Pound Cost Averaging - Investing through market volatility

Pound Cost Averaging is the concept of making regular contributions to your investments in order to smooth out market volatility.

By making regular contributions you naturally purchase fewer units when prices are high and more units when prices are low.

Over the long-term, not only does this create a disciplined investment approach, but this strategy will help take advantage of volatile periods and potentially improve your returns.

Timing the market

One of the greatest things about Pound Cost Averaging is that it removes the worry of making a lump sum investment right before a market decline.

Trying to time the market rarely pays off and often it's more luck than skill- so even seasoned investors avoid falling into this trap. Using Pound Cost Averaging you can be safe in the knowledge that through volatile periods your money will be working to ensure you purchase units at a lower price with a long-term view.

Rising Markets

Of course, there will be exceptions to this philosophy and there is no guarantee that Pound Cost Averaging will result in better outcomes than lump sum investing.

One of these exceptions is a consistently rising market where investing a lump sum from the outset will give you the lowest possible unit price and therefore generate the highest return.

However, the investment journey is rarely a smooth one and given no one knows for sure that markets will consistently rise over your investment journey, the Pound Cost Averaging method can be a useful tool to ensure you don't buy at the wrong time and are able to take advantage of market volatility.

Key Points

Pound Cost Averaging:

- helps create a disciplined investment approach
- removes the worry of making lump sum investments at the wrong time
- enables you to take advantage of market volatility
- is not guaranteed to be the best strategy but is a low maintenance and lower stress approach

Example 1

Example 1, shows the Pound Cost Averaging method for two different customers over a volatile period.

Customer A invests £1,000 a month over the year whereas customer B invests £12,000 in January. Across the year, the market falls and rises with the unit price following the same trend.

By December, Customer A has been able to take advantage of falling prices and has purchased over 1,000 more units and paid a lower average price than Customer B. This leaves Customer A with almost £2,000 more over the 1-year time frame.

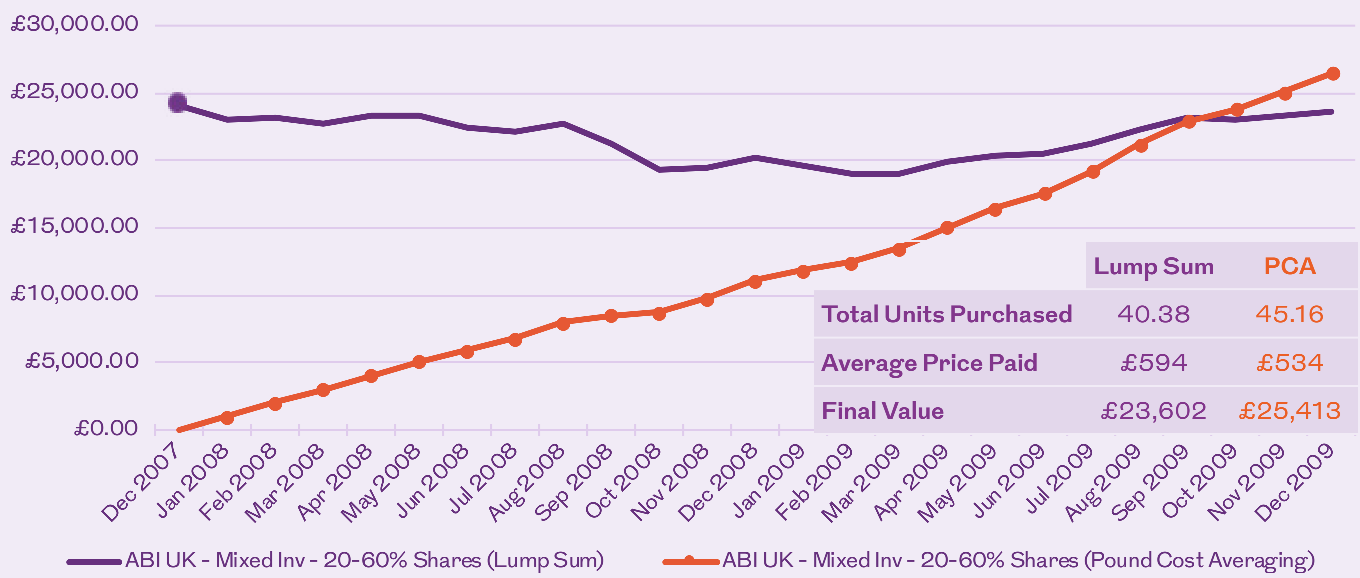
Month	Unit Price	Customer A Contributions	Customer B Contributions
January	£2.00	£1,000	£12,000
February	£1.91	£1,000	-
March	£1.74	£1,000	-
April	£1.70	£1,000	-
May	£1.65	£1,000	-
June	£1.57	£1,000	-
July	£1.52	£1,000	-
August	£1.57	£1,000	-
September	£1.61	£1,000	-
October	£1.65	£1,000	-
November	£1.74	£1,000	-
December	£1.83	£1,000	-
Total Units Purchased		7,077	6,000
Average Price Paid		£1.71	£2.00
Final Value		£12,923	£10,956

Example 2A - Investing through a financial crisis (2007 to 2009)

Example 2A, shows a real example of how using Pound Cost Averaging through the last financial crisis in 2007 to 2009 may have been beneficial.

