What Can Investors Do with a Lump sum?

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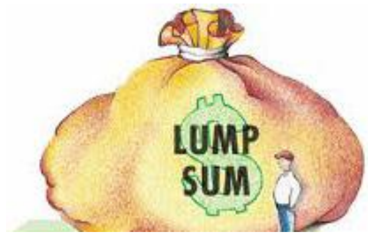

One of the biggest challenges investors will face is the question of timing: “If I have a significant amount of cash, when is the best time to invest it?”

Investing just before a market crash can lead to regret. However, holding cash in a rising market can be an expensive proposition, too. Sitting in cash while stocks rise can be disappointing in its own right. So what can an investor do to balance potential regret in a falling market against the potential for lower returns?

One strategy an investor might use to potentially limit timing risk is known as dollar cost averaging. Dollar cost averaging entails investing a large deposit over time in multiple installments. This strategy can help to limit regret in falling markets. By not investing the full lump sum immediately, the full portfolio is not exposed to market fluctuations until all installments are invested.

During rising markets, however, the strategy may have a cost to investors in the form of lower returns. Because the S&P 500 has returned 9.5 percent on average since 1928, investing into the market incrementally instead of being fully invested has tended to cost investors some of their return.

In a recent study, we tested dollar cost averaging strategies lasting between three and 24 months and found that they tend to underperform lump-sum investing on average. The longer the strategy lasted, the larger the average underperformance has been historically.

The average difference in return was as low as 0.7 percent for a three-month dollar cost averaging strategy to as much as 9 percent for a 24-month strategy. The full study can be found on our website, http://www.regentatlantic.com/media/pdf/Our%20Papers/DollarCostAveraging.pdf

So, the decision to invest incrementally is driven by the competing regrets of incurring market losses soon after making an investment versus being underinvested in a potential bull market. In determining what an investor would regret more, he or she should consider:

Risk tolerance – A more risk-averse investor may find more comfort in investing incrementally.

Existing investment portfolio – Is the entire portfolio getting invested today, or is a relatively small deposit being added to an existing portfolio?

Current market conditions – A more volatile environment may trigger more regret risk for an investor, so dollar cost averaging may be helpful in managing regret.