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News from American Funds

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A strategy for taking the emotion out of investing in volatile markets



Wondering how to survive a down market? Worried about selling out too soon and then having trouble getting back into the market later? The strategy of systematic, or regular, investing is a proven way to take advantage of changing market conditions and avoid the futile approach of trying to time the market.

Regular investing can help you cope with the human tendency of refusing to invest in a declining market, when stock prices may actually be more reasonable.

With a systematic investment plan, a mutual fund shareholder invests the same amount at regular intervals — for example, \$500 each month — regardless of whether stock prices rise or fall. Using this strategy, known as dollar cost

averaging, investors can buy more shares at lower prices and fewer shares at higher prices.

A program of regular investments helps take the emotion out of investing when markets turn particularly volatile because your long-term strategy doesn't change. There is no need to make a drastic adjustment. In fact, often one of the worst things investors can do when

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the market dips is to take their money out of the market, because it often means buying high, selling low and missing the chance to add to a portfolio when prices are lower.

Ideally it would be best to buy when the market is low and sell when it is high. But behavioral finance studies have shown that investors are particularly bad at picking the right times to buy or sell.

“Automatic, regular investing also frees the individual investor from trying to forecast in the short term what the stock market will do,” says Gregg Ireland, a veteran portfolio counselor for several American Funds. “Speculating what the stock market will do in the short term is like predicting the weather next week. It’s an unpredictable variable,” he says.

How does systematic investing work?

To illustrate the potential benefits of dollar cost averaging, take a look at the upper table on this page. In this example, an investor bought shares of a mutual fund at three regular intervals, paying \$15, \$10 and \$20 per share. When the price fell to \$10 per share, the investor bought more shares. When it rose to \$20 per share, the investor bought fewer shares.

The key is that the average cost of the shares was \$13.85 per share, whereas the average price on the market was \$15 per share. This means that the investor was able to save an average of \$1.15 per share simply by investing regularly and using the power of dollar cost averaging. Of course, to take advantage of a systematic plan, investors must be willing to stick to their strategy during bad markets. Regular investing does not ensure a profit or protect against loss, and investors should consider their willingness to keep investing when share prices are declining.

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A systematic investment in action

Now that we’ve discussed the potential benefits of dollar cost averaging, let’s look at how a systematic investment plan might have worked for an investor during the past two decades. For example, consider a hypothetical investment of \$500 per month in Standard & Poor’s 500 Composite Index, with all dividends reinvested, beginning on January 1, 1988, and ending on

December 31, 2007.

During the 20 years of this hypothetical investment, there were periods of market declines with various highs and lows. But at the end of those 20 years, the investor would have built up an account balance of \$372,244, which includes \$54,109 in total dividend payments, on a total investment of \$120,000. The ending value of the investment more than tripled, and the

When prices dip, you can accumulate more shares

Investing a fixed dollar amount on a regular basis means buying shares at a range of prices. When those prices are lower, the dollar amount buys more shares than when prices are higher. By taking advantage of this approach — known as dollar cost averaging — an investor’s average cost of shares can be lower than the average market price at which the shares traded. Consider the following hypothetical example:

Investment date	Amount invested	Price per share	Shares bought
10/1/07	\$1,000	\$15	66.67
1/1/08	\$1,000	\$10	100
4/1/08	\$1,000	\$20	50

Total invested: \$3,000

Number of shares purchased: 216.67

Average price at which the shares traded: \$15

Average cost: \$13.85

Share balance drives dividend income

Because dividends are paid on a per-share basis, the higher your balance of dividend-paying shares, the higher your income. Consider the hypothetical \$500 monthly investment mentioned earlier. As the dollar value grew, so did the share balance and the investment’s income-producing power.

Year-end	Share balance	Annual dividend payment
1988	25	\$127
1998	177	\$2,803
2007	254	\$6,911

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so you may lose money. Please consult your tax or legal adviser.

dividends alone returned nearly half of what was invested.

Though a systematic investment strategy helped create a large account balance in the example, the dollar value only tells part of the story. A very important number to consider is the 254 shares the investor would have acquired had this been an actual mutual fund.

Why share balance is important

Many investors focus primarily on the dollar value of their accounts each month. This can cause anxiety and sleepless nights during periods of market decline. But investors should also look closely at the share balance, or total number of shares they were able to acquire. As the lower table on page 2 demonstrates, share balance is one of the hidden engines that drives growth and income in a mutual fund account.

Since dividends are paid based on the number of shares you own, your share balance can make a significant difference in your current and future dividend payments. In our hypothetical example, the investor received \$127



in dividend payments in 1988 based on 25 shares owned. By the end of 1998, having acquired 177 shares, the dividend payment grew to \$2,803, a considerable difference. With 254 shares by the end of 2007, the dividend payment grew to \$6,911.

When you invest regularly, you will add shares to your share balance even as your account balance fluctuates

up and down. You may not be able to control the market, but you can continue to acquire shares regularly by taking advantage of dollar cost averaging. And you'll get a lower average cost per share over time by purchasing more shares when prices decline.

The bottom line

Regular investing can help you take the emotion out of investing in volatile markets. A systematic investment plan and reinvestment of dividends work together to potentially build wealth. This approach helps you keep your focus on the long term.

Of course, when it comes to making investment decisions, you are not alone in your journey. Talk to your financial adviser about how this approach can make you less nervous during difficult markets, when gloom is ubiquitous, and not overly enthusiastic during bull markets, when irrational exuberance is often widespread. ■

Reinvested dividends help build share balance

Reinvesting your dividends is another way to help your share balance grow. One of the reasons the investor in our example below was able to acquire 254 shares was because the shareholder reinvested dividends automatically. Reinvesting dividends can help you grow your share balance even when financial markets are down or relatively flat. The investor who reinvested dividends ended up with 59 additional shares and a much larger account value. In fact, the dividend payments themselves grew as well.

In the case of a hypothetical \$500 monthly investment in the S&P 500 beginning on 1/1/88 and ending on 12/31/07, reinvesting dividends rather than taking them in cash helped build the share balance.

Investing \$500 monthly for 20 years beginning 1/1/88	Dividends reinvested	Dividends taken in cash	Advantage of reinvesting dividends
Total invested	\$120,000	\$120,000	—
Total dividend income	\$54,109	\$44,794	+\$9,315
Total shares acquired	254	195	+59

Standard & Poor's 500 Composite Index is unmanaged, and the results assume reinvested distributions, but do not reflect sales charges, commissions or expenses.

Security enhancements

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