Retirement Connection

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During his 35 year career with Foresters Financial, Paul has focused on retirement plans. In his current role, Paul provides our branches and Representatives with support and training related to retirement to better serve their existing clients as well as developing new markets.

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Are you financially literate? 7 concepts you should know

People talk about "financial literacy" like it's a complicated subject. But it's actually quite easy: It means understanding basic concepts about money and investing so you can make smart, informed decisions—and perhaps more importantly, not allow yourself to fall prey to financial scams or bad advice.

Studies unfortunately show that many Americans feel unconfident managing their money. The 2014 Consumer Financial Literacy Survey by the National Foundation for Credit Counseling found that only 60 percent of U.S. adults would grade themselves an "A" or "B" when it comes to personal finance knowledge. In other words, 40 percent would give themselves a poor grade.

Thankfully, understanding some basic ideas related to money and investing can greatly improve your financial decision-making. Here are seven financial terms that are essential to know and will serve you well as you save and invest for the future.

1. Budgeting

You should know how to put together a basic budget that factors in your household income, debt, expenses and savings each month. This will help you avoid spending more than you earn and prioritize your financial goals. A budget helps you easily see where your money goes and finds opportunities to save more—whether that's dining out at restaurants less or just cutting out that daily latte at Starbucks. You can build a budget by using a spreadsheet program like Microsoft Excel, but many online tools and applications now make budgeting and tracking your spending quite simple. Take a quick look at mint.com, for an example of an excellent application!

2. Stocks versus bonds

Knowing the difference between stocks and bonds will help you better understand the role these assets play in your investment portfolio. Stocks are defined as ownership shares of a business that typically rise in value as the earnings and value of the businesses rise. Bonds, on the other hand, are a form of debt that a company or government takes out and promises to repay at some point in the future. Historically, stocks overall have outperformed bonds, yet bonds—particularly government bonds—are less risky. You should have both in your portfolio.

3. Asset allocation*

What percentage of your savings is invested in stocks versus bonds versus cash? Understanding asset allocation—or how to divide your money among various types of assets depending on your personal investing horizon and risk tolerance—is a key piece of financial literacy. When you are in your 20s and 30s and have decades until retirement, you'll likely want to keep the bulk of your savings in more aggressive, riskier investments such as stocks. But as you get older and closer to needing to tap into your retirement accounts, you will likely want to shift a greater portion of your savings toward safer investments, such as bonds and cash.

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4. Tax treatment of accounts

You may have various types of accounts available to help you save for the future. For one, you may have a standard brokerage, savings or checking account. These accounts are "taxable"— meaning you pay taxes on any gains you realize each year. But you also may have a 401(k) plan at work that allows you to save money on a tax-deductible and tax-deferred basis. That means you don't pay taxes on your contributions and earnings until you withdraw the money in retirement. These tax savings can be significant over many years. Moreover, you may also qualify to contribute to a Roth individual retirement account (IRA) or Roth 401(k). These accounts do not give you a tax break today, but do allow your contributions and earnings to grow tax-free and you pay no taxes on withdrawals in the future. Tax-advantaged accounts are a valuable tool for retirement savers, so it's important to understand their advantages and to maximize their value, when possible.

5. Beneficiary designations

Your retirement accounts allow you to name a "beneficiary"—the person or people who will inherit the accounts' value should you pass away. It's extremely important to fill out the beneficiary form and keep them up-to-date. If you don't, your accounts' value could end up in your state's probate court and may ultimately be left to someone you didn't intend for it to go to.

6. Compounding interest

This may sound complicated, but the idea is simple: The longer you hold your investments, the more time they have to grow. The earnings that you generate on your investments today can generate their own earnings over time—potentially increasing the overall value of your portfolio. The bottom line: Starting to save and invest sooner rather than later can significantly increase the long-term value of your portfolio. Do not wait.

7. Whole Life versus Term Insurance

Life insurance is a useful financial tool, yet there are two very different types. Whole life insurance—which comes in different forms, including "universal life" and "variable life"—is a product that has cash value that may grow over time. It can be very helpful with several long-term financial goals,
such as transferring your wealth to the next generation and minimizing taxes. Term insurance only protects you in case you or your spouse passes away over a specific time period, such as 20 or 30 years. It generally has a lower premium than whole life insurance, but may pay out a much greater death benefit over the term. If your goal is simply to protect your spouse, children or other family members from financial strain over a specific period, then you would benefit more from a term insurance policy than from a whole life insurance policy.

These are just some of the important financial concepts to know. While you should learn the basics you don't have to be a financial pro to save and invest wisely for the future. Your Representative can guide you through key financial decisions and answer any questions you have. He or she can help you design a financial plan and investment portfolio that serves your needs today while also reaching your goals for the future. The important thing is to get started as soon as possible and not fall off track along the way.

*Asset allocation does no ensure a profit against a loss.

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