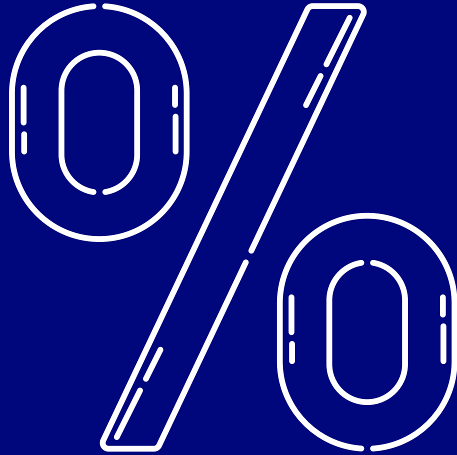
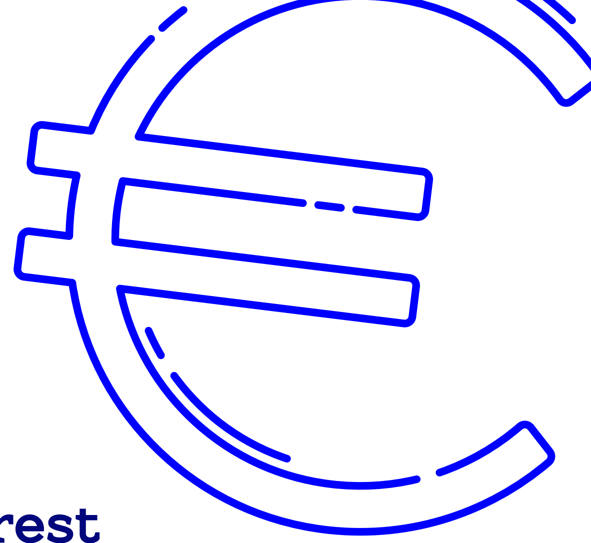
Begin



The power of 'C', Compound Interest the eighth wonder of the world

Bank of Ireland



The power of ‘C’, Compound Interest the eighth wonder of the world

Probably the last time you heard the term “compound interest” was in school? And now, all of a sudden, a financial advisor is telling you that your investment will grow over time due to the effect of compounding!

Confused? Well, you may not be alone! However, it’s vital that we get our heads around this terminology and concept as it can be so fundamental to your financial wellbeing.

“Compound interest is the eighth wonder of the world.
Those who undertand it are destined to collect it.
Those who don’t, are doomed to pay it”

Albert Einstein

Most people think of interest as a cost on what we pay for borrowing when we take out a loan. But interest can work in your favour too, especially when you are in a position to earn it.

And if you want your money to grow, you need to consider finding something other than deposits for a portion of what you own. This might feel uncomfortable and a bit alien to you but it is important to remember the words ‘a portion’. In other words, it’s giving some of what you have, a chance to deliver growth while the remainder remains static. For example, when it comes to saving and investing, compound interest is especially powerful.

Compound interest is the phenomena where your original investment earns a return, this return is added to your original investment amount, and future returns are earned on the (higher) amount. This helps make your investment grow at a faster rate. Time can decrease your risk while increasing your reward. Allowing plenty of time to get to a destination is always a good strategy. When it comes to investing, the more time you have, the more you can benefit from compounding - the snowball effect that happens when you receive returns on your original capital plus accumulated returns. In this way your money can grow faster and faster as the years go by. The longer you keep your money invested, the better your chance of overcoming the inevitable market wobbles.

“Based on past history, if you invested in the stock market for 1 year, your chance of losing money would be greater than 1 in 4. But if you invested for 10 years, that number would drop to about 1 in 25 and after 20 years the risk of suffering a loss falls to zero “

Warning: Past performance is not a reliable guide to future performance.

Quick question for you. Would you rather have:

1. €10,000 a day for 30 days or
2. A cent that doubled in value every day for 30 days?

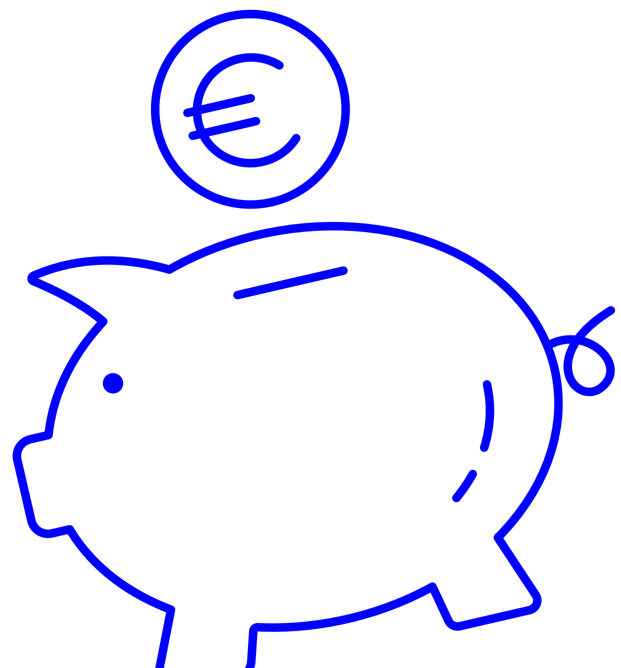
So after 30 days, option 1 would give you a total of €300,000, whereas option 2 would give you about €5.4m (€5,368,719)

Growth doesn't just come from your assets increasing in value, it also comes from reinvesting the income they earn. The chart below shows how a slightly higher growth rate, can have a really meaningful impact on your investments over time, e.g. €10,000 invested at a 2% return gives €12,189 after 10 years, but €17,908 at 6% return over 10 years.

