



**Shannon Davis, CRC®,
 NSSA®,** *Financial Advisor*
 Office: 312.701.1100 x265
 Voice: 234.802.2296
 Text: 440.740.3300
 sdavis@
 retirementplanadvisors.com

Phil Holstrom, MBA,
Financial Advisor
 Office: 312.701.1100 x267
 Voice: 513.288.4024
 Text: 513.802.9705
 pholstrom@
 retirementplanadvisors.com

Edward S. Kindler III,
Financial Advisor
 Office: 312.701.1100 x273
 Voice: 614.756.9292
 Text: 614.779.0999
 ekindler@
 retirementplanadvisors.com

Saving Early & Letting Time Work For You

As a young investor, you have a powerful ally on your side: time. When you start investing in your twenties or thirties for retirement, you can put it to work for you.

The power of compounding. Many people underestimate it, so it is worth illustrating. Let's take a look using a hypothetical 5% rate of return.

How does it work? A simplified example goes like this: Let's take a look using a hypothetical 5% rate of return on a principal of \$100. After a year, you earn 5% interest, or \$5. Another year, another 5%, which adds \$5.25 this time. In the third year, your 5% interest earned amounts to \$5.51, bringing your balance to \$115.76. The more money you deposit, the greater that 5% returns. Let's look at another hypothetical example. If you were to start with a \$1,000 principal in an account that earns 5% interest per year, and contribute \$1,000 a year to the account, you would end up with a total of \$7,078.20 after five years. That's a total of \$1,078.20 earned in compound interest from \$6,000 in contributions. That compounding continues, even if you stop making deposits. All you really need to do is let that money stay put.⁽¹⁾

The earlier you start, the greater the compounding potential. If you're investing for retirement in your twenties, you may gain an advantage over someone who waits to invest until his or her thirties.

Even if you start early & then stop, you may be in a better position than those who begin later. What if you contribute \$5,000 to a retirement account yearly starting at age 25 and then stop at age 35 – with no new money going into the account for the next 30 years. That is hardly ideal. Yet, should it happen, you still might come out ahead of someone who begins saving for retirement later.

Citations:

1. This is a hypothetical example used for illustrative purposes only. It is not representative of any specific investment or combination of investments.

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