How Dollar Cost Averaging Can Benefit You

When it comes to investing you can be sure that there will be ups and downs. Financial markets are in a continual state of flux. It can be impossible to determine the ideal time to buy so many disciplined investors use a simple strategy called "dollar-cost averaging" to help smooth out market fluctuations. Dollar-cost averaging (DCA) is a systematic wealth-building approach in which equal amounts are invested over a fixed schedule buying fewer shares at the premium prices of a bull market and buying more shares at the discount prices of a bear market.

The strategy is a commitment to invest a set amount consistently into an asset or portfolio over a period of time regardless of market prices. You may already use this strategy in your work retirement plan by investing the same dollar amount each pay period in your 401K. To use this strategy, you determine your purchase plans in advance and buy at regular intervals. Because you are investing a set dollar amount and using it to purchase your selected asset(s) at predetermined dates accumulating wealth becomes convenient and efficient.

The value of dollar-cost averaging is that you do not need to worry about investing at the top of the market or having perfect timing. If you have a large sum to invest and you put it in the market all at once you face the risk that a declining market will take a large piece of your portfolio right away. One appealing aspect of using DCA is that you buy more shares when the price is falling and buy fewer shares as the price is rising. Because of this, you must consider your financial and emotional ability to continue investing in a down market before deploying the dollar-cost averaging strategy. Using this method does not guarantee profit or protect from loss. In fact, in a rising market you may forfeit potentially higher returns. However, this strategy is beneficial to minimize short-term downside risk and potential for regret.

Consistency is the key to this long-term investing strategy. Regardless of the market rising or falling, DCA can work in your favor so that over time, your average cost per share of your asset(s) will be lower than the average price per share. The following examples assume a regular investment of $1,000 and demonstrate the effect of this strategy given different market conditions.

Dollar cost averaging ignores the daily market fluctuations that can distract investors from their long-term goals. While there is no guarantee of profit, the DCA strategy can help take away the stress and guesswork of trying to time the market. It allows investors to focus on accumulating wealth and can aid in achieving an overall favorable average price per share. A CERTIFIED FINANCIAL PLANNER™ can help you evaluate your financial situation, consider your tolerance for risk, and determine whether this strategy is appropriate for you.

FLUCTUATING MARKET

Investment		Amount Invested		Price	# of Shares
1		$1,000		$20	50
2		$1,000		$16	62
3		$1,000		$18	55
4		$1,000		$16	62
	Total	$4,000	Average Price	$17.50	229

Average Cost Per Share = $17.46 or ($4,000 / 229)

RISING MARKET

Investment		Amount Invested		Price	# of Shares
1		$1,000		$20	50
2		$1,000		$22	45
3		$1,000		$25	40
4		$1,000		$28	35
	Total	$4,000	Average Price	$24	170

Average Cost Per Share = $23.52 or ($4,000 / 170)

FALLING MARKET

Investment		Amount Invested		Price	# of Shares
1		$1,000		$20	50
2		$1,000		$18	55
3		$1,000		$16	62
4		$1,000		$14	71
	Total	$4,000	Average Price	$17	238

Average Cost Per Share = $16.80 or ($4,000 / 238)

Dollar-Cost averaging is one approach to systematic investing. It does not assure a profit or guarantee against losses in a falling market. As noted above, it requires the investor to have the financial ability and willingness to continue making investments in both up and down markets.

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