Dollar-Cost Averaging: Slow and Steady

- Dollar-cost averaging is a simple, yet effective means of disciplined investing.
- It allows for the purchase of more shares when they are on sale (i.e., at lower prices).

The concept of "dollar-cost averaging" might initially appear intimidating to some, but the practice is actually quite simple. All you have to do is invest the same amount of money each and every month. Pretty simple, right? But what's really nice is that something as straightforward as dollar-cost averaging actually helps you invest smarter.

Say you want to invest $900 in a certain mutual fund. Over three months, the fund's price is $30, $20, and $25. If you invested all of your money immediately, you'd wind up with 30 shares of the fund. However, if you invested $300 into the fund each month, you'd end up with a total of 37 shares. By dollar-cost averaging you were able to obtain seven more shares. Of course, if you knew ahead of time that the fund would fall to $20, you could have bought all of your shares then. But you obviously can't predict the future. Dollar-cost averaging is a smart strategy that forces you to keep investing, even if the market is dropping.

It encourages discipline. Instead of being tempted to sell your investments when prices are falling, you actually buy more.

One great thing about an employer-sponsored retirement plan is that it automatically uses dollar-cost averaging—the same amount is taken out of every paycheck. You can also set up automatic dollar-cost averaging programs with most individual retirement accounts (IRAs).

Please keep in mind that dollar-cost averaging does not ensure profit or protect against a loss in a declining market. However, its benefits are quite clear: Dollar-cost averaging minimizes the effects of market fluctuations, encourages discipline, eliminates the need to decide when to invest, and avoids the temptation to time the market.

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