RBC Global Asset Management

Understanding dollar-cost averaging vs. lump-sum investing

Figuring out the best course of action for investing in uncertain times is not easy. Especially if you've taken a step back from the markets and sold off some of your investments. You may be asking yourself: what's the best strategy to get my long-term financial plan back on track?

When you are ready to invest, you have two main options:

1. Make a lump-sum investment, or
2. Gradually re-enter the markets through a dollar-cost averaging (DCA) strategy. With DCA, you invest a smaller amount at a regular pace.

Which strategy is best for you? Here are a few important things to consider.

What the data tells us

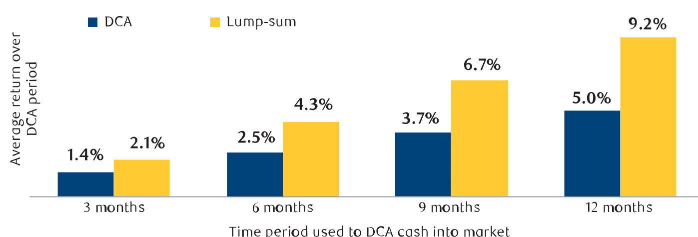
This chart uses data going back over 30 years. It compares the outcomes of entering the market with a lump-sum investment to DCA strategies that invest cash over different periods of time, ranging from three to 12 months.

The results are based on:

- A one-time, lump-sum investment of $10,000 made at the beginning of each time period.
- DCA installments of $10,000, spread out evenly each month over the course of each time period.

The lump-sum strategy came out on top in each time period. This is because markets generally rise over time. So the DCA investor often bought in at higher average prices.

Lump-sum vs. various DCA strategies



Source: RBC GAM, Morningstar. S&P/TSX Composite Index (TR). January 1, 1990 to July 31, 2020

What the data doesn't tell us

While this data is helpful, many of us do not make decisions based solely on stats and figures. When it comes to investing, our emotions can also affect our decisions.

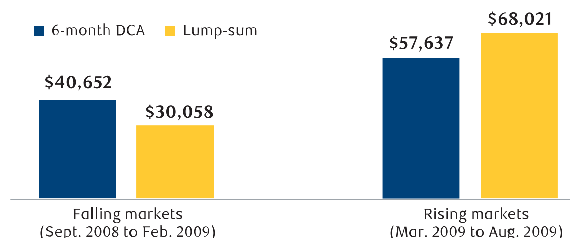
Consider this: if markets start to drop, how will you feel about investing a lump-sum of cash? Will you worry that markets will plunge further – and delay investing? Worry can keep investors on the sidelines – sometimes for an extended period of time.

Using data from the global financial crisis, let's compare the experience of a DCA investor to a lump-sum investor. We look at two six-month periods: one where markets were falling and one where markets were rising.

For the chart below, we make the following assumptions:

- Each investor has $50,000 in cash to invest.
- The DCA investor deployed the cash across six equal monthly installments.
- The lump- sum investor deployed the entire sum of cash on the first day of the same six-month period.

A strategy for all types of markets



Source: RBC GAM, Morningstar. S&P/TSX Composite Index (TR). Value reflects ending value after noted 6-month period.

Key takeaways:

- **During falling markets:** The DCA approach protected the investor's holdings relative to the lump-sum investment. Not shown on this chart: the DCA investor broke even just three months after the bottom in June 2009. Meanwhile, it took the lump-sum investor until December 2010 for the portfolio to eclipse its initial value.
- **During rising markets:** The lump-sum investor outperformed in the six months following the market trough. However, making a lump-sum investment at this point in time would have been extremely unnerving. Particularly when you consider the economic backdrop at the time. Despite trailing the lump-sum results, the DCA investor still captured solid returns, with a more measured approach.

How will you get back on track?

The data shows lump-sum investing often works in favour of investors. But if you are finding it hard to get back into the market, a DCA strategy can help you take that important first step. It can also provide a smoother investment experience. These are both key attributes to helping you stick to your long-term financial plan.

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