Smart Money

SAVINGS | Use 'the sooner the better' system

Don't lose interest

THEO MARINIS

A COMMON question when considering a financial plan is "when should I start to save?" The answer is "as soon as possible".

Quite simply, this is because it's all about taking advantage of compound interest.

Compound interest is the common way interest is calculated. It means that when you earn interest it is added to the original funds and the total amount earns more interest during the next interest period, so basically you earn interest on your interest.

It's a simple idea and one of the most important methods of saving money and investing.

explained ?

And the longer you give compound interest to work, the greater the end result.

To make the most of compound interest, remember that if you leave an investment untouched each year you will earn interest on both your capital and the previous year's interest.

This enables your investment to rise in value at an increased rate – growth speeds up as time progresses so that the last five years growth is greater than the first 30 years.

One of the problems with compound interest is investors don't see a lot of return in the first few years, so the savings are spent before their benefit is realised.

Superannuation savings is also an area that benefits from a compound interest savings strategy. Again, it's 'the sooner the better' to starting saving for retirement.

This is again because the earlier you start, the more you can take advantage of the benefits of compound interest.

Even just a few extra dollars put into your account each week can make a huge difference to your end benefit.

You need to get money into super as soon as you can, as much as you can, for as long as you can.

For example, if you save $2000 a year from age 30 for the next 10 years and then stop, you will have contributed $20,000.

Over the next 35 years (until current retirement age of 65) your investment would grow to $160,000, based on a 7 per cent a year return after tax and fees.

However, if you started saving $2000 a year at age 40 for the next 25 years you would have contributed $50,000. At the end of the 25 years, the investment would only increase to $135,000.

So as you can see the message is simple: time is money.

❑ Theo Marinis is a financial strategist at Marinis Financial Group.

Financial Strategies (SA) Pty Ltd trading as Marinis Financial Group
67 Kensington Road, Norwood SA 5067 T 08 8130 5130 F 08 8331 9161 E admin@marinisgroup.com.au
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