Dollar-Cost Averaging

Dollar-cost averaging takes the guesswork out of timing the ups and downs of the stock and bond markets. This time-tested method for systematic investing can be a particularly good approach in today's uncertain investment environment. Dollar-cost averaging eliminates emotional investment decisions and provides a regular disciplined investment program.

Dollar-cost averaging involves investing a fixed amount of money at regular intervals, such as monthly, quarterly or annually. By investing on a dollar basis at regular intervals, rather than buying a fixed number of shares, an investor can purchase more shares when prices are low and fewer when prices are high. Short-term price decreases are viewed as buying opportunities, assuming that the investment will eventually rebound. The result... the average cost per share is typically lower.

> "Dollar-cost averaging also enables a person to get into the habit of investing early."

This is one way to strive toward long-term saving targets, such as college tuition or retirement. The key to investing in anything, especially the stock market, is to set aside regular amounts for systematic investment. Market timing is not science but rather wishful thinking. In fact, some have suggested that most individual investors do not buy low and sell high. They seem to buy high and sell low. After all, it takes real courage to buy when the stock market is low, the news is bad, and the future looks bleak. That's the time when most individuals sell out.

The following illustration of dollar-cost averaging will show us its principle and its power. We will simplify this visual diagram by placing an initial per share price point of $10 per share. Let us say for example that the price of one share of a mutual fund selling at $10 a share drops by as much as 50 percent over a period of one year. Now this would obviously be a bad situation to happen after you have made an investment—actually a very devastating one and the kind that might influence you to sell out at the bottom.

But then, let's imagine that you continued to have confidence in the holdings of this mutual fund and in its management team, so you continue to invest $100 in the mutual fund every time the share price dropped another $1.00 per share. As the mutual fund share price drops all the way to $5, you continue to invest at each price point and then

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continue to do so as it recovers to the initial starting point of $10. This is certainly not an example of a bull market and yet, what will have happened overall will be very satisfactory.

Notice the results of $100 invested each month, at each point down the ladder and back up again to the original price.

→ Investing an additional $100 at a cost of $10 each buys 10 shares.

→ Investing an additional $100 at a cost of $9 each buys 11.111 shares.

→ Investing an additional $100 at a cost of $8 each buys 12.5 shares.

→ Investing an additional $100 at a cost of $7 each buys 14.286 shares.

→ Investing an additional $100 at a cost of $6 each buys 16.667 shares.

→ Investing an additional $100 at a cost of $5 each buys 20 shares.

→ Investing an additional $100 at a cost of $6 each buys 16.667 shares.

→ Investing an additional $100 at a cost of $7 each buys 14.286 shares.

→ Investing an additional $100 at a cost of $8 each buys 12.5 shares.

→ Investing an additional $100 at a cost of $9 each buys 11.111 shares.

→ Investing an additional $100 at a cost of $10 each buys 10 shares.

→ The final total of dollars you would have invested = $1,100.00

The total number of shares you would now have = **149.128**. The total value of your shares at the end of the year (149.128 X $10) = **$1,491.28**. The total gain on your investment at the point that the share price recovers would be **35.6 percent**.

At no point did the stock ever sell above your initial buying price, but in the end you had a 35 percent profit. And this does not include whatever dividend the mutual fund may have paid. This is the value of dollar-cost averaging!

The above illustration is, of course, hypothetical. An investor should realize that no investment program can assure a profit or protect against loss in declining markets.

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Discontinuing the program during a period when the market value of shares is less than original cost would incur a loss.

For this reason, any investor contemplating such a program should take into account his or her ability to continue it during any such period. Keep in mind that sometimes a stock loses value and never regains its original price. This is the reason the example used a stock mutual fund. It would be less likely to stay at the lower price levels. Although dollar-cost averaging is a good investment tool, investors must realize that no method guarantees a risk-free investment. The value of holdings will only be determined by what a buyer is willing to invest.

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