What is the Cost of Delaying the Funding of Your Retirement?

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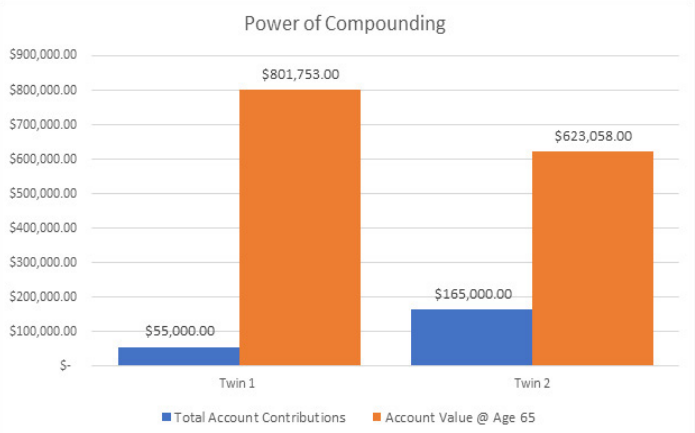
Assume that a set of twins just graduated college. They are both hired at their first jobs with a starting salary of $60,000. Both twins will start work at age 25 and retire at age 65 (40 years in the work force).

Twin #1 will contribute $5,500 in an IRA (at the end of each year) for only the first 10 years (age 25 – 34) for a total of $55,000 of contributions (calculated as $5,500 x 10 years of contributions at the end of each year).

Twin #2 will not contribute to an IRA for the first 10 years but will contribute for the next 30 years (age 35 – 64) for a total of $165,000 (calculated as $5,500 x 30 years of contributions at the end of each year).

Let's assume an 8% annual compound rate. Based on this annual rate, at age 65, Twin #1 will have a future value of $801,753 and Twin #2 will only have a future value of $623,058. Even though Twin #2 has supplied THREE times the contributions of Twin #1 ($165,000 versus $55,000), Twin #2's balance is 22.29% lower!



So when should you start to save? By changing one assumption in the above example, I will illustrate that the answer to this question is clearly RIGHT NOW.

Einstein is quoted as saying: "Compound interest is the eighth wonder of the world. He who understands it, earns it… he who doesn't… pays it."

Continuing with the same fact pattern for Twin #1, let's assume that the $5,500 contribution is made at the beginning of each year (January 1st). Notice that the total contributions of $5,500 for 10 years of $55,000 does not change, other than first-year is being made on the first day of the year (January 1st) versus waiting until the last day of the year (December 31st).

The result is that the future value is now $865,893 versus $801,753, which is an 8% increase (equal to our annual compound rate). This $64,140 difference is the result of the $801,753 at the start of age 64 and not the end of age 64. Allowing $801,753 to grow for one more year at 8% is a $64,140 increase (calculated as: $801,753 x 8%). The $801,753 + $64,140 = $865,893 and can also be computed as: $801,753 x 1.08%.

The concept of having your accumulative balance grow in this example at the assumed rate of return for one more year illustrates the power of the compounding interest effect.

Because there can be a significant cost of delaying your retirement funding, I propose you start saving TODAY! Contributing funds to these vehicles early on in your career can allow your investments the ability to grow over time so that you can comfortably draw upon them in retirement.

Having trouble finding the money to fund your IRA? Understanding the true cost of your spending habits can help! Check out What is the Cost of Your Daily Routine for more information!
