(I am not a financial Advisor, and this is not financial advice. I'm just sharing my "real life" journey with money)

"Hey Dad": Money

Money conversations with my children

"Hey Dad, what's compounding?"

Let's see, kids:

The first thing that you want to do is understand how much interest you can expect to earn on your account balance, by leaving your money in the account for 12 months, without contributing to it or withdrawing from it. Then take your account balance and multiply it by the Annual Percentage Yield that the bank is currently offering on the account.

Let's say, for example, that I have $22,000 in a savings account in an online bank, and it represents 6 months of living expenses (*rent, transportation, food, utilities, personal care, etc.*), that I call my "Emergency Fund". And my bank is offering a 5.05% Annual Percentage Yield on my account, which my online bank of choice, CIT Bank, is currently offering on their Platinum Savings Account. I multiply the $22,000 times the 5.05% **(a)**. That calculation demonstrates that at the end of 12 months, I will have accumulated $1,111 of earned interest on my $22,000 account balance. Based on this scenario, my new account balance at the end of the 12 months is now $23,111 **(b)**:

a) $22,000 x 5.05% = $1,111
b) $22,000 + $1,111 = $23,111

Each year (*12 consecutive months – assuming that the APY stays at 5.05%*), the new account balance gets multiplied by the 5.05% APY, and over the next 5 years, the account generates at total of $6,145 in interest and grows to $28,145, without you doing anything. **That's compounding**…*the process in which earned interest is reinvested to generate additional earnings over time:*

	Account Balance		Annual Percentage Yield (APY)		Interest Earned	New Account Balance
Year 1	$22,000	x	5.05%	=	$1,111	$23,111
Year 2	$23,111	x	5.05%	=	$1,167	$24,278
Year 3	$24,278	x	5.05%	=	$1,226	$25,504
Year 4	$25,504	x	5.05%	=	$1,288	$26,792
Year 5	$26,792	x	5.05%	=	$1,353	**$28,145**
Total Interest Earned ($):					**$6,145**	

Now, you do the calculation, with the same starting account balance of $22,000, but now use a 0.04% APY, which some of the big banks are currently offering. *Let me save you the trouble*. Starting with the $22,000 initial account balance, with an APY of 0.04%, in 5 years your account will generate a measly $8.80 in interest and grow to $22,008.80. *They call that "nuts!"*

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