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Category: Investments

Year-end Dividend Reminder

"Drop in Share Price – Reinvested Shares to Post"

During December, do not be surprised if you see a sudden drop in value of one or more of your mutual funds. It is the time of year when most mutual funds determine the amount of the dividends they are required to pay to their shareholders. Mutual funds are required by tax law to distribute their *realized* profits from sale of securities or dividends and interest they may have collected during the year.

Since 2015 experienced the first market correction in about three years, many managers may have sold holdings they had held for many years. When this occurs, the appreciation which has occurred during the entire holding period, not just this year, is the gain they are required to recognize. Each fund will net the gains they have realized with the losses taken and determine the amount they have to distribute to their shareholders. It is very possible that the total distribution could be one to three dollars per share. This is the cause for the sudden drop in value.

When a fund pays their dividends, they first determine the closing value of the fund for payment date. They will determine the total of the dividends they must pay which can include a regular dividend, short-term gain dividend, and a long-term gain dividend. Knowing these amounts will allow the fund to determine the share price for the reinvested dividends. As an example, the XYZ US Growth & Income fund determined their closing value on the 'payment date' to be $28.60 per share. They also knew they had to pay all three dividend types and this totaled $2.90 per share. With this information, once the fund paid out the $2.90 for each outstanding share, this would create the 'reinvestment price' which is $25.70.

When the dividend payment occurs, the value of the fund is no longer worth $28.60, but is now worth $25.70. This represents a 10.13% drop in share value. But, there is really no drop in value since each shareholder still owns the same number of shares they had before the payment, but they now also have $2.90 in cash for each share they own. For those shareholders reinvesting their dividends, it may take a day or two for the the reinvested shares to post to the account, hence the appearance of a drop or loss in value. However, once the reinvested dividends post, what was thought to be an unexplained drop in value will be restored.

The fund will add additional shares to your holdings for the amount of dividends paid and the new shares will buy in, not at the 'payment date' price, but at the 'reinvestment price'. In my example, this will be $25.70. It is because of this process, mutual fund investors can never judge their true performance by the change in their original purchase price and the current share price. Every time the fund pays a dividend, their share price drops; and since tax law requires

Insights Continued

90% of all gains to be paid out, it is difficult for most mutual funds to grow their share price unless they never sell what they own.

I hope the above information will help you avoid any anxiousness, as most of the mutual funds will declare and pay their annual dividends this month.

Are You a:
Saver – Speculator – Investor

Knowing this is very important and perhaps will allow you to be more comfortable with the daily, monthly, quarterly, and sometimes annual fluctuations in your investment accounts. In many cases, you may see yourself one way but have an account in a different category or something in all three of these accounts in order to achieve specific goals.

Savers – Are those who are seeking growth in their account without taking risk for financial loss. For Savers, the use of savings accounts, certificates of deposit, deferred annuities, and equity index annuities are the types of investment accounts or products used most often. In today's low interest rate environment, the performance of these types of accounts is generally very low and may not outpace the impact of inflation. In the case where the income is taken to meet living expenses, the value at maturity while safe and the same as its starting value will not have the same purchasing power at maturity as it had at inception due to inflation.

Speculators – Are those who are willing to risk some if not *all* of their principal for higher than average returns and generally over a quick or short-term period. For Speculators, none of the types of products used by Savers will meet their objectives. Speculators will use options, stocks, and hedge funds to name a few types of products. As you will see, some of these can also be used by Investors with the primary difference to Speculators being the duration of the ownership expected.

Investors – Are those who are willing to risk some but *not* all of their principal in order to obtain average to slightly higher than average returns. Investors will use options, mutual funds, bonds, variable annuities, and stocks primarily to reach their objective. Additionally, Investors are focused on the long-term, five to fifteen year time horizon, rather than short-term results.

Expecting investment type returns from savings type products will generally create disappointment. Likewise, making an investment but unwilling to risk loss of principle will always create disappointment. Matching each portfolio to your style and objective should allow you to rest easier and allow long-term goals to be met rather than near term volatility causing you to sell out of the market. Regardless of the type of product you may need, we can provide it through Quality Financial Concepts. Please let us know what interest you may have in any of these products.