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Dollar Cost Averaging vs. Lump Sum

(http://simplyrich.com/dollar-cost-averaging-vs-lump-sum/)

Posted on June 10, 2016 (http://simplyrich.com/dollar-cost-averaging-vs-lump-sum/)

Question: I've been a dollar-cost averager for many years; however, I've read recently a Vanguard study which shows lump-sum investing [has] outperform[ed] DCA [dollar-cost averaging] around two-thirds of the time throughout history. Wanted to get your thoughts on which one is better long term. Thanks.

Answer: My opinion is that you should invest the money when you have it to invest: the earlier you do so the longer you can take advantage of the expected returns. Vanguard is right.

Dollar-cost averaging didn't originate as a strategy designed to outperform lump-sum investing. It was simply a concept intended to explain that if people invested the same amount each period, they'd end up paying less per share than the average price of the investment because they'd automatically purchase more shares when the price was lower and fewer shares when the price was higher. That's it.

When applied to a lump sum, spreading out the investment of the funds over time improves the return if the market is nice enough to wait for you to invest all the money before it takes off. Of course, it prevents you from investing everything at a major market top, but if you are trying to time the market, I am the wrong person for you to ask your question.

I believe you should invest based on a sound long-term outlook and not your short-term prediction of the market. That means investing a lump sum at once. If you are going to agonize over the possibility of a crash right after investing a big sum, then use the biblical wisdom of Solomon: cut the lump sum in half and invest one half immediately. Then check your horoscope to decide when to invest the other half or stick with the biblical analogy and put the rest of that baby where it belongs after a nine-month wait. I'm being frivolous, of course, because logic no longer applies once the funds are not being properly invested from the start. Still, if the delay is only a few months, it shouldn't have a major impact on investments to be held for decades, and I'd rather half be invested correctly right off the bat than delay getting started.

Of course, none of this discussion is relevant if we're just talking about adding regular sums from earnings over a long period. In that case, dollar-cost averaging isn't a strategy being compared with lump-sum investing; rather it's a reflection of the reality that one's money comes periodically rather than all at once, making gradual investing the only option. The principle, though, is simple: the best time to invest money is when you have it to invest.

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