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FINANCIAL PLANNING

Guide to…

# Dollar Cost Averaging

## What is Dollar Cost Averaging?

Dollar cost averaging means investing a set amount of money at regular intervals. By investing this way you are not attempting to pick the highs and lows of the market, but rather investing a fixed dollar amount regardless of market trends.

## What are the Advantages?

Some of the benefits of dollar cost averaging include:

- By regularly investing in a market, you are not relying on timing strategies aimed at picking when a market has bottomed or peaked. Dollar cost averaging imposes a helpful investment discipline by completely ignoring timing issues.
- Dollar cost averaging can be beneficial when markets may possibly fall. This is because only a fraction of the total amount to be invested is exposed to declines in the market. Also, when the market price falls, your regular investment amount will purchase more securities. In contrast, if you purchased the investment "up front", your entire investment would decline in line with the market price. This is shown in the example below.
- Dollar cost averaging provides a sound savings regime and is an ideal investment strategy for people with a regular income but without large lump sums to invest.
- The average purchase price of an investment tends to be lower than the average market price over the same period. This is because the fixed amount of money invested each time buys more securities when the prices are low and fewer when the prices are high.

### Example

The following example shows a dollar cost averaged share investment. A fixed amount of $1,000 was invested in a share each month as the market price fell and then recovered to its original value.

| Month | Amount Invested | Share Price | Units Purchased |
|---|---|---|---|
| | $ | $ | |
| 1 | 1,000 | 20 | 50 |
| 2 | 1,000 | 15 | 66 |
| 3 | 1,000 | 10 | 100 |
| 4 | 1,000 | 15 | 66 |
| 5 | 1,000 | 20 | 50 |
| Total | $5,000 | | 332 |

In this example, by dollar cost averaging into the market, the shares were purchased at an average cost of $15.06 ($5,000 ÷ 332). After five months, the investment was valued at $6,640 (332 shares at $20 per share), a profit of $1,640. If the shares had been purchased at the commencement of the five months (ie at $20), there would not have been any gain on the investment when the shares returned to their original value at the end of the five month period. The $5,000 invested would still have the same value, ignoring any dividend income.

## What are the Disadvantages?

Dollar cost averaging is not the answer to all investment problems.

- When market prices are trending upwards, an "up front" portfolio will do better than the dollar cost average portfolio. This is because the full gain on the price rise is captured by the full amount of money invested up front.
- Over a time period in which prices fall steadily, a dollar cost averaging portfolio will still lose money. Nonetheless, in such a situation, dollar cost averaging will generally lose less than the "up front" portfolio.

***Important Note:*** Dollar cost averaging is a strategy designed to increase returns by reducing the average price of an investment. Dollar cost averaging will not reduce the risks inherent in the investment that you choose. Before you undertake any investment you should be aware of the potential risks involved in that investment.



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