

WEALTHWAVE EXPLAINS HOW WEALTH WORKS:

LET'S START WITH 'THE RULE OF 72'

You build your practice, teach lessons, earn your fees, pay your bills. Those are the basics, but there's more to managing your career and your daily life—there's the responsibility we all have to manage finances and either build or preserve wealth for the long haul. Especially for the self-employed Proponent Group member—but really for everyone—taking a big-picture approach to money matters can be challenging. This month's issue of the newsletter contains the first in a series of helpful articles on that very topic. In partnership with WealthWave, Proponent will be devoting new efforts to member education in the important quest to improve our members' financial literacy. This article, covering certain basics of investment, savings and management of debt, starts us down the road to our study of effective habits and skills in the financial realm.

The Rule of 72

Would you rather have a million dollars today or a penny that doubles every day for a month? Most people would take the million dollars and run to the bank. That's one of the reasons most people aren't properly prepared for retirement. Investors who understand the power of compound interest might take a few moments to do the math.

By day 25, you might think taking the penny was the wrong decision. But just six days later, the penny would have grown to over \$10 million! That's the power of compound interest.

Albert Einstein considered compound

"Compound interest is the greatest mathematical discovery of all time." – Albert Einstein

interest to be the Eighth Wonder of the World. He also said that when you invest, it works for you and when you borrow, it works against you. Harnessing this simple concept can make the difference in shrinking your retirement lifestyle to meet your budget or living the retirement of your dreams. So let's take a

closer look at the power of compound interest and a simple tool you can use to make better financial

decisions.

To figure out how often money doubles at a particular interest rate or rate of return, simply divide the number 72 by the interest rate. The result is the number of years it takes for your money to double. So if you have an investment that earns 4% annually, dividing 72 by 4 tells us your money will double every 18 years. If you have a credit card that charges 8% interest, your debt will double every 9 years.

Let's apply this to a real-world scenario. Suppose a 29-year-old golf instructor saves \$10,000. If she earned a 4% return every year, her money would double every 18 years

| | | | | | | | |
|-------|--------|----|----------|----|-------------|----|-----------------|
| DAY 1 | \$0.01 | 9 | \$2.56 | 17 | \$655.36 | 25 | \$167,772.16 |
| 2 | \$0.02 | 10 | \$5.12 | 18 | \$1,310.72 | 26 | \$335,544.32 |
| 3 | \$0.04 | 11 | \$10.24 | 19 | \$2,621.44 | 27 | \$671,088.64 |
| 4 | \$0.08 | 12 | \$20.48 | 20 | \$5,242.88 | 28 | \$1,342,177.28 |
| 5 | \$0.16 | 13 | \$40.96 | 21 | \$10,485.76 | 29 | \$2,684,354.56 |
| 6 | \$0.32 | 14 | \$81.92 | 22 | \$20,971.52 | 30 | \$5,368,709.12 |
| 7 | \$0.64 | 15 | \$163.84 | 23 | \$41,943.04 | 31 | \$10,737,418.24 |
| 8 | \$1.28 | 16 | \$327.68 | 24 | \$83,886.08 | | |

\$10,737,418.22 in just 31 DAYS!

And it doesn't cross the million dollar mark until day 28. That's the exponential Power of Compounding!



How much would she have at age 65?

Most people would somewhat logically think that if you double your rate of return you double the money. Wrong. Since money doubles every 9 years at 8% ($72/8=9$), she'd get 4 doubles by the time she reaches age 65. So that same \$10,000 would grow to \$160,000.

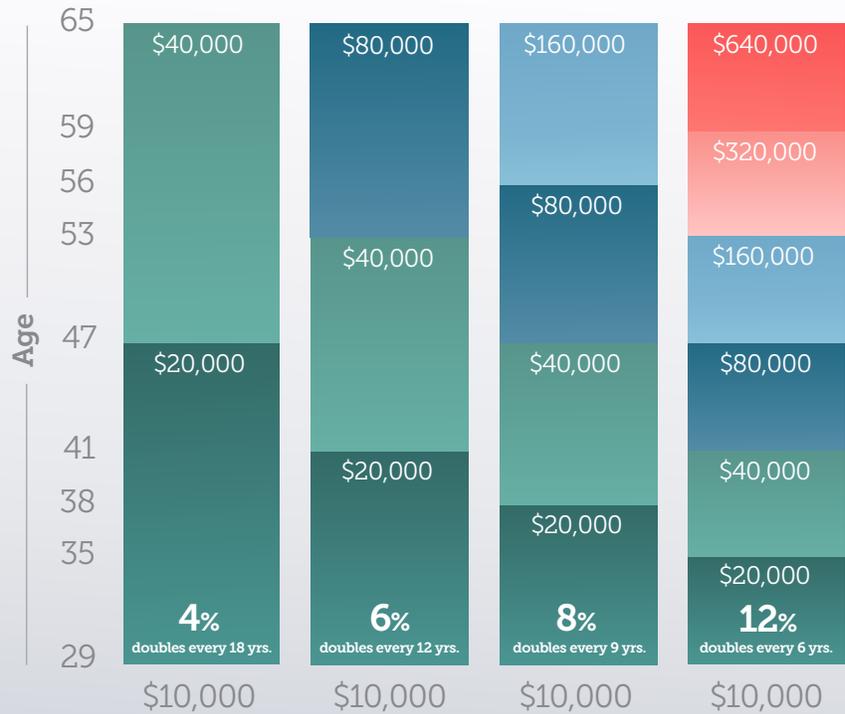
Notice that doubling the rate of return leads to four times as much money.

