



Compound Interest: Money, Relationships, What Else?

To borrow from Investopedia, Compound Interest = 'the interest on a loan or deposit calculated based on both the initial principal and the accumulated interest from previous periods.'

Compound interest is a very powerful tool for your money. I'm going to talk about where your money can earn compound interest and at what frequencies. I will also explain how compound interest can work in other facets of life and where I believe it's most important.

'Interest on interest!' Interest can be compounded daily, weekly, continuous, annually, etc.

To make sure its power is understood let me give a quick example:

You have \$5,000 in an account. It grows in your savings account at 5% APR interest compounded monthly. After the first month it grew by \$20.83. At the start of next month you begin with \$5,020.83. For the second month it grows by \$20.92. That extra \$20.83 helped it grow an extra \$.09, but it has a snowball effect. By the twelfth month you would have an extra ~\$6 because of interest being compounded monthly instead of say annually.

The more money, the more interest, the more time, and the more frequently the money is compounded means the greater the power of compounding interest.

- To strategize and maximize your finances and compound interest: start early, save continuously, save more, find the best interest rates, and save into accounts that compound most frequently.

As the old Chinese proverb states: "The best time to plant a tree was 20 years ago. The second best time is now."

What type of accounts provide compound interest?

- Savings & Money Market Accounts: Daily
- Certificates of Deposit (CD): Daily or Monthly
- Series I Bonds: Semiannually
- Loans: Typically monthly
- Credit Cards: Daily
- Zero Coupon Bonds



Annually Semi-annually Quarterly Monthly

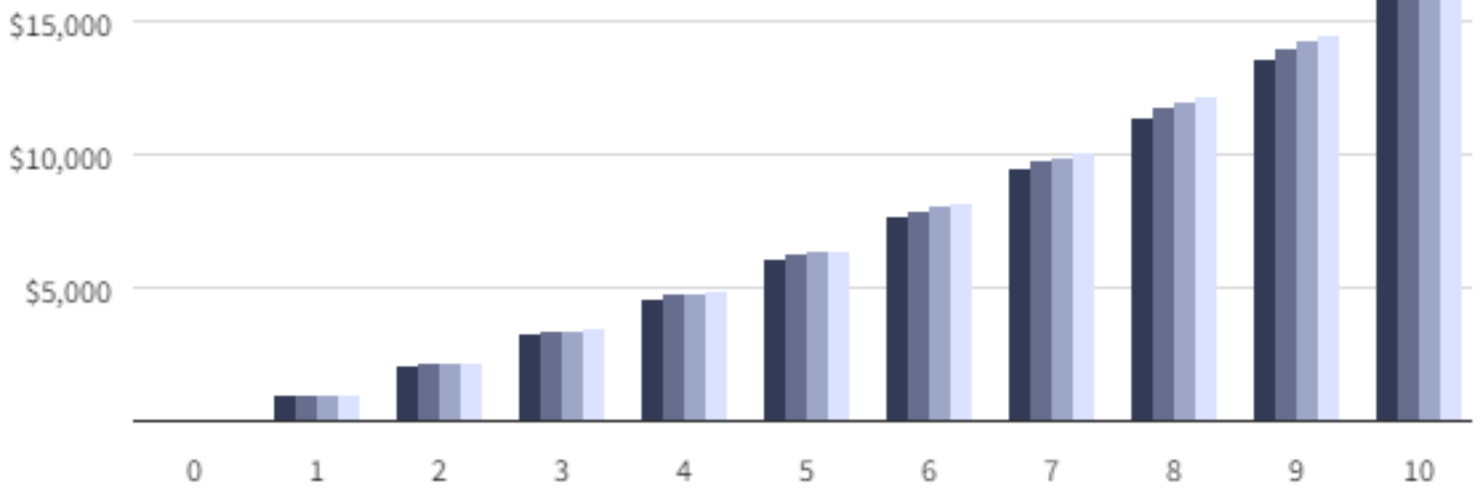


Chart: Investopedia

Investopedia

Compound interest is either building or digging a hole for you. Savings builds up your account while debt digs a hole, especially credit card debt that compounds daily!

The opposite of compound interest is Simple Interest = interest is charged based on the principal only. You are NOT paying interest on interest. Auto loans, mortgages, and other short-term loans typically use simple interest.

Here's an example:

Auto Loan at 2.99% on \$14,000. As you pay down the principal your portion of interest also begins to decrease. The interest each month does not charge interest on itself ever, but only on the new principal balance each month. Simple interest charged monthly based on the changing principal balance.

You want compounding interest at the highest frequency for your savings and simple interest for your debt. Typically these details can be found when signing for a loan or setting up the savings account.



Investments in stocks do not necessarily have compound interest because they are shares that fluctuate in value.

Dividends can be seen by some as a type of compound interest. I would not agree as I see reinvesting dividends as just saving more into your account.

Compound interest needs to be interest earned on interest. Dividends are like the fruit from a tree whereas compound interest is like the seeds from weeds. Seeds produce more weeds. Fruit does not produce more fruit.

Relationships, skills, practice, education & compound interest.

We all have limited time. And we all have the same amount of time. We also have a limited amount of resources. However, compound interest works in our lives just as it does with our money. The more we invest in our own education, our relationships, our skills, then the more growth we see in our life. Likewise we may see certain parts of our life such as our skills become stale if we let them sit there without compounding interest. How can you help your relationships, education, and skills be compounding interest?

Time = Money. Time = Relationships. Time = Education.

Compound interest in our life is a balancing act.

Do we spend more time with Family? Work?
Projects? Education? Money?

A refreshed and simplified financial life allows you to open up your time, clear your head, and save in accounts with compound interest in the most important things in your life, not simply your finances.

Money is not the end goal, it's the means to open up quality time in doing what you cherish most.

"When you coming home, dad?"
"I don't know when"
But we'll get together then
You know we'll have a good time then
.....
I've long since retired, my son's moved away
I called him up just the other day
I said, I'd like to see you if you don't mind
He said, I'd love to, dad, if I can find the time
You see, my new job's a hassle, and the kids have
the flu
But it's sure nice talking to you, dad

- Cat's in the Cradle by Harry Chapin

A Recent True Story:

A man attended a client's son's birthday. It was an exciting and happy 18th birthday for the soon to graduate young man. However, as the man approached his client (the father of the 18 year old) he found a sad demeanor. The father expressed his sorrow because he realized his son was now grown up and the father had missed a lot of time and opportunities to grow with his son. He had worked and saved so much that time had passed without him spending the time he had wanted with his son, time he could never get back.



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