Important Topic: Your "Adjusted Cost Bases" (ACB) may not be what you think

I am often asked about the performance of an investment based on the information provided on monthly statements. Clients see an Adjusted Cost Basis and a Market Value and assume that the difference between the two is the return on the investment. Unfortunately, that is almost always not the case. Allow me to explain.

An investment's Adjusted Cost Basis, otherwise known as ACB or Book Value, is an important calculation for tax purposes. It is of interest to your accountant and, by regulations, appears on your monthly statements. It is needed for capital gains calculations done for tax purposes. However, ACB is rarely helpful in calculating one's return on investment.

1. Distributions Paid Out

The ACB does not capture any distributions (interest, dividends) that are paid out. Any such distributions appear in your account as cash and do not trigger a change in your ACB or Market Value.

For example, if one invests $100 and during the year receives $5 of distributions, the Adjusted Cost Basis remains at $100. The $5 is received separately as cash in your account.

After one year the ACB will be $100 and the market value may also be $100 (short term bond, for example). Looking at the Market Value minus the ACB one could incorrectly conclude that the return was 0% when in fact it was 5%.

If instead, after one year the market value is $106 (equity fund, for example), one could incorrectly conclude that the return was 6% (106/100) when in fact it was 11% ((106+5)/100).

In both cases one's returns are considerably higher than one's statements would lead one to believe.

To properly calculate the return, one would need to factor in all cash distributions, yet your statements do not include that amount.

2. Distributions Reinvested

The ACB does change if distributions are reinvested. The Cost Basis is 'Adjusted' for the additional 'investment'. So now your ACB is your initial cost plus all distributions and importantly, your initial investment amount is no longer shown.

For example, if one invests $100, and during the year receives $5 of distributions that are reinvested, the Adjusted Cost Basis will be changed to $105. That is, the $5 is invested, in addition to the initial $100.

After one year the ACB will be $105 and let's assume the Market Value is also $105. Looking at the Market Value minus the ACB one could incorrectly conclude that the return was 0% when in fact it was 5%.

To properly calculate the return, one would need to consider the distributions as profit and divide that by your initial investment amount.

Let us assume that after one year the Market Value is $110 with an ACB of $105. The return is not 4.76% (110/105), but the correct return is 10.0% (invested only $100 and it is now worth $110).

And if the Market Value is $104 with an ACB of $105. The return is not -1.0% (104/105), but the correct return is +4% (invested $100 and it is now worth $104).

Note that in this last case the ACB is the initial 100 and the reinvestment of the $5 distribution, totaling $105. This did fall to $104, but you still only invested $100. The investment lost $1 after gaining $5.

To do the correct performance calculation one must know the 'Initial Investment' and the treatment of any distributions.

Please let us know if you have any questions about this. We would be happy to explain it further.

Market Update – July 2023

Markets in July continued their upward trajectory with additional positive economic and financial data.

With the US economy again proving to be stronger than forecast, the discussion of a recession has change almost completely. While a recession is now considered possible in 2024 (isn't it always a possibility?), there is a lot of congratulatory writing about how the Fed engineered a 'soft landing'. For those unfamiliar with this term, it refers to the successful slowing of the economy, lowering inflation, but without sending triggering a recession. It is striking the balance that avoids a recession while successfully lowering inflation. Historically interest rates increases did not strike this delicate balance but rather sent the economy into a recession while inflation fell or avoided a recession but with high inflation.

But it 'ain't over'. The full effects of the increase in interest rates have yet to been seen and going forward consumers and businesses could still cut back too far or expand too quickly.

Interesting, one of the least spoken about effects is that which is appearing in the cost of good across Asia. They are falling. Not just China, but the entire region, is starting to report deflation. If this works its way into the costs of goods in the West, and it is hard to see how it will not, we could start seeing deflation over the coming months. This would be a meaningful change with ramifications across the economy including interest rates, spending, employment and more.

Taking a step back, this should have been expected. Last year the prices of goods increased significantly. With inflation falling back down to the 2-3% target those increase have slowed dramatically. But a slowing increase is not a decrease. Prices have not come back down. Now if inflation was caused by Covid triggering a global shut down / slow down which limited the supply of goods (triggering higher prices), then should not the resumption of full trade return the prices to approximately where they were previously? And for prices to fall we would need to experience some deflation.

Whatever does happen, and we do not know the future, we will stick with our long-term plan, confident that we will get to where we intend to be, just not knowing which path we will take to get there.

And so, the focus remains, and must remain, on the long term. One's investment focus should be on strong entities that have opportunity and potential and can weather the inevitable storms and still prove profitable. Invest for the long term and ignore short term fluctuations. Mostly one should focus on one's own life, plan, and goals. At the end of the day that is all that truly matters.

Looking forward, we are neutral on the short term, but remain positive in the medium and long term. We continue to invest new funds (finding some good opportunities) and monitor our positions closely.

Have a great month and let us know if there is anything we can do for you,

- Meir & Adam

Index	Month	Year to Date
Bonds FTSE Canada Universe Bond Index - CAD	– 1.30%	1.10%
Canadian Equity - S&P/TSX 60 Index - CAD	2.20%	7.90%
US Equity – S&P 500 - USD	2.80%	17.40%
International – MSCI EAFE Index - USD	2.70%	15.40%
Emerging Markets - MSCI Emerging Markets Index - CAD	5.50%	8.70%
Real Estate - Dow Jones® Global Real Estate Index - USD	3.70%	5.90%
S&P/TSX Preferred Share Index - CAD	2.10%	2.30%

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