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*Fee-Only Financial Planning*

**From American Century Investments book, *Raising Financially Aware Kids***

## BASIC INVESTMENT CONCEPTS

Before kids start putting money into an investment account, they need to understand some basic concepts about how money grows and some of investing's inherent risks.

### COMPOUND INTEREST

What makes the world of investing work is the power of compounding interest, particularly because the rates of return for investments have historically been much higher than inflation and higher than what can be earned in a savings account. While the math of compound interest can be challenging for young minds, the concept is intuitive.

If $100 is invested in an account that's expected to earn 8% each year, the expected balance would be $108 after the first year ($100 x 8% = $8 + $100 = $108). The next year, the balance would not increase to $116, but rather to $116.64. Where did the extra 64 cents come from? It came from the 8% that was earned on not just the original $100 but also the $8 of growth last year ($108 x 8% = $8.64 + $108 = $116.64). That's the power of compound interest, also known as interest-on-interest compounding. Because interest is earned on not only the principal (what was originally invested) but also the earned interest, the balance grows more quickly.

An extra 64 cents may not seem like much to get excited about, but the power of compound interest becomes dramatic over time. After 10 years, the $100 investment can grow to a value of $215.89, but after 40 years, it would grow to over $2,000! This is the most important element of compound interest: The longer the money is invested, the more substantial the potential returns.

WHATEVER THE GOAL MAY BE, THE BIGGER THE NEED, THE MORE LIKELY IT IS THAT YOUR KIDS WILL NEED TO INVEST THEIR MONEY TO GET THERE.

**Growth of $100 over 40 Years**