Back to Basics: The Power of Dollar Cost Averaging

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we're going to continue on our series of back to basics. So this is a series we're going to do every Thursday. We have about 20 episodes lined up, and we will just work through those. And so every Thursday, come back and learn more about back to the basics. Today's topic is going to be dollar cost averaging and timing in the market. So these are important topics for investors, especially new investors, to understand. So, Andrew, let's talk about dollar cost averaging and timing the market.

Dave [00:00:32]:

So I guess maybe let's define what is dollar cost averaging.

Andrew [00:00:36]:

Yeah, dollar cost averaging is the way to avoid all the problems with the crazy market that there is. You know, one of the refrains from people, as I say, the stock market's way too risky. And if you were to pick one point in time and compare it to another point of time, you might come to the same conclusion. Stocks lose value very frequently and some stocks more frequently than others. But yes, the stock market can be very bumpy, very volatile, a very uncertain place. What dollar cost averaging does is allows you to be invested in the stock market and basically take out that negative effect of the uncertainty that comes with investing in the stock market. And the way you do it is you invest a little bit. It doesn't have to be a little bit.

Andrew [00:01:33]:

It could be a lot. But you invest a set amount consistently over time. So some months you might buy, and it's a terrible time to buy because you bought when the market was expensive. But sometimes you'll buy when it's a great time to buy because the market was cheaper. And so by dollar cost averaging, rather than trying to say, oh, I know exactly when to buy stocks and sell stocks, you take that off of the table. And it helps, I would say, the vast majority of average investors to make good returns in the stock market by eliminating a lot of the risks that can come when you try to figure out the timing of the stock market.

Dave [00:02:16]:

Yeah, exactly. And thats very well put. And I think one of the other great aspects of dollar cost averaging is it helps establish a habit. Something we've talked about many times is investing needs to become a habit. And using something, a process like dollar cost averaging, allows you to develop that habit, because, as you expertly said, you're continually putting money into the market. And that's how you can take advantage of the swings of the market, the ups and downs, and you can smooth out your returns over a longer period of time. But the biggest advantage that, one of the biggest advantages that I see from it is just the ability to develop that habit of, okay, every first Tuesday of the month, I'm going to put $1,000 in the market. And once you start to establish that habit, it becomes a lot easier, in theory, to continue doing that over a longer period of time.

Dave [00:03:14]:

And that's one of the biggest advantages we as an individual investors have, is the ability to control when we put money in the market and how much we put in and what we buy and doing it over a long period of time.

Andrew [00:03:29]:

So somebody whos kind of skeptical with that might say, I would rather put more money in when Im more comfortable and maybe not put as much money in when Im less comfortable. Obviously, going against dollar cost averaging, why would dollar cost averaging be a better idea in a scenario like that?

Dave [00:03:52]:

Steven well, because the idea of investing when youre comfortable and investing when youre uncomfortable also takes into account market timing. And youre trying to determine when you think is the best time to invest in the stock market. And there is no ideal best time. The best time is to do it now. What did Warren Buffett say the best time to plant a tree was 20 years ago, and the second best time is now? I think. To me, the way I interpret that saying was that he was telling me to get off my butt and invest and not wait for the perfect time and just start putting money into the market because none of us can see what's going to happen in the future. My crystal ball is very hazy and a little cracked. And so I have no idea what's going to happen tomorrow or, you know, two weeks from now.

Dave [00:04:41]:

And so instead of trying to go, oh, geez, you know, I just want to wait for the perfect time. There is. There is no such thing. It's you got to start putting your money to work. I read recently that, like, if you look at the five best days of the year to invest, if you didn't invest in those, then you didn't do so well. But the takeaway from that was that you can't predict when those five days are going to happen. And so if you have money in the market, you get to take advantage of those best days. And if you don't, then if you're trying to time the market and you miss it by a day each time and you only invest in those particular moments, then you don't get to partake in the best days of the market.

Dave [00:05:24]:

And so that's where having money in the market can be so beneficial.

