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A New Twist to a Familiar Concept

Effects of Reverse Dollar Cost Averaging

Introduction

Price volatility can benefit investors accumulating their nest egg. This is why dollar cost averaging, buying a fixed dollar amount of a particular investment on a regular schedule, is helpful to those saving. However, that same price volatility can be detrimental to investors withdrawing money, a principle called reverse dollar cost averaging. The long term effect is that retirees get less out of their investments than historical rates might suggest because periodic withdrawals during low market levels leaves permanent damage.

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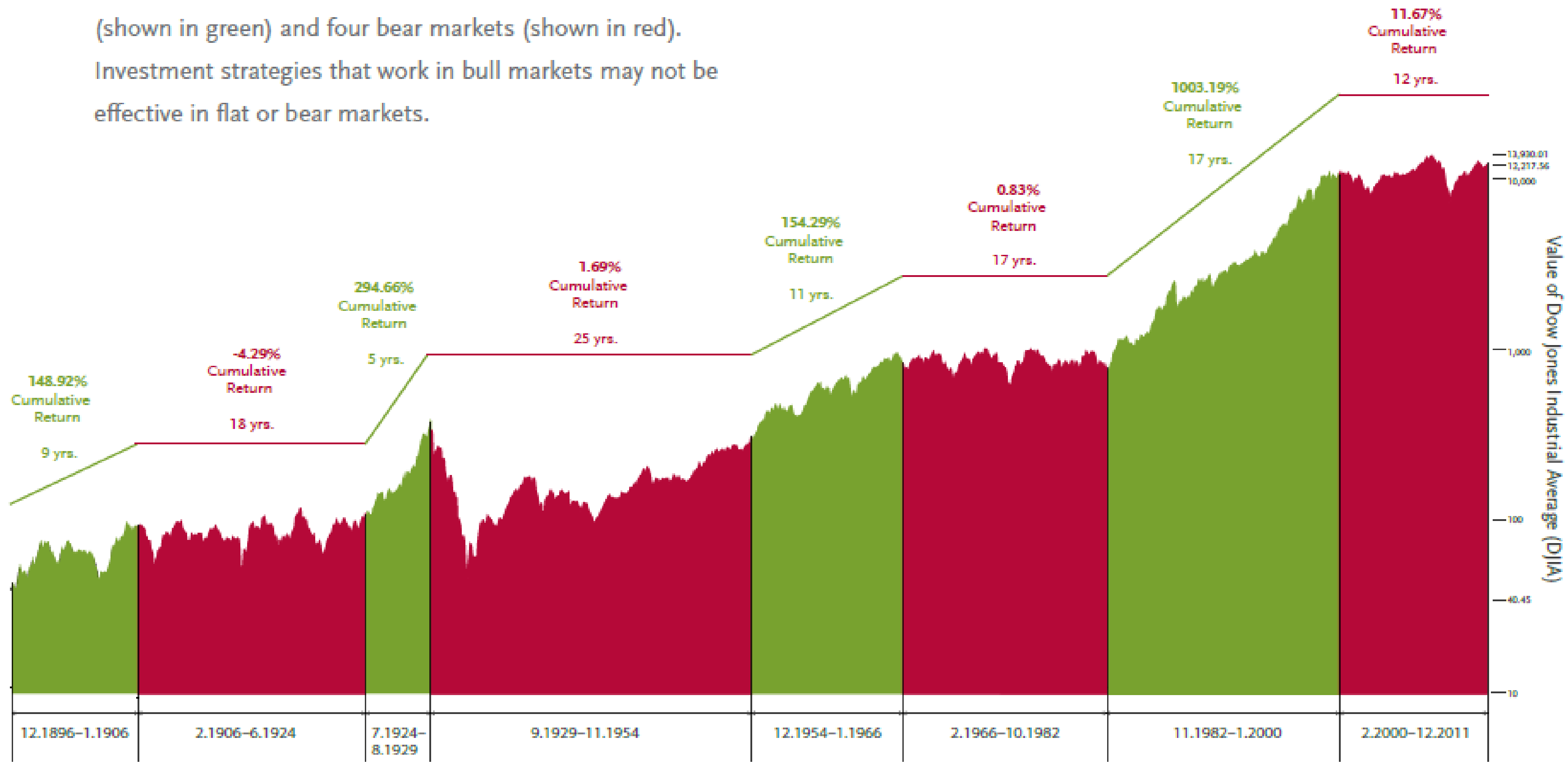
Figure 1

DOW JONES HISTORICAL TRENDS

GUGGENHEIM INVESTMENTS

History shows that the market typically moves in cycles. In the past 115 years, there have been four bull markets (shown in green) and four bear markets (shown in red). Investment strategies that work in bull markets may not be effective in flat or bear markets.



