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Time in market more important than timing

Richard Welty, who answers this installment's questions, is president and chief investment officer of Welty/Solari Capital Advisors LLC. He has been managing client money for more than 25 years and has worked for several large financial institutions, both as an industry analyst and mutual fund manager at G.T. Capital Management. Welty can be reached at 925-283-4960, www.weltysolari.com

Managing Your Money is a regular feature in which members of the Times Investing Panel answer personal finance questions from readers. The answers to these questions are general in scope and do not apply to all situations.

Q: With the U.S. stock market setting new highs daily, is it too late to make additional investments in the market?

A: We believe there is still good value in the market. One of the most difficult aspects of investing is timing. Even seasoned market professionals have a spotty record of correctly predicting the best times to invest.

Probably the most important factor to analyze is an individual's time horizon, which refers to the number of years an individual has to invest. The longer one has to invest, the less important short-term market moves become. Most market professionals agree that what is most important is not "timing the market but time in the market."

As for the current market outlook, the U.S. stock market should perform well over the next 12 months. Earlier in 2006, we went through several periods of market weakness due to concerns that high energy prices or falling home prices would cause a nationwide recession.

I do not believe either factor will cause a recession. Oil prices have fallen dramatically, giving consumers relief at the gas pump. The savings on gasoline has flowed directly into consumer spending at retail stores and restaurants.

Job growth in the United States is still good, and this has a positive impact on consumer spending. Regarding falling home prices, unless they fall at a dramatic rate, a small decline in the price of one's home should not seriously impact consumer spending.

Even with the recent run-up in stock prices, the U.S. market still is reasonably valued. Between June 2002 and June 2006, profits for America's 100 largest companies doubled, while stock prices for those companies rose less than 5 percent on average. This period has been referred to as the "blue chip blues." By mid-summer 2006, many stock market strategists felt U.S. blue –chip companies represented the cheapest asset class in the developed world.

If inflation stays in the range considered acceptable by the Federal Reserve, we can expect that the rise in interest rates is finished. If inflation remains tame, investors can look forward to interest rate cuts in 2007. Rising profit growth combined with continued growth in the economy and flat to lower interest rates should lead to higher stock prices. While the stock market is sure to experience pullbacks, money invested today should see positive returns over the next 12 months.

Q: I recently inherited a little more than $200,000 and want to invest in the stock market for the long term. I have owned some individual stocks and a mutual fund or two in the past. I am not an avid stock market watcher, and I don't keep up with all the new ideas out there. I have been hearing about the growing popularity of exchange-traded funds or ETFs. As an individual investor, should I consider investing in ETFs?

A: ETFs have been exploding in popularity over the past several years. ETFs are a special kind of index fund that tracks the composition and performance of the different market indexes such as the S&P 500, the Russell 2000 or one of the many indexes that track stocks in a specific country or industry. Each ETF has a ticker symbol and trades like a stock.

Among ETFs' many benefits are low expenses. ETFs are economical to buy and especially to maintain over the long run, which makes them attractive to the typical buy-and-hold investor. Annual fees tend to be under 0.50 percent of assets compared with the average mutual fund fees of around 1.4 percent of assets.

Tax-efficiency is another highlight of using ETFs. Actively managed mutual funds are required to pass along realized capital gains and the subsequent tax liabilities to their shareholders.

With an ETF, your chances of being hit with taxes are greatly reduced. Generally, the only time you will be hit with a tax bill is when you sell your shares – hopefully at a profit!

ETFs enable us to provide our clients instant, broad diversification across an entire asset class. We see them as an effective tool in providing appropriate asset allocation for our client portfolios.

The one caveat is that ETFs are not ideal for systematic investing every few weeks or months. Because they trade like stocks, you must pay a commission to buy and sell ETF shares. The costs of frequent buying and selling will eat into your returns.

I think ETFs definitely deserve your consideration.