Simply understanding the Rule of 72 can change the way you think about money. But in order to harness the power of compound interest, *(Continued on next page)*

The Rule of 72

If you had invested \$10,000 at age 29, and if it earned a 4% rate of return, you would have nearly \$40,000 when you turn age 65. If instead, you had earned a rate of return of 8%, at age 65, you would have grown your wealth to almost \$160,000.

The Rule of 72 is a mathematical concept that approximates the number of years it will take to double the principal at a constant rate of return compounded over time. All figures are for illustrative purposes only, and do not reflect the risks, expenses or charges associated with an actual investment. The rate of return of investments fluctuates over time and, as a result, the actual time it will take an investment to double in value cannot be predicted with any certainty. Results are rounded for illustrative purposes. Actual results in each case are slightly higher or lower.



The Impact of Losses



you need to consider two other important factors:

The Risk of Loss

The natural tendency after learning the Rule of 72 is to seek a higher rate of return in all aspects of your financial life.

And that's a good tendency to develop. But you have to be careful about how you seek that higher rate of return. Remember how Einstein said that the power of compound interest works against you if you borrow? He neglected to point out the fact it also works against you if you lose money.

If the 29-year-old in our earlier example realized that she needed to seek a higher rate of return, she might put that \$10,000 in a volatile investment. What

would happen if her account lost 50% one year and then bounced back by earning 50% the next year? Just like she might have intuitively thought that doubling the rate of return would simply double the value of her account, she might think that losing 50% one year and making 50% the next year would leave her account value at even. But let's do the math:

As you can see, you have to earn a 100% return to recover from a 50% loss. This is the negative compounding effect of losses. So as important as it is to seek a higher rate of return, you have to be careful about how you go about it.

The Impact of Taxes – The Rule of 96?

Once our friend finds a way to increase her rate of return while

minimizing or eliminating the risk of loss, she also needs to ensure that she actually gets to keep her gains. If she invests the money in a regular, taxable account, the Rule of 72 may not apply to her. Depending on how the money is invested and her individual tax rate, she might be facing the Rule of 96. This is because some of the gains will be used to pay taxes on the gains, thereby reducing the compounding effect.

Next month's article will focus on simple, powerful ways you can minimize the impact of taxes so that you can keep more of what you earn.

For a WealthWave review of your financial situation, contact Matt Luckey at 770-418-0300 x122 or visit wealthwave.com/mattluckey. PG

Assuming an 8% annual rate...

| | | |
|---------------------------|---------------------------------------|---|
| The Rule of 72 | With a 0% Tax Rate | It takes 9 years for money to double |
| The Rule of 96 | With a 25% Tax Rate | It takes 12 years or 33% longer for money to double |
| The Rule of 120 | With the top 39.6% Tax Rate | It takes 15 years or 66% longer for money to double |

Which rule applies to you?

| | The Rule of 72 Tax-Deferred Account | The Rule of 96 Taxable Account (25% Annual Tax rate) | The Rule of 120 Taxable Account (39.6% annual tax rate) |
|------------------|---|--|---|
| Depends on Taxes | | | |
| Growth Rate | Years | Years | Years |
| 2% | 36 | 48 | 60 |
| 3% | 24 | 32 | 40 |
| 4% | 18 | 25 | 30 |
| 5% | 14 | 19 | 24 |
| 6% | 12 | 16 | 20 |
| 7% | 10 | 14 | 17 |
| 8% | 9 | 12 | 15 |
| 9% | 8 | 11 | 13 |
| 10% | 7 | 10 | 12 |