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Ahead of the Curve:
A Financial Roadmap for Young Adults

For many young adults, financial planning can sometimes feel like a distant concern. Concepts like managing debt, investing in the stock market and opening up a retirement account can sound interesting when discussed with family and friends, but they are often seen as responsibilities to address only after achieving greater financial stability. In reality, it's almost never too early to begin thinking about personal finance. Time is one of the most powerful resources available when it comes to building wealth and establishing good habits early on can dramatically increase the chance of achieving long-term financial success.

YOUR BUDGET IS YOUR FOUNDATION

One of the best things you can do when starting your financial journey is to establish a budget. This is because, when it comes to personal finance (and many other things in life), it's generally harder to get where you want to go if you don't know where you currently are. Creating a budget can be a relatively straightforward process, especially with the availability of simple tools like Microsoft Excel or more specialized personal finance apps like Monarch and Rocket Money. These tools are generally pretty available to anyone with access to a smartphone or computer, and they can help provide a starting point in your financial journey.

There are several guidelines that young adults can use when first starting to think about a budget. For those unsure of where to start, the often-cited 50/30/20 rule can be a good jumping-off point. This framework suggests that 50% of your after-tax income should be reserved for "needs" like housing, food, transportation and healthcare. The next 30% should then be set aside for "wants" like travel, dining out and all those monthly subscriptions that just seem to keep piling up. The final 20% should then be designated for "saving," whether in a brokerage account or some other vehicle. Many young adults, especially those not yet earning a stable income, will read these guidelines and think that because they can't currently save 20%, there's no sense in saving at all until their income is higher. While this is a common reaction, given how valuable a resource time can be, it's almost always better to start sooner rather than later, even if that number is only 1-5% of your income.

EMERGENCY FUNDS: PREPARING FOR THE UNEXPECTED

Once you have built a budget and have a good idea of your income and expenses, a great next step can be establishing what's often referred to as an "Emergency Fund." Setting aside some money in a safe account that's easily accessible can help provide some cover in the event that you encounter unexpected expenses. Life can be complicated, and while nobody can predict the future, it's safe to bet that you will encounter a number of unexpected expenses over the years. Whether it's something mundane like having to get new tires for your car or something more serious like having to cover lost income due to being laid off, having that dedicated amount readily available is a great way to help provide some peace of mind. While it's true that everybody's financial situation is unique, a good rule of thumb when just starting out is to have approximately 3-6 months of expenses available at all times in case of an emergency.

The good news is that there are plenty of great options available where you can still generate a return on your emergency cash. One of the most straightforward choices is to open a dedicated High-Yield Savings Account ("HYSA") with a bank. These accounts are often highly liquid, and in today's market, you can still earn rates of at least 4%, which is much better than the less than 1% rates paid on most standard checking/savings accounts.

THE POWER OF COMPOUNDING

Once you have built out a budget and have set aside 3-6 months of expenses in a dedicated Emergency Fund, you're ready to think about the fun part – how to best grow your savings over time. One option is you can invest that money for the future. Whether investing in a standard brokerage account or a tax-advantaged retirement account, compounding interest, or the idea that the interest you earn on an investment begins to earn interest itself, is one of the most powerful wealth-building tools in personal finance.

To help illustrate the effect of compounding interest, let's say that you begin investing at age 20 and plan to retire at 65. Assuming an average rate of return of 7% and a $50 monthly investment, you could reasonably expect an account balance of approximately $190,000 by the time you retire. What is effectively happening here is that you are investing a total of $27,000 ($50/month for 45 years), but due to the benefits of compounding, your expected account balance would be roughly $190,000. Another way to think about this is that roughly 86% of the account balance at age 65 is growth you have realized over the years, while only about 14% is the money you put in.

Going back to the earlier point on why time is so valuable, let's now assume that everything is the same, but instead of starting at age 20, you now start at age 30. The effects are pretty significant. To be specific, the expected account balance at age 65 would drop to $90,000, less than half of what it would be if you started a decade earlier. You would have put in $21,000 of your own money under this scenario, which means that only 77% of the account balance at age 65 is growth, as opposed to 86%. This trend continues the later you get started, hence why it's so important to begin saving early, even if you are only able to set aside a small percentage of your income.

POTENTIAL DRAWBACKS OF DEBT

It is very easy to get excited when you first start to realize the powerful effect compounding can have on your financial future. With that said, it's important to remember that compounding works both ways. Using credit card debt as an example, you just saw how powerful a 7% rate of return can be when it works in your favor, so now try and imagine a 20% (or even higher) rate of return working against you. The reality is that just a few missed payments on high-interest debt like credit cards can really undermine long-term financial progress. That's why it's often prudent to tackle these types of debts as soon as you can. Sometimes, it can help to think of paying off these debts as if you were earning that same rate of return on your money by investing it. Most people would be very happy to earn a 20% return in the stock market in any given year, so why not pay down a debt with that same interest rate? Otherwise, it's the credit card company, and not you, that is benefiting.

CONCLUSION

Sometimes, getting started with personal finance can feel like a daunting task. Between all the different account types, market volatility, potential tax implications and just general life uncertainties, there are a lot of different aspects to consider. The important thing to remember is that, at the end of the day, getting started with a financial plan is not about setting yourself up to handle any potential obstacle imaginable. It's really much more about trying to build sustainable habits to hold yourself accountable over time. Regularly reviewing your plan and continuing to expand your financial literacy are great habits to adopt in order to help navigate life's inevitable obstacles, and taking the initiative sooner rather than later is a great way to tilt the odds of success in your favor.

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