

LIFE, INVESTED

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## Let the Compounding Commence!

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Chairman and Founder

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Every year, families and friends celebrate students who are graduating from colleges and universities. Parents beam with pride at their children's accomplishments and exhale in relief now that the tuition bills have finally stopped. It's a time when adults give a lot of advice, which is why I have one simple idea I want to pass along to this year's graduating class that I hope you never forget. Parents, take note too, because with college out of the way, you can get back to focusing on retirement.

Let the compounding begin!

In case you didn't come across this idea in an econ class, let me explain compounding simply. It's the process by which the value of an investment increases over time as earnings or interest are reinvested. It's the snowball effect but with money. Here's an example.

If you're a US investor and lucky enough to have up to \$35,000 left over in your 529 college savings plan, you can roll it over into a Roth IRA starting in 2024, provided the account has been open at least 15 years.<sup>1</sup> If you don't touch that \$35,000 for 50 years, and the market averages a 10% annualized return, which is close to its long-term historical average, then guess how much you'll have?<sup>2</sup>

- A. \$1,584,074
- B. \$2,551,167
- C. \$4,108,680

The answer is C. Over \$4.1 million!

If you were to start this in your mid-20s and invest that same initial amount for only 45 years, you'd end up with B, or \$2.6 million. That's great, but not as great as C.

If you do it for 40 years, you'll end up with A, or \$1.6 million. Also good, but, you know, not C.

Another benefit of compounding is that it can help you pursue financial goals along the way, like making a down payment on a home. But don't worry if you spent your whole

college fund or took out student loans. Start with a little and get in the habit of adding when you can. As you can see from this snowballing, having a lot of time can help make up for not having a lot of money.

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*Life is full of surprises, and many of them can come from how your decisions compound over decades.*

In addition to increasing the value of your investments, compounding can also be a valuable force in life. For example, you've made an investment in time and money over the last few years that may have an enormous effect on the rest of your life. How much money are we talking about? College graduates, on average, earn 84% more than those with a high-school education, and that adds up to an extra \$1.2 million over a lifetime.<sup>3</sup> Parents, I hope you're feeling a little better about your investment too.

But it's more than just money. When you get to be like me, someone who graduated from college more than 50 years ago, you see that you are the result of the compounding of your life's decisions, both good and bad. It's hard to quantify exactly, but it's sure there. For example, in graduate school, I decided I didn't want to be a professor. That one decision continues to have a profound impact on the rest of my life. Instead, I started a company with the people I met in graduate school. Four decades later, I'm still working with some of them. I even got to go watch my former professor and current colleague Eugene Fama receive a Nobel Prize in Economic Sciences. That was not on my bingo card when I graduated from college. Life is full of surprises, and many of them can come from how your decisions compound over decades.

So, start rolling your snowball, both in life and in investing. Let the compounding commence!

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1. Laura Saunders, "Your Child Picked a College! Tee Up Your 529 Plan," *Wall Street Journal*, May 5, 2023.
  2. In US dollars. Based on S&P 500 Index annual returns, 1926–2022. S&P data © 2023 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Indices are not available for direct investment; therefore, their performance does not reflect the expenses associated with the management of an actual portfolio.
  3. "How Does a College Degree Improve Graduates' Employment and Earnings Potential?" Association of Public and Land-Grant Universities.

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The investment approach discussed does not assure a positive return or a positive investment experience. There are numerous ways of approaching investing, only one of which is presented here, which may not be appropriate for every individual.

529 Plans are tax-advantaged savings plans available in the United States that are designed to help pay for education.

Eugene Fama is a member of the Board of Directors for and provides consulting services to Dimensional Fund Advisors LP.

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