Anxin Wealth Management (ABN 47 145 533 044)
Suite 207, Sunnybank Times Square
250 McCullough Street, Sunnybank Qld 4109
Tel: (+617) 3727 8802 Fax : (+617) 3727 8899
Email: info@anxinwm.com.au
Web: www.anxinwm.com.au
Skype: anxin.wealth.management

"We strive to give you peace of mind"

Timeless lessons meet new challenges

Valuable lessons can sometimes be lost in the swirling, short-term mists of time.

In October, one of the world's original thinkers on investment markets, economist, academic and author, Dr Burton Malkiel has been in Australia reminding us of some of the timeless investment lessons he has learned over four decades of working and studying investment markets.

Dr Malkiel is a Professor of Economics at Princeton University in the US. He has served on many boards and investment committees during his career (including the Vanguard Group) and is perhaps best known as the author of the classic investment book, A Random Walk Down Wall Street, now in its 10th edition having sold more than 1.5 million copies.

One of the many straightforward but powerful messages Dr Malkiel reminded us of this week was the value of dollar cost averaging.

Many people understand the concept of dollar cost averaging – investing the same amounts of money over regular time periods.

But what has perhaps been clouded by market moves over the years is that dollar cost averaging actually works better in volatile markets rather than those that climb more steadily.

As investors we probably prefer markets like those from 2003 to early 2008 when despite the odd bump along the way the overall direction was pointing up.

Since 2008 and the global financial crisis the new normal has been volatility – lots of it as we have seen in recent months.

Dr Malkiel uses the example of dollar cost averaging strategy where $1000 is invested over five time periods. The market price of the index fund used in Dr Malkiel's example begins at $100, falls to $75, falls further to $55 before bouncing back to $110 before settling back at $100. In other words the market over the five investment periods has ended precisely where it started – a scenario US share investors are well aware of in what is called the lost decade of 2000 to 2010 when the broad US sharemarket ended the decade about the same level it started.

The bad news about dollar cost averaging is that some times you will be buying into a market at high prices; the good news is you will also be buying in around low points.

In this case our investor at the end of the period by dollar cost averaging had a portfolio worth $6060.

By contrast if you had invested the same amount in a market that rose steadily from $100 in $10 increments to $140 – arguably an investor's dream market - you would have had a portfolio worth slightly less - $5915.

The alchemy of the arithmetic lies in the average cost of the shares or units purchased.

The average cost of the dollar cost averaged portfolio was $82.51 compared to $118.34 for the steadily rising market.

The message here is less about the end portfolio value and more about overcoming our behavioural biases. We feel good about investing when markets are trending up steadily. Markets that move more like a roller coaster unsettle us and create doubt about the wisdom of investing – or at least investing at a particular time.

The real value of dollar cost averaging is that the structure of a disciplined investment program like dollar cost averaging helps overcome that behavioural bias that wants to turn us into market timers.

** Written by Robin Bowerman, Principal, Corporate Affairs & Market Development at Vanguard Investments Australia.*