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In the Markets Now

A bear market strategy

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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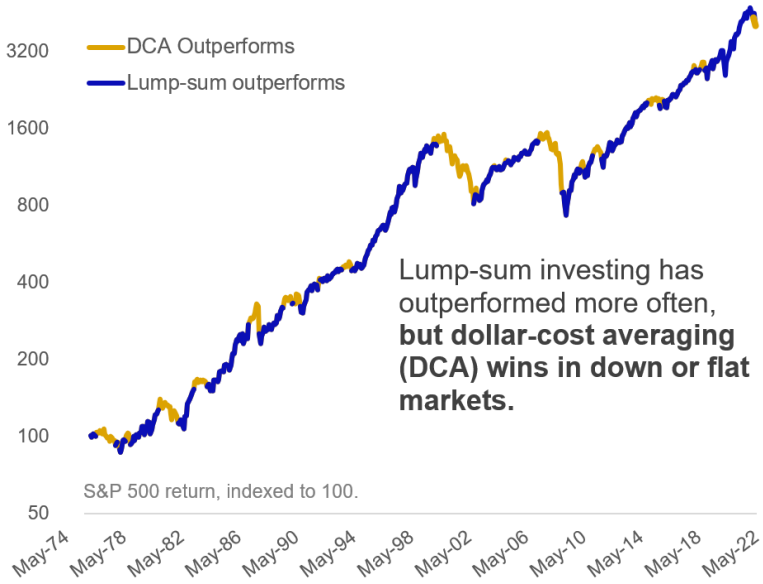
THE BENEFITS OF DOLLAR COST AVERAGING IN A DOWN MARKET

Last year, I wrote about an age-old investing question: if you come into a windfall of cash, is it better to invest it all at once or in intervals over time (commonly called "dollar cost averaging," or DCA). The data spoke clearly. For roughly 75% of the starting dates across history, it made sense to invest as a lump sum right away. This is simply because the market has trended higher over the long-run, and therefore getting money to work sooner proved to be a more winning strategy. Time in the market won out.

However, dollar cost averaging does have its benefits. For one, this strategy can serve as an emotional hedge in the event that a lump sum investment is made at the top of a market. Going all in at once means higher volatility and the potential to see immediate losses should the market act unfavorably. Spreading out an investment hedges against this. Relatedly, as investor Ben Carlson writes, "It allows you to diversify across time. Markets are always and forever cyclical. The problem is we don't know how long the cycles are going to last (or) what the next cycle will look like." DCA mitigates emotion, bad luck, and timing risks.



Past these more qualitative advantages, dollar cost averaging also still outperforms 25% of the time. This brings us to today's note, because the overwhelming majority of that 25% occurs in down markets (as seen to the right). DCA allows one to buy into long-term investments at cheaper and cheaper prices, lowering one's average cost on the way down (and therefore juicing returns on the way back up). While we should expect lump-sum investing to outperform a majority of the time given the longer-term upward trajectory of the stock market, dollar-cost averaging thrives in extended selloffs like we see today.

Trying to time a market bottom perfectly is as difficult as it is risky. Consider that while the average bear market takes close to a year to bottom, the range of lengths across history is wide, from two and a half years to just one month. A bottom can come quicker than one would expect – like March 2020 – well before the economic data would support a rally. Or a bottom can take years to reach, frustrating investors with headfake rallies along the way. So not only does a dollar cost averaging strategy outperform in down markets, it also removes the desire or obligation to try and call a bottom in real time if you have cash to invest.

I am a fan of dollar cost averaging (and other systematic investing strategies) because having a plan beats not having one every single day of the week. To quote Ben Carlson once again, "The wonderful thing about dollar cost averaging is you don't have to try to predict tops and bottoms because you're spreading your bets. No single purchase will make or break your portfolio. It's the perfect strategy for a bear market. **It never feels like it when you're living through them, but the purchases you make during a bear market will almost always be the best investments you make."**

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