

## Manage Investment Risk By Using Dollar Cost Averaging

**Warning:** This information is intended to form general comments only and does not constitute advice. No investor should rely solely on this information when making investment decisions. This information has not been prepared to take account of investment objectives, financial situations or the particular needs of investors. Investors should consult their client adviser, who can assess their particular needs and circumstances when making investment decisions.

### Human Behaviour in Investing

Behavioural finance studies have constantly shown that fear and/or greed still plays a large role in investing and investment markets.

Depending at what point in the investment cycle we are facing will determine what emotion is more dominant.

During periods of negative sentiment, Fear more so than Greed will be the dominant emotion driving investor behaviour. During or following periods of share or property price declines many investors continue to sell their holdings at the lower prices or find it hard to buy investments during these times. Investor paralysis takes over and loss aversion becomes the dominant pattern of behaviour.

During periods of optimism, Greed can takeover as the dominant emotion driving investor behaviour. Investors tend to invest more when markets are soaring and overconfidence becomes the dominant emotion.

The evidence of this is that is we, as a general investment community, continue to buy at the top, and sell at the bottom. Surely a more disciplined investment strategy is necessary.

### Dollar Cost Averaging....the discipline and the tool

Dollar Cost Averaging is 'the process whereby a set amount is allocated to specific investments at regular intervals. This is intended to have the effect of lowering the average price paid for the investments.' [Source: *The Australian Investors' Dictionary*].

Dollar Cost Averaging, when carried out in a disciplined fashion over an extended period ensures that you buy fewer shares or units when the price is high, and more when the price is low.

### How can Dollar Cost Averaging benefit investment returns and reduce human risk?

Consider the following example of two rational people who each invest the same amount of money into a managed fund over the same time period. Investor A attempts to time the market (investing in January over two successive years), Investor B Dollar Cost Averages.

- Investor A invests \$1000 and decides to invest \$1200 in January of each year.
- Investor B invests \$1000 and decides to invest \$100 each month.

### In this issue

Regular investing - a simple but effective strategy

The following table details the investment transactions for each investor:

Investment Month	Investor A	Units Purchased	Investor B	Units Purchased	Unit Price
January	\$1,000	100.0	\$1,000	100.0	\$10.0
February			\$100	10.5	\$9.50
March			\$100	11.4	\$8.75
April			\$100	11.6	\$8.65
May	Why not here?		\$100	11.8	\$8.45
June	Why not here?		\$100	12.5	\$8.00
July	Why not here?		\$100	13.2	\$7.60
August	Why not here?		\$100	12.5	\$8.00
September	Why not here?		\$100	11.8	\$8.45
October			\$100	11.6	\$8.65
November			\$100	11.4	\$8.75
December			\$100	10.5	\$9.50
January	\$1200	120	\$100	10.0	\$10.00
<b>TOTAL INVESTED</b>	<b>\$2200</b>	<b>220</b>	<b>\$2200</b>	<b>238.80</b>	
<b>TOTAL VALUE</b>	<b>\$2,200</b>		<b>\$2,381</b>	<b>\$2,381</b>	<b>\$10.00</b>

The table shows that Investor B is \$181 or 8.2% better off than Investor A ( $\$2381 - \$2200 = \$181$ ) over the period by using the power of Dollar Cost Averaging. Moreover, Investor B has only needed to make a single disciplined decision regardless of markets going up or down. His decision is that he Dollar Cost Averages over the full period in question (i.e. January to January). Conversely, Investor A has had to be clever enough to “market time” his second investment in January of the second year. This is a random decision, driven possibly by nothing more than Greed.

If Fear and Greed didn't influence Investor A, and he was in fact a brilliant market timer, a better result for Investor A would have been to invest his \$1200 in either May, June, July, August or September. Had Investor A invested his \$1200 in any of these months, his final investment result would have been better than that of Investor B.

To achieve this outcome, Investor A needed to be both a brilliant market timer and to overcome the undoubtedly prevailing emotion of Fear associated when the markets were probably still falling. This is a very difficult emotion to overcome.

Investing a fixed amount each month helps reduce the volatility of a portfolio and optimise long-term growth by systematically buying the same dollar amount of a managed investment each month.

### Important Note

Dollar cost averaging is a strategy designed to increase returns by reducing the average price of an investment. Dollar cost averaging will not reduce the risks inherent in the investment you choose. Before you undertake any investment you should be aware of the potential risks involved in that investment.

**Disclaimer:** This publication contains general information only and is not intended to constitute financial product advice. Any information provided or conclusions made, whether express or implied, do not take into account the investment objectives, financial situation and particular needs of an investor. It should not be relied upon as a substitute for professional advice.

© 2009 managed.financial strategy ltd



managed.financial strategy ltd  
AFS licence no. 222600

PO Box 7074  
30 Lisburn Street  
East Brisbane Qld 4169

Telephone: 07 3391 5055  
Facsimile: 07 3391 1711  
Email: super@managed.com.au  
www.managed.com.au