The Macro Impact of Micro-Investing

Once upon a time, we would drop our spare change into a piggy bank or the cup holder of our cars. Then we would use that money to buy some gum or a cappuccino.

Now there are apps that take those extra nickels and dimes and invest them. This type of investing is part of a trend in the finance world dubbed “micro-investing.” But what exactly is this and is it a good idea?

Below, we give you the lowdown on micro-investing, as well as offer some better alternatives.

What Is Micro-Investing?

Micro-investing is investing small amounts of money at a time. This is usually accomplished via an app. Most of these apps allow you to get started for as little as $5 or even free.

How the micro-investing happens depends on the app. Some link to your credit or debit card and round up the nearest dollar when you spend. The difference is then invested in an ETF (exchange-traded fund).

(link to ETF article)

Others auto-debit from your bank account or take a cut of your paycheck. You set up the amount or percentage and the money gets invested in a portfolio based on your investment profile.

The idea is to set up the investment process automatically and for the amount to be so small, it’s practically painless. Over time, you could end up investing hundreds, or even thousands, of dollars a year.

The Limits of Micro-Investing

Some things are great when they're small: mini-cupcakes, baby chicks and your internet bill, for example. But when it comes to the latest trend of micro-investing, not so much.

One of the biggest problems with micro-investing is that it can give you a false sense of financial security. You may believe that, because you're investing, you'll have enough for retirement.

But micro-investing will most likely yield micro-results. By only investing tiny amounts, you're missing out on bigger profits.

Let's say, for example, you use a micro-investing app that rounds up to the nearest dollar on debit card charges and invests the difference. At the end of each year, this spare change adds up to roughly $500.

You're investing like the experts recommend so you don't need to do anything more, right?

Actually, you'll need to do a lot more.

Micro-investing simply isn't enough when it comes to something major like retirement. Because of compound interest, the gap between what you earn on micro-investing versus a more proactive investing strategy can be tremendous.

(link: https://www.investopedia.com/terms/c/compoundinterest.asp)

Another problem with micro-investing are the waiting periods, both to invest and withdrawal.

To invest, you have to wait until you spend or the money is auto-debited from your checking account. The waiting that occurs in between means you have money that isn't earning any interest.

Should you need some emergency funds to pay for a root canal or Fluffy's vet bill? If the money is coming from your micro-investing app, you'll have to wait again. The only choice you'll have is to sell some of your investments and then wait two to six days for the funds to transfer.

Finally, most micro-investing platforms charge monthly or annual fees. Currently, the more popular apps charge either $1 a month, .025% of your investment total or both. These fees may seem cheap but remember that you won't be investing much in the first place.

The waiting periods, fees and financial limits of micro-investing may not seem like a big deal. But the long-term impact of these limitations really add up.

Think of micro-investing like throwing dimes and quarters into a jar each week versus putting in five-dollar bills. You'll have a small fund eventually but you could have had much more if you had put in the fives.

How to Build a Better Nest Egg

Micro-investing simply isn't aggressive enough to fund your future. Here at Finch, we want to help you build a nest egg that a bald eagle would envy.

We advocate creating a budget and using the Finch checking account to actively grow your funds.

(link to budgeting article)

Unlike micro-investing platforms, the Finch checking account has no waiting periods. The money in your checking account continually earns interest from the start. You can also withdraw instantly, at any time.

There are also no minimum deposit requirements or fees to get started.

But let’s say you still choose micro-investing as your plan to save for retirement. You opt for that app that automatically invests your spare change.

The spare change you invest probably won’t equal a ton--we’ll go with the total mentioned above, $500 a year. Your micro-investing app charges $1 a month so at the end of each year, you’ve saved around $488.

Over ten years, you would have put in approximately $4,880 of your own money. Assuming your ETF earns a respectable 8% a year, you would have around $7,300 at the end of the decade. Not bad.

Your friend, who is so responsible she flosses every day, also decides to start investing. However, she wants to be more aggressive with her investing.

Through budgeting, she is able to set aside $5,000 each year. She skips micro-investing and opens a Finch checking account instead.

Assuming she earns 8% on her investments as well, her total at the end of the decade would be around $72,500. That’s a difference of $65,200!

Also, your friend’s total doesn’t include the extra interest she earns by no wait time. Remember that with Finch, her money is invested the moment it hits her checking account. With the micro-investing apps, there’s a delay. Over time, this would make an even larger difference.

While it could be considered a companion technique to a more proactive investment strategy, you can see how micro-investing on its own won’t work. Its micro-results would mean that, instead of traveling the world when you retire, you would be limited to a trip down memory lane.