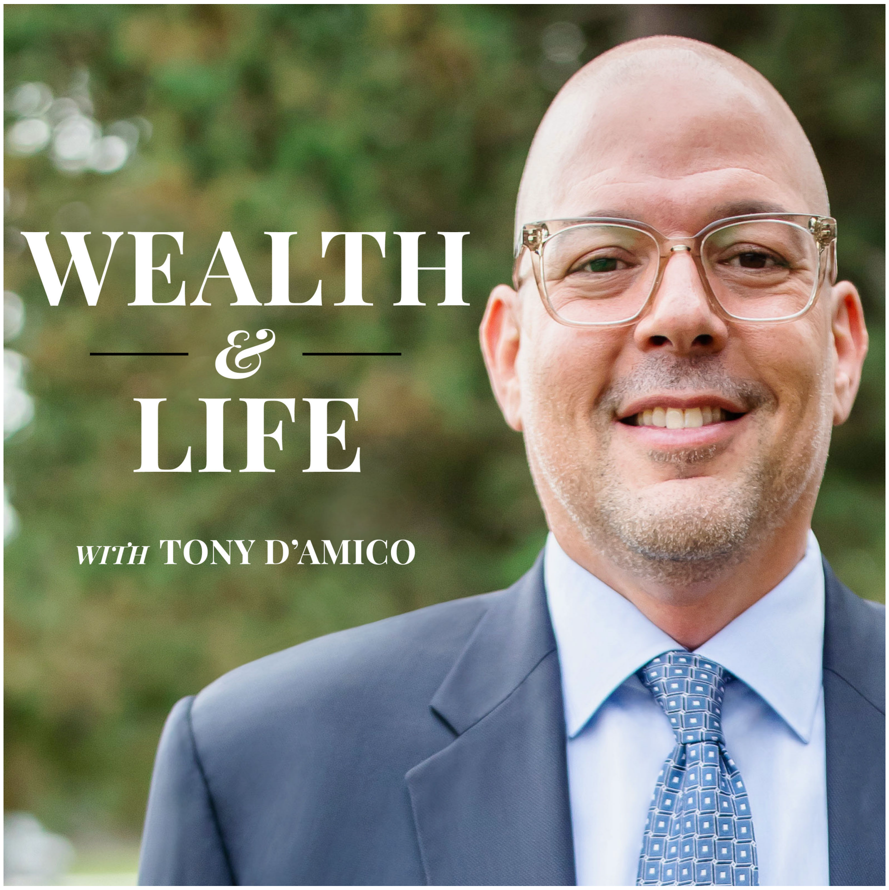
Ep #20: The Power of Compounding



Full Episode Transcript

With Your Host

Tony D'Amico

Wealth and Life **with Tony D'Amico**

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Welcome to *Wealth and Life*, where you'll learn with financial planner, consultant, speaker, and business owner, Tony D'Amico. You'll hear stories from successful business owners and individuals about how they navigated the inevitable challenges that arose as they achieved each new level of success, and you'll get insights and strategies from leading wealth planning professionals on how to achieve your next level of success. Now here's your host, Tony D'Amico.

Tony D'Amico: Hi everyone, Tony D'Amico with Fidato Wealth. Thanks for joining me for this episode of Wealth and Life. And today I'm going to talk to you about a topic that I think is really important. And I want to talk to you about compounding. And I really want to illustrate the power of compounding and how it works in a financial plan. So my question to you is, in 30 days, would you rather have $500,000 or a penny that doubles every day for that 30 days? Okay. All right. So say your answer. Okay, great. So let's go through the math. So you start off with a penny on day one. Day five you're at 16 cents. Day 10 you're at $5.12. Day 20 you're at $5,242. Day 25 you're at $167,772. Day 26, $335,000 and change. Day 27, $671,000. And as you can see, day eight is 1.3 million. Day 29 is 2.6 million. Day 30, 5.3 million.