Logarithmic graph of the Dow Jones Industrial Average from 12/1896 through 12/2011.
Source: Graph created by Guggenheim Investments using data from www.dowjones.com 01/2012.

Performance displayed represents past performance, which is no guarantee of future results. *The Dow Jones Industrial Average is unmanaged and unavailable for direct investment. Returns do not reflect any dividends, management fees, transaction costs or expenses. Contact your financial advisor to discuss this concept further.*

For more information contact Rydex Distributors, LLC at 800.820.0888 or Guggenheim Funds Distributors, Inc. at 800.345.7999.

Dow Jones History

Generally speaking, the Dow Jones Industrial Average has historically had an upward trend with an average yearly return of about 4.94%. Figure 1 shows the closing value of the Dow Jones Industrial Average starting from May 26, 1896. There have been periods of tremendous bull markets causing higher than average returns, but systematic withdrawals during declining markets magnifies the impact of the deduction.

Figure 2

Secular bull market occurs when each successive high point is higher than the previous.				
Start	**End**	**Years**	**Annualized Return**	**Cumulative Return**
12/1896	01/1906	9	10.56%	148.92%
07/1924	08/1929	5	30.44%	294.66%
12/1954	01/1966	11	8.72%	154.29%
01/1982	01/2000	17	15.09%	1003.19%

Figure 3

Secular Bear market occurs when a trend does not rise above the previous high.				
Start	**End**	**Years**	**Annualized Return**	**Cumulative Return**
02/1906	06/1924	18	-0.24%	-4.29%
09/1929	11/1954	25	0.07%	1.69%
02/1966	10/1982	17	0.05%	0.83%
02/2000	12/2011	12	0.93%	11.67%

Bull and Bear Markets

The stock market has rewarded investors with long-term growth. But for most individuals, a realistic time horizon is 10 to 20 years, not more than a century. History shows the market typically moves in cycles, long periods of high returns followed by lengthy periods of lower ones as shown in Figure 2. These periods are called secular trends and there are two types: secular bull market and secular bear market. Figure 3 shows the annualized and cumulative return for the four secular bull and secular bear markets.

Hypothetical Example

A typical investor has a 10 – 20 year time horizon for retirement. A conservative withdrawal rate for an investor with a 20 year retirement is 4% - 5% monthly. Figure 4 and 5 show the growth $1,000,000 invested on January 1, 2000 under various scenarios. Using the Dow Jones as a benchmark for returns, we see the original investment has grown to $1,154,689 by January 1, 2012. However, this number does not factor the withdrawal rate to cover living expenses and inflation (3% annual inflation used for the example). If these are included, the original investment would decrease to $318,451. Since many retirees have accounts at brokerage firms, we must also factor in management fees. Using a 1.50% annual management fee, we see that our investment has declined to $197,828. In contrast, Dollar Cost Averaging with $520,000 and adding $40,000 per year for 12 years, a total investment of $1,000,000, causes the portfolio to be valued at $1,179,218.

