

• THE SECRET OF • COMPOUND INTEREST



What is Compound Interest?

Compounding returns is one of the fundamental concepts of investing and building wealth over the long term.

How does it work?

In an investment situation, compound interest means that each time interest is earned and is added to (or compounded into) the principal balance of an investment, it thereafter also earns interest – accumulation of interest on the interest. The more frequently interest is compounded, the faster the balance grows. Compound interest is one of the most basic and powerful concepts that can enhance the outcome of your investments.

When you're young, you have an asset money can't buy, time. Start saving now and turn pocket change into riches.

Compound interest has been called the eighth wonder of the world. It magically turns a little bit of money, invested wisely, into a whole lot of cash. Even Albert Einstein is said to have called it one of the greatest mathematical concepts of our time.

But you don't need to be a genius to harness the power of compound interest.



How it affects capital growth

When you save or invest, your money earns interest, or appreciates. The next year, you earn interest on your original money and the interest from the first year. In the third year, you earn interest on your original money and the interest from the first two years. And so on.

How it works with debt

The concept works the same with an investment loan. The interest for the loan is compounded, increasing the loan balance, which in turn increases the interest amount. This interest is tax deductible, so when the interest and balance are increasing so too is the amount you can claim as a tax deduction.

Here are three steps to help you make the power of compound interest work for you.

How it improves with time

Start young. When you're in your twenties and thirties, your best friend is TIME. Start rolling your snowball at the top of the hill and you'll have a much bigger mass at the bottom than someone who started halfway down.

Examples

- Investment of \$2,000 per year earning 6%.

After 20 years	\$74,000
After 30 years	\$159,000
After 40 years	\$311,000

- Consider this: Heidi, a 22 year old university graduate, saves \$300 per month into an account earning 10% per year for six years. (That's the average annual return of the stock market over time.) Then at age 28, she starts a family and decides to stay home with the children full time. By then, Heidi had kicked in \$21,600 of her own money. But even if she doesn't contribute another cent ever, her money would grow to a million dollars by the time she turned 65.

Compare that to Paul, who put off saving until he was 31. He's still young enough that becoming a millionaire is within reach, but it will be tougher.

Examples

- Investment of \$2,000 per year, after 30 years earning 4%, 6% and 8%.

4%	\$112,000
6%	\$159,000
8%	\$311,000

- Paul would have to contribute the same \$300 a month for the next 34 years to earn \$1 million by age 65. Although Heidi invested less money out of pocket (\$21,600 over six years vs. Paul's \$126,000 over 34 years) her money had more time to grow, or compound.

Bottom line: Getting rich is easier and more painless the earlier you start.

How returns make a difference

Remember that a little goes a long way. Don't think you have enough money to start investing? You can get into a good managed fund for as little as \$50 a month.

Let's say a 20 year old stashes \$50 a month into a fund earning 10% annually. He'd have \$528,000 by age 65. Not bad for practically starting with pocket change! A little bit can make a difference elsewhere in compounding, too.

Disclaimer

This Fact Sheet has been prepared for general information purposes only and not as specific advice to any particular person. Any advice contained in this document is General Advice and does not take into account any person's investment objectives, financial situation and particular needs.



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