And guess what? If there happened to be 31 days in that month, it would have doubled to $10.7 million. So the correct answer would have been, I'll take a penny a day that doubles every day of that month. And I think if you're going to think about that, a penny doubling every day, if there's 31 days in the month, $10.7 million. That really illustrates the power of compounding. And why do I want to talk about that?

I think one of the biggest misconceptions out there is that when you retire, all of your assets should be conservative. And unless you're a very conservative or a conservative investor, that's often not the best thing for someone. So for example, if someone fills out a risk profile assessment and they can handle a moderate risk allocation, they would roughly be 60% stocks, 40% bonds. And if the portfolio is diversified properly, and there's a lot of boxes to have to check there, you'll have different asset classes that are doing different things at a different point in time.

And if it's really constructed well, the ideal outcome is that while some asset classes are up, others are down, okay? And the point of this is, is that as you take distributions, so let's look at this from the retirement lens, you're moving from accumulation to the distribution phase of your life, right? Taking that income out. So you have to take distributions each month, right? You're done working. Maybe you have other sources like a social security or a pension, but you still need to withdraw some money from your investments and savings.

Ideally, you want to be selling the investments that are up and that's only done if, again, it's really properly diversified. At Fidato Wealth, we use about 14 different funds in our portfolio. Each fund has a high degree of asset class purity. So for example, the small cap fund does not have real estate within it.

There is a separate fund for real estate. So, while some are op others will be down. And because we use threshold based rebalancing, we're selling the winners. So once things cross out of band to the upside, we sell. Conversely, if things drop to the downside, if they cross the bottom band, we get notified that there's a buying opportunity. And whether a client is either in the accumulation or distribution phase of their life, we execute that rebalancing for them.

So first point is, is that if you have the right portfolio, your portfolio isn't built for just the next four years. It's built for a longer duration in mind and it should ignore market volatility for the most part and really ignore the short-term noise. But also too, getting back to compounding. Today, when a couple reaches the age of 65, there's a 47% chance that one of them will live to 90.

Okay. So about a 50% chance that there's going to be 25 years of distributions. So being a financial planner for as long as I have, I've seen plans go from work with clients from that haven't retired yet. I've worked with clients that did retire and passed away. I kind of seen full cycle and there is time. Again, I don't know your life expectancy, right. But if we follow just average life expectancies, and if those hold true, there's plenty of time for compounding. And I think I remember watching a show on TV, a retirement planning show, and it was very clear to me that it was not a fiduciary that was teaching the class or teaching this show on TV rather. And their point was is that when you retire, you're going to have a dollar cost average out of your portfolio and you'll have to lock in losses.

So the point is you do want a dollar cost to average out. That's actually a positive. And if you execute that with prudence and diligence and follow fiduciary principles, follow time tested strategies, what research shows is that it ends up actually being a big benefit. People end up having sometimes more money than they calculated. So it does require again, execution the correct way and that prudence and due diligence.

So there's other research that shows that when a retirement plan fails, the reason is, is that somebody was spending too much money compared to their means. That's, again, why people will work with a financial planner is the one, I don't know. What can we spend? We don't perhaps don't want to be too conservative, don't want to be too aggressive. You want to maybe take a balanced approach and you don't want to take distributions, enjoy the money.

So we often will have to tell some clients that you need to spend more money, or else there's going to be more money left over then you maybe realize. We have to kind of show clients that projections. But it's about spending the appropriate amount of money that you're comfortable with that probability of success and your financial plan. So kind of getting back to the point of today's podcast is compounding has that potential to occur even when you retire. So there's again, potentially 20, 25, 30 years of distributions. If somebody has that amount of time ahead of them, there's all sorts of different economic cycles. There's short-term news that happens. And the best thing to do is have a well-crafted plan and stick to that.

With that discipline and non-emotional approach, it gives you, I think, the best odds of allowing you to participate in that compounding. So hope you felt this episode was helpful. Look forward to seeing you on the next episode. And if you have questions, love to hear from you. You can reach out to us at sayhello@fidatowealth.com. Thanks so much, have a great day now. Bye bye.

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