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ICI VIEWPOINTS

FEBRUARY 27, 2020

Investing Basics: Dollar-Cost Averaging

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As part of the ICI Education Foundation's 30th anniversary celebration, we will be sharing a series of ICI Viewpoints explaining basic investing concepts, drawn from the ICI Education Foundation's Investing Road Trip.

Let's play a quick word association game. The theme: famous enemies. I name one side; you name the other. Ready?

- *Achilles*
- *Batman*
- *Montagues*
- *Hatfields*
- *Aaron Burr*
- *Rocky Balboa*
- *Successful investing*

If your answer to that last one was *emotions*, then you're with me! (Check the bottom of the page for my other answers.)

Quit Playing Games (with My Heart)

Emotions are the enemy of successful investing. Imagine these opposing scenarios:

"Stock prices have tumbled, and you're afraid to keep investing. Why would you want to throw your money at a losing stock?"

"Prices are rising, so you want to buy more shares in the stocks performing best. Why wouldn't you want to buy a winner?"

In the first, the investor is focusing on a stock's short-term volatility instead of its long-term value. In the second, the investor is chasing returns instead of relying on a diversified investing plan. Emotions—such as fear, greed, and hope—aren't a solid basis for investment decisionmaking.

You can't avoid your emotions—particularly when markets are moving sharply, as they are now. But you can manage your investments to limit the impact of emotional swings. One key tool is dollar-cost averaging.

Playing the Averages

Dollar-cost averaging is a systematic approach to long-term investing. This is the practice of investing the same amount of money in the same investment at regular intervals (for example, once a month), regardless of market conditions. Since the amount you invest is always the same, you automatically buy more shares when the price is low, and fewer when the price is high.

Dollar-cost averaging can also be an effective strategy with funds or stocks that can have sharp ups and downs, because it gives you more opportunities to purchase shares less expensively.

A Simple Example of Dollar-Cost Averaging

You have $600 that you want to invest in an equity mutual fund. Should you invest it all at once, or spread your purchases out over increments of $100 for six months? Here's one scenario that shows the potential benefits of dollar-cost averaging.

Month	Investment	Share price	Shares bought
1	$100	$10	10
2	$100	$8	12.5
3	$100	$5	20
4	$100	$10	10
5	$100	$16	6.25
6	$100	$10	10

If you invested your $600 in the first month, you would have purchased 60 shares at $10 per share. If you used dollar-cost averaging over six months, you would own a total of 68.75 shares, and the average price you would have paid per share would be $8.72.

Just Say No…to Market Timing

While "buy low, sell high" seems like good advice, it's incredibly difficult, if not impossible, to predict the market's peaks and troughs with accuracy and consistency—even for the most experienced investors. That's why experts advise putting a fixed amount of money into a stock or bond fund on a regular schedule rather than trying to "time the market."

It's easy to use dollar-cost averaging, and most mutual funds make it even easier by offering automatic investment services. For long-term investors, dollar-cost averaging is a smart way to take the emotion out of investing and to eliminate the difficulty and uncertainty of trying to time the market.

(Hector, the Joker, Capulets, McCoys, Alexander Hamilton, and Apollo Creed. Disagree? Let us know @ICIEF.)

Other Posts in This Series

- Investing Basics: What Is Investing?
- Investing Basics: What Is Risk?
- Investing Basics: Types of Investments
- Investing Basics: Diversification
- Investing Basics: Dollar-Cost Averaging
- Investing Basics: The Benefits of Mutual Funds

- Investing Basics: Tax Benefits to Encourage Saving
- Investing Basics: 529 Savings Plans
- Investing Basics: Compound Returns and the Power of Reinvestment

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