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Never Mind the Record -- Tortoises Win the Race

By DIANA RANSOM
October 8, 2006

Closing at new highs on three consecutive days last week, the Dow Jones Industrial Average officially put the bear market of 2000 to 2002 behind it.

After a small decline Friday, the widely followed market benchmark ended the week at 11850.21 -- up 10.6% so far this year and above the earlier peak of 11722.98 in January 2000, before the Internet bubble burst. It was a 63% climb from the bear-market low of 7286.27 in October 2002.

But by one important performance measure -- and for a significant segment of investors -- the Dow benchmark's recovery from the bear-market blues actually came a while ago.

Measuring the average's performance in points, as is common, ignores the value of the dividends paid by all 30 component stocks. On a "total return" basis, assuming all dividends were reinvested, a hypothetical investor who put $1,000 into each of the 30 Dow stocks on Jan. 14, 2000, got back above the $30,000 starting point in November 2004.

Moreover, in a bear market, investors can accelerate a return to breakeven by continuing to buy stocks as the market tumbles. That's what many people do -- without necessarily planning it that way -- when they have money regularly set aside from their paychecks for a 401(k) retirement plan or other investment account.

Steady Buying Pays Off

To see just how powerful such steady-as-she-goes buying can be, consider a hypothetical investor who at year-end 1999 -- just weeks before the market's 2000 peak -- began putting $100 a month into the Diamonds (DIA), an exchange-traded fund that aims to track the Dow industrials.

As prices fell, and he kept buying more shares, most of his monthly statements would have shown the Diamonds investment worth less than the sums invested.

But since October 2003, that investor has consistently held Diamonds shares worth more than he invested, as calculated by researcher Morningstar in Chicago. (This example excludes transaction fees on the ETF purchases.)

"As easy as it is to get spooked by short-term market fluctuations," you should think about how that volatility can work for you, says Dan Culloton, a senior mutual-fund analyst at Morningstar. This hypothetical investor was back in the black in 2003 because he stayed invested -- and continued putting more dollars in -- "regardless of which way the wind was blowing."

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Making regular investments of a steady size -- often called "dollar-cost averaging" -- has even netted a small profit for another hypothetical investor, who since year-end 1999 has been buying into the exchange-traded Nasdaq-100 Index Tracking Stock (QQQQ). That may not sound like much -- except that the technology-heavy Nasdaq-100 Index the fund tracks is still down a whopping 64% from its all-time high in March 2000.

The steady QQQQ buyer hasn't made much, "but there is a gain there," says Mr. Culloton of Morningstar.

Bear markets are inevitable in the stock market, and it can take many years for a market benchmark to regain its previous level. Not counting dividends, it took the Dow Jones industrials 25 years to recover after the stock-market crash of 1929 and 9½ years after the 1973-1974 bear market. It took two years after the crash of 1987.

From 1928, when the makeup of the Dow benchmark grew to 30 stocks from 20, through 2005, the industrials returned an average 6.7% a year before dividends. But annual returns have varied widely, from a negative 53% to a positive 67%.

Given the market's volatility, dollar-cost averaging can help trim investment risk and may lower your average cost per share. That's because your regular investment buys fewer shares when prices rise. And when prices fall, you put in the same amount and "you are just buying more shares," says John Sweeney, senior vice president of mutual-fund products at Fidelity Investments.

A Lower Average Cost

Mr. Sweeney gives a hypothetical example of contributing $100 a month to a mutual fund over a period of three months.

The fund's share price is initially $10, so the first investment buys you ten shares. A month later, the share price has dropped to $9 and your $100 buys 11.11 shares. The third month, the share price has climbed to $11 and you purchase only 9.09 shares.

The three purchase prices -- $10, $9 and $11 -- average out to $10. But because you bought more shares at the lower price and fewer at the higher price, you've actually got an average cost of $9.93 a share on the 30.2 shares you've acquired.

Dollar-cost averaging can ease the sting of making a big one-time investment, only to see the market tumble. It's also a way to avoid a classic pitfall of investing -- allowing fear or greed to drive your decisions, says Kirk Kinder, a financial adviser at Picket Fence Financial in Bel Air, Md.

Steady periodic investing can help you avoid the temptation to throw big dollars into an overheated market that could be due for a breather -- and also help fight the inclination to stop buying, or sell, stocks when prices are down.

Adds Matthew Chope a financial planner in Southfield, Mich., with Raymond James Financial: "If you are new to investing, or just want a more systematic approach, dollar-cost averaging is a great tool."

Because of a new pension law, some workers may soon get a bigger push toward dollar-cost averaging through their 401(k) plans. The law gives companies a green light to automatically enroll employees in 401(k) plans and also to automatically increase workers' contributions over time.

"It is great if you can always increase" your contribution, such as once a year or each time you get a pay raise, says Susan Hirshman, a wealth strategist at J.P. Morgan Funds.

Invest on Autopilot

Another way to dollar-cost average is to set up an automatic investment plan at a mutual-fund company or brokerage firm. You authorize that company to withdraw money from your checking account or your paycheck at regular intervals and invest the dollars in a mutual fund of your choosing.

Sweetening the deal, especially for younger people with limited savings, is the fact that many fund companies lower or waive their minimum investment requirement if you sign up for automatic investing. T. Rowe Price Group, for instance, typically requires a $2,500 initial purchase for taxable accounts. But it waives that minimum for people who sign up to invest at least $50 a month through its Automatic Asset Builder program.

You could also have money invested regularly into other types of accounts, such as individual retirement accounts and 529 college savings plans.

Financial advisers are divided on whether people holding a lump sum they intend to put into stocks should invest all at once or in installments. Since stocks have generally climbed over time, investing immediately may boost return. But investors lower the risk of a poorly timed purchase by splitting up their buying.

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