

# Understanding your Liabilities - Liabilities Drive Investment Decisions

Submitted by Chris on Mon, 09/10/2018 - 14:00

Who knew that keeping track of our bills could help guide our investment decisions?

Each month, we keep track of our bills: rent, mortgage, water, electricity, internet, and other expenses. We do it mostly so we can avoid late payments and the penalties that come with them. However, there is another reason why we should keep track of these payments, and it will help drive our investment decisions.

When starting to formulate investment decisions, it can sometimes feel a little overwhelming. Short-term securities, long-term securities, stocks, annuities, insurance, and mutual funds, where do we start? There are [many](#) <sup>[1]</sup> places to invest money. When faced with this long-list of investment choices, it is easy to forget the reason why we sat down to invest in the first place, but if we know what our liabilities are, now and in the future, we will be able to create a framework and strategy for our investments. However, what exactly are liabilities?

Specifically, liabilities are what we are legally responsible for paying, now or in the future. They can consist of loans, accounts payable (like bills), mortgages, deferred revenues, and accrued expenses. Knowing our liabilities can help drive our investment decisions because when we see what we need to pay and when we need to pay it, we have a greater understanding of when we need our investments to be more liquid (cash) or less liquid (real estate). For example, when we know we have a recurring payment of \$500 in May, we can plan to have at least that much in cash at that time. At that time, holding all of our assets as 30-year bonds does not make sense for our lifestyle and liabilities. This example clarifies why it is essential to understand our liabilities. Knowing them can help drive our investment strategy and set us up for the future. Here are some specific examples of personal liabilities and some things to know about each one (The list does not include every liability):

## Expenses

Expenses include bills and other payments. Typical expenses include rent, water and electricity bills. We can predict the recurrence of these payments as they are generally contracted to occur on a specific date in a certain amount.

What to know: Keep a list of your monthly expenses so you can plan your investing schedule around them. By understanding monthly payments, it can be easier to implement not only investing strategies but also saving strategies.

## Mortgages

**Fixed-Rate** mortgages are mortgages where you pay the same principal payment and interest amount

every month.

**Adjustable Rate Mortgage** is a mortgage where the interest rate you pay varies with the market. When market rates are low, your mortgage may look more affordable. As the market changes, the change in interest rates may make your monthly payments less accessible.

What to know: Do not forget to factor in interest, and its volatility. The changing interest rates can affect monthly payments, for better or for worse.

## Loans

A loan is a lump sum amount loaned by a bank (or person) that you can pay back in installments.

What to know: Understand the number of installments, the period, and the interest rate of the loan to be paid back. These details will help drive your investing strategy.

## Credit Card Payments

If you do not pay your credit card bills in full each month, you will generally have to pay back the amount with a significant interest rate, meaning the value you initially spent will exponentially multiply as time passes.

What to know: Be aware of banks' interest rates as they all will vary.

Once we understand our liabilities, we can then start to build the framework of our investing strategy. Though there are other things to acknowledge when investing, knowing our liabilities is an essential first step. So, once we know our liabilities, we can start to identify the amounts of money we can use to invest and where we can invest them.

We need to determine what the time frame is for our investments. How long do we have until retirement? Can we utilize long-term investments? Is our time frame shorter and the assets will need to be in a more liquid investment?

This shows how we now understand what our asset allocations should be, because we first took the time to understand the time frame of our liabilities.

Understanding our liabilities is a pertinent step in creating an investment strategy that fits our lives. We each have different liabilities and commitments. Being fully aware of each one will help create a framework for your personal investing.

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asset  
decisions  
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Links:  
investments.  
[1] <http://www.finra.org/investors/types-investments>

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