Key money lessons—as important as ABCs and 123s

As a successful investor, you understand the importance of having a comprehensive financial plan in place to ensure you meet your goals—but do the young people in your life know everything they should know about money? Whether you're a parent, grandparent, aunt, uncle or mentor, you have an opportunity to share key lessons that are best learned at home. And, the earlier you begin the conversation, the more open young adults will be to talk to you about financial matters.

You can start teaching simple concepts, such as the importance of saving, as soon as a child starts receiving an allowance. As children grow up and start earning more meaningful income from part-time jobs, you can emphasize ideas such as paying themselves first. When teenagers become young adults, they're ready for these five key lessons, which can help them get a head start on saving for their goals and set them up for a lifetime of financial success.

1. Always know where you stand

"Budget" and "net worth statement" may sound intimidating to a young adult, but they're straightforward and important elements of any financial plan.

You can explain that a budget quite simply lists income and expenses. If there's a surplus, they can decide whether to spend or save the extra money. If there's a deficit, they can focus on trimming expenses to get back in balance. One of the best things about a budget is that it clearly shows the cost of credit. Demonstrating the cost of credit with an example can be a concrete and powerful motivation for young adults to pay off debt. For example, you can point out that the interest on a credit card or line of credit balance can cost as much every month as a fun night at the movies.

A net worth statement is another way to see at a glance if they're spending too much on entertainment or repairs to a run-down car. Explain that it shows everything they have and everything they owe. Net worth may fluctuate, but the goal should be to grow it over the long term. Show them how successful money management has helped you build a higher net worth that provides you with greater financial security.

2. There's never just one goal

Most people are saving for more than one goal. Some objectives are short term—say, buying a sofa for a student apartment. Other objectives are long term. Once young adults have completed their education and started on a career path, this may mean saving to make a down payment on a home.

The key lesson here is that different goals require different strategies. It's essential that they choose the right type of account (for example, RRSPs, RESPs and TFSAs) and the right investments (for example, fixed income, equities and alternative asset classes) for each objective. You may want to recommend young adults start off by dedicating separate bank accounts to saving for different goals. As they accumulate more savings, they can graduate to several goal-focused investment accounts and develop a coordinated strategy with guidance from an advisor.

3. All assets aren't created equal

On a net worth statement, all assets have a value. However, some assets will appreciate, while others will depreciate. Appreciating assets include a home in a positive real estate market and a well-managed investment account. The classic example of a depreciating asset is a car, which often loses thousands of dollars of its value the moment it's driven off the lot. Other good examples familiar to many young adults are computers, smartphones, game consoles and other technology. Many of these devices cost hundreds of dollars to acquire, but are obsolete and essentially worthless within a few years.

As a general rule, it's a good idea to focus on acquiring appreciating assets, which will contribute to long-term net worth. You can emphasize, too, that it can be perilous to borrow in order to buy depreciating assets. Not only does interest on a loan add to the cost of the asset, but because the asset itself will decline in value it can't be used to pay off the loan.

4. Risk isn't a four-letter word

Risk is a very important concept for young adults to understand and put in perspective. Higher returns generally require higher risk—so risk is far from being something "bad." Yet everyone has a different tolerance for risk, and losing money in the investment markets for the first time can be confidence-shaking for young adults. The first impulse may be to sell. However, if they invested wisely in the first place, choosing a portfolio that balances growth and security and is appropriate for their time horizon, it's actually less risky to stay the course. That way, they aren't locking in losses or skewing their portfolio too much towards other assets.

One of the best ways for young adults to learn about risk is to open a demo or practice investing account. They can try out different strategies with no real money in play and see how the ups and downs of the markets make them feel. They can test different reactions to volatility—selling, holding or a mix of both—and see the outcomes. Through this process, they can get a more accurate sense of their own risk tolerance, which will be invaluable as they start to invest in the real world.

5. Jump higher with a safety net

The young adults in your life have wonderful possibilities ahead of them and, at some point, they may want to go back to school, change careers or start a business. Remind them they'll be freer to follow their dreams if they have a safety net.

They can protect themselves in many ways. An emergency fund helps to bridge gaps in income. A line of credit helps to finance new opportunities, as long as there's a plan in place to pay it back. Meanwhile, insurance can preserve their family's standard of living—for example, by covering health and dental costs if they have to leave a group plan. With protection in place, young adults can take risks in life as well as investments, and achieve their full potential.

By sharing age-appropriate lessons with the young adults in your family, you can pass on your money philosophy. This can lead to smoother money discussions when they're older and even to an easier transfer of wealth between generations. We would be happy to meet with the young people in your life to discuss these key lessons and help them get started with saving, investing and good money habits that will last a lifetime.