Law of Arithmetic: dollar cost averaging & the power of discretionary dividend reinvestment

Dollar cost averaging is an age old investment strategy that takes the form of investing equal dollar amounts on a pre-determined schedule over a set time horizon. The fixed dollar amount ensures that more shares are being purchased when their price is low and fewer when they are expensive. The primary appeal to the dollar cost averaging strategy is the opportunity to reduce the total average cost per share of the investment. The potential drawbacks of this strategy are the automatic nature in which incoming capital is invested, where it is invested, and when. Dollar cost averaging is akin to another well-known investment strategy, dividend reinvestment plans, or DRIP's. A key difference between dollar cost averaging and a DRIP is that in a DRIP the dividend payment is automatically reinvested in the company's own shares.

Jeremy Siegel's extensive research on dividend reinvesting highlights two key reasons why dividend reinvesting (and as a consequence, dollar cost averaging) is so powerful:

> The greater number of shares accumulated through reinvested dividends cushions the decline in the value of the investor's portfolio. It is because of the additional shares repurchased in down markets that I call reinvested dividends the 'bear market protector'.

Reinvested dividends cushion the decline in value because your average cost is being reduced, thus reducing your downside.

> Those extra shares will greatly enhance future returns. So in addition to being a bear market protector, reinvesting dividends turns into a 'return accelerator' once stock prices turn up. This is why dividend-paying stocks provide the highest return over stock market cycles.

By owning more shares at a lower average cost, you stand to benefit at an accelerated rate from a recovery in the investment's price level.

While the power of dividend reinvesting is evident in Jeremy's Siegel's research, there are limitations in using DRIP's:

- Dividends are automatically reinvested in the company's own shares, irrespective of price level
- Not all dividend paying stocks have a DRIP feature

SEAMARK captures this investing style by having the discretion to allocate dividend cash flows into those portfolio holdings that offer an attractive entry point. By utilizing our bottom-up approach to stock selection we have the opportunity to reduce the average cost (bear market protector) and gain from the most attractive stocks expected to recover (return accelerator).

Tyrone Saunders

Tyrone Saunders, CFA
Investment Analyst