Financial Habits And Net Worth

What does it take to achieve financial prosperity?

You already know that our financial habits determine our financial fate. If we avoid credit card debt, spend less than we earn and create a financial buffer against the unexpected, we tend to thrive financially. If we carry a lot of debt or live constantly on the edge, with little savings, then our financial future is much cloudier.

Recently, a paper published by the Federal Reserve Bank of St. Louis proved these truisms in the real world. For eight individual years between 1992 and 2013, the Fed's Survey of Consumer Finances has posted a series of financial questions to thousands of people in all walks of life, at all income levels and ages. Among them:

1) Did you save any money last year?
2) Did you miss any loan or mortgage payments in the last year?
3) Did you have a balance on your credit card after the last payment was due?
4) Do liquid assets make up at least 10% of the value of your total assets?
5) Is your total debt service—the cash you devote each month to paying principal and interest—less than 40% of your income?

The paper scored the answers, giving every positive answer (yes for 1, 4 and 5, no for 2 and 3) one point, assigning zero points to the "wrong" answers. Then they added up the scores for each household and looked at a financial health score taken from the same survey, and compared the two. They found what you would probably expect: that good financial habits are highly correlated with the accumulation of wealth. A small chart at the back of the study, which divided people according to age and ethnic profile, found that individuals who averaged a score of 2.63 had a median net worth of $25,199, while those who averaged a 3.79 score enjoyed a median net worth in excess of $800,000. The average score: 3.01, associated with a net worth somewhere in the $70,000 to $75,000 range, which happens to fall neatly in between the median for people age 35-44 ($51,575) and those age 45-54 ($98,350).