

It's Time to Invest

By Dan Greenshields, CFA

The economy is in the worst shape it's been in decades. The unemployment rate looks headed for double digits. The Stock market has seen the most volatility and large declines since the 1930's; in the last 12 months the market is down between 35-40% depending on which index you look at.

If you're fortunate enough to have socked away some cash during this economic downturn -- or, better yet, if you're expecting a tax refund -- you might be wondering what you should do with your money.

Your first instinct might be to avoid any potential losses and stuff it under a mattress. Or maybe you're thinking you should splurge, and buy that flat screen TV you've been eyeing for a while.

Believe it or not, though, the best place to put your money may be the stock market -- especially if you won't need it for a while.

The market's history speaks for itself. As of December 31, 2008 Large company stocks as measured by the S&P 500 have averaged an annual rate of return of about 9.6 percent since 1926. Smaller company stocks have posted an annual average return of 11.7 percent (Source: Ibbotson 2009).

Of course there are day-to-day ups and downs. But even in a turbulent economy like this one, smart investments will pay off in the long run. In fact, because many stocks are priced well below their actual value, the long-term prospects of a well-diversified stock portfolio are especially good right now.

Economic research firm Morningstar recently calculated the "fair value" of about 2,000 stocks. Researchers found that on average, the stocks they looked at were priced about 38 percent less than their estimated value.

Money manager John Hussman recently argued that the S&P 500 is currently "priced to deliver the highest excess return since the early 1980's." And *New York Times* economics columnist David Leonhardt recently wrote that "at long last, stocks are beginning to look cheap."

Warren Buffett is one of the most successful investors ever, and his favorite measure of market value is its relationship to America's total gross domestic product (GDP). There's some debate over the reliability of this metric, but anything topping 100 percent is typically considered overvalued. In 2000, the market spiked to an astounding 190 percent of GDP, clearly indicating that the market was overvalued. But right now, the market is hovering between 70 and 75 percent of GDP. Dividends yields are also a great metric for relative value; if you owned all the S&P500 stocks or any S&P500 Index Fund you would currently be earning approximately 3.45%. (Source: Bloomberg as of 4/1/09)

Even President Obama has noted the silver lining in the market's downswing. "What you're now seeing," he recently said, "is profit and earning ratios starting to get to the point where buying stocks is a potentially good deal, if you've got a long-term perspective on it."

What all of this means is that now is a good time to put money into the market. Younger investors, in particular, should take this opportunity to buy into the market while it's cheap.

Indeed, many Americans are already looking to take advantage of bargain stock prices. A recent survey commissioned by ING DIRECT found that seven in ten Americans are planning to save, invest, or pay off debt with their federal tax refunds, instead of spending that money.

Of course, it's important to take care of first things first. That means paying off bills and any outstanding debts before investing. It's also important to establish an emergency fund of about three months worth of living expenses.

Finally, keep a long-term perspective. There will undoubtedly be short-term fluctuations in the market, and no investment is without risk. But there's risk to any financial decision. Stuff your money under your mattress and your house might burn down. Splurge on a brand new TV and it might break.

Put your money to work in the market, and it's possible that someday you'll have a large enough nest egg to buy a house, put your child through college, and retire. Times are certainly tough. But from a historical perspective, it's possible that there's never been a better time to invest.

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