$ Investing Basics $

Evergreen Consulting Group Inc. - Richard A. Green, DDS, MBA

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– **Richard A Green DDS, MBA**

Investing is a philosophy.

Dr. L.D. Pankey would always tell the dentist, who was interested in pursuing an individualized, relationship-based practice, “Go home and develop a bank account.” Dr. Harold Wirth would say, “Learn to live on less than you make.” These admonitions are valuable because, if you have a bank account and have learned to live on less, the patient needs you more than you need the patient. You have begun a practice lifestyle consistent with choice. The dynamics of the relationship have changed and you are free to lead and offer others choice.

Financial freedom is that point in your life where you have learned to live on less than you make. Financial independence is that point when the earnings on your invested assets have replaced your hands as an income stream. Applying financial fundamentals to create financial freedom is, as Dr. Pankey often reflected, an important task of the professional.

Investing: Is there a way to make the seemingly complex, simple?

Arnold Palmer once called golf “deceptively simple and endlessly complicated.” The same is true of the accumulation and management of wealth. It is deceptively simple – if you practice everyday for 25 years! That could be good news for dentists who are willing to start early.

As I write this, we are in the midst of a very volatile market with the Dow hovering around 30% below its year 2000 high of 11,723 (remember that altitude?), and a previous quarter unlike any in over thirty years. While many are disappointed and heading for the exits, it is time to recommit to some basic tenets.

Typically the market corrects thirty percent only three times in a lifetime. The first time it happens to you, most sell and run away. The second time it happens, even though the times may seem uncertain, you have seen it before and feel conflicted about selling or adding to your positions. The third time it happens, you realize that there is a better chance the market will return to

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appropriate levels of return than languish forever in the doldrums.

Mutual Funds have a way of helping with your diversification and begin the process of making simple the complex. You may or may not enjoy playing investment sleuth, digging through the large array of mutual funds looking for the next fund. Oftentimes, this style or "Process" is a prescription for mediocrity or worse. Instead of chasing "Hot Funds," bet your future on a good, solid family of funds. It might be time to settle down and get yourself a nice "family."

If you saw your portfolio mangled by this market, as your red-hot stocks or mutual funds suddenly turned cold, here's a solution of forehead-thumping simplicity. Take every spare dime you have, park it at one of the big no-load families, and then buy a fistful of the company's funds. That no-brainer strategy should give you the safety of diversification, without a lot of expense or hassle. Just go to Vanguard, T. Rowe Price, or Fidelity and buy five or six funds, and that will keep you out of a lot of trouble.

Investing is a philosophy, process and discipline.

Remember, as you enter the investment world, you need to ask three questions. (1) What is your investment philosophy? Is it short term or long term? (2) What will you use as a process for selection, buying and selling decisions? (3) What will be your discipline? Will you use Dollar-Cost Averaging on a disciplined weekly, monthly, quarterly, or yearly schedule? Or better yet, will you use Dollar-Cost-Averaging Plus?

What is dollar-cost averaging (DCA)?

DCA is a time-tested technique and will help you manage the risk of market uncertainty. Financial markets are inherently unpredictable. For the busy dental professsional, it becomes difficult to consistently choose the best time to buy and sell in the market. We have been told to "buy low and sell high." Easier said than done!

Instead of trying to choose the right time to invest, you can use DCA, a proven investment strategy based on a Philosophy, Process, and Discipline. It helps reduce your risk and build your investment portfolio over time. Dollar-cost averaging is especially appropriate for the investor with a long-term investment philosophy, because the longer you maintain a regular investment program, the more likely you will be to buy shares at a wide range of prices. Dollar-cost-averaging is not meant to eliminate the risks of investing in financial markets, and it does not assure a profit or protect against a loss in declining markets. The success of the process depends on your ability to continue making regular purchases through "good and bad" market periods.

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There is no method of investment that can guarantee a profit if you should decide to sell at the bottom of the market. But the patient, disciplined investor, who contributes a fixed amount of money in regular installments, reduces the loss that would be incurred if the market declined sharply, just after a single large investment was made.