Andrew [00:05:29]:

Yeah. Essentially pairing it with the long term strategy so you're putting money in consistently. Obviously, we're talking about the asset gathering stage or the building wealth stage, accumulation stage of somebody's life, putting money in and then also making sure you hang on to it and you're not putting money in and then putting it out, taking it out tomorrow with buyers remorse or something. Yeah, it's a very powerful idea. I look back, feel fortunate to have gone through the bear market of 2020 and be forced to see how my stocks did and then fast forward six months and see how they were just six months later. You would be astonished how much a stock can fall and then rebound like a rubber band, just like really fast because of the way the market can be so emotional.

Dave [00:06:20]:

Yes.

Andrew [00:06:20]:

And to your point, nobody knows what days those are, what day the market can crash or what day the market can rebound. But just by staying in those stocks, youre not really buying low, but in essence, by having the conviction to stick with those stocks as if you had bought low and continue to hang on. So that can be a very, very powerful thing that other institutional investors who have people to please, they might not be able to do the same thing, to have that kind of patience, to be able to stick with their investments like that, right?

Dave [00:06:54]:

Yeah, exactly. So if you're newer to investing, how would you suggest somebody start to set up that kind of habit of continually trying to put money in the market?

Andrew [00:07:05]:

Yeah, I think the first step always goes down to see if your employer has a 401K option and if they do a match on your money, take full advantage of whatever the match is, because that's free money, and that's probably more money than you can make in the stock market. If it's a 100% match, you're getting $1 for one. You're not going to get that in the stock market, certainly not instantaneously. So take full advantage of that because that's a huge tool that a lot of employees have. I guess the next step after that, if you've utilized all of the match, is think about your own individual retirement accounts that are maybe outside of your employer, maybe that's a traditional IRA or a Roth IRA, and try to think of amount that you think would be sustainable, one that you can commit to. And you put it the top of your budget line item to say, I can put this much money in every month and it's not going to force me to not buy groceries or not pay my bills, and then just do it for me. I have a habit near the end of the month, go in and put that transfer in and make sure it's in my account so that in the beginning of the month, I can buy something in the stock market. And that's how I do it.

Andrew [00:08:25]:

How do you do it?

Dave [00:08:26]:

I set it up so that we get paid every two weeks. And so the way I set it up is I have money transferred from my. After my direct deposit into my checking account. I have money transferred into my fidelity account. So a few days after the paycheck hits the account, then I have money transferred into the fidelity account so that I can, you know, the following week, I can buy something. And setting up the automation makes it a whole lot easier, because now I know that in my head. I know, okay, it's Thursday, and I got paid yesterday. I need to start thinking about what I'm going to buy next week.

Dave [00:09:05]:

And so it sets up this mindset of, like, who, okay, what am I going to buy? And start looking at the portfolio, you know, looking at what Andrew picked recently. Do I want to contribute more to that? You know, those kinds of things. And then I just try to determine, you know, what I'm going to do. But automating it like that makes it really easy. It's one less, I guess, speed bump that I have to go over to make it happen.

Andrew [00:09:28]:

Yeah, that's powerful. How did you set it up?

Dave [00:09:30]:

Team member so I literally went to fidelity. Fidelity has the ability to transfer money into your account from your checking account or from. You could do it from your payroll provider, too. I know our payroll provider offers the ability to basically set kind of like your 401K does. It can take it. You can designate a certain amount of money to go to a certain account. So whether it's your, you know, an HSA or whether it's, you know, a brokerage account or savings account, whatever you want, you can transfer that money to that account. That's what I chose to do with fidelity is I just have the money.

Dave [00:10:02]:

They come in, pull the money out of my account, and makes it really easy.

Andrew [00:10:07]:

Yeah, it is really that easy. And that's.

Dave [00:10:09]:

Yeah, it really is.

Andrew [00:10:11]:

Investing today.

