

Dollar cost averaging as a long-term investment strategy

Timing the markets can be challenging, even for the most experienced investor. Dollar cost averaging alleviates that pressure.

Today's market environment places many investors at a crossroads between attractive short-term opportunities and long-term investment principles. Some options that feel comfortable today may not yield the results needed as you work toward your long-term goals. This article explores a time-tested strategy for investing in the markets: dollar cost averaging.

WHAT IS DOLLAR COST AVERAGING?

Also known as unit cost averaging or incremental averaging, dollar cost averaging is a strategy that involves making regular investments of the same amount of money over time, regardless of the price of the asset. The strategy is designed to reduce the impact of market gyrations and lower the average cost of the asset – easing the pressure of trying to buy at just the right time.

Participants in employer-sponsored retirement plans such as 401(k) plans are dollar cost averaging, often without even knowing it. Contributions to such plans are typically automated as part of the payroll process, and investors rarely question whether the time is right to buy. They are saving for the long term with the goal of growing their balance over time.

Similarly, by investing a fixed amount of money at regular intervals, you can buy more shares when prices are low and fewer shares when prices are high – which in turn can help reduce the impact of market volatility on the portfolio.

A WAY TO MITIGATE PRICE RISK

Dollar cost averaging can be especially helpful in mitigating the market timing element if you invest during periods of uncertainty or when emotional reluctance is high.

In practice, it's designed to reduce the average cost basis and help lower portfolio risk. It helps you address the emotional challenge of loss aversion, which often has the potential to lead to inaction. However, dollar cost averaging could also leave some returns on the table when markets are rallying, and it does not mitigate some other investment risks.



