



The Power of Compounding

Between your monthly rent or mortgage, a car payment, student loans and other bills, it may seem next to impossible to set aside money for retirement.

But even if you can afford to contribute a few dollars a paycheck to your defined contribution (DC) retirement plan, those dollars can make a big difference later.

Why? It's the power of *compounding*.

What Is Compounding?

Compounding is the magic that happens when the money you save earns interest and that interest generates returns of its own. So, you're earning returns on both your initial investment and its returns.

If you start saving earlier rather than later, you'll earn more in compound interest than someone who waits for a few years to start putting money away.

Here's How It Works

Luis and William can save \$1,000 for retirement each year and both invest with an average return of 7%.

Luis starts saving at age 25. He saves for ten years and then decides to stop saving at 35. He has put a total of **\$10,000** in his account (\$1,000/year x 10 years).

William decides to delay saving until he's 35. He keeps saving \$1,000 every year until he retires at age 65. He has put a total of **\$30,000** in his account (\$1,000/year x 30 years).

Who has more at age 65?

Luis does, even though he saved for just ten years. When he reaches 65, he'll have **\$112,500** in his account. William, on the other hand, will have just **\$102,000**.

Tip

Look at your spending habits to see whether there are any small expenses that you pay several times a month. Reducing these little costs can help you save money faster than you think. It's a budgeting cliché, but cutting a \$4 snack or coffee that you buy every workday will save around \$1,000 a year.



Luis has \$10,000 more in his account than William, even though he stashed away \$20,000 less than William. Starting ten years earlier allowed Luis's money to enjoy its compound growth for longer, and that was a huge advantage.

And there's more.

If Luis had kept on saving \$1,000 annually until age 65, his account balance would climb to almost **\$214,500**—more than double William's account balance.

How Much Can You Afford to Save?

If you think about it, that \$1,000 a year that Luis and William decided to invest works out to be a little less than \$40 from a biweekly paycheck. That's the cost of a couple of movie tickets or one nice dinner out.



Note: Assumes \$1,000 annual contribution compounded annually at 7%.

Tools

Savings Goal Calculator

www.investor.gov/financial-tools-calculators/calculators/savings-goal-calculator

Compound Interest Calculator

www.investor.gov/financial-tools-calculators/calculators/compound-interest-calculator



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