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BULL AND BEAR

Informed Investor Series

Understanding Dollar Cost Averaging White Paper

The **Informed Investor Series** explores how better understanding markets may help you to make the most informed investment decisions possible.

The **Understanding Dollar Cost Averaging** white paper discusses how investing is not always easy when markets are declining. Historically, what we have seen in the markets might suggest that *dollar cost averaging* may be a worthy strategy to consider, particularly if the market is declining.

It is not always easy to invest in stocks when the market declines.

Headlines may create fear, and historically fear has not gone well with investing. Concerns may develop like, "What if the market continues to decline after I invest?", "How much further will the market decline?" and "How much of my money will I lose?".

The fact is no one can predict the future, and while no two markets are the same and past performance is not an indication of future results, historically, what we have seen might suggest that dollar cost averaging may be a worthy strategy to consider, particularly if the market is declining.

Dollar cost averaging is a disciplined, systematic, and unemotional method of investing a fixed dollar amount at regular intervals, regardless of the market's direction.

As an example, let's assume the market is declining or you fear it will decline, and you have $100,000 to invest that would typically be allocated to stocks. One of the historical challenges of investing in the stock market is that the market is cyclical. It goes up in value and decreases in value, but we do not know how much it will go up or how much it will go down, and we do not know when it will do either.

With the $100,000 investment in a declining market, some investors limit themselves to two options; invest all of it at once or not invest any of it out of fear of the declining market.

Dollar cost averaging offers a third option.

Instead of putting all of the $100,000 in the market today, you can invest at regular intervals, regardless of the stock price. Maybe you decide to invest the money in equal amounts over the next 12 months.

The advantage of investing this way is that your money buys more shares at the lower stock prices when the market is declining and fewer shares at the higher prices when the market goes higher. What dollar cost averaging does is take advantage of the fact that markets typically move in cycles.

Let's say that hypothetically you made what we will call a "one-time investment" of your $100,000 -- meaning you put it to work all at once in January of this year when the share price was at $100. If we divide $100,000 into $100 share price, that would mean you bought 1,000 shares ($100,000 / $100 share price = 1,000 shares).

Instead, what if we hypothetically dollar cost averaged into the market over 12 months? Please keep in mind that this is for illustrative purposes only and does not represent the investment or how any particular investment might react in a down market.

Let's assume in our hypothetical example that the market is declining and by July the price is down $80 a share. The 1,000 shares you bought in your "one-time investment" in January would now be worth $80,000, a $20,000 loss (1,000 shares X $80 share price = $80,000).

Month Invested	Amount Invested	Price Per Share	Number of Shares Purchased	Cumulative Number of shares	Value of Cumulative Shares	Amount Remaining in Dollar Cost Averaging Account	Total Value
January	$8,333.33	$100.00	83.33	83.33	$8333.33	$91,666.67	$100,000.00
February	$8,333.33	$95.00	87.72	171.05	$16249.99	$83,333.34	$99,583.33
March	$8,333.33	$90.00	92.59	263.65	$23728.06	$75,000.01	$98,728.07
April	$8,333.33	$85.00	98.04	361.68	$30743.17	$66,666.68	$97,409.85
May	$8,333.33	$90.00	92.59	454.28	$40884.92	$58,333.35	$99,218.27
June	$8,333.33	$85.00	98.04	552.32	$46946.86	$50,000.02	$96,946.88
July	$8,333.33	$80.00	104.17	656.48	$52518.61	$41,666.69	$94,185.30
August	$8,333.33	$85.00	98.04	754.52	$64134.36	$33,333.36	$97,467.72
September	$8,333.33	$80.00	104.17	858.69	$68695.08	$25,000.03	$93,695.11
October	$8,333.33	$85.00	98.04	956.73	$81321.85	$16,666.70	$97,988.55
November	$8,333.33	$90.00	92.59	1049.32	$94438.82	$8,333.37	$102,772.19
December	$8,333.37	$95.00	87.72	1137.04	$108018.79	$(0.00)	$108,018.79

In contrast, by July, our hypothetical dollar cost averaging account would have been worth $94,185.30. We arrive at this number by taking the 656.48 shares we would have purchased by July and multiplying it by the $80 share price (656.48 X $80 = $52,518.61), plus we would have had $41,666.69 of our original $100,000 that we still would not have yet invested. When we add both, we have a total of $94,185.30 ($52,518.61 + $41,666.69 = $94,185.30). This compares to the $80,000 value of our "one-time investment" had we invested all of the $100,000 in January of this year.

Historically, the stock market has moved in cycles and the likelihood could be that eventually, the market might begin to increase, although past performance is not indicative of future results. If the price per share was once again at $100 a share by January of next year, hypothetically, our "one-time investment" would be worth $100,000 (1,000 shares x $100 share price), which would be the original amount invested.

Now let's look at the hypothetical dollar cost average account. Because you were buying more shares as the market declined, it would be worth $113,703.99 (1,137.04 shares purchased over the year by dollar cost averaging x $100 a share = $113,703.99), compared to the $100,000 we would have had if we invested all at once.

This hypothetical dollar cost averaging example would suggest that the benefit of dollar cost averaging in a declining market is that you are buying more shares at lower prices, resulting in your account being worth more than jumping in the market all at once.

It is essential to understand that dollar cost averaging will not protect you from a loss and does not guarantee you a profit. You may lose money if you liquidate shares when the price is lower than the price you purchased them.

However, as you can see, dollar cost averaging has the potential to make what we feel is a significant difference when investing over a period of time and creates a disciplined, systematic, and unemotional method of investing for the long-term investor in a market decline.

Sources:

Bloomberg and Dunham & Associates

Disclosures

Investments are subject to risks, including possible loss of principal. Investors should consider the investment objectives, risk factors and expenses of any investment carefully before investing. Diversification does not guarantee profit or ensure against loss.

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Past performance is not indicative of future performance and are no guarantee that losses will not occur in the future. Future results are not guaranteed and a loss of principal may occur.

The S&P 500, or the Standard & Poor's 500, is a stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 index components and their weightings are determined by S&P Dow Jones Indices. It differs from other U.S. stock market indices, such as the Dow Jones Industrial Average or the Nasdaq Composite index, because of its diverse constituency and weighting methodology. It is one of the most commonly followed equity indices, and many consider it one of the best representations of the U.S. stock market, and a bellwether for the U.S. economy.

A bull market is defined as a market that is up 20 percent or more. A bear market is defined as a market that is down 20 percent or more.

All examples are hypothetical and are for illustrative purposes only. We encourage you to seek personalized advice from qualified professionals regarding all personal finance issues. The solution for an investor depends on their and their family's unique circumstances and objectives.

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