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The Importance of Financial Literacy

Too few Americans understand personal finance fundamentals

IF ONLY MONEY CAME WITH INSTRUCTIONS.

If it did, the route toward wealth would be clear and direct. Unfortunately, many people have inadequate financial knowledge, and for them the path is more obscure.

ARE MOST PEOPLE CLUELESS ABOUT FINANCIAL MATTERS? That depends on what gauge you use to measure financial knowledge. The U.S. ranked fourteenth in Standard & Poor's 2015 Global Financial Literacy Study, with just 57% of the country's population estimated as financially literate.¹

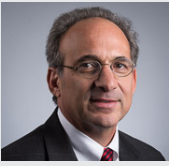
The other 43% of Americans have some degree of financial understanding, but it is mixed with a degree of incomprehension. Witness some examples:

- A recent LendU survey found that nearly half of college students carrying student loans thought those debts would eventually be forgiven if left unpaid.
- This year, Fidelity Investments asked Americans the following question in a multiple-choice quiz: "If you were able to set aside \$50 each month for retirement, how much could that end up becoming 25 years from now, including interest, if it grew at the historical stock market average?" The correct answer was \$40,000, and just 16% of respondents got it right. Another 27% guessed \$15,000 (i.e., $50 \times 12 \times 25$, as if interest was not a factor).
- Only 42% of those quizzed by Fidelity knew that withdrawing 4-5% a year from retirement savings is commonly recommended. Fifteen percent of those older than 55 thought they would be "safe" withdrawing 10-12% per year.
- The S&P 500 has returned positively in 30 of the last 35 years. Just 8% of those answering Fidelity's quiz guessed this.^{2,3}

APART FROM THESE EXAMPLES, CONSIDER ANOTHER ONE AT THE MACRO LEVEL. According to the latest National Financial Capability Study from FINRA (the Financial Industry Regulatory Authority), only about one-third of Americans younger than 40 understand the basic financial concepts of compounding, inflation and risk diversification.¹

Statistics aside, think about how a lack of financial acumen hurts people's chances to build or protect wealth. How about the employee who skips retirement plan enrollment at work, mistakenly thinking that a tax-advantaged retirement account is the same as a bank account? Or the small business owner puzzled by cash flow and profit-and-loss statements? Or the young borrower who fails to grasp the long-run consequences of only making interest payments on a credit card or loan? Financial professionals continually educate themselves.

(Article continued on page 2)



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They stay on top of economic, tax law and market developments. Investors should as well. Ten or 20 years from now, you may find yourself in an entirely different place financially. The economy, the Wall Street climate, and even the investment opportunities before you could all differ from what you see today. If your financial knowledge is 10 or 20 years out of date, you risk being at a disadvantage.

FINANCIAL LITERACY IS NOT ABOUT PREVENTION, BUT INSTEAD ABOUT EMPOWERMENT.

The more you understand about personal finance, the more potential you give yourself to make smart money decisions.

CITATIONS.

1 - marketwatch.com/story/should-colleges-require-a-financial-literacy-class-2017-04-03/ [4/3/17]

2 - investopedia.com/news/3-ways-improve-financial-literacy/ [4/21/17]

3 - marketwatch.com/story/most-americans-failed-this-eight-question-retirement-quiz-2017-03-23 [3/23/17]

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