GRAYISSUE
LONG TERM COMMENTARY

1 November 2005
Issue no. 50

A little goes a long way – the power of compound growth on your savings

Warren Buffet referred to the 'power of compounding' as the eighth wonder of the world. The power of compounding is about the power of making your money work for you: earning interest today on the interest that you earned yesterday. It also holds the key to financial security for most of us as we live longer and need to save more for our retirement. We therefore make no apology for updating and redistributing an example used in a previous version of the GrayIssue to illustrate this principle.

The South African Savings Institute barometer report (released in May 2005) showed that gross savings as a percentage of Gross Domestic Product (GDP) fell from 15% in the 3rd quarter of 2004 to 13.5% in the last quarter 2004. This decline took place in the face of the lowest interest rates in years, rising household income and against a backdrop of an increase in savings as a percentage of GDP in developing Asia and other emerging markets. "Spend it" rather than "invest it" seems to have become the trend for South African consumers, fuelling the spending boom. What else could South African consumers be doing with their increased household income and what benefit or impact could even a little financial discipline and prudence have for them in the future?

The simple hypothetical example below highlights how 'a little money *can* indeed go a long way':

1. If you had saved just R20 per month in a bank account from the end of May 1974 until the end of September 2005 (31/05/1974 – 30/09/2005), assuming a money market return over the period of 13.04% p.a.*; your money would have grown to R 53 940 (after tax at a rate of 25%).
   * This return would not have actually have been possible on R20 each month because the return / savings interest rate decreases as the amount saved decreases, but it serves as a conservative estimate for this example.

2. Taking this one step further, if you had invested the R20 a month in the stockmarket and received the FTSE/JSE All Share Index (including dividends) return over the same period, your money would have grown to R 403 354.

3. Had you achieved the return that Allan Gray earned for its clients, your R20 per month would now be worth R3.594 million**.
   ** Equity returns used above are for all our clients since we started the business on 15/06/74. Please note that the minimum monthly debit order into any Allan Gray unit trust fund is R500 and also that our first unit trust, the Allan Gray Equity Fund, was only launched on 1 October 1998.

The table below illustrates this example, as well as showing the capital accumulated by saving various amounts monthly and investing this in different ways.

Monthly savings	Total investment (376 months)	After tax cash in bank (25% tax rate)*	FTSE/JSE All Share Index	Allan Gray Limited**
R 20	R 7 520	R 53 940	R 403 354	R 3 594 740
R 50	R 18 800	R 134 849	R 1 008 384	R 8 986 850
R 100	R 37 600	R 269 698	R 2 016 768	R 17 973 701
R 500	R 188 000	R 1 348 488	R 10 083 841	R 89 868 505
Annual compound growth rate	**N/a**	**9.8%**	**18.3%**	**29.6%**

This example illustrates the profound impact of saving a small amount regularly, investing it wisely and letting the power of compound interest work for you. You can substantively improve your financial situation and if you start saving sooner rather than later you will be a step closer to being financially independent when you retire.

Commentary by Johan de Lange, Director, Allan Gray Investor Services