Lump Sum vs Regular Contributions

Lump sum investing refers to a process of investing the entire amount of money in one transaction either to a single investment portfolio or spread across several investment products.

Regular contributions is an investment method that divides the planned capital to be invested into periodic purchases of a target asset or investment portfolio. The investments are made at regular intervals and typically made in as a consistent amount. As a result, this technique removes the temptation to try and time the market in order to make the 'optimal' investments. The impact of volatility on the entire purchase can be reduced through this process of dollar-cost averaging, given that you are regularly contributing to the portfolio over time. As a result, dollar-cost averaging is a powerful tool that could be suitable to accumulate savings and wealth over time.

When should you use each strategy?

Arguably, there is no correct way of investing or a textbook answer to creating wealth, however there are a number of sensible principles that one can follow. Each strategy has its merits and drawbacks that are important to consider. At Global Financial Consultants (GFC), our Financial Planners can tailor the investment strategy to your needs and situation.

Lump Sum Investing

Lump sum investing generally results in a lower cost as investing all of your money at once may lead to lower brokerage or transaction costs, rather than making multiple smaller investments through a strategy of regular contributions.

If you have a significant sum of money in your bank account sitting idle, you may find that it is steadily losing its purchasing power due to inflation, opportunity cost, and other factors. As a result, you could be missing out on opportunities for progress. You could be able to put your money to work right away by investing it in a diversified portfolio aligned to your own financial goals and objectives, and allow for the force of compounding returns to do the rest.

However, lump sum investing can in some circumstances carry a greater risk as you are investing all of the cash at once. There will always be a chance that the market will fall after you've made your investment, exposing you to short-term volatility, and potentially unrealised portfolio losses.

Regular Contributions

A strategy of making regular contributions has the potential advantage of reducing many of the behavioural biases that might affect investment decisions. This is critical since it is supported in a number of empirical studies; "Do lump-sum investing strategies really outperform dollar-cost averaging strategies?" by Lu, Hoang and Wong (2020), "Dollar-cost averaging just means taking risk later" by Shtekhman, Tasopoulos and Wimmer (2012, p5), that while making an investment decision, emotions and fear can be difficult to distinguish. As a result, investors can avoid making ineffective decisions based on greed or fear, such as buying more when prices rise and are near their peak, or panic selling when prices fall.

Regular contributions can provide some clients the psychological comfort of easing your funds into the market by eliminating the arduous task of attempting to time the market. The strategy of making regular contributions can also allow investors to gradually reduce their investment entry price over time if markets decline. This allows the investor to mitigate some of their entry risk when constructing their portfolio.

However, smaller but more frequent transactions can result in higher transaction costs such as brokerage and, as a result, a higher total expense ratio, when all things are considered. These fees can pile up rapidly and eat away at profits, so they have the potential to keep you from achieving your financial goals. Furthermore, every dollar spent on transaction costs is a dollar that is not invested or compounded.

How can GFC help?

Our consultants are trained to seize opportunities and identify threats across a wide range of investments, which allows us to give you quality solutions and manage your portfolio effectively. For those who have an existing savings plan be it cash, property or shares, you can consider a lump sum investment where you put all your cash to work by investing the entire sum of money into your chosen investments. This type of investment is especially ideal if you're looking for a long-term investment option.

A lump sum investment is a more flexible type of investment as you can hold it in the form of shares, managed funds, bonds, hedge funds and other investment options from all over the world. If you're holding onto a lump sum of money from selling your business or property or if you're receiving an inheritance, a lump sum investment can be a smart way to exploit the gains from the investment market.

References

Lu, Richard, Vu Tran Hoang and Wing-Keung Wong. 2021. "Do lump-sum investing strategies really outperform dollar-cost averaging strategies?" Studies in Economics and Finance 38(3): 675-691. https://doi.org/10.1108/SEF-04-2018-0107

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