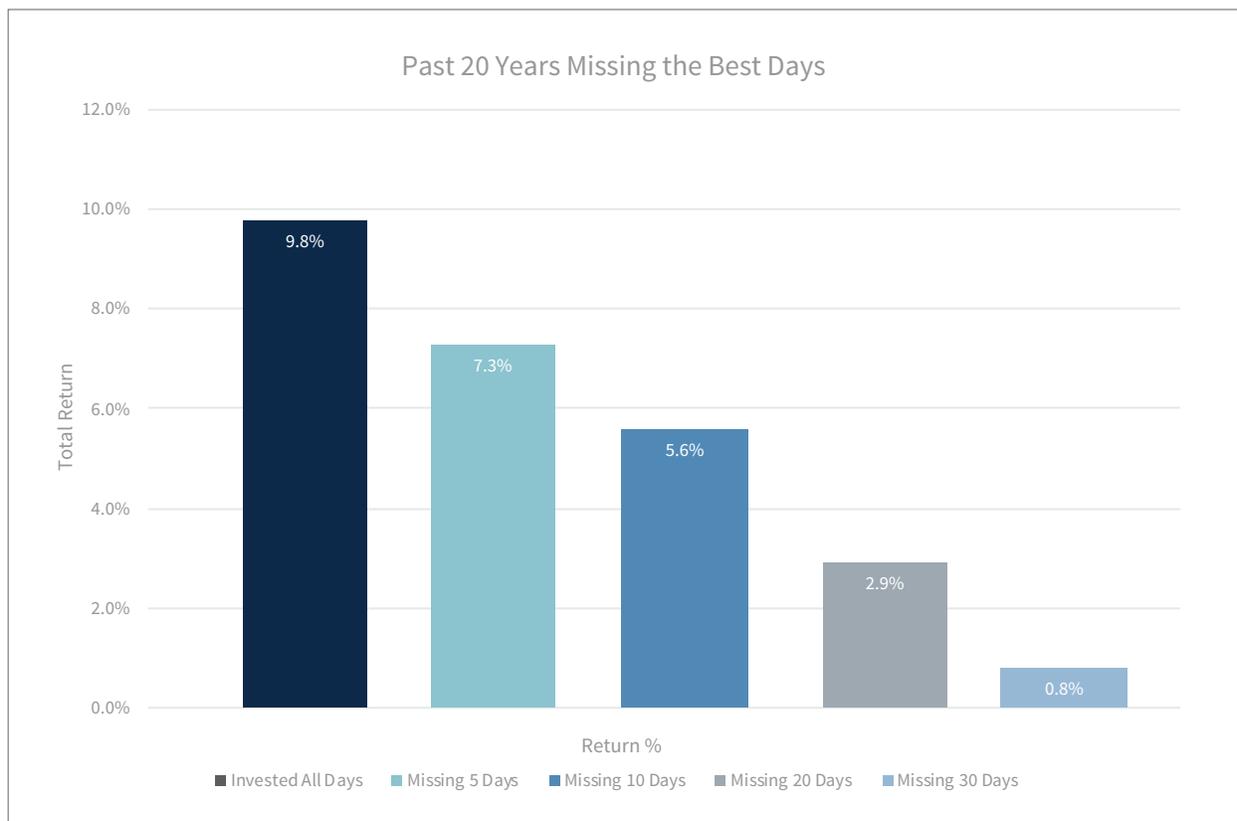
KEY TAKEAWAYS

- Dollar cost averaging involves making regular investments over time, rather than investing a large amount at a single price point.
- Dollar cost averaging can help mitigate the element of market timing during periods of uncertainty or when emotional reluctance is high.
- Though volatility is uncomfortable, missing even a handful of the market's best days can be costly for a long-term investor.

MISSING JUST A FEW DAYS IN THE MARKET HURTS

Historically speaking the market tends to penalize those who attempt to time it, while rewarding those who stay the course. Timing the market inevitably means missing some rallies. Over the past 20 years, when investors missed just the 10 best days of the equity market, their total return was nearly halved to 5.6% on an annualized basis, compared to 9.8% for someone who remained invested for the whole period.

These best days often come at a time of extreme volatility and are followed by whipsawing actions in either direction. Some of the biggest one-day gains happened during crisis periods: in October 2008, November 2008 and March 2009 during the financial crisis, as well as March 2020 during the COVID-19 pandemic.



Returns for investing in the S&P 500 Index, study assumes a zero return for the days not invested in the market. Data from 12/2002 to 12/2022.

Source: AMS Research; Bloomberg; S&P 500 Index

From December 2002 to December 2022, the amount by which a portfolio's annualized return was reduced due to missing the market's best days are substantial. The more days missed, the greater the cost.



It is the time in the market that matters, not timing the market.

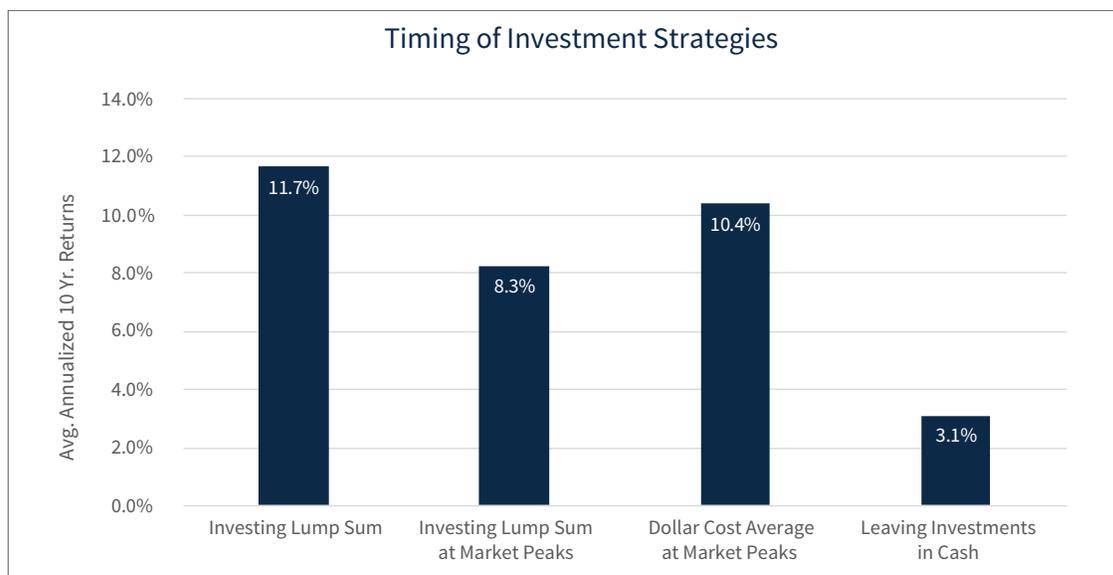
WHAT HISTORY TELLS US ABOUT DOLLAR COST AVERAGING

By comparing historical returns, we can measure the efficacy of dollar cost averaging.

