

Compounding Wealth

Published on: 1 March, 2019 | Author: Investment Team

One of our analysts was contacted by a millennial friend of his about an 'investment opportunity'. The promoters of this scheme claimed you could make 10% a month, guaranteed. There is however, quite literally, not a single sliver of truth in the phrase "10% a month, guaranteed".

First, very few things in life are guaranteed and investment returns are certainly not one of them.

Second, 10% a month on an investment of £1,000 will grow to £28 billion after a short span of 15 years, making such an investor the wealthiest person in Britain. If someone is making such a claim, reach for your calculator, not your wallet. Claims of extraordinary returns can be disproved with simple maths.

Compound interest is a very powerful force and a good understanding of it can improve investment returns and also reveal the limits of growth. There is a legend about the person who created the boardgame of chess. When the inventor showed it to the emperor of India, the emperor told the inventor to name his reward. The inventor asked for a grain of rice in the first square of the chessboard followed by two grains of rice in the next, four in the next and so on, continually doubling the amount of grains for all 64 squares. The emperor was shocked by the seemingly humble request of the inventor but promised to grant his wish.

However, doubling the amount of rice on each chessboard square 64 times creates 18 billion billion grains of rice. This is enough rice to cover more than half of the entire surface of the planet. The emperor made a poor judgment by underestimating the power of compound interest.

In the long term, the most important driver for compounding wealth is not the initial amount of capital but the amount of time the capital is left alone to grow. Imagine an Investment of £10,000 growing at a nominal rate of 7% a year. After 40 years, it would have gone up 15-fold to £150,000. Now imagine another investment twice as large at £20,000 growing at the same rate of 7% a year. After 20 years, it would have grown to only £77,000. Starting with an initial investment that was twice as large but grew for half the time led to a halving in the returns.

This is why it is important to focus on long term returns and allow the power of compounding to do the work for you.

Important Information: Any views, insights, or commentary are for general information only, do not constitute personal investment advice or research, and are intended for UK residents. They may not be appropriate in all jurisdictions. While sourced from information we believe to be reliable, we make no guarantee as to accuracy or completeness. Past performance is not a guide to future results, and the value of investments can go down as well as up.

Regulatory Disclaimer: Tacit Investment Management is the trading name of TIML Limited (No. 9228395), part of Tacit Holdings Limited (No. 10611211). Both companies are incorporated in England and Wales, with the registered office at 14 Hanover Square, London W1S 1HN. TIML Limited is authorised and regulated by the Financial Conduct Authority (FCA ref. 670184) and approves and issues this communication under Section 21 of the Financial Services and Markets Act 2000. Please note, tax and estate planning services are not regulated by the FCA.