

# multiplier effect

LONG-TERM INVESTORS KNOW THAT COMPOUNDING INTEREST IS ONE OF THE BEST WAYS TO GROW THEIR WEALTH OVER TIME.

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Simply put, compound interest pays interest on your principal with a twist. Unlike simple interest that calculates interest based on a fixed rate, compound interest allows you to grow your money further. This is because the interest you've paid initially, adds up to and becomes part of the principal that accrues interest during the next period. So what you have is a continuously growing principal amount without you having to make another deposit.

If you choose to make regular deposits to go along with your automatically-growing principal, over time, the results can be positively staggering. Compound interest makes your money work diligently for you by continually feeding upon itself to grow at a substantially faster rate than with simple interest. It's a great concept to ponder on when you think about investments, but a dreadful thought if applied to your debts.

It's no wonder that Albert Einstein called compound interest "the eighth wonder of the world". Every savvy investor, when given a choice between a good investment with compound interest and a great investment with simple interest, will pick the good investment every time.

They know that over time, the investment that compounds will outperform the other. After all, an Investment should be defined as an instrument with a two-fold purpose:

1. To generate income
2. And to increase in value over time.

Hence, if you "invest" a lump sum (known as capital), you should get regular small payments of some kind while the actual value of the capital itself increases. So the lump sum you get in the end should equal to a much bigger amount.

## THE BEAUTY OF COMPOUNDING INTEREST

In forex trading, the role of compounding interest is ever more significant. Let's say you start off with a capital of US\$3,000. The capital then generates a return of five per cent every month. Over one year, the investment would look like this:

Start:	US\$3,000
1 <sup>st</sup> month	US\$3,150
2 <sup>nd</sup> month	US\$3,308
3 <sup>rd</sup> month	US\$3,473
4 <sup>th</sup> month	US\$3,647
5 <sup>th</sup> month	US\$3,829
6 <sup>th</sup> month	US\$4,020
7 <sup>th</sup> month	US\$4,221
8 <sup>th</sup> month	US\$4,432
9 <sup>th</sup> month	US\$4,654
10 <sup>th</sup> month	US\$4,887
11 <sup>th</sup> month	US\$5,131
12 <sup>th</sup> month	US\$5,387

Here's where the significant effect of compound interest can be seen more tangibly. In the first month, the return of five per cent a month yielded a profit of US\$150 (from US\$3,000 to US\$3,150).

In the last month of the year, the return of five per cent a month yielded a profit of US\$233 (from US\$4,654 to US\$4,887). In retrospect, the "investment" didn't have to work any harder to generate the extra absolute return.

With simple interest, this investment would only generate a total return of 60 per cent a year. However, with compound interest, the investment would generate a handsome return of 79.59 per cent a year – almost 20 per cent more than if simple interest was used!

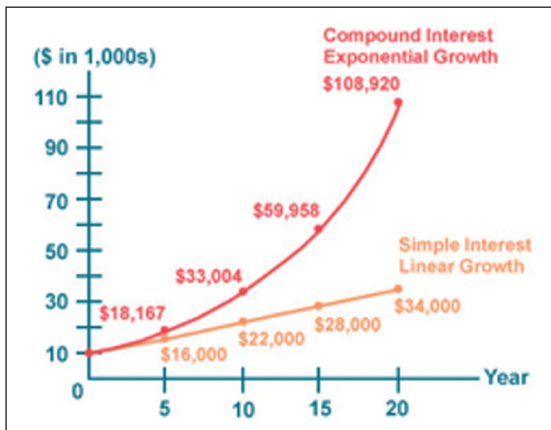
Over time, the magic of compound interest can be truly mind-boggling. Your investment would look like this:

Start:	US\$3,000
1st year	US\$5,387
2nd year	US\$9,675
3rd year	US\$17,375
4th year	US\$31,203
5th year	US\$56,037
6th year	US\$100,635
7th year	US\$180,726
8th year	US\$324,559
9th year	US\$582,861
10th year	US\$1,046,735

Here's the bad news: If you start much later, you would need to start with a small invested amount of US\$3,000 to see a significant return of US\$1 million in 10 years. Here's the good news: If you start investing early, you would only have to start with a higher initial capital to reach the same goal.

As an example, if you start investing five years later, and want to achieve the same financial results, you would have to play "catch-up" and start-off with an invested amount of US\$56,037.

There's now only one question left in your head: "Which investment can give me a compounded return of five per cent a month?" Lean a little closer and I'll tell you: forex trading. If the best time to start trading forex was three years ago. Then the second best time is now. **SI**



Mario Singh is the co-founder and CEO of FX1 Academy, a pioneer in retail forex education. For more information, visit [www.fx1academy.com](http://www.fx1academy.com)