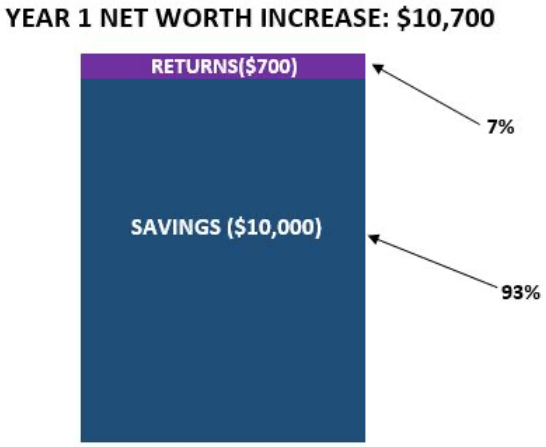
December 1, 2022

How Many Years Does It Take for Investment Returns to Matter More Than Savings?

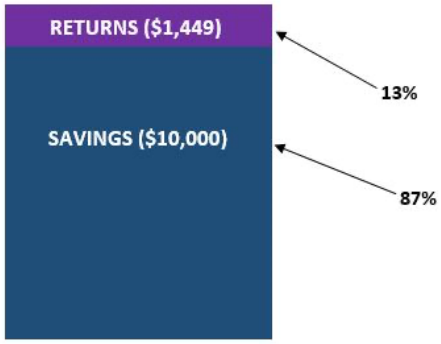
Suppose you invest $10,000 in the stock market in a given year and earn a 7% return on your investment. At the end of the year, you have your initial $10,000 plus $700 in investment returns for a total of $10,700.

This means 93% *($10,000 / $10,700)* of your net worth growth came from savings and only 7% *($700 / $10,700)* came from investment returns.



Suppose the next year you invest another $10,000 and again earn a 7% return. This year you would earn $1,449 *(($10,700 + $10,000) * 7%)* from investment returns. This means 87% *($10,000 / $11,449)* of your net worth growth came from savings and 13% *($1,449 / $11,449)* came from investment returns.

YEAR 2 NET WORTH INCREASE: $11,449



If we keep doing these calculations each year, we'll find that investment returns account for more and more of yearly net worth increases as time goes on:

Ann. Savings: $10,000		Ann. Returns: 7%	
www.PedlarFinancial.com			
Year	**Net Worth**	**% Net worth increase that came from savings**	**% Net worth increase that came from investment returns**
1	$ 10,700	93%	7%
2	$ 22,149	87%	13%
3	$ 34,399	82%	18%
4	$ 47,507	76%	24%
5	$ 61,533	71%	29%
6	$ 76,540	67%	33%
7	$ 92,598	62%	38%
8	$ 109,780	58%	42%
9	$ 128,164	54%	46%
10	$ 147,836	51%	49%
11	$ 168,885	48%	52%
12	$ 191,406	44%	56%
13	$ 215,505	41%	59%
14	$ 241,290	39%	61%
15	$ 268,881	36%	64%
16	$ 298,402	34%	66%
17	$ 329,990	32%	68%
18	$ 363,790	30%	70%
19	$ 399,955	28%	72%
20	$ 438,652	26%	74%

In year 1, investment returns only account for 7% of net worth growth.

In year 2 they account for 13% of net worth growth.

Then 18% in year 3…

Notice how it takes about 11 years for investment returns to account for more yearly net worth growth than savings:

Ann. Savings: $10,000		Ann. Returns: 7%	
www.PedlarFinancial.com			
Year	Net Worth	% Net worth increase that came from savings	% Net worth increase that came from investment returns
1	$ 10,700	93%	7%
2	$ 22,149	87%	13%
3	$ 34,399	82%	18%
4	$ 47,507	76%	24%
5	$ 61,533	71%	29%
6	$ 76,540	67%	33%
7	$ 92,598	62%	38%
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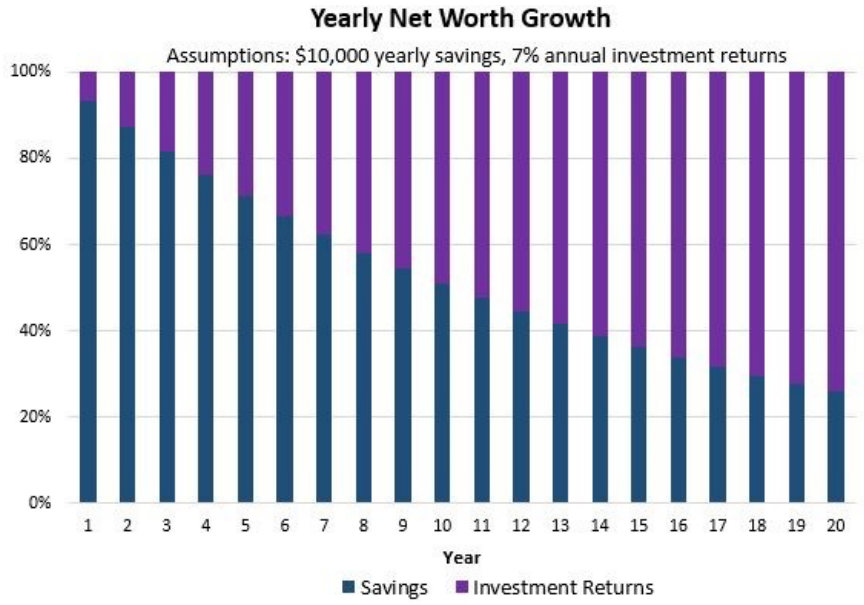
19	$ 399,955	28%	72%
20	$ 438,652	26%	74%

