

News update

Mutual fund basics

About book values

What is a book value? This is probably the most frequent question we get asked by clients regarding their account statements. It certainly seems to be a topic of confusion. So, I would like to briefly explain how to understand book value figures on your account statements.

As a simple starting point, the book value figure is typically the original cost of the investment. Let's use an example. Say, you deposited \$5,000 into your Richardson GMP account and invested this amount into Mutual Fund A. On your statement, for Mutual Fund A, it would show a book value of \$5,000. The market value would be the change in daily value, based on the change in the daily price of Fund A.

The book value figure of mutual funds changes over time with fund distributions and rebalancing, and thus, over time, book value is not an accurate figure of your original investment cost. This means that the total bottom line book value of your account will also change over time due to fund distributions and rebalancing.

For example, let's assume Mutual Fund A declares a year end distribution of \$100, which is reinvested. On your statement, for Mutual Fund A, the new book value would be \$5,100. Over time, as Mutual Fund A declares more distributions, your book value figure increases. The book value becomes especially inflated for income-oriented mutual funds that pay a more frequent, monthly distribution. After many years of distributions, the book value for these fund holdings can be much higher than the original investment cost.

Mutual fund distributions are paid from the net asset value (NAV) of the fund

This is another fact you should be aware of. A mutual fund distribution actually reduces the NAV (the daily reported price) of the fund, holding the market constant. In other words, assuming the fund's portfolio is unchanged with the markets, a fund distribution actually reduces the price of the fund by the amount of the distribution. So, over a longer period of time, regular distributions do have an impact on both the book value and market value of your fund holdings. You do get more units with a distribution; but there certainly have been instances in the past where a fund declares a big year-end capital gain distribution, effectively inflating the book value and reducing the price (NAV) of the fund at the same time, holding the market constant.

The point here is that, over time, the difference between book value and market value becomes less accurate for performance comparisons. Therefore, for mutual fund holdings, the best way to measure performance over time is to compare the change in market value (factoring in deposits and withdrawals), and not to compare book value and market value.



As an example, let's assume your original investment of \$5,000 into Mutual Fund A grows over time to \$6,000. At this point, we decide to switch Mutual Fund A to Mutual Fund B. On your statement, for Mutual Fund B, it would show a book value of \$6,000. So, with rebalancing over time, your original book value changes and no longer reflects your original investment cost.

The book value figure of stocks does not change with dividends, as normally, dividends are paid as cash. Therefore, the book value for a specific stock does normally reflect your original investment cost into that stock. However, rebalancing of stocks over time does change the total bottom line book value of your account.

Rebalancing also changes the book value of your mutual fund

As an example, say your original investment of \$5,000 into Stock A grows over time to \$6,000. At this point, we decide to sell Stock A and use the proceeds to buy Stock B. On your statement, for Stock B, it would show a book value of \$6,000.

So, the conclusion here is that, over time, the book value shown on your statement may not necessarily reflect your net invested amount or original investment.

A few final things to note

For investments that are transferred in from other institutions, the book value figure that we show on the statement may not reflect your original book value or investment cost from the other institution. In some cases, depending on the other institution, it may reflect the transfer value. And, the book value figure also may not reflect the true adjusted cost base of your investment holding for tax reporting purposes. A good example here would be some trusts that have return of capital; in this case, the original investment (book value) is reduced by the return of capital portion to get the true adjusted cost base for tax reporting purposes.

The lesson, therefore, is when in doubt about the accuracy of your book value figures on your statements, it is simply best just to give us a call.

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