

## Cost Averaging vs Lump Sum

*"Fear has a greater grasp on human action than does the impressive weight of historical evidence."*

- Jeremy Siegel



The debate between Cost Averaging (CA) versus Lump Sum (LS) can be as comprehensive as you want it to be.

This article is divided into the sections below, so please feel free to jump to the one(s) that suit your time-and-effort commitment to this tricky, but solved, problem.

- 1. The Scenario**
- 2. The Options**
- 3. The Answer**
- 4. The Answer With Nuance**
- 5. The Detailed Answer**
- 6. The Wrong Answer**

## 1. The Scenario

If you currently find yourself in any of the following scenarios, you have thought about CA versus LS:

- You have received an inheritance
- You have come into a chunk of cash via a business or investment sale, a new contract, a bonus from work, or a lottery win (you jammy git)
- You find yourself with a lot of money saved, sitting there, earning you less than it should

You want to invest this cash so it compounds in the background.

However, you hear markets are a little topmy right now, with expensive valuations, the top 10 stocks in the US making up 40% of the S&P 500's market cap, and talk of dot-com comparisons.

At the same time, you also have heard that time in the market beats timing the market, missing out on even a few great days eats into returns that cannot be made back, and the opportunity costs of not investing are the compounding cost of waiting, inflation, and FOMO.

## 2. The Options

You decide to undertake some research as to which is the better approach:

- **LS:** invest all your available money in one go, asap
- **CA:** invest all your available money, but in increments. You like the idea of equal monthly payments over a year

But you have no time for research! So you talk to the guys at Biograph, who do indeed have the answer...

### 3. The Answer

Lump Sum.

### 4. The Answer With Nuance

We can really only deal in probabilities based on what would have been a better approach in the past.

**CA *can* outperform LS in falling markets.**

The obvious problem is we don't know when markets are going to fall.

And markets generally rise (75% of the time<sup>1</sup>).

And the longer you wait to get your money invested, the more your purchasing power will be affected and the more you're likely to miss out on growth.

And when the market is falling is exactly when you'll be least enthused about investing in it. There are always valid reasons to think markets will continue to fall or at least stay low for a while – that's why they crash! The world closed down in March 2020. S&P 500 returns for the year 2020 were +18.4% with dividends reinvested<sup>2</sup>. That did not seem plausible when we were all at home playing with our Zoom backgrounds.

And so, the historical odds of CA working are against you. You're simply *more likely* to buy in at higher average prices over the course of your planned investment horizon.

**LS outperforms on average across markets, market types (rising or falling), and even when stock prices are relatively high.**

Lump Sum has beaten CA ~65% of the time for most markets over 10-year periods<sup>3</sup>.

It even outperforms on average when it comes to bear markets (~54% of the time), or when stocks are trading in the 95<sup>th</sup> percentile of historical valuations (~64%). These are the times for the CA approach to shine, in theory<sup>3</sup>.

Finally, LS into a 60/40 (US stock/bond) portfolio outperformed CA into a 100% stock portfolio in most periods from 1997 to 2022<sup>4</sup>.

**In other words, LS investing tilts the odds in your favour vs CA.**

**So why even consider CA if LS is more likely to give better results?**

Please reread the Siegel quote from the top of the article which answers this question.

Although LS is the odds-on better choice, it also has the potential to be a more painful decision. You invest everything today and markets fall 10% over the next week. Ouch.

Evidence from behavioural finance suggests that *“Buying stocks on a given day and then watching them fall is more psychologically painful than not buying stocks and watching them raise, even if the economic impact is identical”*<sup>3</sup>.

This insight shows how limited it is speaking in generalities when it comes to investor behaviour...I for one am wired in the exact opposite way to this statement!

Everyone is different and, if it's more likely you'll stick to a plan by trickling rather than pouring into the market, then CA is a reasonable choice for you. **The asset allocation and long-term plan is what really matters.**

If in a hypothetical or real scenario, having now seen that LS is more likely to yield better results and you're still worried about investing your available cash today, the problem may be that you're investing in a portfolio that is too risky for your preferences.