Reviewing 40 years of data and using the S&P 500 index as a proxy, Raymond James researchers conducted an analysis of long-term returns over multiple time periods to calculate the impact of a dollar cost averaging strategy. The analysis evaluated returns in multiple scenarios, including overall average annualized 10-year return, purchasing at a market peaks, using a dollar cost averaging strategy at market peaks, and leaving the investment in cash.

During the review period the market experienced four peaks:

- August 31, 1987
- August 31, 2000
- July 31, 1992
- October 31, 2007



Source: S&P 500 Index annualized 10 year return data from 3/31/1983 - 3/31/2023; FactSet

Regardless of what month, investing a lump sum on the first day of any month during the 40-year period yielded an average annualized 10-year return of 11.7%. However, opportunity costs are very high for holding cash and not participating in the equity markets. Cash produced the lowest return of any scenario, with an average annualized 10-year return of 3.1% over the study period.

The unlucky investor with poor timing who invested a lump sum amount at one of the market peaks – when prices were high – reduced their average annualized 10-year rate of return by 3.4%. But an investor who began investing at a market peak but used a dollar cost averaging approach, stepping into the market at equal increments for seven months to help offset that poor timing risk, saw an average annualized 10-year return of 10.4%.

In the chart above, you can see that investors who used a dollar cost averaging strategy were able to increase their returns when market conditions weren't as favorable. The key to dollar cost averaging is not to try and time the market, but rather to start investing and make consistent investments over time.



From 1927 to 2023 – a span of 96 years – the S&P 500 index saw positive performance in 63 years, which was 66% of the time.

THE SHORT-TERM BENEFITS OF HOLDING CASH WHILE RATES ARE ATTRACTIVE

For the first time in a long time, money market rates are attractive, with meaningful yields around 5% compared to the S&P 500 dividend yield of approximately 1.5% and the Bloomberg aggregate bond yield of approximately 4.7%. This is a sharp contrast to much of the past decade, when money market funds saw average yields around 0.5%. Combined with the perception of minimal drawdown risk, cash as an asset class is competitive and a seemingly obvious choice for investors faced with uncertain market environments.

Whether, and how much, you as an investor should allocate to cash depends on the intended objectives of your capital. But it's important to be aware that the cost of waiting could be high.

If your goal is growth appreciation, the plan to take shelter in cash today for a short period of time is enticing and could compensate for the potential risks in the more volatile equity market. However, opportunity risks have proven to be very material should markets unexpectedly rally during the same period. Fear of missing out, as opposed to using a vehicle like dollar cost averaging to make regular investments, can entice investors to chase market returns at the wrong time.

Capital slated for bond allocations, either to fund steady income streams and/or align with a more conservative risk tolerance for investors, comes with a less compelling risk-reward, if invested in cash today. As central banks approach the end of interest rate increases, we believe we are likely to return to a normal interest rate environment, around 2-3% for the 10-year Treasury. This is much lower than the interest rate levels offered today.

Buying intermediate or longer-term bonds when interest rates, and corresponding yields, are high may give investors a greater chance to meet their long-term financial goals. Whereas staying in cash and short duration Treasury bills could bring reinvestment risks if interest rates decline with a maturing economic cycle. Bonds are providing better cash flow and yields today compared to recent history. Additionally, lower interest rates inverse the relationship between price and yields – which generally benefits the bond investor. The consequence of staying in cash could mean investors who wait may buy into the bond market at lower rates.

FREEDOM BALANCED: THE 60/40 PORTFOLIO

This brings us to a portfolio with a balanced investment objective, one that owns roughly 60% stocks and 40% bonds. Typically, stocks and bonds act as counterbalancing hedges for one another – this was the case for much of the period since 2000. From 1970 to 2000, however, it was common to see stocks and bonds move in tandem when the market was concerned about high and persistent inflation.