Dave [00:10:12]:

I know Ramit SETI has talked about that for years as, like, automating your finances and can make those things a lot easier. And that's one of the things that I love about, like, a 401K, for example, is that it automates it for you. That goes a step further and actually makes the investments for you. So it just completely takes that out of you, you out of the equation, which makes it that much easier to contribute because you don't. For the most part, you don't see the money coming out of your account. It just goes. And then you, every once in a while you check your 401K balance. Oh, I have money in there.

Dave [00:10:46]:

Wow. That's awesome. But the fact that it also automates the investments for you too makes it just that much easier. And like you said, the match is just an added bonus to setting all that up.

Andrew [00:10:57]:

So we talked a little bit about the mechanics of dollar cost averaging. If we could go back though, because Im sure every investor at some point of time has challenged this philosophy to say it doesnt apply to me, im better than this. But what is the reason why you dont think most investors can time the market? Its simple. Just buy when its low and sell when its high. Buy and the stocks down and struggling. Sell it when everybody has gotten excited, excited about and the stocks doubled. What's so hard about that? So what's the problem with that?

Dave [00:11:33]:

Well, the problem with that is there, well, there's a lot of problems, but the biggest problem is none of us know what's going to happen tomorrow. And so the air quote bottom that you may be buying at that may not be the bottom. It could go down farther. And you know, who here has bought a company and had a drop raise their hand? Me and Andrew. It happens. You buy. This is the absolute perfect time. You love this company and it's a price that you think is a good price and you buy it and it goes down five next day.

Dave [00:12:04]:

It's part of the game and it's impossible to know what direction the company is going to go. And even bitcoin has its downtimes. And how many times have we seen in the market recently? I'm going to cherry pick some data, but Netflix dropping 20% in a day, meta Facebook dropping 1015 percent in a day, dropping almost 50% in months. Ajin, a company that I own, dropping 50% in two days. Those are unforeseen events and none of us know that can happen. On the flip side, Nvidia jumping 20, 30% in a few days recently, those are unforeseen events. And if you get lucky, you know, that's awesome. But you got to remember it's, that's exactly what it is.

Dave [00:12:55]:

It's luck. You know, you aren't taking the company at the exact perfect time and it jumped 30% just because you bought it that day. The stock doesn't know you own it and it doesn't care. And so trying to time the market is, it's impossible. You never know when the top is going to be. And you never know when the bottom is going to be. And you also don't ever know who's going to be another side willing to buy. If it's dropping like a rock, it might be a lot harder to find somebody to buy it than if it's going up.

Dave [00:13:25]:

So it really comes down to that. And then that's not even taken into the equation. You know, all the biases and frailties and insecurities that we humans have. And that's, that's a whole other bag. So to me, that's why it drops. Why it's so hard is because we don't know what the future is going to hold. You have no idea.

Andrew [00:13:44]:

Yeah, we really don't. It's funny to think that the market is this master invention of humanity, which in a way it is, but we can kind of look at it as a machine and forget it's made up of a bunch of humans who, you know, have mental health issues, go through divorces, just have terrible tragedies that happen to them. All these, like you said, unforeseen events that that's just on the personal side. And then you zoom out and expand out to what happens with companies and how fast their fortunes can change. And so the idea that something as simple as dollar cost averaging can shield you from that absolute reality that we can't run away from, simple, but very, very powerful and it can help you. And, you know, maybe can. I know we've talked about on the back to the basics already, but just to give an overview, if Im day one, day two into the stock market, this dollar cost averaging thing sounds like a good idea for me. What kind of expectations should I have for those first couple of investments Im putting into the market?

Dave [00:14:58]:

Steven, youre going to see a lot of craziness. Youll see a lot of volatility. What that really means is youre going to see a lot of ups and downs. If you are like most people, when you first step into the stock market, you're going to check your brokerage account at least half a dozen times, if not a dozen times a day, and you're going to see the price go down $0.50, go up a dollar two go down seventy five cents and then up twenty seven cents. And it's going to be all over the place. You may, depending on the company, you may not see a moving much at all. There are stocks like that, too. But if you buy something super volatile, like a Tesla, for example, youll see it bounce all over the place in the course of a day, in the course of a week, in the course of a month, youll see wild fluctuations because a lot of the share price is driven by emotion, by Elon being Elon, and the emotion of people that follow him and invest in his company.

