Dollar-cost averaging for investing in mutual funds

Finance, Investment

The “ constant dollar plan” or dollar-cost averaging refers to spending a fixed amount ofmoneyto invest in a mutual fund at regular intervals (“ Dollar-Cost Averaging,” 2009). When price per unit is low, the investor purchases a greater number of units than when the price per unit is high. An alternative would be to make a large investment at any given time. But, in this scenario, the investor is bound to make a big loss if unit prices suddenly fall (“ Dollar-Cost Averaging”). Thus, dollar-cost averaging reduces investment risk by smoothing out the ill effects of cost fluctuations (“ What is Dollar Cost Averaging,” 2009).

According to State Life Insurance which has its own mutual funds: “ In the end, the average cost per share should be lower than the average share price” (“ What is Dollar Cost Averaging”). Investors in mutual funds must consider the expense ratio as they decide on how much to invest at any given time. This is a fixed percentage of investment paid out to mutual fund managers. An individual who invests $25 must pay the same percentage of his or her dollar amount that another individual making an investment worth $2500 must pay (McWhinney, 2009). Dollar-cost averaging allows the investor to plan wisely as far as his or her budget is concerned.

Yet another advantage of dollar-cost averaging for investing in mutual funds is that the investor may instruct his or her bank to transfer a fixed amount of money at regular intervals to the mutual funds managers’ bank account. The individual who invests thus has allocated his or her investment budget wisely. What is more, the investor may use dollar-cost averaging for investing in a mutual fund by spending a fixed dollar amount from his or her paycheck each month. In this way, dollar-cost averaging may be applied for employer-sponsored retirement plans to boot (“ What is Dollar Cost Averaging”).

Still, the fact that dollar-cost averaging lessens investment risk over the long haul remains as the most important advantage of this technique. References Dollar-Cost Averaging. (2009). Investopedia. Retrieved May 9, 2009, from http://www. investopedia. com/terms/d/dollarcostaveraging. asp. McWhinney, J. E. (2009). Dollar-Cost Averaging Pay. Investopedia. Retrieved May 9, 2009, from http://www. investopedia. com/articles/mutualfund/05/071305. asp. What is Dollar Cost Averaging. (2009). State Life Insurance. Retrieved May 9, 2009, from http://www. statefarm. com/mutual/sc/invest_know/dollarcst. asp.