Investing "101"

Here is some practical information that brings us back to the basics of investing. | **BY R. RICHARD EVERETT**

INVESTING for the first time can be scary, intimidating, and downright nerve-racking. No one wants to lose all of their hard-earned money to a bad investment- and yet, novice or first-time investors have been known to do strange and foolish things. I have met people who have never invested before and suddenly they buy a start-up company because they heard a "hot tip" down at the barbershop, or they buy stock they know nothing or little about because Uncle Harry was talking about it at the latest social gathering.

It's amazing to see the kind of research that goes into purchasing a new television or refrigerator; yet, we blindly throw our money into a stock with little or no research! I have encountered several individuals who lend to or invest with a family member or close friend to open a new restaurant, retail store, or manufacturing operation—with virtually no research. Granted, some of these opportunities occasionally work out, but most do not. Unfortunately, the first-time investor loses everything and never attempts to invest again—too bad!

There is an immense difference between investing, speculating, and gambling. The scenarios previously mentioned are speculating and gambling, not investing. Investing can be exciting and potentially rewarding. Think about this—the Dow Jones Industrial Average (DJIA), an index* was at 40 in 1929 (just after the stock market crash that led into the Great Depression). On December 31, 2001, the DJIA closed at 10,021. In conjunction with this, the average annual compounded rate of return for the Dow over the past 100 years is just shy of 11%—not bad! Doing some quick math, that's over a 25,000% increase. (*It is not possible to invest directly into an index and past performance may not be indicative of future results.) Of course, please realize that an individual would have needed to be invested consistently throughout the entire 72 year time period to potentially receive these levels of returns. This illustration does not take taxes and/or inflation into consideration. However, it does show that, by having a longer investment time horizon, one could potentially benefit from being invested.

In order to take advantage of the potential growth of the stock market...assuming you can withstand risk, you should follow what I call *THE SIX KEY STEPS OF INVESTING*:

Principle #1: Buy Quality

Stocks generally go up when company profits go up. There is a strong correlation between what the market does and what companies earn. Warren Buffet, chairman of Berkshire Hathaway and perhaps the most outstanding investors of our times, has made an absolute "killing" in the stock market by purchasing large blocks of well-known, well-managed industry leaders such as Coca-Cola, Gillette, Geico and American Express. Of course, all securities are subject to market risk including possible loss of principal.

Principle #2: Diversify

We have all heard the phrase numerous times—"Don't put all of your eggs in one basket." This philosophy is definitely true when it comes to investing. A diversified portfolio can reduce risk by dividing investment dollars among a variety of investments, such as stocks, bonds, and real estate.

"Give a portion to seven, and also to eight, for thou knowest not what evil shall be upon the earth." Ecc. 11:2.

Principle #3: Buy Systematically

Simply put, systematic investing means making regular investments at set intervals over time. This disciplined approach allows you to focus on long-term financial goals and not on the short-term ups and downs of the market. When you invest systematically, you buy more shares when prices are low and fewer shares when prices increase. This concept is also called dollar cost averaging*. If you invested just $100/month for 30 years in one of the mutual funds established in 1928, it would have grown to over $500,000! Dollar cost averaging, to say the least, can be very effective!

**Footnote*: Investments must be regular and the same amount each time. If the investor discontinues the plan when the market value is less than the cost of the shares, he or she will lose money. The investor must be willing and able to invest during the low price levels. This plan does not protect the investor in a steadily declining market.

Principle #4: Use Professional Advice

For many investors, professional advice can make a big difference in the outcome of their investment returns. Going it alone, new investors can easily self-destruct because their tendency is to purchase a stock or mutual fund featured in a financial magazine. The problem with

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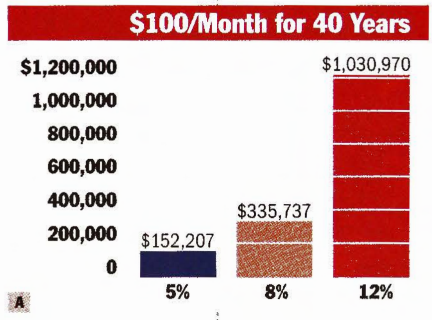
this is, by the time the publication gets into the hands of "mom and pop" investor, the investment may have already seen its best days. The first time investor usually buys high and dumps the investment the first time there is a downturn, thus—selling low. Buying low and selling high works much better!



