# Investing Basics

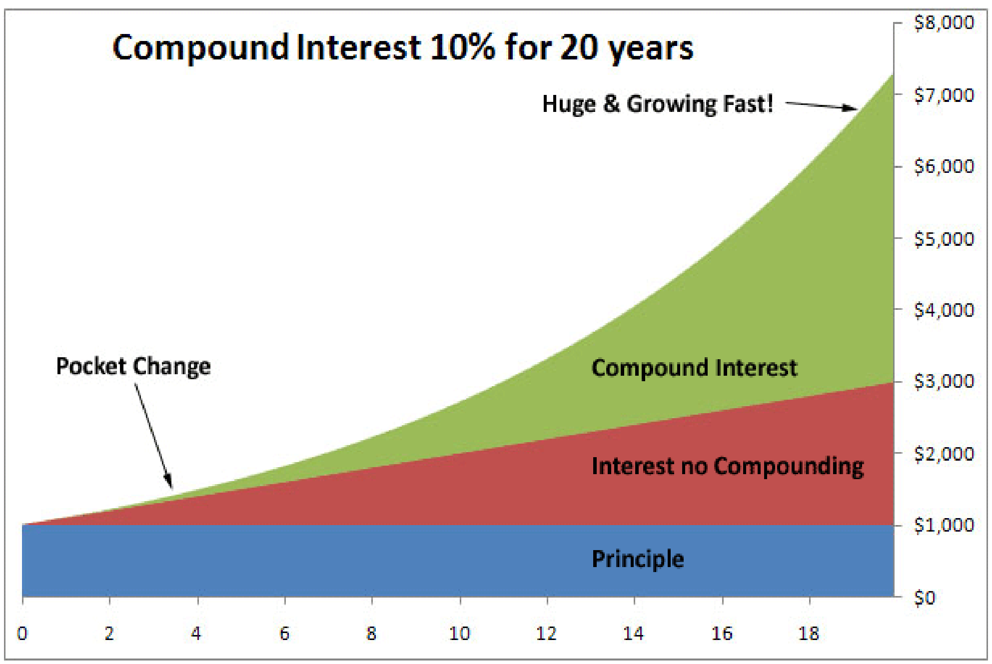
**Compound Interest**- The most important factor for dramatically increasing the value of your investments is compound interest. Compound interest simply put means interest on your interest. As you can see below when you have compound interest it makes a very substantial difference to the value of your investment over time!

## Saving vs Investing

**Saving-** Holding money that you intend to spend on something in the future. (Ex. Saving 50$ a month for a year in a savings account to buy a new flat screen TV)

**Investing-** Putting money in some type of investment where your goal is for your money to gain value over time. (Ex. investing $100 a month in a mutual fund to fund your retirement.)

**Investing Early**- Other than compound interest itself, the next most important factor is time. If you give your money time to grow it will grow more rapidly as time goes on. See the charts below for a visual of the difference it can make. So make sure to take advantage of this while you are still young!




### The Story of Two Savers

*Saver A spends his money partying for 8 years, then opens a tax-deferred account earning 12% at age 26 and invests $150/Month for the next 40 years*

**Contributions = $72,000**

*Saver B invests $150/Month for 8 years in a tax-deferred account earning 12% and saves NOTHING for the next 40 years*

**Contributions = $14,400**

**Which saver ends up with more money?**

| Saver A | | | Saver B | | |
|---|---|---|---|---|---|
| Age | Annual Amt | Total | Age | Annual Amt | Total |
| 18 | $0 | $0 | 18 | $1,800 | $1,902 |
| 19 | 0 | 0 | 19 | 1,800 | 4,046 |
| 20 | 0 | 0 | 20 | 1,800 | 6,462 |
| 21 | 0 | 0 | 21 | 1,800 | 9,183 |
| 22 | 0 | 0 | 22 | 1,800 | 12,250 |
| 23 | 0 | 0 | 23 | 1,800 | 15,706 |
| 24 | 0 | 0 | 24 | 1,800 | 19,600 |
| 25 | 0 | 0 | 25 | 1,800 | 23,989 |
| 26 | 1,800 | 1,902 | 26 | 0 | 26,868 |
| 27 | 1,800 | 4,046 | 27 | 0 | 30,092 |
| 28 | 1,800 | 6,462 | 28 | 0 | 33,703 |
| 29 | 1,800 | 9,183 | 29 | 0 | 37,747 |
| 30 | 1,800 | 12,250 | 30 | 0 | 42,277 |
| 35 | 1,800 | 34,506 | 35 | 0 | 74,506 |
| 40 | 1,800 | 74,937 | 40 | 0 | 131,305 |
| 45 | 1,800 | 148,388 | 45 | 0 | 231,405 |
| 50 | 1,800 | 281,827 | 50 | 0 | 407,815 |
| 55 | 1,800 | 524,245 | 55 | 0 | 718,709 |
| 60 | 1,800 | 964,644 | 60 | 0 | 1,266,610 |
| 65 | 1,800 | 1,764,716 | 65 | 0 | 2,232,200 |

**Saver B has outpaced A by over $467,000!!**

**DON'T PROCRASTINATE**

**<u>Saving for Retirement</u>**- With the advances in medical technology people are now living much longer than in the past. This has made retirement planning essential. The best way to guarantee that you can have a comfortable retirement is to invest early, as shown above, as well as opening a retirement account. IRA's (Individual Retirement Accounts) come in two basic forms: Traditional and Roth. The simplest way to describe the difference in these two types is this:

*Traditional IRA*: Money is **not** taxed initially, but then taxed when taken out. (Principal + Interest are taxed)

*Roth IRA*: Money **is** taxed initially, but there is not tax when taken out. (Principal Taxed, Interest **NOT** taxed)

**What are the benefits for each type of account?**

***Traditional IRA*:** The amount that you invest gets subtracted from your gross income for tax purposes, lowering the amount of taxes you have to pay. (Ex. If I made $50,000 in 2013 and I invest $5000 in a traditional IRA, I now only have to pay taxes on $45,000 worth of income, lowering the amount of taxes I have to pay). So traditional IRA's can be very useful for people who have solid incomes and wish to lower their tax burden. Keep in mind, unlike the Roth IRA you do have to pay income taxes when you withdraw your money from the Traditional IRA account.

***401k Plans*:** A very popular plan in today's business world is the 401K. A 401k is basically just a type of Traditional IRA where your employer matches your contribution up to a certain amount. (Ex. Let's say your employer is willing to match the first $1000 that you invest in your 401k plan. This means that for every dollar you invest in your 401k, your employer will invest that same amount, up to $1000, into your retirement account.)

Note: If you are offered this by an employer you should always invest up to the max that your employer is willing to match. After all, it is free money! Think of it this way, when you invest in your 401k your investment doubles instantly!

***Roth IRA:*** For young adults the Roth IRA is a very powerful tool. This is because, as stated above, the interest that your Roth IRA earns does not get taxed. For Example: Let's say I have contributed $75,000 to a Roth IRA, and it has produced $500,000 in interest, which is very possible. The $500,000 that I have gained from interest is never taxed!!!

Note: I **cannot** take out the **interest** I have accrued until I am 59 and a half, or I will have to pay income taxes on it, along with a 10% penalty (Applies to both Traditional and Roth). I **can,** however take out any **contribution** that I have made to my Roth IRA penalty and tax free ($75,000 in this case).

Why can the Roth IRA do this, but Traditional cannot?  This is simply because you have already paid the taxes on your Roth IRA contribution, whereas you have not for the Traditional IRA.

## So in what order should I invest in for retirement?

**401k**

↓

**Roth IRA**

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**Traditional IRA**