THE SAFER AND COST-BENEFIT INVESTMENT

Applying the Ringgit-Cost Averaging or Value Averaging Strategies for a Better Investment

Some of us are blessed with a large sum of money that we'd like to invest but our biggest fear is the stock market volatility. On the other hand, perhaps like most of us, we do not have a lot of cash lying around to put in the market. Either way, allow me to introduce to you the two effective strategies that can get your money working for you with less risk and cost via the Ringgit-cost averaging and value averaging.

The common understanding of Ringgit-cost averaging is that instead of investing a sum of money all at once, you invest regularly bit by bit over a specific time period. For example, if you have RM12,000 at the beginning of the year to invest in an equity unit trust fund, you might invest RM1,000 each month over the course of a year instead of investing it all at one go.

While ringgit-cost averaging still works well, value averaging continues to outperform by producing generally higher potential returns.

The idea behind this strategy is that it helps you to reduce risk because you're ultimately buying a selection of stocks (via a diversified fund) at a variety of prices throughout the year, instead of buying all these shares at a single price.

Value averaging on the other hand works slightly differently. When you apply the value averaging strategy, you will first need to figure out how much money you will need to accumulate for a certain goal, such as retirement. Then, based on the annualised return you expect to earn on your investments, you work out how much you must invest each month to achieve that goal. Both methods require different amounts of effort and yields different results.

Do note that the Ringgit-cost averaging and value averaging strategies do not provide some magical formula that simultaneously boosts gains and lowers volatility. Neither Ringgit-cost averaging nor value averaging will give you any real control over the returns you earn as this is largely determined by the markets.

Nevertheless, these methods will give you a disciplined framework for saving effectively. In addition, these strategies may lower the volatility of your portfolio somewhat, and more importantly, help you sleep at night.

Ringgit Cost Averaging

Ringgit-cost averaging is good for people who get frightened when the market drops after they made a lump sum investment. These people will feel better spreading out their investment thoroughly over the year because it means regularly investing a fixed sum regardless the movement of the stock market.

When prices are high, this monthly investment buys fewer units, and when prices are low, the same amount of money buys more units. Over time, you will probably wind up with more shares at lower prices than if you bought them all at once. This method reduces your average share cost and spreads your investment risk over time. By putting money in a little at a time, you spend less time worrying about whether the market is going up or down.

It is also simple to put this strategy into practice. Investors can do a simple standing order that transfers a monthly sum from their bank accounts into our unit trust funds. They can also obtain a CIMB Bank Credit Card through CIMB Wealth Advisors and conveniently charge their monthly investment on the card.

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Value Averaging

Value averaging on the other hand provides a much more systematic way of reaching a specified amount than regular Ringgit-cost averaging. Since you are monitoring the value of your portfolio, you know right down to the Ringgit whether you are on track and, if you are not, exactly what you need to do to get back on track.

Let's say your goal is to accumulate RM500,000 over the next 20 years. If you believe you can earn an annualised return of 8%, then you would need to put away about RM875 a month. You can then chart your progress month by month towards that goal. Here's where the "value" part of value averaging comes in. Let's say that, at the end of the first year, instead of having the RM10,950 you should have to be on track toward your goal, a downturn in the markets leaves you with just RM10,000. That would mean that the next month, instead of investing your usual RM875, you would invest an additional RM950 to bring your portfolio's value to where it should have been in order to remain on track towards your goal. This process will be repeated every month but in months where you fall behind, you would add to the amount you invest each month. In months where your returns are higher than expected and your portfolio's value gets beyond where it needs to be, you would scale back your monthly investment, or even possibly end up selling some units.

There are various ways to carry out this strategy. Instead of adjusting your investment amount each month, you could recalculate it every three months or six months, even yearly. This is the essence of how value averaging works.

But like any system, value averaging has some drawbacks. If the market goes into a prolonged slump, or if you simply overestimate the potential return you can earn, you could end up having to make very large contributions to keep your account value on track. If you're not able to make these higher contributions, you may have to abandon your plan, or create a new one.

As compared to Ringgit-cost averaging, this strategy requires more discipline and effort. You will need to actively monitor your portfolio and re-adjust the amount you invest according to whether you are below or above your investment target to reach your goal. Unless you are highly motivated, it is likely you'll need a financial planner or advisor to help keep you on track.

Value averaging also requires you to remain calm and continue to purchase stocks when everyone else panics. , Apart from that you must also invest in far larger amounts than in calmer times. This is precisely why value investing works better than ringgit-cost averaging: It forces investors to buy more unit trust funds when prices are low than when they are high, increasing overall potential returns, on average. Knowing value averaging is superior to ringgit-cost averaging is not enough. Putting it into practice requires you to not only manage your investments, but also manage your emotions.

Comparison of the Strategies

Ringgit-cost averaging forces investors to spend a fixed dollar amount at regular intervals on a particular investment or portfolio, regardless of the unit price and time horizon. However, value averaging is more ideal for investors who want to achieve their financial goals within a specific time horizon. It is a formula-based investment technique where a mathematical formula is used to guide how much is invested into a portfolio over time.

While ringgit-cost averaging still works well, value averaging continues to outperform by producing generally higher potential returns. According to Michael Edleson, author of Value Averaging, "Value averaging is about as close to 'buy low, sell high' as you can get without a crystal ball." I encourage you to read this book if you wish to find out how to put value averaging into practice.

In a nutshell, the main benefit of both methods is that they provide a disciplined framework for saving and taking advantage of the power of compounding interest, which could potentially lower your portfolio volatility.

Most importantly, most people are not saving nearly enough for retirement, so the focus should be on saving more, not less. At the end of the day, the solution is to save as much as you reasonably can regardless of what the market is doing. When you're investing for long-term goals, your ultimate aim is to reach those goals. And the more you save, the better the odds of you attaining that goal. **SI**

This article is courtesy of **Datuk Noripah Kamso, Chief Executive**
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