Perhaps a LS into a less-risky portfolio makes sense for you to be comfortable. Or CA into a riskier one.

**The best approach is the one that fits for you, therefore the best approach is to talk to your financial advisor about your particular situation and risk tolerance.**

## 5. The Detailed Answer

If you'd like more detail and data behind the statement above that LS > CA in general, the below research papers are where to go.

Noted is what they include above and beyond concluding that LS is the way forward, as well as the takeaway quote.

- [PWL Captial](#)<sup>3</sup>
  - Benjamin Felix conducts analysis on skew, bear market returns, and valuations.
  - *"Given the data supporting lump sum investing we believe there is a strong statistical argument to avoid dollar cost averaging unless it is absolutely necessary from a psychological perspective."*
- [Ritholtz Wealth Management LLC](#)<sup>4</sup>
  - Nick Maggiulli investigates returns over a 2-year buying window for CA across asset classes.
  - *"When deciding between dollar cost averaging vs lump sum, it is almost always better to lump sum (invest it now), even on a risk-adjusted basis...Generally, the longer you wait to deploy your capital, the worst off you will be."*
- [Vanguard](#)<sup>5</sup>
  - Megan Finaly and Josef Zorn use 10,000 simulated-return scenarios and tested various types of portfolios and CA period lengths.

- *“Lump-sum investment strategies beat common cost averaging investment strategies two-thirds of the time.”*
- **Dimensional**<sup>6</sup>
  - Shows positive market returns over 1-, 3-, and 5-year periods after new market highs and after market declines.
  - *“Both theory and data suggest that lump-sum investing is the more efficient approach to building wealth over time.”*
- **Morgan Stanley**<sup>7</sup>
  - Dan Hunt outlines the pros and cons of each approach, backed by a Monte Carlo simulation.
  - *“In an analysis of more than 1,000 overlapping, historical seven-year period, Morgan Stanley Wealth Management’s Global Investment Office found that lump-sum investing generated slightly higher annualized returns than dollar-cost averaging in more than 55% of cases. For example, in an “aggressive” portfolio with high allocations to stocks, the lump-sum approach would have yielded a 0.41% higher return than dollar-cost averaging over 12 months.”*

## **6. The Wrong Answer**

There is total agreement that sitting on the sidelines and waiting for the markets to crash before going all in is the wrong approach. The inability to forecast, the opportunity cost along the way, and risk of not acting soon enough after a crash are factors too strong to make this a reasonable tactic.

## References

<sup>1</sup> <https://returnsweb.dimensional.com/> From 1926 to 2023 (98 years), the stock market (as represented by the S&P 500 or its predecessor indices) has had positive returns 74.49% (73 up years) of the time, and negative returns 25.51% (25 down years) of the time since 1926.

<sup>2</sup> <https://www.spglobal.com/spdji/en/indices/equity/sp-500/#data>

<sup>3</sup> <https://pwlcapital.com/dollar-cost-averaging-vs-lump-sum-investing/>

<sup>4</sup> <https://ofdollarsanddata.com/dollar-cost-averaging-vs-lump-sum/>

<sup>5</sup> [https://corporate.vanguard.com/content/dam/corp/research/pdf/cost\\_averaging\\_...invest\\_now\\_or\\_temporarily\\_hold\\_your\\_cash.pdf](https://corporate.vanguard.com/content/dam/corp/research/pdf/cost_averaging_...invest_now_or_temporarily_hold_your_cash.pdf)

<sup>6</sup> <https://my.dimensional.com/taking-stock-of-lump-sum-investing-vs-dollar-cost-averaging>

<sup>7</sup> <https://www.morganstanley.com/articles/dollar-cost-averaging-lump-sum-investing>

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## Risk Warning

The value of units can fall as well as rise, and you may not get back all of your original investment.

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