Dave [00:15:58]:

You can see a lot of volatility in that company. It doesnt mean that when you see a lot of volatility that its a bad investment. It just means that theres a lot moving parts and there's a lot of people investing in that company. And like Andrew said, there's a lot of people behind this and other emotions are tied up in that. And that's going to affect the ups and downs of a company. And so when you first invest in a company, whatever it may be, it's not always going to go up to the right every day consistently. You're going to have a few updates, a down day, a few updates and three down days and then four up days and then five down days. But you have to force yourself to zoom out and just realize that this is art of the game.

Dave [00:16:36]:

And if you look at it over the long term, you'll see it go up to the right. And that's the most important part.

Andrew [00:16:42]:

Yeah. You know, I mentioned the word game a few times and really investing in the market is so complex. Everybody really does have their own game they're playing or their own agenda that they're trying to carry out. So to use that Tesla example again, I might look at a company like that and try to interpret the stock price movements based on my frame of reference, my lens, the way I like to invest. I like to look for something that I think is a fair price and I like to hold it for a very long time. But you have a lot of other traders who might be trying to jump in and out within an hour or two. You know, you might have people who are playing these hedging games or they're, you know, I'm going to go long electric vehicles with Tesla and I'm going to go short electric batteries with Albemarle, and I'm going to make that trade for two weeks and I'm going to sell out both of those. Right.

Dave [00:17:32]:

Right.

Andrew [00:17:32]:

We could be talking about billions of dollars for one guy whos doing his own agenda and then hundreds of people with $10 doing their own agenda also. So you can have so many different combinations of all those things. You put all of those factors together. And yes, in the short term you get a stock price that doesnt make a lot of sense, because theres too many factors they just cant account for.

Dave [00:17:54]:

Right.

Andrew [00:17:54]:

And thats why the markets always been uncertain and why it will always be uncertain because the worlds bigger than just me and Dave or listener out on the other side. Its a big, big market, Trey.

Dave [00:18:07]:

Its a huge market. Its a huge market. And I think when you kind of combine all those factors, it really does help explain why it moves so much and why theres so much volatility. And to further your point, theres a lot of people that are very long in video, like they think that this is going to be the next great company. And I'm not saying it's not. But there's also other people on the other side that think that it's a tremendous, monstrous bubble and they're betting that it's going to burst and they're going to benefit from that. And those two contradicting forces can help sway how the company moves in the market, depending on the sentiment about news that goes on with the company. And that can have a huge impact on the forces that you see with an investment.

Dave [00:18:59]:

I read recently, I think it might have been Warren Buffett was talking about the mastering of the money part of investing is probably fairly rudimentary, but the mastering the emotional side of it is easily the hardest part because that is what really drives the craziness of the market is how we feel about things and our, you know, as you said, our inhibitions and our thoughts and our feelings really drive how we behave. And those behaviors are felt through us buying or selling a company.

Andrew [00:19:37]:

Yeah. Yeah, for sure. And there's just so many biases that play into that that, uh, we could probably talk about that for hours, right?

Dave [00:19:48]:

Yeah, for sure. We good. So how would you suggest somebody avoid trying to time the market?

Andrew [00:19:55]:

Yeah, I mean, it comes back to the dollar cost averaging and then combining that with the long term mindset and really making sure you understand that mindset correctly, I mean, you could build a portfolio full of 2025 great businesses, great stocks. But if youre constantly trying to micromanage it, then you probably wont see its true potential. And its a balancing act, too. You also dont want to hang on to grenades, and there will probably be stocks you pick that turn into that, too. So it is a balancing act. But in general, I think having that long term mindset and combining it with dollar cost averaging is probably the best, easiest, simplest thing you can do to combat against the market timing.

Dave [00:20:38]:

Yeah, for sure. So what are your thoughts on people coming to a large sum of money versus continually just dollar cost averaging. Is it better to take the, let's say you come into $10,000, for example. Is it better to throw that whole chunk in at one time, or is it better to use dollar cost averaging to try to mitigate some of the risk and some of the potential mis pickings, if you will, choosing poorly?

