A safer way to invest in stocks

Investing in stocks can be really risky—particularly when somebody invests a lot of money at once and expects quick results.

But it's also true that investing in stocks can be surprisingly safe for certain investors. The men and women who are putting regular amounts into stock funds through 401(k) plans, for instance. For investors who put set amounts into stock funds, month after month and year after year, long-term success is a virtual certainty.

A test drive

To see how investing a fixed number of dollars at regular intervals demolishes risk, let's go back in time to the end of 1928. (Congratulations on winning the Presidency, Mr. Hoover!)

From 1929 through 1938, stocks turned in their worst ten-year performance in modern history. Over those ten years, remembered for the Crash of '29 and the Great Depression that followed, dreams of investment success turned to nightmares for many Americans.

Reggie and Joe: two hypothetical investors:

Reggie Pierpoint has just inherited $10,000, and at the end of 1928, he invests it all in stocks.

Joe Paycheck doesn't have that kind of money. Instead, he invests $1,000 in stocks at the end of 1928. He invests another $1,000 a year later, and another $1,000 a year after that. By 1938, Joe, like Reggie, has invested a total of $10,000.

Look at their results, as measured by the S&P 500-stock index, as of the end of 1938:

• Reggie lost ground. Even with dividends reinvested, Reggie ended 1938 with less than he started. His annualized investment return? A discouraging *minus* 0.9%

• Joe moves ahead. Wall Street may have laid an egg, but Joe managed to make an omelet. By investing $1,000 every year, he acquired more and more stock at bargain prices. By the end of 1938, with dividends reinvested, his total investment of $10,000 was worth almost $15,000. His annualized return? A respectable 7%. Not bad under the circumstances.

The flip side

For comparison, the absolute *best* ten years for stocks thus far, as measured by the S&P 500, was the decade 1949-1958. Someone like Reggie who invested $10,000 at the end of 1948, and reinvested all dividends, would have piled up more than $60,000 ten years later. Someone like Joe, investing $1,000 a year, would have accumulated almost $30,000.

Most ten-year periods aren't that good. But most aren't as bad as 1929-1938, either.

Joe’s investment program was safer than Reggie’s because he took advantage of *dollar cost averaging*.* Today’s investors who build their retirement funds by investing regular amounts on a regular schedule enjoy the same advantage. If the stock market does take a tumble—and tumbles are to be expected from time to time—these dollar cost averagers will be able to acquire relatively more stock per dollar. Result: a larger nest egg in the long run.

“The stock market is like a gambling arena only in the short run,” writes Norman Fosback, editor-in-chief of *Mutual Funds Magazine*. “In the long run, stock fund investors are invariably winners.” He must have been thinking of investors like Joe.

For less stress, dollar cost average

O.K. Suppose Great Aunt Harriet did remember you in her will. Suddenly you have, say, $24,000 to invest. You want to put your windfall in stocks for long-term growth, but you’re worried about investing that much money at “the wrong time.”

Solution: Dollar cost average. Invest $6,000 now and bank the rest. Invest another $6,000 six months from now, another $6,000 a year from now and make the last installment in 18 months.

Let’s suppose you put your money in Hypothetical Stock Fund. The price of HSF goes from $30 to $40 a share, then plummets to $20 before returning to $30 a share. If you had invested all $24,000 in HSF immediately, at $30 a share, after 18 months you would merely be breaking even. But you didn’t. You dollar cost averaged. So you’re ahead of the game:

	Amount invested	Share price	Number of shares purchased
Now	$6,000	$30	200
Six months	$6,000	$40	150
12 months	$6,000	$20	300
18 months	$6,000	$30	200

Total invested: $24,000
Average Price: $30
Total shares : 850

Bottom line: You invested $24,000 at an average price of $30 per share. But dollar cost averaging allowed you to buy more shares at $20 than you bought at $40. After 18 months you own 850 shares worth a total of $25,500!

*Systematic investment neither ensures a profit nor protects against loss in a declining market. Because dollar cost averaging involves continuous investment in securities regardless of fluctuating prices, the investor should consider his or her financial ability to continue purchases through periods of declining prices.

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