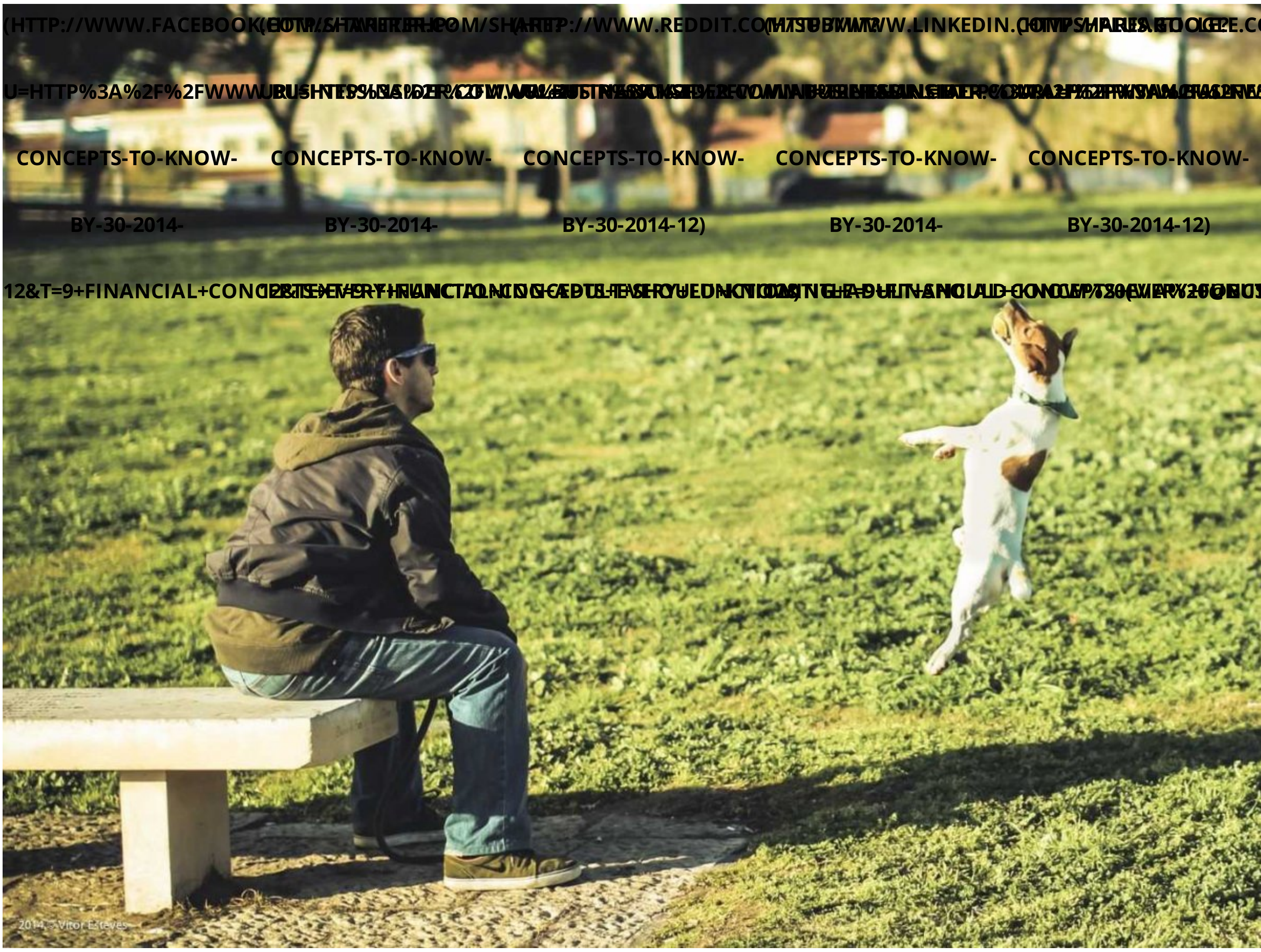
24



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It’s a good place to start.

When you’re the one in charge of your money, it’s best to have some understanding of basic financial concepts.

But where to start?

Save some Googling with this list of what to know about money by age 30, created with the help of certified financial planner Mary Beth Storjohann, founder of Workable Wealth (http://workablewealth.com/).

1. Net worth

"Your net worth (http://www.businessinsider.com.au/how-to-calculate-your-net-worth-2014-6) is a measure of your financial health," Storjohann says. It's the result of your total assets minus the total amount you owe.

You're in good financial health if your net worth is well into the positives, and you have some work to do if your net worth is anywhere in the negatives. "Net worth can also be used to measure how far you've come over time," Storjohann says.

