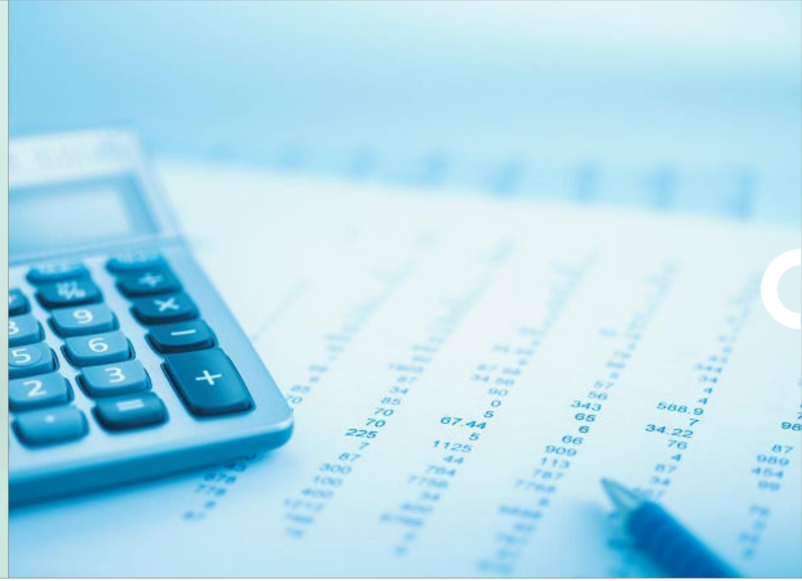

Investment Concepts – **Dollar cost averaging**

Dollar cost averaging involves investing amounts of money at regular intervals.
By investing this way, you are not attempting to pick the lows or highs of the market but rather investing regularly (and usually a fixed dollar amount) regardless of investment market trends.

How it works

The following example shows a dollar cost averaged share investment. A fixed amount of $1,000 was invested in a share each month as the market price fell and then recovered to its original value.

MONTH	AMOUNT INVESTED	SHARE PRICE	UNITS PURCHASED
1	$1,000	$20	50
2	$1,000	$15	66
3	$1,000	$10	100
4	$1,000	$15	66
5	$1,000	$20	50
Total	**$5,000**		**332**

Note: This is a hypothetical example for illustration purposes only and does not relate to a specific financial product.

In this example, by dollar cost averaging into the market, the total shares were purchased at an average cost of $15.06 ($5,000/332). After five months the investment was valued at $6,640 (332 shares at $20 per share), a profit of $1,640. If the shares had been purchased at the commencement of the five months (ie. at $20), there would have been no gain on the investment when the shares returned to their original value at the end of the five-month period. The $5,000 invested would still have the same value, ignoring any dividend income.

Benefits

The benefits of adopting a dollar cost averaging strategy may include:

- By regularly investing in an investment market, you are not relying on timing strategies aimed at picking when a market has bottomed or peaked. Dollar cost averaging imposes a helpful investment discipline by completely ignoring timing issues.
- It may be beneficial if markets fall. This is because only a fraction of the total amount to be invested is exposed to declines in the market. Also, when the market price falls, your regular investment amount will purchase more investment shares or units.
- It may provide a sound savings regime and a suitable investment strategy for people with a regular income but without large sums to invest.

Risks

These include:

- When market prices are trending upwards, a portfolio purchased up front will do better than the portfolio purchased using dollar cost averaging. This is because the full gain on the price rise is captured by the full amount of money invested up front.
- Over a time period in which prices fall steadily, a dollar cost averaging portfolio will still lose money. Nonetheless, dollar cost averaging will generally lose less than an upfront purchased portfolio.

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Compounding Interest

Often referred to as the "eighth wonder of the world," compounding interest lets your money work for you.

Compound interest causes **your wealth to grow faster**. It makes a sum of money grow at a faster rate than simple interest because you will earn returns on the money you invest, as well as on returns at the end of every compounding period.

If you were to invest money and take the interest each year and spend it, the amount you have invested will never grow. If you allow the interest to compound the balance will grow each year at a greater rate because it is growing off a larger base amount.

Having interest paid regularly also increases the return, so an investment with monthly interest payments will compound more than the same investment with annual interest payments.

To provide a simple example, if you were earning a 6% return, with interest paid monthly, the amount of monthly interest would be 0.5% (which is still 6% per annum).

The table below illustrates this.

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7
Initial/Total investment	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000
Annual Interest 6% reinvested	$106,000	$112,360	$119,102	$126,248	$133,823	$141,852	$150,363
Monthly Interest 0.5% reinvested	$106,168	$112,716	$119,668	$127,049	$134,885	$143,204	$152,037

The return over 7 years is $1,674 more with monthly interest. Daily interest would provide an even better result!

Compounding returns can apply to any investment where income that is earned can be added back to the capital, as is the case with most pooled superannuation investments. It can also be achieved with other investments like managed funds, and with some direct shares, where dividends can be reinvested rather than paid out.

This document contains general advice. It does not take account of your objectives, financial situation or needs. You should consider talking to a financial adviser and read the relevant Product Disclosure Statement (PDS) before making a financial decision. This document has been prepared by Lifestyle Financial Services, a division of Priority Advisory Group, which is a Corporate Authorised Representative of *Fortnum Private Wealth Ltd* (ABN 54 139 889 535), AFSL 357 306. Information in this document is based on current regulatory requirements and laws, which may be subject to change. While care has been taken in the preparation of this document, no liability is accepted by Lifestyle Financial Services, Fortnum Private Wealth, its related entities, agents and employees for any loss arising from reliance on this document.

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