



# CAPITAL IDEAS

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## The Sooner the Better

There are two reasons why the best time to invest is sooner than later. First, there is a substantial body of evidence that suggests that efforts to “time the market” tend to be unproductive. Simply having funds available should be all an investor needs to wait for. Second, but more significant, is the magic of compounding. The following examples of investors Sally, Sam, Jane, and John will illustrate our point.

Sally begins to save \$5,000 a year when she is 25 years old. She continues to save this amount for ten years, until she is 34, at which point she stops saving, having invested a total of \$50,000. Sam, on the other hand, waits until age 35 to start saving. He then saves \$5,000 a year, for the next 30 years, investing a total of \$150,000, or three times as much as Sally. Who comes out ahead – Sam or Sally? Assuming a **10 percent** per annum compound rate of return, at age 65, Sally will have generated a portfolio of about \$1.4 million. Despite having saved and invested three times as much, Sam’s portfolio will have grown to only \$830,000, or 40 percent less than Sally’s. When Sam and Sally are 75, their two portfolios will have grown to \$3.7 million and \$2.2 million, respectively.

The longer one waits to begin saving, the worse it gets. If Jane waits until she is 45 to begin investing, she must save \$24,000 each year for the next twenty years to achieve the same portfolio value that Sally has. (Remember, Sally only had to put aside \$5,000 for ten years.) If John waits until age 55 to begin his investment program, he will have to save \$87,000 a year for ten years to reach the same goal.

Even in an environment of slower economic growth, the numbers still demonstrate a similar message. If we assume an **8 percent** per annum compound rate of return, when Sally reaches 65 years old, her portfolio is still worth \$737,000, while Sam’s portfolio at 65 still lags behind at \$570,000. Jane and John don’t have to save quite as much to catch up to Sally. Beginning at age 45 for Jane and age 55 for John, they must respectively sock away more than three times and ten times per year (i.e., \$16,000 for 20 years or \$50,000 for ten years, respectively) to be even with Jane at age 65.

This illustrates the powerful role time and compounding play, as well as how even a modest drop in long-term rates of return can significantly affect one's investment objectives. The moral is simple. If an individual can postpone buying those desirable consumables during his or her youth and can instead save a reasonable amount in a passively invested diversified asset class portfolio, he or she should be able to acquire a whole lot more of those desirable consumables later in life.

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