Be careful where you go! *Try this exercise sometime.* Suppose you had $10,000 to invest. You walk into a bank for advice. What are they most likely to recommend? Probably a C.D. Walk down the street to an insurance agency. What are they most likely to recommend? Probably life insurance or an annuity. Walk down to the next block and walk into a brokerage firm. What will they suggest? Probably stocks, bonds, or other investments. Where is the objectivity? Whether you're age 25 or 65, whether you're worth $1,000 or $1,000,000, whether you want growth or safety, investments should be made based on your suitability. Try an independent financial planner. They don't just sell products. They put specific plans together and make specific recommendations based on your goals, risk tolerances, and personality. Prescribing without proper diagnosis is malpractice and potentially deadly!

Principle #5: Buy for the Long Term

Unless you are nearing the point of withdrawing your funds, it's better to have a long-term perspective, at least three to five years. Although prolonged bear (down) markets are a possibility, the variability of average annual returns over long periods of time is much less than over shorter periods. Patience helps the investor survive the ups and downs of the stock market. Sure, the market was up roughly two out of three years since 1990, but what about the down years? The market's 31 down years averaged a negative 13.32% return—but the 67 up years averaged a positive 22.32%. Also, the market has had back-to-back negative years only twice since World War II. *What is the moral of the story?* Over time, the positives have outgained the negatives. Don't look at the "bumps in the road"—keep an eye on your long-term goals.

When asked the secret to investing in the stock market, Peter Lynch, one of the greatest money managers, responded—"not to get scared out of the market." John Templeton (a devout Christian who has given away millions of dollars, a true lighthouse on Wall Street), also one of the great portfolio managers of the past 50 years, is often asked what the secret is to successful investing strategies. His answer—"Ignore fluctuations. Do not try to outguess the stock market. Buy a quality portfolio and invest for the long term."

Principle #6: Understanding the Importance of Compound Interest

Most people think a few extra percentage points of interest don't amount to much money. Not so! Understanding the value of compound interest is key to pursuing financial freedom. The following chart shows what happens if you invest $100 per month at 5%, 8%, and 12% for 40 years (the amount of years we typically work. *See figure A*).

Get the point? By receiving a hypothetical 12% rate of return vs. 5%, you don't end up with 7% more money. In this case, it's 700% more money. It pays to invest wisely (if you can assume the market risk of potentially losing the entire invested amount)!

The Rule of 72 is another powerful illustration on the "magic" of compound interest. Divide the interest rate you are getting on your money into the number 72. The answer is the number of years it takes for your money to double. Let me illustrate. Take 6%, which is the current bank rate. Six divided into 72 is 12. In other words, it will take 12 years for your money to double at 6% interest. Now—suppose you could get a 12% rate of return. Twelve percent is just slightly less than what the Dow Jones Industrial Average has returned for the past 104 years. Twelve into 72 is six. It only takes six years for you to potentially double your money at a 12% investment return. Suppose a 25-year-old had $10,000 to invest *(see figure B)*.

Rule of 72

AGE	6%	12%
25	$10K	$10K
31		$20K
37	$20K	$40K
43		$80K
49	$40K	$160K
55		$320K
61	$80K	$640K

B

This is a profound example of the difference between saving and investing—a $560,000 difference! It is also a great example of good stewardship.

We have the wrong definition of risk and safety. For example, if I put $5,000 in something, get $6,000 back, and it doesn't buy me what $5,000 used to buy me, then it's not safe.

Don't be left behind; get started today! After all, **MONEY DOESN'T TAKE CARE OF ITSELF!** ■

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