Financial Literacy Introduction – September 2024

Money. Almost everybody values it, but not everybody understands it.

A number of years ago, some of our clients suggested that we give talks to professional groups about investing. We developed an hour-long presentation to lawyers, specifically those working with private clients receiving financial settlements.

Many of their private clients lack prior experience with financial planning, particularly around investment decisions. This lack of experience could leave the client vulnerable to inappropriate investment advice or result in poor decision-making, or with the additional stress, cause the client to avoid or defer important decisions. This can be true whether the settlement comes results from a personal injury, a divorce, the sale of a business or an inheritance.

Being financially literate is important for these professionals to assist their clients. But it is equally important for individuals, who might find themselves in similar situations or upon a spouse passing away and suddenly being responsible for managing their personal finances.

What do we mean by financial literacy?

For our purposes, financial literacy is the ability to understand basic financial concepts required to attain their financial objectives. Often, those objectives are preserving and growing wealth while assuring a sustainable, regular income from that wealth over the longer term, e.g., 20-30 years.

Understanding and determining your own financial objectives is the foundation of implementing responsible and successful investing.

Wealth preservation sounds simple enough. It means not sustaining a permanent loss of a meaningful portion of your wealth. This should not be confused with the normal fluctuations of asset valuations, which we witness in stock markets.

Growing wealth results from a savings program as well as earning a positive return, over an extended period, on the assets that you own. This *period* should be measured in years or even decades, not months and quarters.

Investment objectives are dynamic and are likely to evolve over time and with significant changes to personal circumstances. At some point(s) in everyone's life, they will require income generated by their investments. Traditionally, this happens when people retire from their work, and they no longer receive a regular salary. Some people will continue to enjoy pension income related to their prior employment or from government-maintained social security regimes.

With respect to company-based pensions, there has been an evolution away from defined benefit plans to defined contribution plans in recent decades. There has also been increased availability in many countries of "regulated" accounts that provide tax benefits upon contribution but over which employee would make investment decisions – including the decision to allow a professional advisor to manage it.

The financial services industry has developed a myriad of new and innovative investment products and services, trading platforms, targeted at both evolving institutional interests and individual investors managing their own investments.

Without question, assessing what is an appropriate platform or are appropriate investment securities has become a much more challenging part of many individual investor's decision-making. We do not believe that one must become acquainted with the majority of the financial products available to meet a basic test of financial literacy; however, exposure to the basic building blocks of a wealth-building investment plan is probably necessary.

Why is financial literacy important?

First, it will greatly assist in describing one's financial objectives. Meeting those financial objectives will require thinking about when income will be required and the size and sustainability of that income.

Second, it provides a foundation for necessary estate planning and addressing certain risks.

Finally, it provides peace of mind.

There are a number of basic concepts to understand as one becomes more financially literate. Many private banks and family offices provide financial literacy education and guidance to the children of their wealthy clients. But it is a subject that is important to everyone who is or will become responsible for their own financial decision-making.

These concepts include: asset allocation (including diversification principles), risk management, budgeting and financial planning, including an understanding of your sources of income and short-term liquidity.

As someone becomes more involved in their financial planning and investment horizons, they may start to consider concepts such as ESG priorities (environmental, social and governance-related), more sophisticated risk management approaches and evolving products that provide access to alternative asset classes that were previously only available to large institutions.

We will expand on each and provide practical illustrations or examples.

Just as reading and writing in our native language is a benchmark of general literacy, minimal financial literacy should be encouraged for everyone in a modern economy.

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