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Key Financial Ratios Every Investor Should Know

15% Liquidity Ratio:

Liquidity ratio means how many months of expenses you can meet by tapping your cash assets.

Liquidity ratio = Cash (or near cash) / Monthly expenses

If your monthly expenses are ₹50,000 and cash assets are ₹2 lakh, your ratio is 4.0 (or 25%).

A higher ratio is better as it means you can cover more months of expenses through your cash.

Ideally, 15% of your portfolio should comprise liquid assets.

20% Savings Ratio:

Savings is one of the most critical parts of building your net worth and to meet future goals like retirement.

Savings ratio = Total savings in a year / Gross annual income

Total savings will include everything from your investments to putting money in your emergency account. New investors can start with a savings ratio of 10% and gradually increase it to the ideal 20%.

Total Insurance Cover:

Insurance is the backbone of your finances because it helps to cover possible uncertainties in life, such as accidents, surgeries, job loss, fire, and even death.

As a thumb rule, if you have dependents, your life insurance cover should be a minimum of 10 times your annual income, so that it's sufficient to meet their needs till they are financially independent.

In the case of health insurance, it should be 50% of your annual income so that it also covers any job loss that you might suffer due to medical reasons.

50-30-20 Budgeting:

Knowing your cash flow helps you keep track of whether you're living within your means or overstepping your boundaries.

Net cash flow = Monthly income – Monthly expenses

It's equally important to know the break-up of your expenses. These can be divided into fixed expenses such as rent, school fees, electricity bills, EMIs, etc., and variable expenses like dining out and shopping.

Under the 50-30-20 rule of budgeting, your necessary expenses shouldn't cross 50% of your monthly income, the indulgence part should be limited to just 30%, and you should save at least 20%.

Inflation Rate and ROI:

Most of us keep track of the returns we are getting from our investments, whether it is 6% on FDs or 15% from equities. But you must also keep track of the ongoing inflation rate as this determines if your money is actually earning for you.

If the inflation rate is higher than the returns on your investment, you won't be able to save enough for your future goals.



Loan Balance and Interest Rate:

Keeping track of the interest rates on your loans will help you understand how long it will take to pay them off or switch to a more affordable loan.

50% Debt-to-Asset Ratio:

This number will help you know how much money you owe to others for the assets you own. This includes any loan, including your credit card debt.

Debt-to-asset ratio = Total liabilities / Total assets

Generally, when you're younger, this ratio can be high, as you might have a home loan, education loan, etc. However, it should never cross 50% of your gross income. As you get closer to retirement, this ratio should dwindle to zero.

Targeted Net Worth:

This number is going to help you reach your financial goals, especially retirement. You can fix your own retirement corpus, of course, but it's also good to track how much your net worth should be at a particular age.

A common formula from the book *The Millionaire Next Door* is:

Targeted net worth = Age × (Gross Income / 10)

So, if you're 40 and earn ₹20 lakh a year, your net worth should be ₹80 lakh, which will include all your assets and savings.

Credit Score of Over 800:

You can think of your credit score as your financial report card, which represents how responsible you are with borrowed money. This number ranges from 300 to 900.

Having a high score means that you will get better deals on loans and credit cards.

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* Mutual funds are subject to market risks. Please read all scheme-related documents carefully before investing. Past performance does not indicate future results. Investments are subject to market fluctuations, and there is no assurance of returns.

