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The Magic Wealth Ingredient

Tags: investment planning [1]

There is a legend about a successful financial advisor in Warren Buffett's stomping grounds of Omaha, Nebraska. It is reported that this advisor has learned the art of communicating the basics of wealth building with the local farmers. The advisor, who we will call Fred Smith, greets clients in his office with a window behind his desk that overlooks fields of blowing wheat and corn.

Many clients look at him skeptically when he explains the simple power of investing for the long-term and multiplying their savings into large amounts of money from their modest savings. They often blink at him with glazed over eyes and ask: 'How can this be?'.

To demonstrate his point about the magic of compound growth by owning a share of the growing profits over time of a group of world class equities, Fred leans across his desk and picks up a glass vial.

He points to the seeds of wheat inside it and states: If I show this vial to a resident of a city such as New York or any major urban centre and say to them with these few seeds I can populate many acres of land to grow vast amounts of wheat to feed entire cities, what do you think they would say to me?

They would likely stare at Mr. Smith in disbelief. Yet that is exactly what he is suggesting can happen to the modest savings Mr. & Mrs. Jones if they have the patience to focus on the long term. This is the same patience the couple bring to their successful farming business with the ability to handle adverse weather conditions, volatile grain prices, long days of hard work, pestilence, government regulations and crop failures amongst other challenges on their path to success.

The magic ingredient to their success is the power of compound growth on savings. For example, a dollar invested for 20 years at 8% grows to $4.66 and if left to compound for another ten years for a total of 30 years it more than doubles again to $10.06. While the return matters, the most important factor is the number of doublings that occur in one's lifetime.

Several books* and consumer finance personalities use the following example: If you were offered $1 million dollars right now or the option of taking an American penny (recognizing that Canada no longer has a penny) that is doubled in value every day for 30 days, which offer would you take?**

The other key ingredient is time to allow compound growth to work its magic. And it is never too late to put compound growth to work for you. Whether you are in your early 20's or even in your late 50's time and compound growth on your savings can work for you. Many people now live into their late 80's and 90's so even someone who is just retiring can look forward to another thirty years or so as their investment time horizon.

* One consumer oriented book that uses this example is called Rich is a State of Mind?.

** The answer is to take the penny! Do the math yourself and see what happens.

Need help with long and short term investing?
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