Dollar cost averaging overcomes fluctuations

Trying to "beat the market" to make a financial killing is one of the most frustrating challenges which investors face.

Playing the stock market as if it is a Las Vegas casino is a crapshoot. Why try something that confounds even the experts? You either have to be clairvoyant or extremely lucky consistently.

Soothe your nerves. Try another, more sensible strategy: dollar cost averaging.

This strategy calls for the investment of a fixed amount of money in mutual fund units at regular intervals during a specified period of time. By following this strategy, investors will actually lower the average cost of their periodic investments.

The principle of dollar cost averaging is simple: As the unit's value rises, investors buy fewer units. As the value falls, investors buy more.

For example, suppose you decide to invest $100 a month in a mutual fund. When you start, the fund's units cost $10 each. So, your $100 buys you 10 units. During the next four months, the fund's price per unit rises from $10 to $11, then drops to $9 and later to $8. At the end of these four months, you will have 42.7 units, or 2.7 additional units than if you had invested a lump sum of $400 to buy 40 units all at once.

The beauty of dollar cost averaging is that investors don't have to worry about market timing. They are buying units consistently, whether the market goes up or down. It also eliminates the temptation to stop buying when the units drop in value or to go wild spending when units start rising. You become detached, oblivious to market shifts. Like the classic advice says, you are buying low and selling high.

By taking advantage of dollar cost averaging, the average cost of all the units investors have brought is less than the average prices of those units when the investor bought them.

The lower average cost will improve the investor's position even more, and also provide him/her with capital gains.

For example, let's say you invested $100 a month for only six months. Since the unit price in the first month was $15, you bought 6.66 units. During the next six months, the price swung up and down, reaching as high as $16 and falling as low as $12, then returning to $15. Averaging Price - $14.16, Total Units - 42.73, Average Cost Per Unit - $14.04. As you can see, your investment grew by $41.05, for a gain of 6.8 per cent. If you had made a single $600 investment, you would have about broken even after six months. By using dollar cost averaging, you have come out ahead.

Many mutual fund companies offer a periodic purchase plan that allows you to take advantage of dollar cost averaging.

Month	Unit Price	Units Bought	Investment	Total Value
1	$15	6.66	$100	$100.00
2	$13	7.69	$100	$186.58
3	$14	7.14	$100	$300.00
4	$12	8.33	$100	$357.88
5	$16	6.25	$100	$577.12
6	$15	6.66	$100	$641.05

Submitted by Lou Mulligan, Money Concepts – Financial Planning Centre, Milton

Borrow now for your RRSP

In 1991, the federal government put in place a new rule that allows Canadians to carry forward unused RRSP deduction room for up to seven years. If you have not used your full contribution room for past years, you may use it against 1995 income to further reduce your tax liability.

To find out what is available, look at your 1994 Notice of Assessment. This is the form that either comes with a refund cheque attached to it or an envelope to put what you still owe in. On the NOA you will see a line that states what contribution room you have available for 1995.

Let's assume you have $25,000 of contribution room available and your marginal rate of tax (the percentage you paid on your last dollar of income in 1995) is 50%. The highest marginal rate of tax in Ontario is 53.2% for those with taxable income in excess of $63,468.

Now we wander off to our favorite financial institution. This is important, because not all institutions will give you the same deal. The better arrangements generally allow the investor to borrow the money and not have to place the RRSP deposit with the institution they borrowed the money from. This is called freedom of choice.

So, $25,000 borrowed at a rate of prime plus 1% (8%) will have servicing costs of $166.67 a month for the first 90 days. At this point, we should see a tax refund equal to our marginal tax rate times our contribution amount ($25,000 x 50%) for a refund of $12,500. At the end of 90 days we have a loan balance of $12,500 remaining and a monthly expense of $565 for two years to pay the loan off.

Where's the benefit? If we assume our RRSP contribution grew by 8% (tax free, mind you) for two years, we'd have an asset equaling $29,160. Our interest costs for the term of the loan would be about $2,600. Couple that with principal payments of $12,500 and we have a net profit of $14,059 on a cost of $15,100. Don't be shy, look at your Notice of Assessment to see if there's a potential gold mine there.

By Michael Bourgon, Donaldson Bourgon Financial Services, Milton

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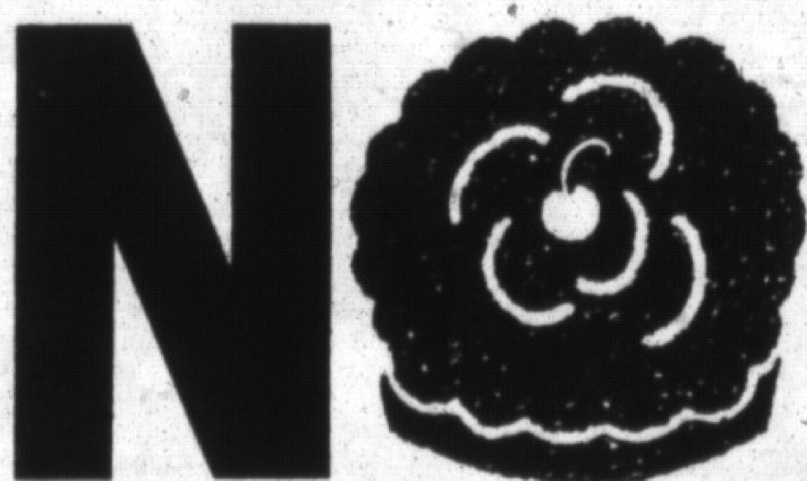

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