Pound-Cost Averaging

Key Benefits:

- Investors may benefit from volatile markets as it could mean purchasing more units at a lower price.
- It helps establish a disciplined routine and can help overcome behavioural biases.
- By 'drip-feeding' smaller amounts of capital into the market, total risk exposure is diversified and reduced.

Protecting Capital

There are several stages to an investment decision; starting with when to invest new capital. Investors can invest all at once or over time and drip feed money into the market, a method known as 'pound-cost averaging'.

Pound-cost averaging is the process of investing capital in smaller amounts in a systematic and routine manner. Attempting to time the market by investing when the market dips and selling when it peaks is almost impossible. In many cases trying to do so results in lower returns over the long-term when compared to simply holding an investment. This is due to innate behavioural biases that can tempt investors to panic and cut losses. Instead, by investing at regular intervals it helps to overcome this temptation as the investment becomes an ongoing activity that continues regardless of any temporary gains or losses. Alongside establishing a disciplined routine, pound-cost averaging can help protect your capital against market falls. Phasing your investments reduces the risk of buying on the 'wrong day'. This is because only the invested portion of your portfolio feels the loss instead of your entire capital.

Investor Example

Figure A below highlights an example with two Investors:

- **Investor A** has £6,000 and implements a lump-sum strategy to put all their capital into the market on the same day.
- **Investor B** also has £6,000 but instead invests £500 a month to try and take advantage of pound-cost averaging.

In this 12 month example, markets rise and fall, and the unit price starts and finishes at £10. For Investor A this is bad news since they exposed all their capital to market risk and have made no gains. Conversely, Investor B has made a positive return since they were able to invest regularly and take advantage of market dips to buy in at a lower unit price.

Figure A - Pound-Cost Averaging: Buying the dip
Source: Zurich, 2020

Hypothetical unit price

January	£10.00
February	£9.00
March	£11.00
April	£12.00
May	£9.00
June	£6.00
July	£7.00
August	£8.00
September	£9.00
October	£7.00
November	£8.00
December	£10.00