Figure 4

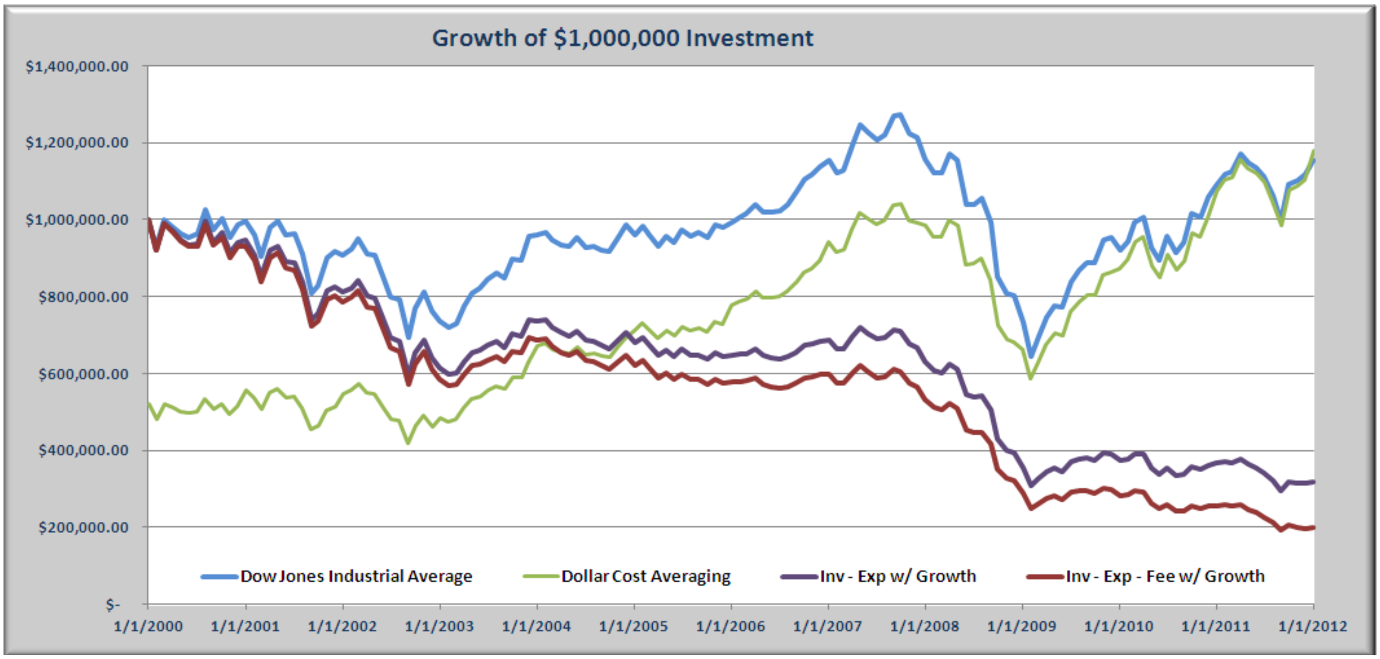


Figure 5

Date	Dow Jones Industrial Average	Dollar Cost Averaging	Inv - Exp w/ Growth	Inv - Exp - Fee w/ Growth
1/1/2000	$1,000,000	$520,000	$1,000,000	$1,000,000
1/1/2001	$995,140	$557,473	$945,533	$931,152
1/1/2002	$906,720	$547,940	$812,239	$786,932
1/1/2003	$736,144	$484,860	$613,688	$584,024
1/1/2004	$958,644	$671,408	$736,843	$687,471
1/1/2005	$958,815	$711,528	$681,216	$622,097
1/1/2006	$993,084	$776,959	$647,216	$576,917
1/1/2007	$1,153,663	$942,592	$687,687	$596,631
1/1/2008	$1,156,284	$984,733	$631,641	$532,002
1/1/2009	$731,305	$662,805	$354,555	$286,914
1/1/2010	$920,187	$873,995	$372,994	$283,212
1/1/2011	$1,086,961	$891,544	$337,118	$243,553
1/1/2012	$1,154,689	$1,179,218	$318,451	$197,828

Figure 6

Year	Yearly Fees	Cumulative Fees
2000	$14,137	$14,137
2001	$12,075	$26,212
2002	$8,621	$34,833
2003	$7,564	$42,397
2004	$7,563	$49,960
2005	$6,629	$56,588
2006	$6,256	$62,844
2007	$6,045	$68,890
2008	$3,990	$72,879
2009	$2,064	$74,943
2010	$3,825	$78,768
2011	$2,276	$81,044

Management Fees

Management fees can be beneficial to a client because the advisor's interest is considered to be more in line with the investor. Figure 6 shows the amount of fees an advisor would receive based on our example above. Since market rallies can increase advisor payout, the cumulative fees after 11 years is $81,044 or over 8.15% of the original investment.

Conclusion

Having a conservative withdrawal rate may not be enough to make retirement funds last as long as expected. It is difficult to tell which direction the market will head and investment strategies that work in bull markets may not be effective in flat or bear markets. Having a thorough understanding of these trends and the current market environment may help you better prepare for upcoming financial goals.