

The Power of Compounding

Working in the financial services industry, we are confronted with the power of compounding on a daily basis. We see clients who make it work for themselves (investments) and clients who make it work against themselves (debt).

We also see how this phenomenon affects every area of life, most notably health, fitness, career and relationships. Our minds, being linear thinking machines, find it very difficult to grasp the true power of what compounding can lead to in our lives. The tragedy for those who don't follow the two steps that compounding requires is that their lives are robbed of unimaginable progress.

While most of us overestimate what can be achieved in the short term, we routinely underestimate what can be achieved in the long term.

The Two Magic Ingredients

Compound interest is nothing more than earning interest on interest. In year two, it may seem insignificant, but given enough time, the numbers become substantial. Think of it as a snowball that slowly grows into an avalanche.

Generating compounding returns in all areas of our lives is not a formality. You will no doubt be able to think of a few people whose lives seem to plod along linearly while others are leaping forward. Being on the right side of this divide is simple but not easy, requiring you to follow two steps.

The first step that compounding demands is time. This is a challenge for those who are impatient and those who start later than they should have. It's the reason we encourage people to start saving from their first paycheck and why your oldest friends are probably your best friends. It's also why today is the best day for starting anything new in your life.

However, compounding only comes into play after you start. The second demand of the

equation is work. It only compounds what you put in. Nothing in, nothing out. Are you providing the system with the correct inputs? For financial compounding, you have to make the contributions. For health compounding, you must make the healthy choice today and again tomorrow. For fitness compounding, will you do the exercise tomorrow when you don't feel like it?

The passing of time is not enough to result in progress. This is evident in many people's lives. If you break the streak, not even time can save you. While the plodder sits around waiting for the compounding, the leaper is focused on step one - doing the work!

Do the Work!

Every area of your life can be significantly stronger in one to two years, but only if you understand what needs to be done and commit to doing it. If you do this for a decade without letting up, your previous situation will likely be almost unrecognisable.

The idea of becoming 1% better every day has been popularised by James Clear in his excellent book "Atomic Habits". In it, he says, "Every action you take is a vote for the person you wish to become."

It's no coincidence that one of the world's longest investors is also one of the wealthiest. Warren Buffett has amassed unimaginable fortunes, but, notably, more than 99% of his wealth has been achieved after age 55.

The lesson for us is simple; do the work for long enough, and the result becomes inevitable.