

Getting you there

Dollar cost averaging



You may have heard the term “dollar cost averaging” in discussions about your retirement savings and your company’s workplace plan. Have you ever wondered what the term means, and considered if you could be benefiting from it?

The following example is hypothetical.

What is dollar cost averaging?

Dollar cost averaging is an investment strategy that involves investing the same amount of money on a regular schedule, regardless of the market price of the investment. If you’ve been investing in mutual funds using automatic payroll deduction, you already have dollar cost averaging working for you. Look back at your statements and you can see that, although the dollar amount you invested may have remained constant, the unit price of your funds fluctuated from month-to-month. By using dollar cost averaging, you avoid trying to guess whether the market is going to go up or down.

Using dollar cost averaging in a fluctuating market

The chart below provides an example of dollar cost averaging at work. Starting in January, an investor begins by investing \$100 each month in a fund. In January, the fund is selling for \$10 per unit, so a \$100 investment buys 10 units. In February, the fund’s price increases to \$11 per unit, so

\$100 now buys 9.1 units. In March the price drops to \$6 per unit, and so the \$100 investment buys 16.7 units. So, by the end of March, \$300 has been invested, 35.8 units have been purchased, and the investment is now worth \$214.80 (35.8 units times \$6 per unit).

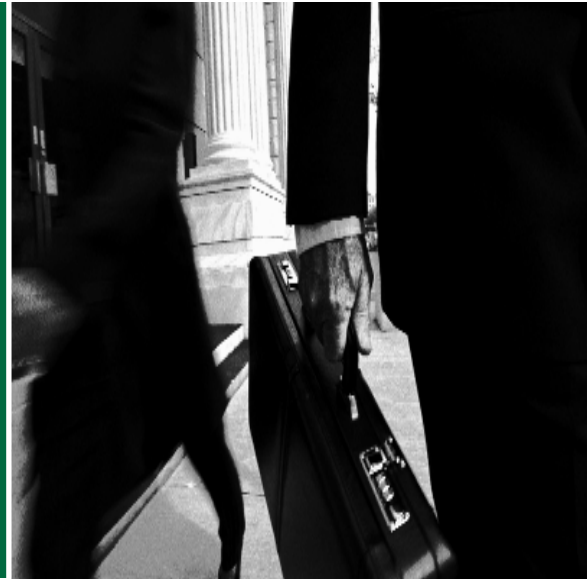
Over the course of the next several months, the market begins to rise once again. As you can see, at the end of five months, the fund’s unit price has risen from a low of \$6

in March to \$9 in May. In this example, dollar cost averaging has paid off. The \$500, invested in \$100 increments each month, have purchased 59.4 units, which are now worth \$534.60.

Month	Amount invested per month	Unit price	Number of units purchased	Units in your account	Total market value in account
January	\$100	\$10	10.0	10.0	\$100.00
February	\$100	\$11	9.1	19.1	\$210.10
March	\$100	\$6	16.7	35.8	\$214.80
April	\$100	\$8	12.5	48.3	\$386.40
May	\$100	\$9	11.1	59.4	\$534.60
Totals	\$500	\$8.80 Average	59.4 Total		

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Now consider what may have happened if dollar cost averaging had not been used. Suppose that same \$500 had been invested all in one lump-sum back in January, when the fund was valued at \$10 per unit. Only 50 units would have been purchased, meaning that by May, with the fund valued at \$9 per unit, the total market value in the account would be worth only \$450.

A strategy for the long-term

While the preceding example shows dollar cost averaging working to an investor's advantage over a five-month period, it is important to keep in mind that this method of investing is not designed for short-term profit making. In fact, dollar cost averaging as an investment strategy is only useful if maintained on a long-term basis.

Using dollar cost averaging as an investment strategy does not ensure a profit, nor does it guarantee against loss in declining markets. Since dollar cost averaging involves continuous investment in securities regardless of their changing price levels, you should consider your financial ability to continue your purchases through periods of low prices.

What is the potential advantage of dollar cost averaging?

The advantage is simple: Your contributions buy more units when the price is lower and fewer units when the price is higher. Studies show that investors who use dollar cost averaging tend to have a lower average cost per unit by investing the same amount of money on a regular basis than they would if they had purchased a fixed number of units at the same intervals. Remember, though: Dollar cost averaging does not ensure a profit or protect against a loss in declining markets. For the strategy to be effective, you must continue to purchase units in both up and down markets.

Still not participating in your workplace retirement savings plan? You are missing out on plan benefits. Enrol today!

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