Compounding Tips to Reach $200,000 or More!

Description

As most established investors are aware, the ability to compound money over time is one of the most important aspects to becoming a successful investor. Although the initial sum of X can take a long time to build up, the time to double that is almost always shorter, then shorter again to triple it, and so on. While patient investors are keenly aware of this, newer investors can sometimes use a quick explanation and path to reach the goal.

Starting with $0, an investor making annual TFSA (Tax-Free Savings Account) contributions of $5,000, while compounding the balance at a rate of 12%, will need almost seven years to reach $50,000. Breaking the numbers down, the contribution will total $35,000, and $15,000 will come from the returns. Let’s take $50,000 as X.

Starting now with $50,000, the time to reach $100,000 will be no more than four years, assuming the rate of return is a consistent 12% and contributions remain $5,000 annually. To move the needle by another $50,000 ($100,000-$50,000), an investor will contribute only $20,000 and receive $30,000 in returns. Remember, the returns are on the entire balance, not just the new contributions.

The same investor begins with $100,000 and needs to hit the $150,000 mark. At a rate of return of 12% and annual contributions of $5,000, the time frame is down to fewer than three years. The tighter time frame translates to no more than $15,000 in contributions and $35,000 in returns.

Lastly, to quadruple the original $50,000, the investor will need only two years with $10,000 in contributions and 12% in returns, which translates to growth of almost $40,000.

Let’s look at this exercise from start to finish. The total time frames between Xs were seven years, four years, three years, and two years, a total of 16 years. It is important to consider that the money doubled over the past four years, while in the first seven years, the growth was a total of $15,000, or 30%, of the ending $50,000.

While this exercise may not be encouraging to all, it is meant to encourage investors to start early. While $50,000 may seem exciting early on, the reality is that $50,000 for an investor with a $1,000,000 portfolio is no more than 5% of the balance. With enough time, we can all reach the $1,000,000 mark.

The hardest part is, of course, hunting down an investment that will return the required 12%. Taking Canada's biggest corporation as an example, shares of **Royal Bank of Canada** (TSX:RY)(NYSE:RY) have returned a total price return of 66% over the past five years in addition to the dividend. Currently, the dividend sits a little over 3.5%. For investors doing the math, the average annual return is north of 16%!

While investors can't expect the returns of any company to repeat over time, investors are justified in searching for an investment where good investments have been found before.

Put another way: if you pan for gold, you don't go to another panner's river; you find another river close by.

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