€10,000 invested for different periods at different annual returns					
Annual Return	2%	4%	6%	8%	10%
10 years	12,189	14,802	17,908	21,589	25,937
20 years	14,859	21,911	32,071	46,610	67,274
30 years	18,113	32,434	57,434	100,627	174,494
40 years	22,080	48,010	102,857	217,245	452,592
50 years	26,915	71,067	184,201	469,016	1,173,908

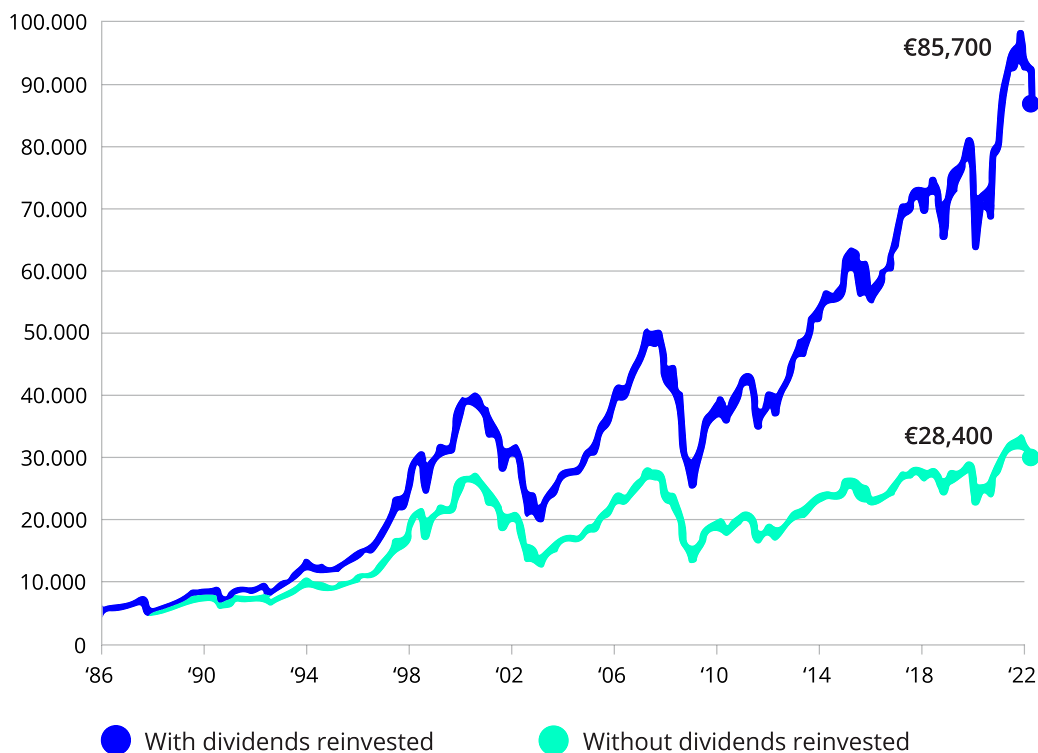
Source: Bank of Ireland

Warning: These figures are estimates only. They are not a reliable guide to the future performance of your investment.
Warning: The value of your investment may go down as well as up.



Let's look at a real example from stock market investing. When we invest, we hope to benefit from the capital value rising but also that it earns income. When we hold property, it earns rental income. While bonds usually generate what are called coupons. Company shares can often pay healthy dividends, which is your portion of the profits the business earns. If you re-invest income in more assets, you can compound your growth. The chart below shows a real example where we compare the growth in an investment in European shares with and without dividend re-investment. The difference can be considerable. In this case, it is growing a €5,000 investment to over €85,000 when dividends are reinvested versus growing it to €28,000 without dividends reinvested.

The Effects Of Compounding



Source: JP Morgan Asset Management

Warning: Past performances is not a reliable guide to future performance.
Warning: These figures are estimates only. They are not a reliable guide to the future performance of your investment.

Of course, with all investments there is a risk that the returns will fluctuate, you may suffer declines in the value of your investment and you may get back less than what you invested. But good advice and long-term planning can reduce these risks. Remember future returns are not guaranteed.

Finally, all investment strategies require planning and patience. But remember, it is the power of compounding that will do a tremendous amount of work in building your portfolio, regardless of whether that is through a pension or regular investment. It's the reason why investing can be a superior means of achieving personal money goals, building wealth and taking advantage of the market's potential for growth.

Talk to us today

"Arrange your investment meeting in the way that suits you"

Call us on 01 5119702*

Drop into your local branch

Arrange a call back or start your investment online. Visit boi.com/exploreinvesting

bankofireland.com/exploreinvesting

*Calls may be recorded for service, verification, analysis and training purposes.

The information contained in this article has been prepared by Bank of Ireland ("BOI") for information purposes only and is not meant as advice. BOI believes any information contained in the article to be accurate and correct at the time of publishing.

Life assurance and pensions products are provided by New Ireland Assurance Company plc., trading as Bank of Ireland Life. New Ireland Assurance Company plc., trading as Bank of Ireland Life is regulated by the Central Bank of Ireland.

Advice on Bank of Ireland Life products is provided by Bank of Ireland, trading as Bank of Ireland Insurance & Investments. Bank of Ireland trading as Bank of Ireland Insurance & Investments is regulated by the Central Bank of Ireland.

Bank of Ireland is a tied agent of New Ireland Assurance Company plc trading as Bank of Ireland Life for life assurance and pensions business.

Members of Bank of Ireland Group.

Information correct as at November 2022.

Bank of Ireland