The Benefits of Dollar-Cost-Averaging

Dollar-Cost-Averaging

Dollar-Cost-Averaging is an effective process used by investors as a way to place a fixed dollar amount into an investment on a recurring basis. It is a popular strategy among financial planners and advisors who often recommend clients invest a constant amount at the beginning of each selected period. By following a regimented investment schedule, the investor can confidently put capital to work without regard for the current state of financial markets. During periods when the market has declined, the investor will be able to purchase more shares, and conversely, they will purchase less shares during times of market appreciation. By doing so, investors can mitigate cognitive bias in their decision making.

A Look at the Math

Most people enjoy purchasing a good or service on sale, especially if it is something they would have purchased regardless. Using this same logic, with Dollar-Cost-Averaging an investor can purchase more stock when prices have declined, and less stock when prices have risen. Over the long run, an investor's average cost of purchase will be less than the average stock price. Let's take a look at the example below.

Month	Amount Invested	XYZ Share Price	Shares Purchased
1	$500	$150	3.33
2	$500	$100	5.00
3	$500	$120	4.17
4	$500	$90	5.56
5	$500	$130	3.85
6	$500	$150	3.33
	Total Invested	**Average Share Price**	**Total Shares**
	$3,000	$123	25.24
	Average Cost per Share		
	$118.88		

In this example we have invested in a fictional stock, XYZ, on the first of each month for a 6-month period. For the purpose of this exercise lets assume that you are able to purchase fractional shares. During this time the average share price of XYZ was $125, whereas our average cost per share was only $118.88. Having implemented a Dollar-Cost-Averaging strategy, we were able to add more shares at a discount and less when they were trading at a premium.

Volatility Equals Opportunity

Long-term investors employing the Dollar-Cost-Averaging strategy have the greatest opportunity during periods of increased volatility, especially during corrections. By applying this disciplined approach, investors can benefit from purchasing stock at steep discounts and bringing down their average cost. This is particularly beneficial when stocks are on sale as it gives investors the opportunity to improve on the markets long term annualized return of ~9.9% over the last 30 years. (S&P500 annualized return since 1990)

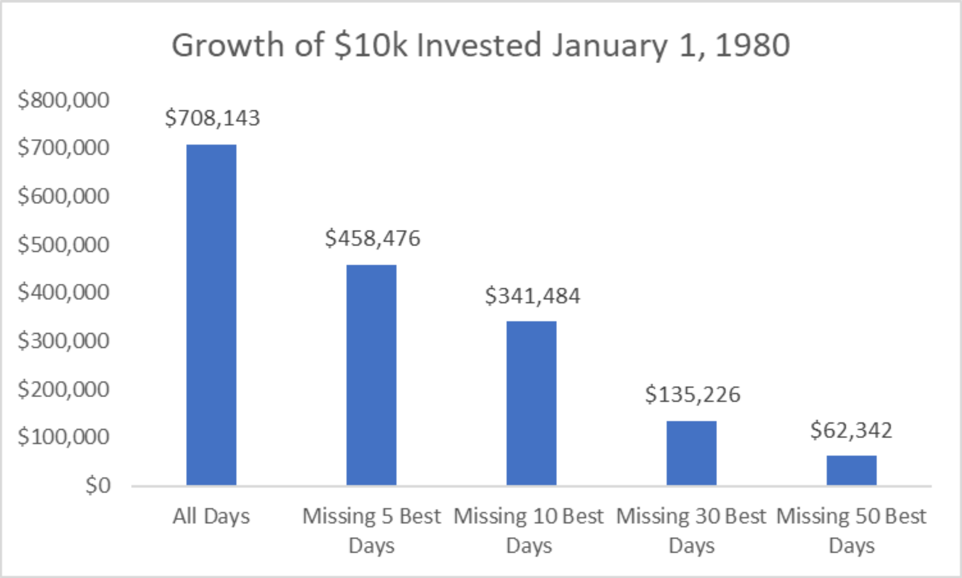
During sustained draw downs, many investors panic and stop investing, or worse, sell. In periods of market weakness, it is the time to take advantage of lower stock prices with a systematic approach that enables you to invest in high-quality companies that are trading at a discount.

Confidence to Stay Invested

Dollar-Cost-Averaging provides many benefits to investors: a systematic process which mitigates emotional bias, a process to add more shares at a discount, and a consistent long-term approach to help grow savings. Dollar-Cost-Averaging can also provide investors the confidence to stay invested during falling markets.

During corrections and recessions there are many record-setting days of upside in the market. As the market is famously difficult to time, panicked investors are often disposed to selling towards the bottom when their emotions are severely tested. Although they may take solace in holding cash, missing out on the market's subsequent best days during periods of volatility can be destructive to long-term savings.

In the chart below we look at the growth of $10k in the S&P 500 starting January 1, 1980, and the impact of missing out on the market's best days.



Source: FMRco, January 2019

As the saying goes, "It is about time in the market, not timing the market." By remaining invested, and systematically contributing to their savings, investors are best positioned to benefit from volatility in the market.

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