

AI-01933 Personal Finance Health

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Synthesize the company financial health into the domain of personal finance. What items will I be looking to assess the health of my personal finances

Drawing an analogy between company and personal finance, the items you should assess to understand your financial health are essentially the same concepts applied on an individual level. Just as a business uses financial statements to track its performance and position, you can use similar tools to evaluate your own finances.

Here's a breakdown of key personal finance items, synthesized from corporate finance concepts:

1. The Balance Sheet: Net Worth

A company's balance sheet provides a snapshot of its financial position at a specific time, listing assets, liabilities, and equity. For personal finance, the equivalent is your Net Worth.

- **Assets:** These are the things you own that have value.
 - **Current Assets:** Liquid assets that can be easily converted to cash. This includes cash, checking and savings accounts, and short-term investments.
 - **Long-Term Assets:** Less liquid assets that are held for long-term value. This includes real estate (your home), retirement accounts, long-term investments, and other valuable property (e.g., vehicles, collectibles).
- **Liabilities:** These are the debts you owe.
 - **Current Liabilities:** Debts that are due within a short period, typically one year. This includes credit card balances, personal loans, and any other

short-term debt.

- Long-Term Liabilities: Debts that will be paid off over a longer period. This includes mortgages, student loans, and car loans.
- Net Worth: Calculated as Total Assets - Total Liabilities. A positive and growing net worth is a key indicator of strong financial health.

2. **The Income Statement: Cash Flow**

A company's income statement tracks its revenues and expenses over a period to determine its profit or loss. For personal finance, this is your Cash Flow.

- Income (Inflows): Money coming in from all sources. This includes your salary, bonuses, side hustle income, interest from savings, and investment returns.
- Expenses (Outflows): Money going out. This includes both "needs" (rent/mortgage, groceries, utilities, insurance) and "wants" (dining out, entertainment, subscriptions).
- Cash Flow: Calculated as Total Income - Total Expenses. A positive cash flow means you are earning more than you spend, which is essential for saving, investing, and building wealth. A negative cash flow indicates you are spending more than you earn, which is a significant sign of financial distress.

3. **Key Financial Ratios and Metrics**

Companies use various ratios to analyze their financial statements. You can apply similar ratios to your personal finances to gain deeper insights.

- Debt-to-Income (DTI) Ratio: This measures how much of your income is going toward debt payments. A lower DTI ratio indicates a more manageable debt burden. Lenders often use this to assess your ability to take on new loans.
DTI Ratio = Total Monthly Debt Payment/Gross Monthly Income
- Savings Rate: This measures the percentage of your income you are saving. A higher savings rate signifies that you are building wealth and preparing for the future. A common guideline is to save at least 10-15% of your income, but a higher rate is always better.
Savings Rate = Monthly Savings/Gross Monthly Income
- Emergency Fund: This isn't a ratio, but a crucial metric of liquidity and resilience. It's a pool of cash to cover unexpected expenses like job loss or

medical emergencies. A good rule of thumb is to have at least three to six months' worth of living expenses saved.

Other Important Considerations

- **Credit Score:** Similar to a company's credit rating, your credit score reflects your creditworthiness. A higher score gives you better access to loans and lower interest rates.
- **Risk Management:** This is about protecting your assets and income. Just as a company insures its property and operations, you should have adequate insurance (health, life, disability, home/auto) to protect yourself and your family from financial shocks.
- **Long-Term Planning:** This is your "business plan" for the future. It includes setting financial goals for retirement, major purchases, or other life events and creating a strategy to achieve them. This involves things like a retirement savings plan and investment strategy.