Philequity Corner (Mar. 13, 2006)
By Ignacio B. Gimenez

Time is money, so start early

The most important key to wealth building is to start saving as early as possible. Many young workers today spend most of their salaries on clothes, gadgets, or eating in fancy restaurants. And little, if there is at all, is left for savings/investment. Some even go to the point of *overspending* by making major purchases through debt early on, thinking that they can make up with higher investments in later years. Unfortunately, money does not work that way. Thanks to the *power of compound interest*, cash invested today has a geometric (ever-increasing) impact on future wealth.

To illustrate the point, consider two would-be investors; both assume a retirement age of 60 and a 10 percent compounded annual return on investment.

Jack is 20 years old and decides early on that he will save for his retirement by investing P1,000 every month for 10 straight years before taking it easy afterwards. Nicolas, also 20 yeas of age, decides that he will defer saving until he is 30 years old, but afterwards he will invest P1,000 a month for the rest of his working years.

Upon retirement, Jack would have invested a total of P120,000 and Nicolas would have invested a total of P360,000. Yet, Jack would retire with P4,063,591.66, almost twice the P2,260,487.92 that Nicolas would get.

By investing earlier, not only would Jack increase his money 33 times compared to Nicolas' 5 times, but Jack would have taken only a third of the time (10 years) that Nicolas spent in investing (30 years).

Jack Age	Investment	Nicolas Age	Investment
20	P1000/ month	20	0
21	P1000/ month	21	0
22	P1000/ month	22	0
23	P1000/ month	23	0
24	P1000/ month	24	0
25	P1000/ month	25	0
26	P1000/ month	26	0
27	P1000/ month	27	0
28	P1000/ month	28	0
29	P1000/ month	29	0
30	0	30	P1000/ month
31	0	31	P1000/ month
…	0	…	…
59	0	59	P1000/ month
60 (Retirement)	**P4,063,591.66**	**60 (Retirement)**	**P2,260,487.92**
Less: money invested	(P120,000)	**Less: money invested**	(P360,000)
	P3,943,591.66		**P1,900,487.92**
Money Increased	**33 fold**		**5 fold**

In fact, Jack could even stop saving after the first 5 years and still be ahead of Nicolas upon retirement.

Want to be like Warren?

There's no better example to illustrate the *power of compound interest* than to talk about Warren Buffet. Warren who? For those new to the investment world, Warren Buffett is considered the world's greatest investor. Quoted from Lowenstein's book, **Buffett: The Making of an American Capitalist**, *"In the annals of investing, Warren Buffet stands alone. Starting from scratch, simply by picking stocks and companies for investment, Buffett amassed one of the epochal fortunes of the twentieth century… By virtue of this* ***steady, superior compounding****, Buffett acquired a magical-seeming net worth of $9.7 billion, and counting."*

But that was way back in 1995 when the book was written. Today, Buffett is ranked 2nd richest man in the world (according to the latest Forbes survey) with $42 billion in assets – next only to Microsoft's Bill Gates with $50 billion.

In the same way, the public shareholders who invested with Buffet also got rich. If one had invested $10,000 with Buffet when he began his career in 1956 and stuck with him all throughout these years, that person would have an investment worth $351,419,100 today.

Of course, even by today's standards, $10,000 is way above what a typical Filipino investor can afford to invest. But what if we try to apply Buffett's magic of *steady, superior compounding* to an investment program that even an average Joe can afford?

The Average Joe can …

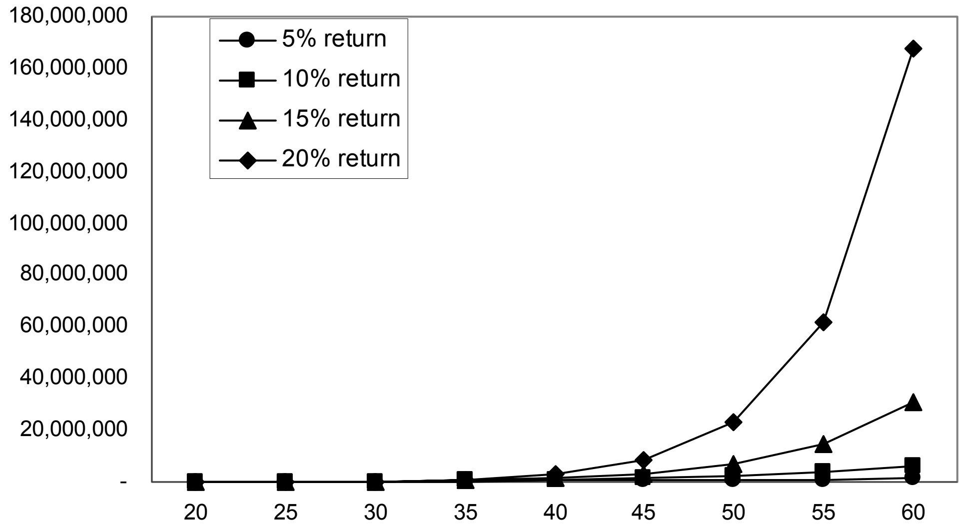
In our previous example, we used a P1,000 monthly investment because we think this is an amount affordable to an average Joe. Even students can afford to save this much, if they just save P50 from their allowance (equivalent to a burger meal or any *merienda*) for just 20 days in a month.

Now, let's assume that an average Joe starts investing at the age of 20. He invests P1,000 a month all throughout his working years up to his retirement at 60 - for a total investment of P480,000.

See how Joe's money grows using different annual rates of return (assumed constant for the next 40 years).

1) **At 5 percent** - If Joe places his money in time deposit with a much higher rate of 5 percent, he would get P1,526,020.16 upon retirement. At this rate, Joe would have increased his investment 2-fold.
2) **At 10 percent** – If Joe places his money in a combination of equity and fixed income funds earning a compounded annual return of 10 percent, he would end up with P6,324,079.58.
3) **At 15 percent** – If Joe places his money in an aggressive equity fund earning a compounded annual return of 15 percent (which is very good by today's standards), Joe would end up with P31,016,054.77.
4) **At 20 percent** – If Joe places his money in a superior equity fund consistently earning a compounded annual return of 20 percent (among the world's best by today's standards), Joe would retire a multi-millionaire with P167,384,879.55.

Joe Millionaire's money upon retirement



The graph above illustrates the magical powers of compound interest. The longer the investment period and the higher the rate of return, the greater will be geometric growth of your investment. The end figures themselves are almost inconceivable especially when investments are made over a long period of time.

So, is Warren Buffett's secret then just a simple hat trick? Turning $10,000 in 1956 to more than $350 million by 2006 is just equivalent to earning an annual compounded return of slightly over 23 percent.

It may not seem that daunting, especially since the PHISIX itself has gained an average of 26 percent for the past 3 years. However, Buffett's magic not only lies in delivering high returns but on consistently delivering high returns – and for half a century at that.

Realistically, even if average Joe's returns are half or even a third as good as Buffett's, he will still end up as Joe Multi-millionaire upon retirement. And so can you. The key is to start early and to invest regularly. So what are you waiting for?

For comments and inquiries, you can email us at gime10000@yahoo.com or info@philequity.net.