PINNACLE
EDUCATION SERIES
Volume 12

Dollar Cost Averaging: What is it & why would I use it?

As an investor, once you've decided what you are going to buy, the big question becomes, "When should I buy it?" You hear a lot about "market timing." To time a purchase, you need to know what pushes the asset's price up or down. Then you need to watch the market and act at the best moment.

For new investors – or those who can't or don't want to invest that much time managing their portfolios – an investment strategy called dollar-cost averaging may be a good alternative.

What Is Dollar-Cost Averaging, and How Does It Work?

With dollar-cost averaging, you divide the amount you intend to invest in one specific asset (such as a stock, fund or ETF) into several equal-size purchases you make over time. Thus, it can help you not make a lump-sum investment that's poorly timed.

Let's say you want to invest $1,000 in Company 'x' shares and decide to spread the purchases over five months. You will buy $200 of shares each month, regardless of the share's price. In months when the share price is higher, you will buy fewer shares. In lower-price months, you will buy more shares.

How does that help? Well, let's look at an extreme case. Say the share price is $50 in month 1, $40 in month 2, $20 in month 3, $25 in month 4 and $40 in month 5. Here's how many shares you will buy:

Month	Investment	Share Price	# of Shares
1	$200	$50	4
2	$200	$40	5
3	$200	$20	10
4	$200	$25	8
5	$200	$40	5
		Total # of shares	32
		Average Share Price ($1,000 / 32)	31.25

If you had bought all $1,000 in shares of Company 'x' in month 1, you would have 20 shares, and they would be worth $800 after investing in month 5 (20 x $40). But, by using dollar-cost averaging, you will have 32 shares worth $1,280 (32 x $40).

What Are the Best Times to Use Dollar-Cost Averaging?

Dollar-cost averaging works best in markets that tend to increase over time, such as the stock market has done historically, especially if you invest in something like the S&P 500 Index. However, it is less favorable when you invest in an individual stock unless you know about the company, monitor the share performance and sell it when you see unfavorable indicators.

This strategy can be good for building wealth over time as a passive, hands-off investor. An example would be your 401(k) plan at work, where you decide how much of your salary you want to invest each month.

Typically, you pick from mutual funds or index funds available in your employer's plan. Investments are made like clockwork, regardless of fund pricing. And, over time, because your average share cost may be lower, you will tend to lose less when an investment declines in price and gain more when it increases.

This strategy also protects you from emotional buy-and-sell decisions, particularly those made out of greed or fear. The market volatility created by the Covid pandemic is a good example.

On February 19, 2020, the market was at a record high. In 33 calendar days, it fell 34%. By the end of 2020, the S&P 500 was up more than 65% from the low point in March. *[Source:https://www.cnbc.com/2020/12/30/how-the-pandemic-drove-massive-stock-market-gains-and-what-happens-next.html]*

Suppose you had shares in the market in early 2020 and sold in a panic near the bottom of the 34% drop. Then, say you were too scared to buy in again as the market started moving back up, and you waited until the end of the year to buy – when things looked stable.

If you were following the dollar-cost averaging strategy and had continued buying throughout the period, you would have benefitted from the low-lows as well as the new highs. And you would have avoided the emotional rollercoaster.

Dollar-cost averaging is not a failsafe investment strategy, but it can work for you under certain circumstances.

- Thomas J. Roberts
Principal & CEO

www.pinnacleadvisorgrp.com
2851 South Pike Ave., Suite D, Allentown, PA
ph: 610.797.2201 • em: info@pinnacleadvisorgrp.com • fx: 610.7971022

Disclosures

All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

ETFs trade like stocks, are subject to investment risk, fluctuate in market value, and may trade at prices above or below the ETF's net asset value (NAV). Upon redemption, the value of fund shares may be worth more or less than their original cost. ETFs carry additional risks such as not being diversified, possible trading halts, and index tracking errors.

The principal value of a target fund is not guaranteed at any time, including at the target date. The target date is the approximate date when investors plan to start withdrawing their money.

Growth investments may be more volatile than other investments because they are more sensitive to investor perceptions of the issuing company's growth of earnings potential.

Value investments can perform differently from the market as a whole. They can remain undervalued by the market for long periods of time.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

The fast price swings in commodities will result in significant volatility in an investor's holdings. Commodities include increased risks, such as political, economic, and currency instability, and may not be suitable for all investors.

Currency risk is a form of risk that arises from the change in price of one currency against another. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

www.pinnacleadvisorgrp.com
2851 South Pike Ave., Suite D, Allentown, PA
ph: 610.797.2201 • em: info@pinnacleadvisorgrp.com • fx: 610.7971022