



Power of compounding in SIP investments

How great would it be if our money worked as hard to grow as we did to earn it! Well, this can be accomplished by the magical concept of compounding.

The power of compounding in SIP (Systematic Investment Plan) is a force to be reckoned with. Compounding in SIP works on the concept of earning interest on interest, which leads to exponential growth over time and, if you invest regularly in a SIP, even small amounts can accumulate into a significant corpus due to the power of compounding in SIP. Does that not sound like a dream come true?

As the quantum of your investment grows with time, the returns generated are reinvested, leading to even higher returns in the future. The longer your investment horizon, the greater the potential for compounding to work its magic and make you financially independent. Financial advisors prompt you to begin your investment journey as soon as possible, because of this unique benefit of SIPs. Additionally, SIPs also enable you to remain financially disciplined with regular investments. Even a small amount invested regularly over a long period can generate substantial wealth through the power of compounding.

As an investor keen on SIPs, you should have patience and a long-term investment horizon to garner the highest possible benefits. Over time, the benefits of compounding can result in significant wealth creation, making it an incredibly powerful tool for investors.

What is compounding?

Compounding is a simple but very powerful concept. It is a process in which the interest earned on the principal amount is reinvested, so that, from that moment on, the interest that has been added also earns interest. Your investment will therefore generate earnings from not only the initial principal invested, but also the subsequent interest earned over the coming period.

How does compounding work in investments?

Compounding is essentially a long-term investment strategy. For compounding to work, two things are required – reinvestment of earnings and time. When you choose to reinvest the interest earned on an investment, your returns themselves start earning. Thus, you are effectively transforming your investments into an income generating asset where your money is working for you to generate wealth. The so-called “power of compounding”, if invested in the right assets, has the ability to generate enormous returns. Let us take an example of two individuals, one of them starts investing an amount of Rs.1,000 at the age of 25, but the other only begins at 35. Assuming a rate of return of 12% compounded annually for both of them, by the time they are 50, the former would have accumulated an amount of Rs.17.9 lakhs while the latter would have accumulated only Rs.5 lakhs! Therefore, the sooner you start

investing, more time you will have to reap the benefits of compounding (Source: <https://www.moneycontrol.com/personal-finance/tools/magic-of-compounding-tool.html?classic=true>).

Power of Compounding in SIP Investment Plans

[Investing in mutual funds](#) through SIP is a simple and disciplined way of accumulating wealth over a long period of time. A SIP investment can be done by making small periodic payments instead of a lump-sum. Mutual funds entail two types of earnings – dividend and capital gains. If, instead of withdrawing your earnings, you choose to reinvest it in the same plan, you can reap the benefits of compounding.

Benefits of SIP:

It is easier to build wealth using a SIP since it only involves making small disciplined investments. By making these investments, over a longer period of time, you get to invest at both the high and low points in the market thus averaging out over a long-term and eliminating the need to time the market.

By combining a variety of different assets including stocks and bonds, mutual funds provide the advantage of diversification along with the benefits of exponential growth in your investments through the process of compounding.

Explain how compounding works on SIP using an example

Let us illustrate compounding with the help of an example. Suppose you start with a monthly SIP of Rs. 5,000 invested at the rate of 12%. The returns earned by the end of the year will be Rs. 4,047. This amount will then be added to your initial principal of Rs. 60,000, making your new principal Rs. 64,047. This process will continue thereby generating a future value of Rs 4.1 lakhs at the end of 5 years, Rs. 11.6 lakhs at the end of 10 years and around Rs .50 lakhs at the end of 20 years (Source: www.sipcalculator.in) You can experience the power of compounding yourself by using a SIP calculator, a tool available online which helps you calculate the wealth gain and expected returns on your monthly SIP investments.

[SIP plans](#) are a very simple and convenient way of achieving one's financial goals. The key to reaping the benefits of compounding is starting early and being consistent.