Investment Concepts – Dollar cost averaging

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

Benefits

- By regularly investing in an investment 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
- Beneficial when markets may 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 investment shares or units, and
- Providing a sound savings regime and ideal investment strategy for people with a regular income but without large sums to invest.

How it works

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	$20.00	50
2	$1,000	$20.00	66
3	$1,000	$10.00	100
4	$1,000	$15.00	66
5	$1,000	$15.00	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.

Risks and Consequences

- When market prices are trending upwards, a portfolio purchased up front will do better than the portfolio purchased using dollar cost averaging. 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, dollar cost averaging will generally lose less than an upfront purchased portfolio.

Version: 1.06