COMPOUNDING INTEREST AND RETURNS

Compounding Interest:

- **Compounding interest** is every investor's best friend. Suppose you invest $100 in a fund with a fixed 5% annual return. After one year, the investor will have 5% of the $100 added to his or her account. Here, that's $5. That means, at the start of year two, the investor will actually have $105. In year two, the investor again gets 5%, but this time instead of 5% of $100, the investor receive 5% of $105 or $5.25 meaning the fund grows to $110.25. In year three, the investor receives 5% of $110.25 or $5.51, bringing the balance to nearly $116. For doing nothing more than leaving the money in place, the investor received almost $16 in 3 years.

Compounding Returns:

- If, instead of $100, the amounts are increased to $10,000, the investor begins to build $500 in year one, and $525 in year two. Unfortunately, finding that sort of return isn't so simple. Only fixed income investments, produce a set rate of return. Currently, fixed income investments bring low rates of return. Most investors opt to invest in funds that purchase shares of stock in companies or a mix of stocks and other investments. The returns are not fixed and far from certain, but generally, over many years should still show a compounding return.