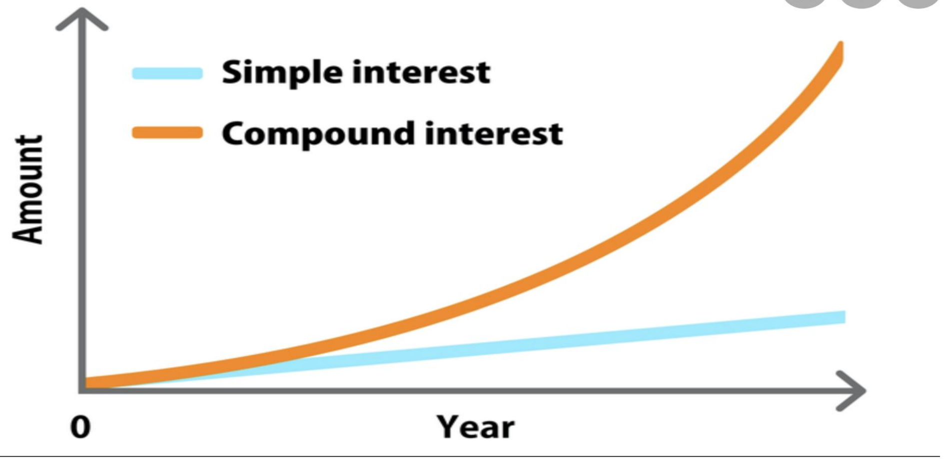
Introduction to Compound Interest and Stock Market Investing

DividendStockpile.com

Multiply Your Money

Albert Einstein once described compound interest as the “eighth wonder of the world,” saying, “he who understands it, earns it; he who doesn’t, pays for it.”

Compound interest is when the interest one earns on a principal balance is reinvested and generates additional interest.



Compound Interest In Action

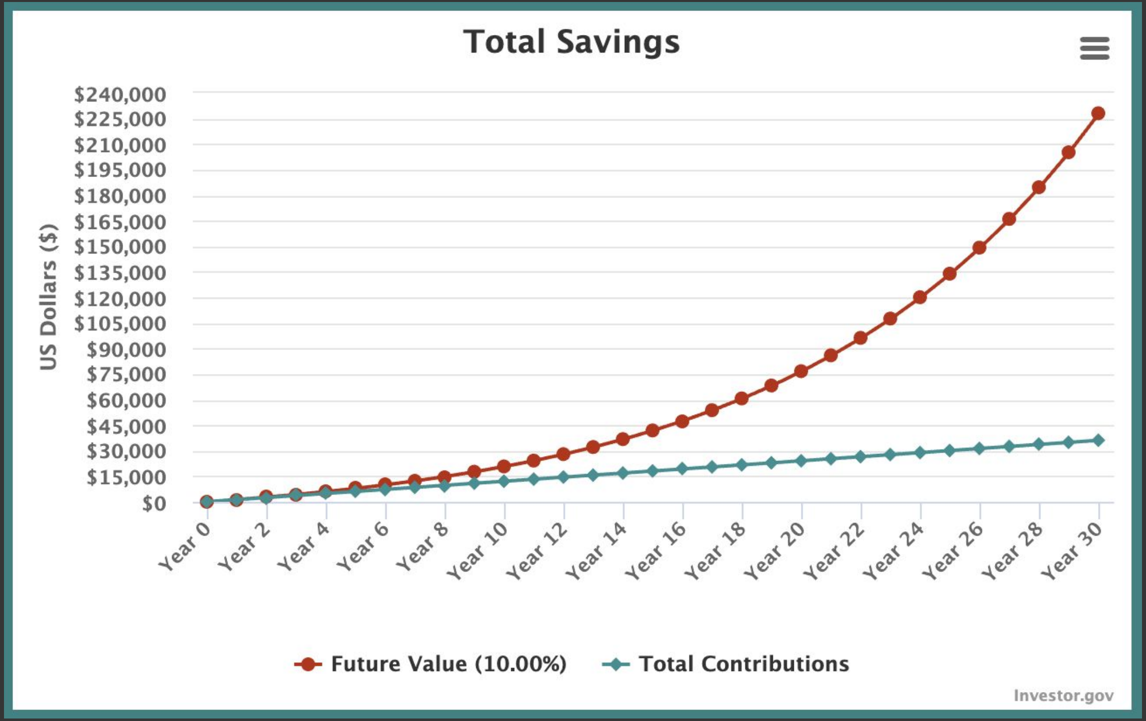
Scenario 1: Start with $100, invest and earn 8% a year in compound interest

	$ Change from previous year
Year 1 - $100 x 1.08 = $108.00	$8
Year 2 - $108 x 1.08 = $116.64	$8.64
Year 3 - $116.64 x 1.08 = $125.97	$9.33
...	...
Year 10 - $199.89 x 1.08 = $215.89	$16

How much would you have if you invest $100 a month for 30 years if you get 10% return?