Andrew [00:21:08]:

Yeah, I guess it depends on how much money we're talking about, right. If you're coming across a million dollars and it's an inheritance and it could be a big chunk of your life savings, then that's probably a conversation with a financial advisor. Right? If we're talking about $10,000 because you got lucky in your march madness bet that you have, you know, 30 or 40 years until retirement and you expect to be putting in thousands of dollars into the market over your lifetime, then, you know, that's a different conversation, too. So, you know, I think it kind of depends on what kind of a hypothetical we're talking about here.

Dave [00:21:46]:

I would say if somebody came into it and they want to put all of, let's say that they won their March Madness pool and they want to put all $10,000 into the market April 5, what would you tell them to do? Would you rather them dollar cost average that amount into the market over a period of time, or do you think it would be better to just, okay, plunk it all down on one thing or several things?

Andrew [00:22:11]:

Yeah, I mean, theres two ways you could do it. One way, which has a lot of data backing it up, is to just plunk it down into an index fund. If youre an index fund investor, just plunk it down into that and then let the market kind of run its course. They say time in the markets more important than timing the market. And so that generally tends to work most of the time over history. If you did it that way, if you're a stock picker like Dave and I are, I would definitely dollar cost, average it if I want to March Madness pool tomorrow since we're recording this before it's all wrapped up. Yeah, I would definitely dollar cost, average it. What about you?

Dave [00:22:50]:

Yeah, I would definitely dollar cost, average it. I think we've talked about this in the past. If you have a large sum of money that you want to put into the market, trying to come up with ten best ideas to put into it at one time, I think would be near impossible. So I think trying to find one or two good ideas in a single month is hard enough. So tripling or quadrupling that I think would be really really difficult. So I think if youre picking individual companies, I would set aside a certain amount every month that I would want to put in and then treat it as a bonus dollar cost average to the money I was already normally putting in and just work, work through it that way.

Andrew [00:23:34]:

You know, actually, I changed my answer. This is going into the. The archives of podcasts and Internet history, right. If you have something to back the truck into you, I would put it into that. So it's not like 100% your portfolio. I feel like there's a pitch like that that's screaming at my face. So I would I would load into that. So let's go march madness.

Andrew [00:23:57]:

Right?

Dave [00:23:57]:

Right. Okay, so since we're recording this in the past, who do you have winning the tournament?

Andrew [00:24:04]:

Uh, I mean, just for. Because it's local for me. I go for Duke and only because my wife's going for Unc. So I gotta take the other side.

Dave [00:24:15]:

Yeah.

Andrew [00:24:16]:

But no, I do like the coach k legacy.

Dave [00:24:18]:

Yeah.

Andrew [00:24:19]:

How about you?

Dave [00:24:20]:

I am picking Marquette to win the whole thing. So that's where my daughter in law went to school. And so we're rooting for Shaka, Sparta and the golden eagles to win it all.

Andrew [00:24:31]:

The golden eagles.

Dave [00:24:32]:

Yeah.

Andrew [00:24:33]:

That's quite the mascot.

Dave [00:24:35]:

Yes, it is, for sure. So I guess in the future, we'll look back on this and go, ooh, we were way wrong.

Andrew [00:24:43]:

Oh, always. Yeah.

Dave [00:24:45]:

All right, folks. Well, with that, we will go ahead and wrap up our show for today. I wanted to thank everybody for taking the time to come listen to us, and I hope you're enjoying our back to the basics series. This is designed to help you become a better investor, and this can be a great resource that you can use in the future and in the past. So with that, we'll go ahead and sign us off. You guys go out there and invest with a margin of safety. Emphasis on the safety. Have a great week, and we'll talk to you all next week.

Dave [00:25:14]:

Bye.

contained just for general information and educational purposes. Only it is not intended as a substitute for legal, commercial, and or financial advice from a licensed professional review, our full disclaimer@einvestingforbeginners.com.