How do you measure up?

Financial ratios help you assess your fiscal fitness

By David Whitemyer

"I've got all the money I'll ever need," comedian Henny Youngman once joked, "if I die by four o'clock." That's certainly no way to plan life's investments. But how long could you last on your savings?

Financial ratios can help answer that question. Used by mortgage lenders and business analysts to gauge risk and measure fiscal vitality, financial ratios are a simple tool for measuring how much money you have, and how much you owe.

"In an ideal world, personal financial ratios would function similarly to health ratios, like blood pressure and body mass," suggests Dr. Ruth Lytton, associate professor of financial resource management at Virginia Tech University. "There'd be widespread public awareness and motivation for annual checkups."

Cash–asset, debt–limit, annual-debt–service. The list of ratios goes on and on. And you don't need to be a CPA to do your own annual checkup. Using elementary math skills, anyone can tally up the most helpful ratios: liquidity and debt-to-asset.

Staying afloat on liquid dough

Your liquidity ratio determines the capacity of your household to meet current obligations, should your income draw to a blinding halt. To determine your liquidity ratio, divide your total liquid assets by your monthly expenses. Let's say you have $1,000 in a checking account and $9,000 in a money market fund. That's 10 grand in liquid assets. Your monthly expenditures, including house payments, equal $2,000, so your liquidity ratio is 5:1. You're in good shape, since most financial advisers recommend achieving a ratio of at least 3:1, or 6:1 if you're self-employed.

In the black or in the red

Debt-to-asset ratio determines solvency. To be insolvent is to have a negative net worth, where debts exceed assets. In short, it's the first step toward bankruptcy.

Ignoring housing costs and equity, divide your total liabilities by your total assets. Financed automobiles and credit card debt are common liabilities. If you owe $25,000 in student loans, for example, and another $5,000 on a car, your debt equals $30,000. Adding up your stocks, 401(k) balance, and passbook account, say your assets total $60,000, making the debt–to–

Illustration by John Ritter

asset ratio a healthy 0.5:1. You're solvent! If the debt side of your ratio is above 1.0, you're insolvent.

"Although insolvency is cause for alarm," advises Lytton, "the degree of alarm must be considered relative to the stage of one's financial life cycle." An insolvent 50-year-old considering retirement would be in more of a predicament than would a recent college graduate with strong future income potential.

Laugh all the way to the bank — or not

In fact, when you do a financial checkup with ratios, the final numbers don't express the complete picture. You must gauge the results with your own goals, your personal aversion to debt, and your need for security.

Charles Dickens expressed a sort of financial ratio in his classic *David Copperfield*, when Mr. Micawber explained, "Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought six, result misery."

Happiness should be the desired result, but as most will agree, money doesn't buy happiness. What Dickens' character was hinting at was that a healthy financial ratio may lead to peace of mind.

Learn about more financial ratios in the NetBenefits Planning Center, at **http://planning.netbenefits.com**.