Any Guesses?

$228,032.53!

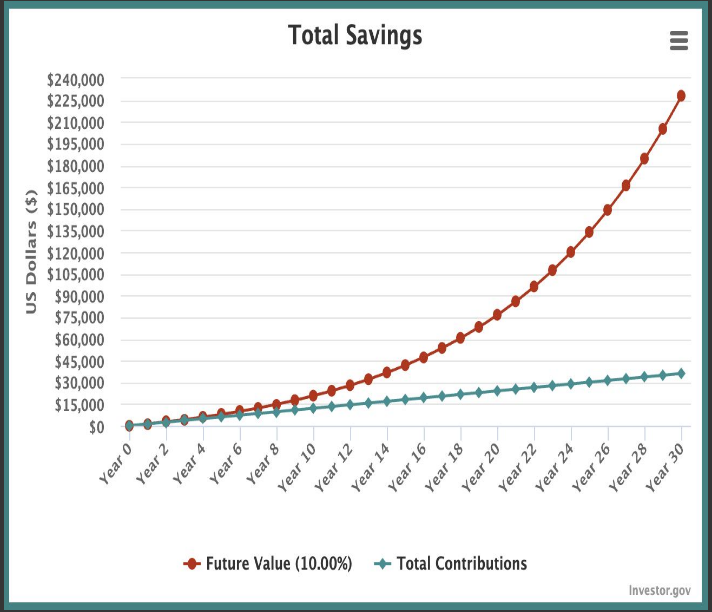

Total Savings
US Dollars ($)
$240,000
$225,000
$210,000
$195,000
$180,000
$165,000
$150,000
$135,000
$120,000
$105,000
$90,000
$75,000
$60,000
$45,000
$30,000
$15,000
$0
Year 0
Year 2
Year 4
Year 6
Year 8
Year 10
Year 12
Year 14
Year 16
Year 18
Year 20
Year 22
Year 24
Year 26
Year 28
Year 30
Future Value (10.00%)
Total Contributions
Investor.gov

You Invested:

$100 + ($100 x 360) = $36,100

You have:

$228,032.53!



How much would you have if you save that $100 a month for 30 years in a savings account if you get 0.5% return?

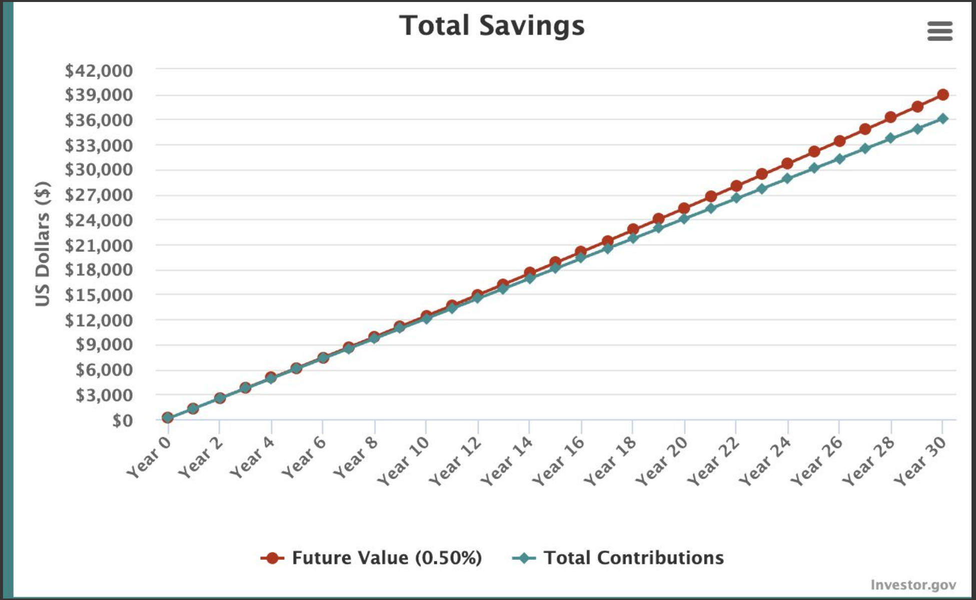
Any Guesses?

You Saved:

$100 + ($100 x 360) = $36,100

You have:

$38,947.69!



Let's get a little crazy

How much would you have to invest each month starting at age 16 to have $2 million at retirement?

Any Guesses?

$127 a month - that is it!

Your ending balance could be **$2,006,913!**

The power of compound interest over time is incredible!