In 2022, after decades of low inflation, that scenario reappeared: High inflation, rapid interest rate increases and weakening growth resulted in equity and bond prices moving down at the same time. A stock market correction combined with the bond market's worst performance in its history, dating to 1975, made it a challenging year for balanced investors.

Looking at the worst years for a balanced portfolio dating back to 1973 – benchmarked to the S&P 500 index and the U.S. Aggregate Bond index – the 60/40 allocation recovered to provide positive returns four of the next five years.

The balanced portfolio also delivered an average of 8.5% annualized return for the five-year period in all instances following years with a loss of more than 1%. History shows patient investors are rewarded for having a well-constructed portfolio and staying the course with their investment plans, especially during rough patches of the market cycle. Dollar cost averaging enables that long-term, consistent participation in the market.

	Down Year	Ann. Return Next 5 Yrs
2022	-16.1%	–
2018	-2.6%	9.1%*
2008	-20.1%	12.7%
2000	-0.8%	3.2%
1994	-0.4%	20.2%
1981	-0.5%	19.4%
1973	-6.1%	5.8%
Average		11.7%

Source: S&P 500 Index and AMS Research

Data from 12/29/1972 to 07/31/2023

*2018 5 yr. return represents 12/31/2018 to 07/31/2023

CONCLUSION

The old adage, “The market climbs a wall of worry,” comes to mind as we face another challenging market environment. We know that markets typically skew positive over the long term and the greatest attribute to a well-developed investment plan is helping you, as an investor, feel and stay engaged. A dollar cost averaging approach is a time-tested strategy designed to mitigate the emotional biases or fears of investing in advance of a market drawdown.



Freedom portfolios allow for a variety of dollar cost averaging plans, from biannual investment to bimonthly options. A few potential benefits to consider:

- **Consistent and disciplined investments**
- **Staying in the market to capture the long-term appreciation opportunities**
- **The U.S. stock market, which historically goes up more often than it goes down**

Finding the right strategy doesn't have to be an all or nothing leap of faith. Talk to your advisor about setting up a dollar cost averaging strategy with automatic and consistent contributions.

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Bloomberg Barclays Aggregate Index: Measures the changes in the fixed rate debt issues rated investment grade or higher by Moody's Investors Service, Standard and Poor's, or Fitch Investor's Service, in that order. All issues must have at least 1 year left to maturity and have an outstanding par value of at least \$300 million. The Aggregate Index is comprised of the Government/Corporate, the Mortgage-Backed Securities, and the Asset-Backed Securities indices.

Standard & Poor's 500 (S&P 500): Measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It consists of 400 industrial, 40 utility, 20 transportation and 40 financial companies listed on US market exchanges (mostly NYSE issues). It is a capitalization-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 68% of the investable U.S. equity market.

Freedom Foundation portfolio contains mutual funds. Mutual funds are sold by prospectus only. Investors should carefully consider the investment objectives, risks, charges and expenses of an investment company carefully before investing. The prospectus contains this and other information about an investment company and is available from your financial advisor. The prospectus should be read carefully before investing.

Additional considerations should be taken into account when considering a fee-based account as an alternative to paying commissions, including the anticipated level of trading activity and use of the products and services available in the account. You should understand that the annual advisory fee charged in these portfolios is in addition to the management fees and operating expenses charged by mutual funds. These additional considerations, as well as the fee schedule, are listed more fully in the Client Agreement and the Raymond James & Associate's Wrap Fee Program brochure.

Important information related to portfolio risks:

It is important to review the investment objectives, risk tolerance, tax objectives and liquidity needs before choosing an investment style or manager. All investments carry a certain degree of risk, and no one particular investment style or manager is suitable for all types of investors.

- Fixed-income securities (or “bonds”) are exposed to various risks including but not limited to credit (risk of default or principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks.
- There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise. Short-term bonds with maturities of three years or less will generally have lower yields than long term bonds which are more susceptible to interest rate risk.

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