The Law of Compounding And Why You Should Apply It.

If you're skimming your eyes through this article right now, it means you're pretty passionate about increasing how much money you currently have. You want a better life for yourself, you also want to learn how to improve your financial literacy and make it work for you before you even think about retiring.

If you have a business and you're interested in learning how to multiply your earnings, then you would be shocked at this simple, yet ignored law that can change your financial life forever. Does how to make 5 figures income monthly even with your current net worth sound impossible to you? Stay glued to this article for just a little longer to see how you can do this.

First off, what is the law of compounding?

It is simply applying the principle behind compound interest, which is the interest calculated on the accumulated interest over time as well as on your original principal. How do you explain little amounts of money here and there, snowballing itself into a multi-million dollar investment? Interests on interest. You don't necessarily need to put in work to make it yield income for you. If you have an incredible knack for being patient, it just does!

Let's give you a more relatable example and shift the big terms aside. Assuming you earn a paltry sum of $100 a month and you make a decision to save and invest about $50 from your income every month for 10 years and let's say that investment gives 10% simple interest yearly, you would have a final amount of $10,518 stashed aside for simply doing nothing.

Well, all you did was be consistent and patient, if that counts as work. This differentiates the rich vs the wealthy.

How To Calculate Compound Interest.

To calculate your compound interest manually, you need a formula which is provided here. We'll also teach you how to calculate your compound interest with a realistic example. Get your pen and paper ready. Or your phone notepad. Whatever works for you.

If you'd prefer something fast and quick, click here to calculate your compound interest automatically.

For manual calculations, the formula for calculating compound interest is;

A = P (1+r/n) ^ (nt)

Where A = the future amount

P = the initial deposit or loan amount (principal investment)

r = the interest rate represented as a decimal

n = the number of times the interest is compounded per year

t = the number of years the money compounds for

Now for a more realistic example, let's say you invest $2000 which gives a 4.5% interest monthly for a period of 5 years. How much would you have accrued by the end of 5 years?

$A = 2,000 (1 + .045/12) \wedge (12 \times 5)$

$A = 2,000 (1.00375) \wedge (60)$

$A = 2,000 (1.25179)$

$A = 2,503.59$

This means you'd have gotten an added sum of $505.59 as profit for saving and investing just $2000 for 5 years. What if you had invested more, maybe added to your principal on a monthly basis, how much do you think you'd have amassed as profit at the of the period of 5 years? I'll leave that to you to calculate and see.

The Law of Compounding; Too Good To Be True?

Funny enough, the law of compounding isn't all rosy and easy to apply. The benefits are usually the best parts of it but you need to know that there are downsides.

Yes, it takes an excruciatingly long time to get your stated profits back but provided that you see what you stand to gain and stay focused on the long-term goal, you'll be fine. The Law of compounding isn't a principle you decide to apply just for the sake of it. If you're in a quick rush to get money, this definitely isn't the route to go.

You need to keep your financial goals in mind and remind yourself of the reasons to save money and keep yourself going. This ensures you don't back out at the last minute. At this rate, if you play your cards right, you can start saving by the age of 20 and retire at 45. This is where some financial literacy tips come in handy.

Factors That Make Your Money Grow Faster Using The Law of Compounding.

- Time.

This factor can't be emphasized enough, because it’s the most important. The earlier you start, the more interest you amass over time. Also, the longer you leave your money to compound, the more profit you’re guaranteed. It's pretty simple.

If two individuals decide to operate the law of compounding with the exact same amount of principal but with 5 years and 10 years periods attached to those investments respectively, we know the individual with a 10 year period of compounding, will definitely accrue more profits.

- The interest rates involved.

A higher interest rate means a faster compounding rate. Simply put, the interest rate placed on your principal and subsequently accumulated interests will determine how much more profit you’d be accruing as time goes by. The higher the rate, the better.

- Withdrawing and depositing your money.

If you plan on compounding the right way and multiplying your original principal, it would be best to leave and not withdraw the profits of your money at different points in time over the stipulated period you plan to compound. Let your profit do the growing. The more you withdraw, the less profit you make from your accumulated interests. Focus on doing more deposits than withdrawals to reap the best of this principle.

Advantages of the Law of Compounding.

- Not a lot of Capital Needed

Compound interest can turn a small initial investment into a large profit over time. You don't necessarily need to have so much money to start it out. All you need is determination, consistency, and time.

- Financial Growth

With the law of compounding, you can improve your business strategies and grow a small business into a full-blown enterprise over some time.

- Financial Literacy

It ensures you're financially literate due to the critical decisions you would have to make daily. Going into the investment market isn't something to be done without in-depth research and a proper understanding of the trends and statistics involved in it. This is where you would indulge financial literacy and this would help you develop yourself, your business, and your financial responsibilities all simultaneously.

- Generational Wealth

Compound interest makes your money grow rapidly because the rate of appreciation is determined based on the assets you earn over the years in addition to the initial principal sum. It ensures you are wealthy, as your initial investment and the gains that you have made increase together.

- Sorts out Family Needs

If you are saving for your child's education, the power of compound interest is unquestionably applicable. It helps you plan appropriately when making future preparations for faimly needs. Begin saving when your children are still in diapers, rather than when they are looking for a college to attend. Makes the hassle so much more easy.

- Early Retirement

You can retire early if you start applying the law of compounding today! Most wealthy individuals today operate this principle at a much higher principal and they all started small. It's not too late to begin saving and investing a good percentage of your earnings. By the time you're older, your future is a whole lot financially stress-free because you paid the price early.

Not sure how to start out applying this law? You can schedule a meeting here and see where it takes you. Or read more articles on how you can effectively compound your money at whatever stage you are currently.