

## Investing is easy: Just enlist the Small Dogs of the Dow

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Having taught students at all levels, from college to adult education, I have learned the value of repetition. So let me state once again: Investing is not difficult.

Anyone with a modicum of common sense should have no difficulty building a successful portfolio.

Yes, it is that easy and, no, you do not need professional advice or specialized computer software or expensive newsletters and whatever else is being touted these days by those claiming to have an inside track.

Unfortunately, there are investors, or would-be investors, who continue to look for Wall Street's Holy Grail, that flawless method for deciding which stocks to buy and when. Regrettably, there is no Holy Grail and, to make matters worse, Wall Street offers no guarantees. Yet, for some the search has become an obsession, while for others it is a hopeless crusade. In either case, their frustration leaves them vulnerable to the vultures who prey on the uninformed.

Meanwhile, you can dramatically increase your probability of investment success if you pay attention to two simple rules. The first is that the higher the return, the higher the risk. The second is that capital appreciation takes time. Like baking a cake or brewing beer (as a matter of disclosure, I have done neither), capital appreciation cannot be rushed. Over time, a portfolio with quality ingredients can and will produce outstanding results.

Furthermore, there is one method anyone can use to build a decent portfolio in about 20 minutes. Your total commission cost, using a discount brokerage house, should not exceed \$35 and you do not have to look at your portfolio for a year.

Developed by money manager Michael O'Higgins, this often-maligned methodology is referred to as the Dow 5 theory, or Small Dogs of the Dow, and it was originally described in his book "Beating the Dow," (Harper Collins Publishers, 1991). The strategy limits your horizon of possible investment candidates to the 30 companies that make up the Dow Jones industrial average.

As O'Higgins points out, these companies are among the most widely held, widely analyzed and widely publicized companies in the world. Combined, the 30 Dow companies have assets of more than a trillion dollars and more than 4.5 million employees.

They may gain, lose, spin off, acquire, merge, rename themselves, reorganize, or even drop out of the Dow, but they are an integral and vital part of our economic system. In one form or another, they are here to stay.

The Dow 5 theory consists of selecting the five lowest-priced of the Dow 30 stocks, selected from the 10 with the highest dividend yield. You buy an equal dollar



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amount, not an equal number of shares, of each of these five companies and hold the shares for one year. On the anniversary of your purchase, you again identify the five lowest-priced stocks out of the 10 with the highest yield and adjust your portfolio accordingly.

For 2009, the total return for the Dow 5 was 27.72 percent. The S&P 500 had a return of 27.9 percent, while Fidelity Magellan (FMAGX) returned 35.73 percent and the Vanguard Index 500 (VFINX) 19.73 percent.

Does the Dow 5 theory work every year? No, it does not. For 2008, the return on the Dow 5 was a negative 49.1 percent. At the same time, the return on the S&P 500 was a negative 37 percent; Fidelity Magellan, a negative 49.4 percent. The Vanguard Index posted a negative return of 37 percent. Much of the Dow 5's decline that year was due to General Motors.

During the past 10 years, through 2008, the average annual returns were 2.7 percent for the Dow 5, 0.7 percent for the S&P 500, a negative 0.5 percent for Magellan and 0.6 percent for Vanguard. Those numbers are an illustrative example of Siegel's Paradox, where a loss of 50 percent will require 7.2 years to return you to a break-even point, assuming you receive a 10 percent compounded annual return.

Your year can start at any time. If you decided to begin on March 9, the list was Pfizer, Kraft, AT&T, DuPont and Verizon, with a combined average dividend yield of 5.14 percent.

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