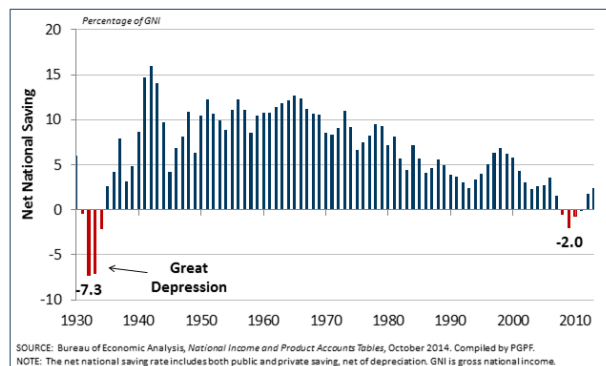


As investment managers we sometimes take it for granted that the power of saving and investing is clearly understood. But we shouldn't assume anything. The national savings rate in the United States has averaged well below 5% for a decade or more (see chart to the right), and today's rate of roughly 3% will do nothing to help people retire, pay for college, or even buy that 1960's Dodge Dart we used to have as a kid!! For example, if you are lucky enough to earn \$100,000 a year and you save only 3% by putting it under your mattress, it will take you over 33 years to save up just one year's salary. This isn't going to pay the bills in retirement!!



So how do you turbo-charge your savings? First, saving more is never a bad idea. The 10% rule of thumb has been with us for years, and for most people that is still a decent rule to go by. If you can set aside 10% a year from an early age you stand a decent chance of retiring comfortably and meeting some of the other goals many people have (paying for college being the most common). However, simply setting money aside will leave many of us short. To truly succeed we need to harness the Power of Compounding.

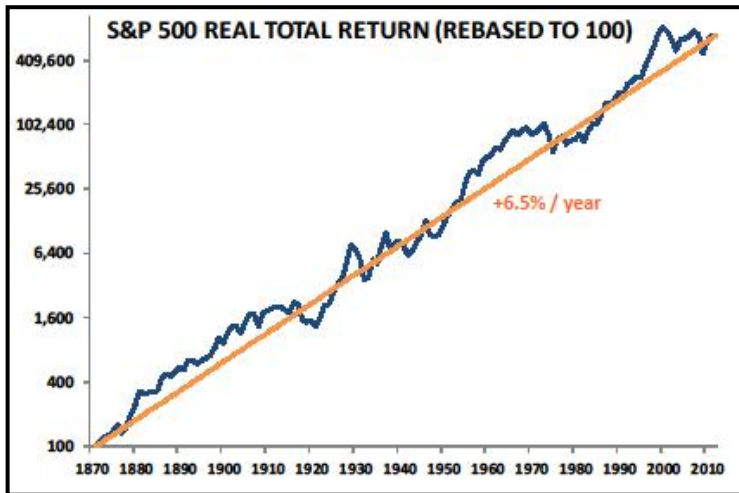
The Power of Compounding

Albert Einstein is meant to have said that “**Compound interest** is the eighth wonder of the world. He who understands it, earns it...he who doesn't...pays it.” Far be it for us to argue with Einstein. An easy way to show what he meant is to put numbers on the dynamic. The table below shows you how a single investment of \$100 will grow at various rates of return. For example, \$100 set aside at age 15 will grow to \$1,147 by age 65 if it earns 5%. At a rate of 20% the same \$100 will grow to a staggering \$910,044.

Age	5%	10%	15%	20%
15	\$100	\$100	\$100	\$100
20	\$128	\$161	\$201	\$249
25	\$163	\$259	\$405	\$619
30	\$208	\$418	\$814	\$1,541
40	\$339	\$1,083	\$3,292	\$9,540
50	\$552	\$2,810	\$13,318	\$59,067
60	\$899	\$7,298	\$53,877	\$365,726
65	\$1,147	\$11,739	\$108,366	\$910,044

What's happening in the above example is that the investment gains are earning money, helping boost returns. For example, in the first year the \$100 investment earns \$5 when a 5% return is realized. In the second year not only does the \$100 investment earn another \$5, but year 1's earnings (\$5) also earn a return (in this example 5% of \$5 is \$0.25). So the investment return goes from \$5 in year one to \$5.25 in year 2. Over time the original investment can mushroom quickly as these earnings garner their own return (they compound).

Of course returns of 15% or 20% only come by taking a lot of risk. Returns on the S&P 500 can be found going back to 1870 (see Robert Shiller's site at: <http://www.econ.yale.edu/~shiller/data.htm>). The chart below shows that over this period the S&P has compounded at 6.5% a year after **inflation** (say 9% returns before inflation).



Clearly these returns are not risk free (think 1929 and 2008). But for those investors who can stomach the volatility, the compounding power of the U.S. equity market has been huge (roughly similar to the 10% column in the table above).

For those with less tolerance for risk, high income stocks, corporate bonds, and even government bonds can play an important role in building a portfolio that can compound over time. We address the different investment options in the next section, Types of Investments.

The power of compounding is the single most important reason to start investing early and to continue investing throughout a lifetime. Getting to the point where your money is working for you is essential if anyone wants to achieve lasting financial security and stability.