viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

Winter 2020 newsletter

Performance: Stock, Mutual Funds and Exchange Traded Funds

Recently, a handful of clients have inquired about how to interpret investment performance on the mutual funds we hold in their portfolios. One would think it would be as easy as looking at the unrealized gain/loss column and making a quick calculation; however, it's not quite that simple. With this in mind, we thought we would use this newsletter to delve into the issue of performance accounting for individual equity-based positions held in our portfolios.

We utilize three different equity-based investment vehicles to enhance portfolio diversification – stocks, exchange traded funds (ETFs), and mutual funds. Performance measurement and security accounting work a bit differently for each of these investments.

Stocks and ETFs are similar in many ways. If they do not pay a dividend, you look at the unrealized gain/loss column on your statement and the profit (or loss) will simply be the change in value from purchase date through the current valuation date. If the security pays a dividend or has a special distribution – whether in cash or shares – the total return is enhanced by the amount received and this is considered in the calculation as well.

If these investments are in a taxable account, the investor will pay income taxes on the dividends and/or special distribution in the year received. Capital gains tax will be paid when the position is liquidated.

Mutual funds are a bit different. When you buy a mutual fund, you are buying into a fund that holds previously purchased securities. Typically, investors are buying mutual fund shares that have imbedded unrealized gains. When the fund manager sells a position inside the fund, this gain must be paid out to fund shareholders. This payment does not change your original purchase price but does lower the per share value of the fund.

For example, if you purchased 10 shares of a mutual fund at $10 per share, your position will have a cost basis of $100. If the fund was required to distribute $2/share in realized imbedded capital gains, the current share price would drop to $8 ($10-$2=$8) giving you a market value for the position of $80. However, the cost basis shown on the unrealized gain/loss statement would still be $100. This means that your unrealized gain/loss statement on the position would show a loss even though you had not lost anything. In a taxable account, taxes are paid on the distributed imbedded capital gain and it is recovered when the position is sold.

As with stocks and ETFs, many mutual funds also distribute regular dividends as well. So, to arrive at the real return for most mutual funds, you would need to consider any capital gain and dividend distributions you received as well as the current market value of the position.

This calculation is further complicated if you are reinvesting dividends and capital gains into more shares because each purchase will be made at a different share price over time.

It's rarely possible to tell the actual profit on any investment simply by looking at the realized gain/loss page on your brokerage statement or quarterly report. For Marshall & Sullivan clients, please reach out to us if you would like us to calculate individual security performance for you.

Best wishes for a happy and profitable New Year!

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What a Year

2019 goes down as the 6th best since the S&P 500 was started in 1957. It was up almost 3 times its average. All major stock indexes we follow are up double digits. Even with this great return the S&P 500 is still fairly valued at 18 times earnings. This is nowhere near where it was in 2008 or during the dot com era.

For 2020 we expect the market to continue to grow but not as high as the rate of 2019. With it being an election year, we also think it will be more volatile with one or two 10% drops during the year. We have been building cash in our accounts and are prepared to take advantage of this volatility.