Investment returns overtake savings

After that point, investment returns become the primary force that pulls net worth higher.

Here's another way to view these numbers:



It turns out that no matter how much you save each year, these numbers hold true. For example, suppose you saved $20,000 consistently each year instead of $10,000:

Ann. Savings: $20,000		Ann. Returns: 7%	
www.PedlarFinancial.com			
Year	Net Worth	% Net worth increase that came from savings	% Net worth increase that came from investment returns
1	$ 21,400	93%	7%
2	$ 44,298	87%	13%
3	$ 68,799	82%	18%
4	$ 95,015	76%	24%
5	$ 123,066	71%	29%
6	$ 153,080	67%	33%
7	$ 185,196	62%	38%
8	$ 219,560	58%	42%
9	$ 256,329	54%	46%
10	$ 295,672	51%	49%
11	$ 337,769	48%	52%
12	$ 382,813	44%	56%
13	$ 431,010	41%	59%
14	$ 482,580	39%	61%
15	$ 537,761	36%	64%
16	$ 596,804	34%	66%
17	$ 659,981	32%	68%
18	$ 727,579	30%	70%
19	$ 799,910	28%	72%
20	$ 877,304	26%	74%

Investment returns overtake savings

Only the net worth numbers change. The percentages stay the same.

But what if you earn less than 7% annual returns on your investments? Suppose you save $10k each year again but instead earn 5% annual returns:

Ann. Savings: $10,000		Ann. Returns: 5%	
www.PedlarFinancial.com			
Year	Net Worth	% Net worth increase that came from savings	% Net worth increase that came from investment returns
1	$ 10,500	95%	5%
2	$ 21,525	91%	9%
3	$ 33,101	86%	14%
4	$ 45,256	82%	18%
5	$ 58,019	78%	22%
6	$ 71,420	75%	25%
7	$ 85,491	71%	29%
8	$ 100,266	68%	32%
9	$ 115,779	64%	36%
10	$ 132,068	61%	39%
11	$ 149,171	58%	42%
12	$ 167,130	56%	44%
13	$ 185,986	53%	47%
14	$ 205,786	51%	49%
15	$ 226,575	48%	52%
16	$ 248,404	46%	54%
17	$ 271,324	44%	56%
18	$ 295,390	42%	58%
19	$ 320,660	40%	60%
20	$ 347,193	38%	62%

Investment returns overtake savings

We see a similar pattern: Investment returns slowly begin to account for more net worth growth over time, but in this scenario, it takes about 15 years for returns to become more important than savings.

This brings up an interesting question: **How long does it take for investment returns to overtake savings for different annual return amounts?**

This table reveals the answer:

Annual Return	Years Until Investment Returns Overtake Savings
3%	24 years
4%	18 years
5%	15 years
6%	12 years
7%	11 years
8%	10 years

**This table assumes you consistently save the same amount each year.*

The lower your annual investment returns, the longer it takes for returns to overtake savings. Even with a fairly high 8% annual return, it takes a decade for investment returns to become more important than savings. This illustrates just how important savings are in the beginning of your net worth journey.

Keep in mind that for this analysis we assumed you invested the same amount each year. It's likely that as you get older, your yearly income will increase, and you'll be able to save more each year.

To see how increased savings impact these numbers, feel free to email me directly at apedlar@sterlingmutuals.com and I would be thrilled to send you the excel spreadsheet that allows you to modify the annual savings, annual savings increase, and annual investment returns.