

Your Money

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How Does Your Money Grow?

I'm 19 years old and I just started working. All I can manage to save at this time is \$500 per month in my credit union. Sometimes I wonder if it's worth it, as my savings seem to grow so slowly. I feel tempted to just spend this money until I can really afford to save more. What you would advise? – Tempted

Congratulations on your decision to start saving some of your income, regardless of how small you think it is. Don't discount the value of your current savings effort. Remember the Jamaican adage, "Every mickle mek a muckle." In financial terms this means that you should be content to save the little you have over time, and eventually you'll get all the money you need.

Last week we looked at three keys to starting a savings plan and ensuring its success: pay yourself first, save at least 10 per cent of your salary, and use automatic deductions to save consistently. Once you've gotten into the savings groove, how can you make your money really grow faster?

In order to understand how money grows we need to discover the secrets of some crucial investing principles. Making money is not a mystery- it just requires a willingness to learn and the discipline to stick to a game plan.

Time is of the essence

The power of time is the most important asset in your favour. The fact that you have started to save so early in life will make up for the small amount of your savings. It really is not about how much you can save, the important thing is how many years you have to make your money work for you.

Let's assume that you've saved up \$2,000 so far, and you continued to save \$500 per month for the next 41 years until retirement age of sixty. If you received a net interest rate of 6 per cent compounded monthly, you would have amassed over one million dollars in that time!

Remember that you're just starting out in the workforce. As you develop your skills you'll be able to earn more and also save more money. If you decided to increase your saving amount by 10 per cent every year, using the above example, you would have more than \$4.2 million in your account in 41 years! The key for you right now is to be consistent and disciplined by continuing to save regularly.

The magic of compounding

It's been said that compounding is the eighth wonder of the world. Compounding is when the interest that you've earned is added to your principal at the end of an agreed period, and this combined amount forms a new principal for the next period. Your principal is what the interest rate is calculated against.

Let's look at compounding at work: assume that you never saved more than the \$2,000 you have now and you left the money in your account for the next 41 years. If you earned a net interest of 5 per cent per annum compounded monthly, the \$2,000 would have grown to about \$15,000 by the time you were sixty. If your money did not compound, \$2,000 at a net interest rate of 5 per cent would only earn \$100 per year or \$4,100 in 41 years.

Find out from your financial institution how often your money compounds. An account in which your saving is compounded monthly will help your money grow faster, than one which compounds every six months or annually. Shop around for investments that compound your interest more often every year.

A per cent more makes a difference!

It is important to consider your interest rate especially when your saving amount is small. We often dismiss the value of an extra percentage point in interest. Using the above example, let's say that you were able to invest your \$2,000 and receive 7 per cent net interest instead over the same period. You might be surprised to learn that the 2 per cent difference would have more than doubled your savings in 41 years, as you would have accumulated over \$33,000. In fact if you were able to double your net interest rate to 10 per cent, your account would be at over \$112,000 by age sixty. This dramatic difference is due to the wonderful power of compounding.

Since your savings will be small at this time, you should seek out investment options that can give you a higher return. However, it's important to note that higher returns can sometimes present more risks for your money. Speak to a financial expert and get advice on investing possibilities that might suit your needs and give you more 'bang for your buck'.

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