latest word

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Compound Interest - it's right up there with SEX!!

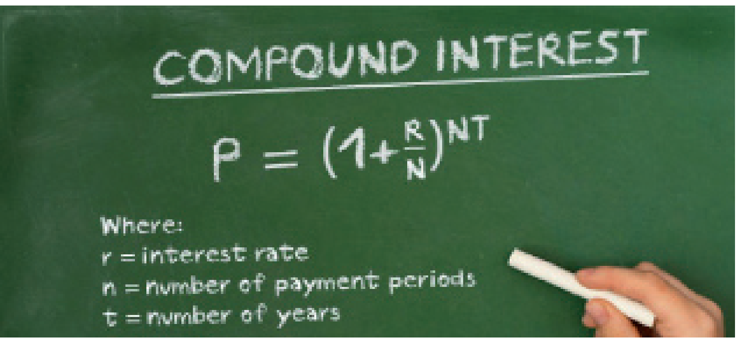
"Compound Interest is the eighth wonder of the world. He who understands it, earns it..... He who doesn't..... Pays it ..." Albert Einstein

If the words "*Compound Interest*" in the title didn't grab your attention and interest, I'm hoping the old adage "*SEX SELLS*" holds through and you're reading this article.

Because what I'm about to talk about is right up there in importance ...... and you should be teaching your children about it!!

How can I put this, if you don't understand it, and you're not using it, you're literally *recklessly fecking away* the time value of money.

The best way to explain it is to let the numbers do the talking, and then you can decide if it's important to you or not.



So let's talk about John and Mary.....

Mary's Dad, is big into this compound interest stuff and teaches her about the importance of *paying herself first* and setting aside a little bit of her income *first time and every time* to savings and her future financial security (and freedom!).

John's Dad thinks Compound Interest is really boring, and encourages John to live while he's young, there'll be time enough for saving later.

So let's say John and Mary both save €100 per month for 20 years with an average interest rate of 5%.

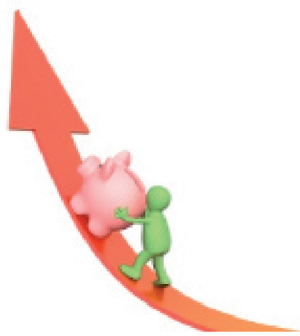
However Mary saves from age 20 to age 40 and John saves from age 40 to age 60.

They both save €24,000 (€100 (per month) x 12 (months per year) x 20 (years)

At age 60 John has a total amount of €40,745.

At age 60 Mary has a total amount of €108,110.

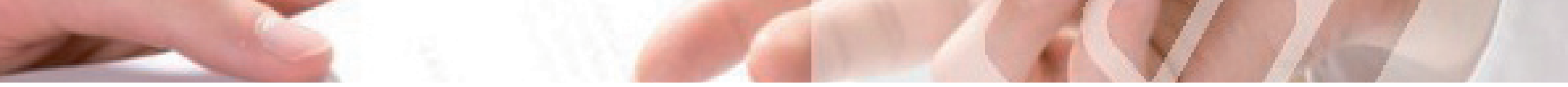
That difference of €67,365 is the time value of money my friends, that €67k of sexy or as it's more traditionally known, *compound interest.*



Ok now, let's go mad and double the savings from €100 per month to €200, for both John & Mary, again Mary starting at 20 and John at 40.

At age 60 John then has a total amount of €81,491.

At age 60 Mary then has a total amount of €216,221.

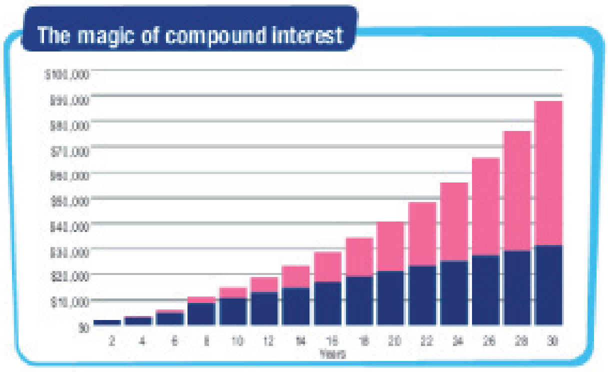


In that second example, they both saved an amount of €48,000 over 20 years (€200pm x 12months x 20years).

However because Mary understood the time value of money, for the same saved amount of €48,000 (i.e. €200 a month by 20 years), she gained an additional €168,221 whereas John gained an additional €33,492, as Mary had 20 more years of time on her side to let her money work for her. So Mary has €134,730 more cash than John for the same amount of saving because she appreciated the time value of money and saved earlier. *Now isn't that kinda sexy?*

Now I know some of you may say.... yeah, yeah, yeah I get it and yes, yes, yes..... *compound interest is really cool* however, I don't have the money to save. That may well be the case, particularly at a point in time, such as in a recession. However, just let me point out the relationship between the time value of money and your expenses, which may put things in a different light.

Let's say you purchase a new car for example (at age 30), which can very quickly depreciate. Let's say it's worth €10,000 less after two years. What is the true cost of that depreciation? At 65, that €10,000 that you lost through depreciation could have been the equivalent of an extra €50,000 in your pension fund. (again assuming 5% average return for example purposes)



Let's say you're spending an extra €50 per month on your TV Package for extra premium services like movies and sports? What's the true cost of that over the long term? Well over 30 years, that could equate to an extra €41,000 in your pension fund and again demonstrating the power of compounding, that same €50 per month over 35 years could equate to an extra €55,500 in your pension fund or bank account. The damage or benefit increases over time.

Look I know there isn't discretion over large amounts of people's expenses but where there is, a longer term view is worth having in very measurable monetary way.

A little bit of delayed gratification can go a long way.

So as Albert Einstein said, depending on your understanding of compound interest, you're either earning it or paying it.

So what's the moral of the story?

Before you get bogged down with what asset class, what fund, what return etc, etc .... just begin saving asap!!, because, in the long term when you began saving will be a key deciding factor in whether you're financially free, financially secure or indeed up a well known not so fragrant creek without a paddle!!

The later you begin the more it's going to cost you.... big time.... real cash.

Finally, you may be a little shy about talking to your children about sex, but please don't be shy about telling them all about the joy of compound interest ...... sooner rather than later.

Last word

Thanks for taking the time to read our "latest word"

Feedback on our newsletters is always welcome and gratefully received. joe@fwf.ie.

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