So, how can you start this powerful force?

The answer is investing in the stock market.

The U.S. Stock Market

Since 1929, the U.S. Stock Market has returned an average of 10% a year!

Saving vs. Investing

- What’s the difference?
- When should each be used?
- Benefits and risks

Saving

Put money aside from your income into a bank account

- **When to use**

  Use savings for short term needs

  Typically for expenses that may come due in up to 3 years

  Examples: emergencies, buy a car, travel, computer/electronics

- **Benefits**

  Guaranteed to keep its value

  Available immediately

- **Risks**

  Inflation reduces your buying power over time

Investing

Use a portion of your savings to buy ownership in companies through the stock market

- **When to use**

  Investing should be for long-term needs and timelines

  Typically for future needs that may come due in more than 3 years

  Examples: retirement, college education, home purchases

- **Benefits**

  Historically increases in value more than inflation and higher than savings

  Can provide income

- **Risks**

  The stock market can be volatile and you can lose money

Only invest money in the stock market that you do not need in the short term.

The stock market (and stock prices) fluctuate up and down and you don't want to need to use the money when there is a downturn.

Tip

Historically, there has never been a 20 year time period in the U.S. stock market that the market was down.

Invest for the long term!

OK, So How Do I Invest?

1. Open an investment account at a brokerage company
2. Research the type of investments you want to make
3. Add money and choose your investments

Brokerage Companies

In order to invest in the stock market, you have to open an account with a brokerage company. <u>A brokerage account is not an investment, it is only the vehicle you use to make a stock investment.</u>

You can choose a few types of investment accounts within the brokerage: taxable account, retirement account, college savings, etc.

Taxable: You can use the money any time, but you get taxed on any gains and dividends (more about this later)

Retirement: Tax-Free or tax-deferred, but there are restrictions on when and how you can take the money out. Examples are IRA and ROTH IRA

College Savings: Use the proceeds of your investment for college related expenses. Called a 529 College Savings Account.

Brokerage Companies

There are a lot of great brokerage companies, you need to find one that you like and meets your needs. Here are some features you should look for.

Free Trades: You no longer should have to pay to buy and sell stocks.

Research Tools: There are many investment choices, it helps to have research tools to help you identify good investments

Customer Service: This is your hard-earned money, make sure you can talk to someone at the brokerage company if you have questions or concerns

Some options include: Fidelity Investments, Charles Schwab, TD Ameritrade, M1 Finance

Types of Investments

Once you have your account open, the world of possible investment options is open to you. There is no one way to invest, you can pick the investments that fit your goals, timeline, and risk tolerance

Exchange Traded Funds (ETF):

- A premade basket of companies that you can buy all together.
- Provides instant diversification and easy to do.
- You don't have to do much research and will get average returns.
- Most have a small annual fee that is paid to the company who runs the ETF
- Examples: VOO, VTI, SCHD, DGRO

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Individual Stocks:

- Direct ownership in companies.
- You can pick to own any of thousands of companies.
- Requires more research to understand if a company is worth investing in.
- Investing in a single company can be risky, you should look to create a portfolio of 20-30 individual companies or more.
- Have the chance of higher returns than the overall market, but more risk

Types of Investments

There are two main ways to make money in stock investing: Growth Investing and Dividend Investing

Growth Investing:

- Buy shares of companies and sell in the future at a (hopefully) higher price
- Only make money when you sell. While you hold the stock you have "unrealized" gains or losses
- Have to sell your stocks to use the cash

Dividend Investing:

- Buy shares of companies that pay you a share of the profit every month, quarter, or annually
- A dividend is a cash payment to the owners of the business, you don't have to sell to use the cash
- You can use the cash when it is paid or you can use it to buy more shares of the company, increasing your ownership and value of your investment

Add Money and Choose Your Investment

Once you have opened your account and have done your research, you are ready to invest!

You can buy investments a little at a time, called Dollar Cost Averaging, or all at once, called Lump Sum.

Dollar Cost Averaging: the practice of investing a set dollar amount at regular intervals. This systematic approach will buy more shares when the price is low, and less shares when the price is high, but it averages out over time. This method will avoid using all of your money at once in case the stock prices fall

Lump Sum: the approach to buy all your stocks at one time when you have the money. This will get the money in the investment quickly but you could risk buying at a high price.

The most important thing.

Remember to invest for the long term with money that you will not need in the next few years.

Tip

The longer you hold an investment, the higher chance you have of letting compounding grow your money!

Good luck!

Main Takeaways:

1. Compound Interest is amazing
2. Investing is the best way to let compound interest help you
3. Invest for the long term
4. The sooner you start, the more time compounding has to work

website: www.DividendStockpile.com