THE GLOBE AND MAIL

Money 101: Three things every teen should understand about money

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Special to The Globe and Mail
Published Thursday, Feb. 04, 2016 4:41PM EST
Last updated Thursday, Feb. 11, 2016 4:40PM EST

A few years ago, an economics student by the name of Panupol Sujjayakorn, from Thailand, took a break from his studies to compete in the World Scrabble Championships. He won the contest – and he could barely speak English. He knew how to spell thousands of words that he didn't even understand. I was speaking to my kids this past week about the feat. "See, Dad – it's not important to understand anything. All I need to do is memorize stuff," my youngest said. That's not exactly the life lesson I wanted to pass along.

The fact is, no amount of good memory is going to help you make wise financial decisions in life. And no one is learning much about money at school. Our oldest son, Win, will be graduating from high school this year, and our other two kids aren't far behind. Today I want to talk about three things I think every teen should understand about money. If you're a young person, I've written this for you.

Saving for the future should start now.
Money is important. There are two ways to "get money." First, spend time and effort to earn money through work. Second, start with a little money and watch it grow on its own. Over time, you want more of your money to come from this second source. When it comes to growing your money, time is critical – so you need to start soon. Take the example of twins, Jack and Jill. Jack saved $1,000 every year from the age of 25 to the age of 45 – a 20-year period. That is, he set aside $20,000 in total. Then he allowed his savings to grow to the age of 65, at which time he had amassed $117,976 (assuming a 6-per-cent return annually). Jill, on the other hand, was a procrastinator. She didn't start saving until age 30. She also saved $1,000 every year, from age 30 to age 65 – a 35-year period, for a total of $35,000 saved. She also earned 6 per cent each year. At age 65, Jill had just $111,435 – less than her brother even though she had saved more money. The reason? Jack had five more years for his money to grow. A note to parents: Start your kids saving in a tax-free savings account as soon as they are 18. They may not have RRSP contribution room yet, or enough income to claim an RRSP deduction, so a TFSA makes good sense.

Learn the basics of investing.
There's no shortage of stuff to learn about how to invest the money you've saved. So, let's start with the basics. You need to understand that there are three basic types of investments: Cash, bonds and stocks. You should understand the difference between these and that cash is the least risky (in terms of volatility – that is, seeing your investment go up and down in value). As for bonds: When you buy a bond, you're lending money to a business or government. They'll pay you for that – in the form of interest. Eventually, they'll repay you the money you've lent to them. Bonds are riskier than cash because you might not get repaid – but that risk is usually low. Then there are stocks. When you buy stocks, you're becoming an owner in the business. You'll be entitled to receive a share of the profit, which is often paid to you as "dividends." Not all businesses pay much in dividends, and if the business does poorly, you may never get any. Further, if the business does poorly enough, the value of your stocks may drop. Or the value of the stocks might rise if the business does well. Stocks are the riskiest of the three asset classes – but can come with the greatest reward, as well.