Steps To Successful Investing

The following are a few guidelines and suggestions on investing that may be helpful. They represent sound ways to grow a portfolio while providing adequate built-in safeguards for long-term preservation.

Establish Investment Objectives and Stick with Them

Periodically, stock funds take a hammering. But over long spans of time, stocks as a group have consistently come up winners. Measured over 20-year periods, stretching all the way back to 1871, stocks beat bonds 94 percent of the time and cash 99 percent of the time.

Cash isn't the stuff you carry around in your wallet; rather, it refers to safe, readily-accessible assets like Treasury bills and money-market funds. Since 1926, there have been many bull and bear markets. Yet, throughout the entire period, common stocks have returned an after-inflation (the only return that really counts) average of 7 percent annually, according to Jeremy J. Siegel, a Wharton School finance professor. This compares to long-term government bond's measly 1.7 percent and Treasury bills with an after-inflation return of 0.5 percent.

For patient investors, stocks have built up an overwhelming advantage over other investments. What does that mean for the average investor? When the newspapers and networks proclaim doom and gloom with headlines about uncertainty, one needs to place them into perspective and remain committed to long-term objectives.

Invest for the Long Term

"Patience is a key ingredient to investment success."

You have heard that patience is a virtue? It is especially true when it comes to investing anything of value, whether it be your time, your support, or your money. Patience is a key ingredient to investment success. Long-term investing can pay off very nicely despite fluctuations in value over the short term.

According to many financial professionals, stock investments have a long-term growth rate well in excess of bonds, Treasury securities and inflation. For any 20-year period during the last six decades, the S & P 500 has never experienced a loss on an inflation-adjusted basis.

In fact, short-term downturns often present excellent long-term investment opportunities. Historically, investors have often realized their biggest gains during market panics. So it makes sense to increase your equity positions when everyone else is selling out. If you have short-term objectives, keep investment maturities short.

Stay Invested

An investor needs to leave his/her money invested for compounding to work to its fullest. The importance of time to investment success is illustrated by the Rule of 72. This commonly used mathematical formula bears repeating here. To estimate the amount of time it takes money to double, you divide 72 by the assumed interest rate. Assuming a 7.5 percent annual rate of return, an investment of $5,000 today will grow to $10,000 in nine and one-half years. By staying invested for the long term, you can be assured that you will not miss out on the next bull market.

Practice Dollar-Cost Averaging

How brave of an investor are you? Do you see yourself as a risk-taker? Have you ever tried to beat the market and lost? Do you have the courage to buy stocks only after prices have risen sharply, then find yourself selling them after prices have already fallen?

There is a simple way to avoid these investment pitfalls: a periodic investing technique called dollar-cost averaging. By investing a fixed amount on a regular basis, an investor can avoid the difficulty of deciding the best times to invest. Another result of investing the same dollar amount each period is that you automatically purchase fewer shares of an investment when prices are high and more shares when prices are low. In this way, you can help lower your average cost per share over the course of your investment plan.

Of course, like any investment strategy, dollar-cost averaging is not foolproof. It neither assures a profit nor protects against losses in a declining market. In addition, such a plan involves continuous investments in stocks and mutual funds regardless of fluctuating price levels. An investor should always consider his or her financial ability to continue their purchasing through periods of low price levels.

A Proverb and an Example – We can understand the principle of dollar-cost averaging by taking a look at the following biblical proverb:

> Steady plodding brings prosperity; hasty speculation brings poverty.
> Proverbs 21:5 TLB

Dollar-cost averaging takes the guesswork out of timing the ups and downs of the stock and bond markets. This time-tested method for systematic investing can be a particularly good approach in today's uncertain investment environment. Dollar-cost averaging eliminates emotional investment decisions and provides a regular disciplined investment program.

> "Dollar-cost averaging also enables a person to get into the habit of investing regularly."

Dollar-cost averaging involves investing a fixed amount of money at regular intervals, such as monthly, quarterly or annually. By investing on a dollar basis at regular intervals, rather than buying a fixed number of shares, an investor can purchase more shares when prices are low and fewer when prices are high. Short-term price decreases are viewed as buying opportunities, assuming that the investment will eventually rebound. The result... the average cost per share is typically lower.

This is one way to strive toward long-term saving targets, such as college tuition or retirement. The key to investing in anything, especially the stock market, is to set aside regular amounts for systematic investment. Market timing is not science but rather wishful thinking. In fact, some have suggested that most individual investors do not buy low and sell high. They seem to buy high and sell low. After all, it takes real courage to buy when the stock market is low, the news is bad, and the future looks bleak. That's the time when most individuals sell out.

The following illustration of dollar-cost averaging will show us its principle and its power. We will simplify this visual diagram by placing an initial per share price point of $10 per share. Let us say for example that the price of one share of a mutual fund selling at $10 a share drops by as much as 50 percent over a period of one year. Now this would obviously be a bad situation to happen after you have made an investment—actually a very devastating one and the kind that might influence you to sell out at the bottom.

But then, let's imagine that you continued to have confidence in the holdings of this mutual fund and in its management team, so you continue to invest $100 in the mutual fund every time the share price dropped another $1.00 per share. As the mutual fund share price drops all the way to $5, you continue to invest at each price point and then continue to do so as it recovers to the initial starting point of $10. This is certainly not an example of a bull market and yet, what will have happened overall will be very satisfactory.

Notice the results of $100 invested each month, at each point down the ladder and back up again to the original price.

1. Investing an additional $100 at a cost of $10 each buys 10 shares.
2. Investing an additional $100 at a cost of $9 each buys 11.111 shares.
3. Investing an additional $100 at a cost of $8 each buys 12.5 shares.
4. Investing an additional $100 at a cost of $7 each buys 14.286 shares.
5. Investing an additional $100 at a cost of $6 each buys 16.667 shares.
6. Investing an additional $100 at a cost of $5 each buys 20 shares.
7. Investing an additional $100 at a cost of $6 each buys 16.667 shares.
8. Investing an additional $100 at a cost of $7 each buys 14.286 shares.
9. Investing an additional $100 at a cost of $8 each buys 12.5 shares.
10. Investing an additional $100 at a cost of $9 each buys 11.111 shares.
11. Investing an additional $100 at a cost of $10 each buys 10 shares.
12. The final total of dollars you would have invested = $1,100.00

The total number of shares you would now have = 149.128. The total value of your shares at the end of the year (149.128 X $10) = $1,491.28. The total gain on your investment at the point that the share price recovers would be 35.6 percent.

At no point did the stock ever sell above your initial buying price, but in the end you had a 35 percent profit. And this does not include whatever dividend the mutual fund may have paid. This is the value of dollar-cost averaging!

The above illustration is, of course, hypothetical. An investor should realize that no investment program can assure a profit or protect against loss in declining markets. Discontinuing the program during a period when the market value of shares is less than original cost would incur a loss.

For this reason, any investor contemplating such a program should take into account his or her ability to continue it during any such period. Keep in mind that sometimes a stock loses value and never regains its original price. This is the reason the example used a stock mutual fund. It would be less likely to stay at the lower price levels. Although dollar-cost averaging is a good investment tool, investors must realize that no method guarantees a risk-free investment. The value of holdings will only be determined by what a buyer is willing to invest.