2. Inflation

Inflation refers to the sustained increase in the price of goods and services. As prices rise due to inflation, you'll be able to afford less and less. Storjohann points out that the historical inflation rate is 3% per year.

"What's most important is whether your income is rising at the same rate as inflation," Storjohann says. If your pay is not keeping up with inflation, you won't be able to afford much a few years down the road.

3. Liquidity

"Liquidity is how accessible your money is," Storjohann says. Cash is the most liquid your money can be, because you can access it immediately. While the inaccessibility of certain assets, such as your home or your retirement accounts (http://www.businessinsider.com.au/heres-what-to-keep-in-mind-when-setting-up-your-retirement-account-2014-7), gives them time to gain value, there are some cases where you want money at your fingertips.

“Your emergency fund (http://www.businessinsider.com.au/how-much-emergency-savings-do-you-need-2014-8) should be in a cash account since it needs to be readily available in case of an emergency,” Storjohann says. “Money you have invested in the stock market is not as available, because you risk losing some of it if you take it out.”

4. Bull market

A bull market (http://www.businessinsider.com.au/this-bull-market-will-continue-in-2015-2014-12) refers to a market that is on the rise, which is a good thing. That means that prices of shares in the market are increasing. Usually a bull market also means the economy is in a good state, and the level of unemployment is low. The US is currently in a bull market (http://www.businessinsider.com.au/this-bull-market-will-continue-in-2015-2014-12).

5. Bear market

A bear market is the opposite of bull. In other words, the market is declining. Share prices are decreasing, the economy is in a downfall, and unemployment levels are rising.

It sounds like a bad thing (and it certainly isn’t good), but Storjohann says the most important thing to keep in mind is that the market is a “rollercoaster,” meaning it’s bound to go up and down and people shouldn’t panic every time the market looks a little ursine. “Millennials have time on their side,” she explains, “and over time money has the ability to grow.”

6. Risk tolerance

Remember that roller coaster we were discussing a moment ago? According to Storjohann, risk tolerance refers to how comfortable you are with these swings. “It’s about whether you understand the cycle or stress out about it,” she says. How high your risk tolerance is determines how aggressive you can be with your investments.

Risk tolerance (http://www.investopedia.com/terms/r/risktolerance.asp) isn't just emotional — it depends on how much time you have to invest, your future earning potential, and the assets you have that are not invested, such as your home or inheritance. Major banks such as Wells Fargo (https://www.wellsfargo.com/investing/retirement/tools/risk-tolerance-quiz/), Merrill Lynch (http://www.individual.ml.com/?id=15261_45434), and Vanguard (https://personal.vanguard.com/us/FundsInvQuestionnaire) provide online tools to help determine your own.

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Your net worth says a lot about your financial situation.

7. Asset allocation and diversification

Asset allocation — where you keep your money — depends on your individual needs and goals. It’s also the basis of diversification.

The goal of diversification is managing the risk we touched on in point six — if you keep your eggs “all in one basket,” as Storjohann describes it, what happens to your wealth if the basket falls and breaks? You’re going to want some wealth stored elsewhere. “Diversification allows for balancing,” Storjohann says. “You give up some upsides, but you lower some downsides.”

Be aware that simply scattering your investments around might not be effective. To be effectively diversified, you have to be strategic about where you invest (http://www.businessinsider.com.au/investing-mistake-on-diversification-2014-10).

8. Interest

Interest can work for or against you, depending on the context.

When it comes to saving money, “Interest means your money is going to work for you,” Storjohann says. When you put your money in a savings account at a bank, you’re letting that bank borrow your money. Interest is what they pay you to borrow it; it’s a percentage that can go up or down depending on the state of the economy.

On the other hand, when you borrow money from someone — think your credit card issuer — you pay interest to them for borrowing that money, just like the bank paid you to borrow yours. You’ll keep paying interest until you’ve paid that money back, which is why it’s important to stay out of debt, or if you’re in debt, to pay it off as quickly as possible (http://www.businessinsider.com.au/the-steps-i-used-to-pay-off-81000-of-debt-2014-12).

9. Compound interest

Compound interest is interest that you earn on a “rolling balance,” and not on the initial principle, Storjohann says.

Here's an example: If you start off with $US100 earning 7% interest annually, after your first year you'll have $US107. The next year, you'll be earning 7% interest on *$US107* and not $US100 (you'll earn $US7.49 instead of $US7).

It doesn't sound so impressive when we're discussing $US7 at a time, but compound interest (http://www.businessinsider.com.au/compound-interest-retirement-funds-2014-3) is the concept that powers the exponential growth of retirement savings. As Business Insider's Sam Ro (http://www.businessinsider.com.au/compound-interest-retirement-funds-2014-3) puts it, "It's the deceivingly simple force that causes wealth to rapidly snowball."

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