MONEYWISE

TOTAL RETURN

I'm No Fortuneteller

So, don't ask me where the markets are heading tomorrow. What I do know: Dollar-cost averaging doesn't require a crystal ball

ONE OF THE ODD THINGS ABOUT BEING A FINANCIAL specialist is that I have a lot more conviction in my long-term expectations than in my short-term ones. People have a hard time understanding this, because it runs counter to the way life works. Where will you be tomorrow at noon? You probably have a good idea. How about on June 6, 2013? You probably have no idea whatsoever.

When it comes to the stock market, though, I'm much more comfortable predicting that the market will be higher 10 years from now, say, than I would be saying the market will be higher tomorrow. What about market peaks and troughs? No one can pinpoint market bottoms or market tops. Lately, a lot of investors are asking whether now—meaning today or tomorrow—is a good time to buy. What they often mean is: if I invest in stocks now, will they go straight up from here without falling? I don't know and neither does anyone else.

Investors need to adjust their thinking. A more realistic and helpful question is: Given today's tremendous uncertainty and immense volatility, what's the best way to make sure you don't invest a lot of money at a horrible time? The answer, in my opinion, is a practice called dollar-cost averaging. With dollar-cost averaging, an investor commits to buying a specific dollar amount of an asset (stocks, bonds, etc.) at regular intervals, usually monthly, whether that asset goes up or down in value. It's actually the way most people invest: in a 401(k) or 403(b) retirement plan, a portion of each paycheck gets put to work. Dollar-cost averaging into a stock or stock mutual fund means you will automatically buy more shares when the price is low than you do when the price is high. And that's what you want to do!

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Say you want to buy $5,000 worth of a stock that bounces around a lot and commit to investing $1,000 monthly. The price per share starts at $50, and you buy 20 shares. The next month it surges to $60, so you only buy 16 shares. Then it falls to $40, and you buy 25 shares. The stock subsequently falls to $30 the following month, and you buy 33 shares. Finally, it returns to just under the original price, to $45, and you buy another 22 shares. Obviously, if you had instead invested the entire $5,000 by buying 100 shares at the original price of $50, you'd have lost $5 per share, or $500. But by dollar-cost averaging, you'd own 116 shares worth $5,220, a nifty little $220 profit. That's the mathematical wonder of dollar-cost averaging.

Right now, the psychological benefits of dollar-cost averaging are even more beneficial. Imagine an investor—let's call her Simone—who began investing on Halloween 2007. A $10,000 investment made all at once that day in the S&P 500 Index would have shriveled to a mere $4,905 by the end of February 2009. Simone would know that she bought at the worst possible time. On the other hand, if Simone had used dollar-cost averaging, her $10,000 would've shrunk to $6,458 over the same period. That's not great, but it's not nearly so bad on a dollar basis and Simone would be less likely to beat herself up over the poor timing.

It's fortunate that most American investors already invest via dollar-cost averaging plans in their employee-sponsored retirement plans. To them I'd say a couple of things. First, yes, your plan balance has fallen over the last 18 months, but you've got a good game plan. Second, keep at it! Too many people fall prey to the temptation to stop investing because they see their balance falling. Over the long term, the stock market tends to compound nicely, so even if an investment made today loses value over the next three, six, or even 12 months, the likelihood that it will have gains in 10 years is very high. As I said at the beginning, I really don't know what will happen in the months ahead, but I'm confident in a very bright future, years down the road. **—Mellody Hobson**

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