BT Panorama

Part 3 – What is your personal balance sheet?

Our personal balance sheet is made up of four segments. On the positive side of the ledger is our income and assets, and on the reverse side our expenses and liabilities.

Income

The lifeblood of your balance sheet. Can be replenished not just by wages but also by growing your pool of income producing assets.

Expenses

The energy expended to maintain our day-to-day lifestyle. A near endless list of items including bills, groceries, petrol and impulsive purchases that you know are not really needed.

Assets

The heart of your balance sheet. Income enhancers and the key to life enrichment. Things like dividend paying shares, investment properties and term cash accounts.

Liabilities

Consider it your balance sheet's aging process. Includes big ticket items that drain your income like cars and loans. It's not all negative as an investment loan once paid off switches over into an asset.

As we progress in life our balance sheet will become more complicated and personalised to our lifestyle but there are some well-trodden paths that many of us experience.

When you achieved your first job and received a pay check your balance sheet was likely a simple affair. After paying for rent and food and setting aside a bit for bills the rest was available to enjoy a rapidly expanding social agenda.

At this point your personal balance sheet probably only consisted of two parts: income and expenses.

As we move into life we find partners, make decisions about having a family, buy a house and meet our material needs for cars, furnishings, and increasingly, electronic goods.

Realistically this is the point where most of us start making big decisions about life goals and aspirations, and it is a time when our balance sheet has expanded to include assets and liabilities.

Life may be getting complicated but the goal is simple

Our aim is to use our earnings to build an income-producing asset base, so that over time the returns from our assets meets our expenses and liabilities – this is known as financial independence.

In a wealth adviser's perfect world on the day we got that first pay check we would be putting some aside. As our savings expanded we would start accumulating income producing assets like dividend paying shares and fixed interest products while saving up a deposit for a home.

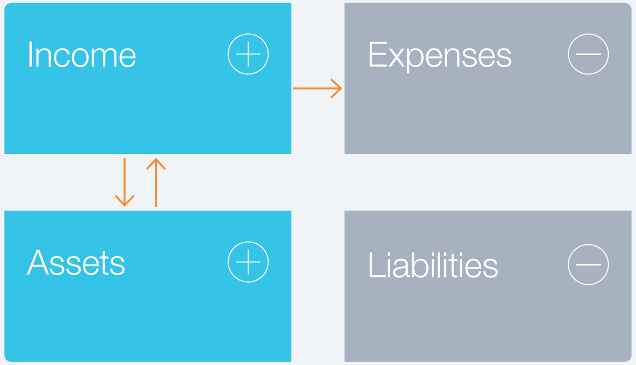
We could also take the option of using a cash hub to manage our affairs. These hubs typically accrue interest on a daily basis and are a central point from which to pay all your bills, while also managing your deposits and how your cash is dispersed.

And we would be prudent in the use of credit cards and accumulating debt. According to the Australian Securities Investments Commission (ASIC) the average credit card has $4,400 owing and clocks up $800 a year in interest.

Now this exceptional person – and they do exist – would from the start have a balance sheet that is optimised for balance sheet enrichment, as income would rapidly start producing assets that in turn add to our income. Such a focused individual would likely avoid cash draining liabilities, and being income and asset focused, would minimise expenses.

Their balance sheet would work like this.

The focused balance sheet



But balance sheet enrichment does not necessarily equate to lifestyle enrichment.

For instance some people are focused on material goods. It may be a temporary spending pattern that occurs after a large pay rise or a single income family moving to two incomes, or it may be more ingrained as a lifestyle choice. But the result is that income feeds directly into expenses and liabilities, bypassing the critical build of assets.

Choosing this path may deliver luxury cars, boats and the latest furnishings but the items purchased depreciate over time and add nothing to long term wealth ambitions.

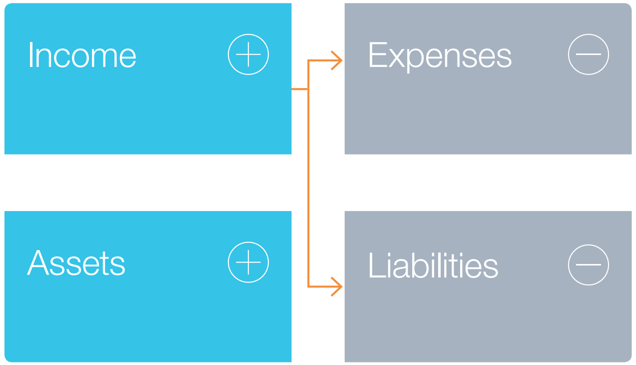
It also places the household at risk of a change in fortune.

There is no right or wrong when it comes to how you choose to live your life but the "I want it now" balance sheet poses a real threat to meeting long term aspirations.

In particular, if a change of fortune occurs later in life there may be few options left to address the shortfalls in your balance sheet before retirement age, leaving a potential scenario of living out your twilight years on an aged pension.

According to ASIC about 65 per cent of older Australians rely on a pension – about $33,000 for a couple – as the main source of personal income at retirement. It's a sobering statistic but from a psychological perspective not particularly surprising.

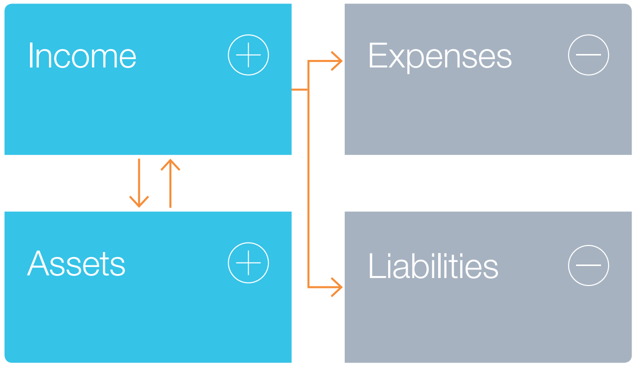
I want it now



So the ideal personal balance sheet would be to address the happy between the two.

If we take "the focused approach" and marry it with the "I want it now" balance sheet we end up with a more measured direction that many households will follow to achieve savings and wealth creation as well as material wants.

The measured approach



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