

How Jill Beat Jack; The Wonders of Interest Compounding in a Tax-Free Retirement Plan

AUTHOR: MICHAEL CONGER

Jill plans long-range. She would like to have a large nest egg when she retires. Jill is 22 and elects to put \$50 each paycheck (semi-monthly) into her employer's 401(k) plan. Even if Jill stops saving at age 32, her retirement account will continue to grow, free of any tax.

Jack is 22 and prefers spending his money. He knows his retirement is a long way off, so he delays making contributions to the 401(k) plan. At age 32, Jack decides that it's time to start saving \$50 per paycheck, but now it's ten years after Jill had started saving.

Who has more money saved for their retirement plan at 65 - Jack or Jill? Everything is even for Jack and Jill, except the one variable, Jack does not save for the first ten years.

The interest assumption is that both Jack and Jill earn 8% interest, compounded annually. That's the traditional rate of return for the S&P-500 stock index.

Jill

240 contributions of \$50 each = \$12,000 when Jill stops saving at 32

Principal amount saved = \$12,000

Interest = \$6,099

Jill leaves the money alone.

Thus, \$18,099 continues to grow tax-free.

Total at 65 = \$229,424

Jack

792 contributions of \$50 each = \$39,600 when Jack stops saving at 65

Principal amount saved = \$39,600

Interest = \$142,749

Total at 65 = \$182,349

WINNER: Jill has \$47,075 more than Jack, even though she stopped saving at 32.

What if Jill had continued saving after 32, and continued saving until age 65?

Principal amount saved = \$51,600

Interest = \$360,176

Total at 65 = \$421,926

Early saver + steady saver + long-term saver = successful saver!

Your personal financial circumstances may differ from Jack's and Jill's, and probably does, but any dollars saved, no matter how many, will help set you up for a financially successful retirement.

First Lesson: Start saving as early as possible in your job!

Second Lesson: *Length of Time* for interest compounding is the largest factor of all.

Third Lesson: Another key to success is Dollar-Cost Averaging into investments.

Fourth Lesson: Steady, long-term contributions to a retirement plan add up to the most.