

CHRISTIAN MONEY \$ENSE

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The Magic of Compounding

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When it comes to saving money for the proverbial “rainy day,” there are a few things which must be considered. First, one must begin early. The earlier one begins to save money in a disciplined manner, the longer funds have to accumulate. Second, remember that a little saved over an extended period of time will amount to much saved. Third, the longer an amount is in the savings vehicle, the more interest is gained on that money. Fourth, when your money is able to compound itself, it will grow at a greater rate. Fifth, the greater the rate of interest, the greater the power of compounding and the growth of your money.

What exactly is compounding? Simply put, compounding is interest earning interest. It is interest which is earned on your original investment (the principal) and its accumulated interest. Every time the amount is compounded, the previous interest is added to the principal. In effect, your principal is increased without investing more money. You can use the power of compounding when your savings vehicle earns interest at regular intervals. By not touching the principal and adding the interest to the principal, you will begin to earn interest on your interest as well as on the principal. If you continue to add money to your savings at regular intervals, the growth is much greater. So over time, a small amount invested or saved regularly will build into a much larger sum.

Let’s look at a couple of illustrations.

- Ten dollars saved each week for 5 years (\$2,600) at 2.5% interest will grow to \$2,760 at the end of 5 years. At the end of 10 years (\$5,200) the amount will grow to \$5,897. At the end of 20 years (\$10,400) the amount will grow to \$13,400. If you save more and invest at a higher rate of interest, the growth is even greater.
- If you were to save \$1,000 per year in a mutual fund that yields 4%, leaving the dividends to compound, in 10 years your investment would be worth about \$12,500. In 20 years, \$1,000 per year

at 8% would be worth about \$31,000. If you were to invest the same amount at 8%, the investment would be worth \$15,600 and \$49,400 respectively at the end of 10 and 20 years.

- If you were to invest \$5,000 per year for 10 years in an investment vehicle that pays 10% interest per year, at the end of 10 years the investment would be worth about \$87,700. If you did the same for 20 years, the investment would be worth \$315,000.

It is easy to see from the illustrations the power of compounding interest over time. So in review, how can you make compounding work for you?

- **Invest Regularly**—Get into the habit of adding money to your savings vehicle at regular intervals whether weekly, monthly, bi-annually, or annually.
- **Invest Early**—The longer your money can work for you, the better compounding works for you.
- **Reinvest**—Do not spend the interest on your savings investment. Reinvest the interest or dividends depending upon the savings vehicle.

Good stewardship of that which God has entrusted to us demands that we are wise in how we save and invest our money. Remember, the purpose of savings is to provide for future family needs and the support of God’s work, not just to accumulate wealth and material things. Let us determine to be the best stewards we can of what God has entrusted to us as well as what He allows us to earn and accumulate. Remember, “For where your treasure is, there will your heart be also” (Matthew 6:21).

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