

## **Compounding: One Reason Investing Is Fun**

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Over the years, I have heard 'compounding' described as magic, as one of the wonders of the mathematical world. And it truly is. So please read this, meditate on it and come back to me at a later time on this. If you truly understand and you are able to adjust your behaviour to take advantage of compounding's benefits your life can be changed for the better.

Most people seem to have some idea of the concept, and some do fully grasp the implications. However, few seem to act on it in the real world. I have discussed compounding with my kids since they were young teenagers and the eldest, who is now working, is taking advantage of it.

The idea underlying compounding is that your money works for you. Almost 250 years ago Adam Smith described how throughout human history we had almost exclusively only been able to barter our labour for money or other goods. Very few had the capital stock(savings) available to invest. This has certainly changed. Most working people can set aside some savings if they can forgo some immediate gratification. Though this is admittedly often difficult as marketers are so brilliant at triggering our desires.

I think concrete examples can help to reinforce the abstraction of compounding. The two I come back to are the ones I use for my kids and children of clients who begrudgingly sit through my Investing 101 talk to get their parents off their backs. The first is, if a young person can start maximizing their Tax-Free Savings Account once they get their first job and earn 6% per year, how much money would they have at retirement? The number is \$1,266, 050.00 dollars! Starting an automatic savings or a preauthorized chequing program when one gets their first job, would make it simple to start investing and compounding their money by 'paying yourself first'.

The second is another simple illustration using historical data. This is a good one for young people again since it is over an eighty-year time frame and with a young person starting out today and with modern medicine this could be a very real scenario. How much would 1000 dollars be worth if invested in 1940 in the S&P 500 with no new money put in and dividends reinvested. The answer is \$4,650, 000 dollars. That is astounding to most people. We must include the caveat that past performance is no indication of future returns. But it does show the true power of compounding and the importance of time. So, get the young people in your life on board.

Both examples above are programs easily accessible to anyone that can save money. Get going now. Let your money work for you instead of bartering your time and labour for a paycheque. Since the more time you have your money working for you, the better the end results, make an effort to talk about compounding with the young people in your life. They will thank you and remember your wisdom forever.