IT'S ALMOST TOO SIMPLE

→ Compound interest is a saver's best friend and a spender's biggest foe

When it comes to your finances, there's one gift that's sure to keep on giving — compound interest.

It's the key to building your nest egg — or the mistake that can put you deep in debt — yet two-thirds of Americans are clueless when it comes to this important concept, according to researchers at George Washington University.

On a basic level, compound interest is earning or charging interest on top of interest. Here's a simple example:

Let's say you have a savings account that earns 1 percent interest once a year, and you put $1,000 into it. After the first year, you'll earn $10 in interest.

Now, if you leave that money in the account for another year, you'll be earning interest on the original balance, plus the interest you earned in the first year ($1,010).

That means the interest in the second year will add up to $10.10.

If you continue to leave that money in the account, you'll keep earning more and more.

Compound interest plays a huge part in saving for retirement because your balance will grow more quickly. On the flip side, if you rack up debt, compound interest will add up, making it difficult to pay it off.

There are a few principles to follow to make compound interest work for you:

Save early

Time is the key to making compound interest work for building your retirement. I recommend young workers start saving from the day they get their first paycheck. Keep in mind, you need to keep the money you earn in the account to capitalize on compound interest, so resist the temptation to withdraw.

Minimize fees

Do you know how much you're paying in fees for your 401(k)? The majority of people enrolled in a workplace savings plan don't. Just as interest compounds to build your retirement savings, fees will compound to cut it down.

Even small fees can make a big difference in your nest egg over time. Talk to your human resources department or benefits manager to learn more about your employer's plan to see if there's a way to bring down the fees.

Pay off debt

Compound interest can send credit card debt spiraling out of control.

When you carry a balance on your credit card, the company will charge you interest on the amount you owe. Over time, your debt will grow because you'll be charged interest on the original principal, plus the interest you've accrued. If you have debt, devote as much as you can to paying it off as quickly as possible.

Read the fine print

Many credit card companies calculate compound interest not yearly or even monthly, but *daily*. That means your interest is being added to your principal every day, which makes it that much harder to pay it off. Make sure you understand how your credit card works. The best bet, however, is to pay your credit card bill in full each month.

It's powerful!

If you're still struggling with the concept of compound interest, consider this question: Would you rather have a million dollars or would you rather start with a penny and double your money each day for a month?

Sounds like an obvious answer, right? Wrong. The doubling penny will earn you more than $10 million after 31 days.

Now, you're not going to find a bank that will double your money every day, but the example — illustrated at tinyurl.com/penny-double — proves the power of compound interest.

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