The Value Averaging Investment Strategy Q & A

By Bruce Ramsey

Value averaging is a formula based investment strategy which has be shown to achieve lower average costs and higher rates or return than alternative strategies. The power of the Value Averaging method derives from its marriage of two proven but separate techniques: **Dollar Cost Averaging and Portfolio Rebalancing**. Below are questions and answers addressing some of the more common concerns about Value Averaging.

Can Value Averaging help an investor achieve their desired savings or retirement goals?

Yes, based on our back testing of data there is a very high probability that this is possible. Most of the questions in discussion forums and blogs focus too much on performance and whether VA will outperform Dollar Cost Averaging or other investment strategies. There is enough research, including ours, available that proves that VA outperforms, investors should really be focusing on achieving their targeted saving or financial goals. In some instances we have seen where the price of a stock or fund is lower than where it was 5 years prior and yet an investor would have still met their specified goal and made a substantial profit.

Is Value Averaging market timing?

No, the real purpose of Value Averaging is to achieve a specific target value in a specific time frame. The buying and selling (trading) is driven purely by mathematics which determines the amounts to buy or sell based on the value of the investment <u>not</u> on the price of the stock / security. The direction of the market is irrelevant.

Do you need to have a lot of cash in a side fund in order to implement the Value Averaging strategy?

You do not need to have a lot of cash available in a side fund however, you do need to have some cash available in case a larger investment is required. The way to do this is as follows: First determine the stock to invest in and amount of money required to be invested each period, example $500. Next put three to four times the required amount (e.g. $1,500) into a cash account (side fund). When the time comes to make the investment, if less money is required to be invested than normal, e.g. $400, then the difference ($100) is added to the cash account. If more money is required, e.g. $700, the additional cash ($200) is taken from the cash account. This way there is always cash available when a larger than normal amount is required to be invested and when less is required or there is a sell, the cash account is replenished. You can also have a cap on the maximum amount to be invested at any one time e.g. 2 times or $1,000.

How do you minimize the effect of taxes?

Taxes can be minimized in several ways. The most obvious one is that you could use a **tax sheltered account** (RRSP, IRA, 401k) to implement the VA strategy.

For non-tax sheltered accounts, you could:

- Implement a **no sell rule**. What this means is that you do not sell when the portfolio is above the target value. This is also how buy and hold investors can use the strategy.

- Use **delayed selling**, meaning that you only sell after you get two concurrent sell signals. This reduces the amount of transactions in a given time frame. Our research has shown that this method actually increases the overall rate of return.

- Have less frequent transactions by making trades quarterly.

Why do people still use Dollar Cost Averaging (DCA) knowing that Value Averaging (VA) produces higher returns?

After reviewing numerous discussion forums and blog posts on Value Averaging we believe that most investors do not truly understand the nuts and bolts on how VA works and how to implement it.

This could be for the following reasons:

Most investors who have learn't about VA and believe it is a better strategy than DCA do either one of two things. **1**. They stick with DCA because implementing VA requires work in calculating the required investment each period as opposed to using DCA and having an automatic fixed investment each period or **2**. They create a spreadsheet to test the strategy, however, if the process of entering up to 5 years of historical share prices is not automated it becomes tedious and time consuming. To properly back test and prove the strategy with many securities requires an automated system. Therefore most investors manually try it with a few securities and decide that it requires too much effort and is too much work so they end up quitting and going back to using DCA.

In addition, financial planners and mutual fund companies continuously promote DCA as a way to save money for the future. They do this simply because of the reasons outlined above. In North America, no one has made a serious effort and taken the time to build an automated software system to demonstrate and prove that VA is better, until now.

We have built a very powerful web based software program that allows us to back-test the VA strategy on any U.S. traded stock, ETF or mutual fund. Based on our testing we have found that the strategy works very well and in some cases significantly outperforms DCA.

Has the Value Averaging been implemented and accepted anywhere?

The VA investment strategy has successfully been implemented by several mutual fund companies and brokerage firms in India and Singapore. In addition, it is continuously written about in Indian financial publications and promoted by financial planners there as an alternative option to Dollar Cost Averaging.

What will make the VA strategy more widely accepted?

The answer is Software Technology. If brokerage firms were to implement the technology that allows investors to back test and apply the investment strategy then two things would happen. **1**. More investors would adopt the VA strategy because they would be able to see and truly understand how it works, and **2**. The brokerage firms would promote the strategy because it would increase their revenues from the recommended trades that the system would generate.

There is enough research and documented proof that the VA method works.

Additional information and detailed research on the Value Averaging investment strategy can be found at www.valueaveraging.ca