The purple line shows investment in the ABI Mixed Investment 20-60% shares with a single payment of £24,000 whereas the orange shows regular £1,000 contributions over the same period.

You can see that the Pound Cost Averaging method here has resulted in a greater number of total units purchased, a lower average price paid and a higher final value.

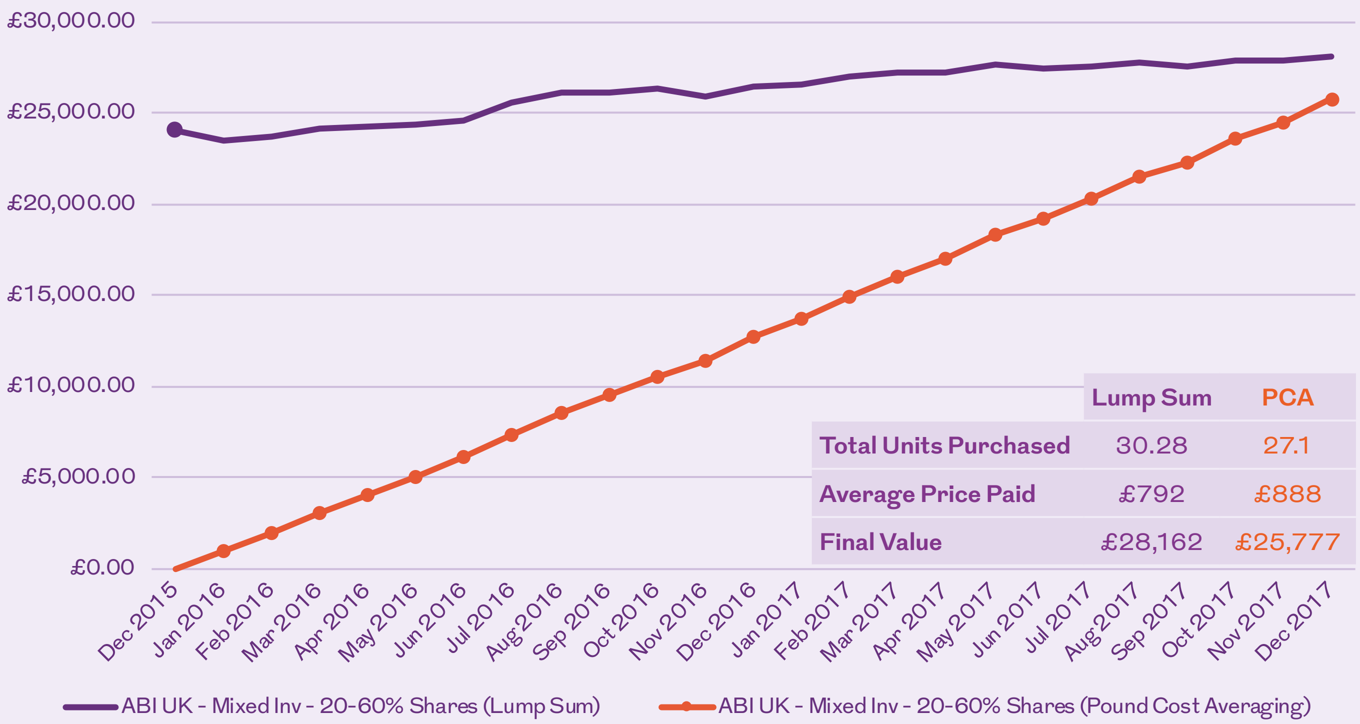


	Lump Sum	PCA
Total Units Purchased	40.38	45.16
Average Price Paid	£594	£534
Final Value	£23,602	£25,413

Example 2B - Investing in a rising market (Dec 2015 to Dec 2017)

Example 2B then shows a real example (using the same basis as in Example 2A) of how the Pound Cost Averaging method may result in poorer outcomes in a market which overall, has net positive returns.

What it really comes down to however, is individual investor preference. Using either method (or even a mixture of both) a well-structured, long-term investment strategy should help you on the way to building enough investments to support you through retirement.



	Lump Sum	PCA
Total Units Purchased	30.28	27.1
Average Price Paid	£792	£888
Final Value	£28,162	£25,777

Remember, investments can go down as well as up and you might not get back all the money you paid in.

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