

The Power of Compounding

If you invest \$600 a year (that's \$12.50 a week) for the first eight years of a 40 year period with annual compounding of 10%, you will earn more than someone who invests \$600 a year from years 9 through 40.

What does "compounding" mean???

Everest



Year	Early Funding		Late Funding	
	Contribution	Year-End Value	Contribution	Year-End Value
1	\$600	\$660	\$0	\$0
2	\$600	\$1,326	\$0	\$0
3	\$600	\$2,059	\$0	\$0
4	\$600	\$2,864	\$0	\$0
5	\$600	\$3,751	\$0	\$0
6	\$600	\$4,726	\$0	\$0
7	\$600	\$5,799	\$0	\$0
8	\$600	\$6,978	\$0	\$0
9	\$0	\$7,676	\$600	\$660
10	\$0	\$8,444	\$600	\$1,326
11	\$0	\$9,288	\$600	\$2,059
12	\$0	\$10,217	\$600	\$2,864
13	\$0	\$11,239	\$600	\$3,751
14	\$0	\$12,363	\$600	\$4,726
15	\$0	\$13,599	\$600	\$5,799
16	\$0	\$14,959	\$600	\$6,978
17	\$0	\$16,455	\$600	\$8,276
18	\$0	\$18,100	\$600	\$9,704
19	\$0	\$19,910	\$600	\$11,274
20	\$0	\$21,901	\$600	\$13,002
21	\$0	\$24,092	\$600	\$14,902
22	\$0	\$26,501	\$600	\$16,992
23	\$0	\$29,151	\$600	\$19,291
24	\$0	\$32,066	\$600	\$21,820
25	\$0	\$35,272	\$600	\$24,603
26	\$0	\$38,800	\$600	\$27,663
27	\$0	\$42,680	\$600	\$31,029
28	\$0	\$46,948	\$600	\$34,732
29	\$0	\$51,642	\$600	\$38,805
30	\$0	\$56,807	\$600	\$43,286
31	\$0	\$62,487	\$600	\$48,214
32	\$0	\$68,736	\$600	\$53,636
33	\$0	\$75,610	\$600	\$59,599
34	\$0	\$83,170	\$600	\$66,159
35	\$0	\$91,488	\$600	\$73,375
36	\$0	\$100,636	\$600	\$81,313
37	\$0	\$110,700	\$600	\$90,044
38	\$0	\$121,770	\$600	\$99,648
39	\$0	\$133,947	\$600	\$110,213
40	\$0	\$147,342	\$600	\$121,834
Investment	\$4,800		\$19,200	
Earnings		\$142,542		\$102,634

Great question Everest! First, you need to know some definitions:

The money you put into the bank to begin with (the \$600 each year in this example) is called "*the principle.*"

The amount the bank (or other financial institution) agrees to pay you for letting them hold onto your money is called "*interest.*" This example shows 10% interest per year.

If you leave your money in the bank and don't touch it, at the end of the year you'll have *the principle* PLUS *the interest* in your account (in this example, it would be \$600 + \$126 = \$726).

Next year when you put in \$600 more, you'll then be earning interest on THAT \$600 plus the \$726 from last year (\$600 + \$726 = \$1326). In other words, you're not just getting interest on the principle, you're getting interest on the interest the bank has already paid you! That's called "*compound interest.*"

Compounding is a process that causes the value of your investment to rapidly become higher over time due to *compound interest* – you get interest on interest on interest and so on.

So the longer you leave your money in the bank, the more it will earn for you!

\$14,400 more was invested in the "Late" example but there was **\$40,000 less** in earnings - just from starting early and taking advantage of *compound interest*!