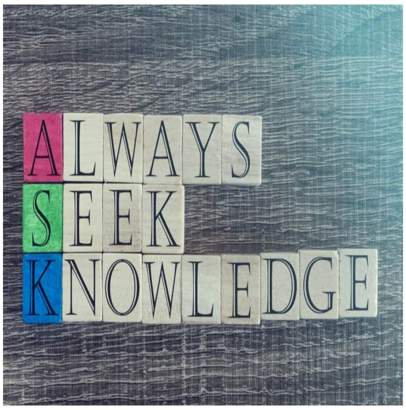

DCA Investing Explained With 2 Canadian Stock Examples

Description

DCA investing or dollar-cost average investing is the simple idea of buying the same dollar amounts in a volatile asset. Back in the day, a financial advisor would explain dollar-cost averaging in a mutual fund as buying more shares when the price of the fund is down and fewer shares when the price of the fund is up. So, you'd get an average cost basis.

The idea is to reduce the impact of short-term volatility and that the price of the underlying asset is expected to head higher in the long run. Consequently, you would be building wealth by investing, say, $500 per month for many years.

You can also apply the same concept when buying exchange-traded funds and stocks.

The DCA investing strategy is simple and easy to follow. However, investors should carefully choose what assets to dollar-cost average into. In other words, make sure what you're buying is worth investing in.

Let's go through some examples of DCA investing in stocks.

DCA investing in Manulife stock

After identifying **Manulife** (TSX:MFC)(NYSE:MFC) as a safe dividend stock, you may be interested in DCA investing in the stock. You might target to invest a total of $3,000, but you don't want to invest in a lump sum to avoid bad market timing and you may not *have* $3,000 in cash at the time. So, you could dollar-cost average into the stock.

For example, you might have bought:

- $1,000 worth of stock at $23 per share in 2019,
- $1,000 worth of shares at $18 per share in 2020 during the pandemic market crash, and,
- $1,000 worth of shares at $25 per share this year.

Assuming commission-free trading, your average cost basis would be $22 per share and your yield on cost would be 6%. Conservative, risk-averse investors would be thrilled with a long-term return of more than 6%. Additionally, price appreciation should provide greater returns.

Notably, Manulife stock should continue increasing its dividend. Its payout ratio is sustainable at about 36%. It just increased its dividend this month, and its five-year dividend growth rate is about 9.6%. The dividend stock is also cheap trading at a price-to-earnings ratio of about 7.8. With exposure to emerging markets in Asia, Manulife could potentially continue increasing its dividend at about 8% per year over the next few years.

Dollar-cost averaging in Algonquin

Algonquin Power & Utilities (TSX:AQN)(NYSE:AQN) is another high-yield dividend stock that's trading at a value. If you're interested in DCA investing in the stock and invest a total of $9,000, you could buy in thirds.

Your trades could look something like this:

- $3,000 worth of AQN shares at $15 per share in 2019,
- $3,000 worth of shares at $18 per share in 2020, and,
- $3,000 worth of stock at $17.60 per share now.

Your average cost basis would be $16.87 per share and your yield on cost would be 5%. The stock has sold off along with the correction in renewable energy utility stocks. However, 80% of Algonquin's business is actually regulated utilities. In any case, the dividend stock appears to be undervalued for accumulation. According to analysts, AQN trades at a nice discount of about 20% from their 12-month mean price target.

The Foolish investor takeaway

Identify quality investments that you want to invest in for a long time. Then, you can consider dollar-cost averaging into them. However, you don't necessarily need to buy equal amounts. For example, for a full position of $9,000 that you plan to accumulate after three buys, you could buy $1,000, $3,000, and then $5,000 if you suspect the stock price could go lower over time.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. NYSE:AQN (Algonquin Power & Utilities Corp.)
2. NYSE:MFC (Manulife Financial Corporation)
3. TSX:AQN (Algonquin Power & Utilities Corp.)
4. TSX:MFC (Manulife Financial Corporation)

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