DCA can be used as a process of investing with your tax-deferred or your after-tax portfolio. It really depends on your circumstances, objectives and temperament. The advantage to block investing is best realized with after-tax investing since it is easier to track your cost basis when you sell and hopefully need to pay capital gains tax. With a tax-deferred portfolio, all revenues come out as ordinary income; therefore, cost-basis tracking is only used for evaluating the overall performance of your funds.

What is dollar-cost averaging plus (DCA+)?

This is another technique that can enhance your dollar-cost-averaging discipline. At times, the market corrects 10% (summer 1996), 20%, or 30% (October 1987). These major market corrections allow those with a systematic discipline to accelerate the accumulation of lower priced shares and average down their base cost per share. This technique requires some cash in your portfolio.

Some investors use dollar-cost-averaging with monthly deposits; others use a quarterly deposit discipline. In addition to these regular deposits, when the market index corrects 10%, you double up on these regular deposits, at 20% you double up again and at 30% you double up again. For example, if your regular deposit was $100, a 10% correction would encourage a $200 deposit; a 20% correction would encourage a $400 deposit; and a 30% correction would encourage an $800 deposit. Since the price per share is so dramatically reduced and the regular deposit is doubled up, the average price per share in your portfolio is averaged down.

Market fluctuation can happen over a short or long time period. It is important to keep investing even in the presence of a down market. These techniques (DCA and DCA+) have been used for years and continue to be used by long-term investors. It is not uncommon to see a 10% or 20% correction. A 30% correction may only be seen two or three times during your investing lifetime. (For example, in. October 1987, there was a correction of greater than 30%, during which many investors had a hard time adding to their positions let alone doubling up three times – or what about today's market!) With a long-term investment philosophy, the DCA+ technique is handsomely rewarded in a fluctuating market.

Start with DCA, then, as you gain experience and begin to understand market movement patterns, add the Plus (+) formula for market corrections. Good Luck. Remember, no one cares for your money like you do. Educate yourself to financial markets!

There are other key attributes to any investment: risk, return and cost.

Returns are all but impossible to predict, while it is relatively easy to hold down investment costs and control risk. Often, as we search the 4,100 stock funds looking for the next superstar, we forget about risk and cost, and we focus relentlessly on performance. During the 1990's, when performance was soaring, many investors bought the funds with the best "last year's" performance. This pattern found many buying a slew of fund companies and thinking inaccurately that they were building a well-diversified portfolio.

But you say, "I thought I was diversifying, so what would you do instead?" While hindsight is always 20/20, using a process that would encourage you to buy within a big no-load fund family, which limits your costs and controls risk, would be a good process.

Sure, by limiting yourself to one company, you restrict your choice of funds. But I would argue that's a benefit, because it forces you, the investor, to be more intelligent about your fund selection. If you would buy half-a-dozen funds from a large fund family, you should end up with half-a-dozen funds that pursue somewhat different strategies, thus ensuring that you are at least moderately well diversified.

At the same time, costs should also be reasonable. Thanks to economies of scale, the biggest no-load fund companies typically offer funds with relatively modest expenses. While that doesn't guarantee good performance, because every big fund family has a lemon or two, it does tend to make it unlikely that you will have an unmitigated disaster.

The large fund families monitor their funds very carefully to ensure the funds follow their prescribed investment style. They are willing to make a change if a manager is performing poorly. Many of the small funds do not have those controls in place. Sticking with a single no-load company will also eliminate a fistful of financial headaches: You can easily move money among funds, you will receive statements listing all of your holdings, and you will simplify matters for your heirs.

To simplify your finances, stash all your investments at one no-load fund family. Here are eight companies listed by Morningstar that offer a number of funds in their family of diverse funds with low investment minimums. The second column presents the number of funds offered by each company. The third column presents the % annual expense of investing in each fund family.

	#	%
American Century	50	1.00
Dreyfus	53	0.84
Fidelity Investments	62	0.63
Northern Funds	25	1.09
Strong Funds	43	1.09
T. Rowe Price	76	0.83
USAA	31	0.72
Vanguard Group	65	0.27

You may find the choice of funds overwhelming. To learn how you can make one endlessly complicated pursuit much simpler, first consider your personal investment philosophy, process, and discipline, then you will be able to design a simple approach to what can seem a very complicated industry, and in that way, reflect your desire to achieve balance and diversification in your life and in your portfolio. Stay the course, do the discipline.

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