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Dollar-cost averaging is an investment strategy that many people use without even realizing it.
If you invest through an employer-sponsored retirement plan, such as a 401(k) plan, chances are you are already using this strategy.
With dollar-cost averaging, you invest the same dollar amount at regular intervals.
If you deduct a set amount from your paycheck each pay period and invest it in your retirement savings plan, that's dollar-cost averaging.
This strategy offers three potential benefits.
First, dollar-cost averaging is convenient — it puts investing on auto-pilot.
And that can be a smart way to build assets for your future.
Second, with dollar-cost averaging, you don't have to worry about the best times to buy and sell, a concept known as "market timing."
Even the most seasoned professional investors have trouble timing the market.
Finally, dollar-cost averaging can help you take advantage of unexpected swings in the market. Why?
Let's take a look at how dollar-cost averaging works.
Because you're investing the same dollar amount each time you invest, you buy more investment shares when prices are low, and fewer when prices are high.
Over time - especially the long term — this has the potential to result in a buying advantage.
Let's look at a simple, hypothetical example.
Let's say you invest $100 per month for six months in mutual fund A.
The price of mutual fund A bounces up and down each month, as shown here in the Share Price column.
At the end of that six-month period, you have invested $600 and own 32.2 shares of mutual fund A.
If you divide the total amount invested by the number of shares you own, your average cost is $18.63 per share.
However, if you add up the changing prices over that six-month period and divide by six, the average price is $19.17.
So in this example, the average cost of the shares purchased is lower than the average share price.
Because dollar-cost averaging involves continuous investments regardless of changing prices, you should consider your ability to continue purchases through periods of low and high price levels.
Dollar-cost averaging does not ensure a profit or protect against investment loss.
Of course, all investing involves risk, including the possible loss of principal, and there can be no guarantee that any investing strategy will be successful.
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