

## Pound Cost Averaging ‘Ravaging’

The term Pound Cost Averaging refers to investing regular small amounts over time as opposed to investing a lump sum all at once. The aim is that more shares are purchased when share prices are low and fewer shares are purchased when prices are high.

However, the opposite to this can occur where the investment return on a capital sum varies significantly over the investment term which, combined with regular income withdrawals, eventually erodes the capital sum.

To illustrate this our hypothetical investor has a drawdown fund of £100,000 and based on the cash flow model provided to him, an annual withdrawal of £5,000 at the end of each year is suggested.



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Based on a return of 5% per annum, the capital value of the fund should remain at £100,000. However this is not guaranteed. The value of the fund may fall below £100,000 or increase above that level and what actually happens to the capital depends upon the returns that are achieved during the year, even if the average annual return over the period is 5%.

The following table looks at returns over 10 years

Average returns of 5% per annum – annual withdrawal of £5,000 taken at the end of each year						
	5% per annum – average return achieved each year		5% per annum – high returns first		5% per annum – low returns first	
Year	Return	Residual fund	Return	Residual fund	Return	Residual fund
1	5%	£100,000	18%	£113,000	-10%	£85,000
2	5%	£100,000	13%	£122,690	-5%	£75,750
3	5%	£100,000	10%	£129,959	2%	£72,265
4	5%	£100,000	8%	£135,356	3%	£69,433
5	5%	£100,000	6%	£138,477	5%	£67,905
6	5%	£100,000	5%	£140,401	6%	£66,979
7	5%	£100,000	3%	£139,613	8%	£67,337
8	5%	£100,000	2%	£137,405	10%	£69,071
9	5%	£100,000	-5%	£125,535	13%	£73,050
10	5%	£100,000	-10%	£107,981	18%	£81,199

The same average return has been achieved over the period but where the returns were higher in the first five years there is over £107,000 left after 10 years.

Where returns were lower in the first 5 years, the capital is eroded because the withdrawal taken exceeds the returns made.

Therefore, even though the overall return over the period is the same there is less than £82,000 left after 10 years – a difference of over £26,000!

**For help and advice regarding drawdown, please call us on: 01789 263257 or email: [justask@jifs ltd.com](mailto:justask@jifs ltd.com)**

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