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Investing for the long-term, and relatively at a higher rate of return, compounds the value of your investments due to re-investment of profits over the investment horizon. Table 1 below illustrates this impact. For example, if an investor invests Rs 100,000, earning a rate of return of 10% per annum the value of his or her investment will grow to about Rs 673,000 in 20 years. The same investment earning a rate of return of 15% per annum would grow to Rs 1.64 million in the same time period. Thus, whereas the rate of return differential is 50% (15% p.a. versus 10% p.a.), the increase in the value of investment is more than double (Rs 1.64 million versus Rs 673,000). Another interesting fact to note from Table 1 is that there is incredible benefit of investing early. For example, Rs 100,000 invested at 15% p.a. for 20 years, will grow to about Rs 1.6 million. The same Rs 100,000 invested at the same rate of return of 15% p.a. for 25 years rather than 20 years will grow to about Rs 3.3 million – double the amount. Thus, by investing 5 years early, you can actually double your money.

Compounding also depicts how the value of an investment erodes if it earns a return less than the inflation rate. As can be seen from Table 2, if an investor keeps Rs 100,000 in a current account of a bank earning 0%, whereas inflation rate is 10% per annum, the inflation-adjusted value of his or her Rs 100,000 will erode to about Rs 62,000 in 5 years, and Rs 24,000 in 15 years. Table 2 also shows that the investor has to earn a return equal to the prevailing inflation rate to keep the real value of his or her investment intact. To achieve real growth in investment value, the return on the investment should be higher than the inflation rate. For example, if the prevailing inflation rate is 10% per annum, and the investor is earning a 15% per annum rate of return on his or her investment, the inflation-adjusted value of the investment will almost double in 15 years.

Some of the takeaways for investors from the tables below are that: (i) the sooner you start to save, the greater the benefit will be; (ii) a slightly higher rate of return will have a substantial impact on the value of your investment over the medium to long term; and (iii) a higher rate of return than inflation will ensure that the value of your investment increases in the real term. Stock market and real estate offer a higher rate of return over the long term versus bank deposits. Therefore, investors are advised to invest a portion of their assets in these two asset classes. If an investor had placed Rs 100,000 in a bank in Pakistan 15 years ago earning a profit rate of 9% per annum, his or her investment would have grown to about Rs 364,000 at present. If the same investment were made in the Pakistani stock market, it would have grown to about Rs 733,000 in the same period, at an average rate of return of 14.2% per annum. If an investor is not willing or able to invest in the stock market and / or real estate, then we suggest investing in money market funds that are presently providing a rate of return of around 10% per annum. This is better than keeping money in a current account or a savings account of a bank.

Table 1

Initial Investment of Rs. 100,000			
Years	10%	15%	20%
1	110,000	115,000	120,000
5	161,051	201,136	248,832
10	259,374	404,556	619,174
15	417,725	813,706	1,540,702
20	672,750	1,636,654	3,833,760
25	1,083,471	3,291,895	9,539,622

Table 2

Initial Investment of Rs. 100,000, Expected Inflation of 10% Per Annum				
Years	Inflation Adjusted Value at 0% p.a. Return	Inflation Adjusted Value at 5% p.a. Return	Inflation Adjusted Value at 10% p.a. Return	Inflation Adjusted Value at 15% p.a. Return
1	90,909	95,455	100,000	104,545
5	62,092	79,247	100,000	124,889
10	38,554	62,801	100,000	155,974
15	23,939	49,768	100,000	194,795
20	14,864	39,440	100,000	243,278
25	9,230	31,255	100,000	303,829