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Investing at an Early Age

The benefits of advance retirement planning.

Provided by Chris Eller

You've probably been told at least a few times in your life that you should be putting money aside "for a rainy day", but perhaps it hasn't yet crossed your mind to begin planning, specifically, for your future retirement. If you think it's too early, or if you feel you're not yet ready, financially … think again. Even with a certain amount of debt from car payments, student loans, and living expenses, there are several different ways that a young person can invest their money (and their time) wisely.

While it's true that some people begin investing later in life and still manage to enjoy comfortable returns on their investments, one only needs to see a few friends have financial troubles to realize that things don't always work out that way. Investing earlier in life can sometimes make the difference between retiring when you are ready and retiring when you are able; while you may be healthy well into your senior years, that's not always guaranteed.

401(k)s and Roth IRAs. Many employers offer 401(k) plans, which are retirement savings accounts. You may be fortunate enough to find a job where the employer offers matching contributions to the plan. 401(k) plans are fairly versatile and, since the contributions are generally not taxed until disbursement, your take home pay may not seem quite so diminished.[1]

Another investment which can go a long way is the Roth Individual Retirement Account (IRA). Since the money is taxed before deposit, the funds can be enjoyed tax-free upon retirement. One other feature is flexibility: you have the option to withdraw the money you have deposited (though not the earnings) without penalties, making the Roth IRA a potential source of emergency funds.[2]

A powerful force. Perhaps the greatest advantage to investing at an early age is the effect that compound interest can have on your savings. A long disputed quote has Albert Einstein claiming that compound interest "is the most powerful force in the universe." Regardless of who actually said it, there is some truth to the joke.

What makes compound interest special? It is interest based not only on the principal, but from previously accrued interest. In the short term, it's not terribly impressive, but over thirty years or more, it can produce a handsome dividend.

Great minds have been fascinated with compound interest for generations. Founding Father Benjamin Franklin, who liked to posit that a penny saved was a penny earned, decided to put it to the test. At his death in 1790, he bequeathed £1000.00 each to the cities of Boston and Philadelphia, with intent to build trade schools and public works projects in one-hundred years' time. Compound interest did the trick, netting $572,000 for those cities in 1891. The fund was closed in 1990, with institutes named for the statesman and scientist earning a $7 million dollar bounty.[3]

Making it work for you. If you were to place a small sum of money into a bank account that offers compound interest and leave it alone for a long period of time as Franklin did, your money would grow. For example: $100.00 left alone in the bank for thirty years at a 10% annual compounded interest rate would multiply to $1,744.94.[4]

However, if you were to add money to the account over time, the compounded interest would only grow and could create a very healthy supplement to whatever other retirement plans you may have in place. Say that you started with $1000.00 in an account offering 15% interest; an account you added $600.00 to per year ($50.00 a month). In 40 years, if you kept up your deposits, the account would hold $1,495,435.86.[4]

Things to consider. These are hypothetical situations; you may be able to contribute more or less money as time goes on. You may find an account that earns a different level of interest. Inflation needs to be considered as well; just as a million dollars today doesn't get you as far as it did forty years ago, it may not seem like a lot of money once you're ready to retire.
There is no guaranteed path to financial security, but a young person has advantages that shouldn't be squandered. A combination of investments, with an eye to the long-term, can make all the difference.

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Citations.
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