How Important Is 1 Little Percentage Point?

By Mark Charnet

For most of us, we were introduced to the subject of percentages in elementary school; however, we really didn't receive an *education* until we got our first credit card bill that we didn't pay in full the month before and realized how expensive it was not to pay in full and on time. The credit card and finance companies have the ability legally to charge up to 24.99% and in some states as high as 29.99% on outstanding balances. For some, the minimum payment, as calculated by the bank or finance company, is virtually all interest and if only the minimum payment is made, the balance can take a virtual decade to repay. In my experience as a financial advisor, I have seen people with debt on their car or home exceed the value of the asset. Today there are record amounts of people who owe more on their homes than they are worth. This is based in part, by not fully understanding, "How important is 1 little percentage point" and the concept of negative amortization.

More fortunate people learned about the power of 1% by comparing the rates of savings accounts or Christmas clubs or CD's from one bank or credit union to another. Most home buyers compared mortgage rates before purchasing their first home looking exclusively for the lowest rate, which, in most cases is not the only criteria in the mortgage selection process. A smaller group learned by comparing the yields on corporate or municipal bonds and dividend paying stocks before making a buying decision.

Regardless of the form of education, each group of people were negotiating over as little as a fraction of 1%, whether to receive more or to pay less. The number one can be a very large number indeed and can best be demonstrated utilizing a future interest calculator available in any office supply store or Radio Shack! The future interest calculator is the most powerful tool in the world for those seeking to understand how money works and who aspire to set goals, such as when a mortgage can be paid off if you pay an extra $200 a month or how much you would need to invest every year to be a millionaire in 20 years at an 8% rate of return, beginning with nothing down or one of my favorites, given a 3% annual inflation rate, if you reach your goal to accumulate that million dollars in twenty years, what will it be worth in today's dollars. I'll give you that answer, $543,794.

Now, I don't want to bore you with numbers, but I want to educate you. This article is titled, "How important is one little percentage point." Let me demonstrate. If the inflation rate in the example above was just one little percentage point more, 4% instead of 3%, twenty years from now the million dollars is worth only $442,002 a further reduction of $101,791. One more little percentage point of inflation to 5% over the twenty years reduces the $1,000,000 to a paltry $358,485, a 64% reduction in purchasing power - UGH! Let me restate the problem to give even further impact of the power of just 1%. How much lump sum will I need in twenty years given a 3% annual inflation rate to equal $1,000,000 in 2007 dollars? Answer $1,806,111. But if inflation is just one itsy bitsy point more, the answer jumps to $2,191,123. Just one more teeny weenie 1% increase to a 5% inflation rate, to have a million dollars in today's dollars, the lump sum required would be, are you sitting down, please sit down………………… $2,653,297. Need to rationalize these numbers? Just look at the price of a car, a gallon of milk, a college education, the cost of a nursing home or the price of your own home twenty years ago as compared to today and run to Radio Shack or Staples, buy a future interest calculator (also known as a business analyst) plug those figures into your new machine and see for yourself not only the negative power of inflation, but, "How important 1 little percentage point can be!"

The lesson learned today is that in order to keep ahead of inflation we must secure a rate of return on our savings and portfolio that exceeds not only the rate of inflation, but, the negative force of taxation, which, only makes the mission of accumulating capital that much more difficult.

In conclusion, a rate of return in excess of inflation is the primary goal for all of our invested dollars, followed by not sharing too much with the state and federal government and finally, not to lose any of our capital while positioned for greater returns. Can this be accomplished - YES and if you would like to learn more you have a few options. **First, is to attend the upcoming Retire-ment and Estate planning Workshop Event sponsored by this paper and the YM-YWHA, November 13th at the "Y", One Pike Drive in Wayne commencing promptly at 6:30pm, where you'll have a chance to meet me in person.** Another is to write me with any questions you would like answered on any of your personal financial planning matters and lastly is to look at our consumer website www.1APG.com which contains articles, newsletters and even a calculator like the one described in this article that you can use absolutely Free. Just click on "learning center" then calculators.

Hope to see you at the "Y" for this exciting event and if there are any specific financial planning topics you would like me to write about in future issues of Life and Leisure, please send me an email with your thoughts and suggestions.

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