OPINION

Bothered by your investment returns? You may be looking at them wrong

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The investing disappointments of last year have made a return appearance in early 2023.

Bonds and bond funds have given up their gains in January, and stocks have lost momentum. We won't see a clear up or down market trend emerge until there's more confidence that inflation is easing enough to project a path for lower interest rates. Meantime, prepare for some unpleasantness in your monthly investment statements.

Rona Birenbaum, a Toronto-based financial planner and founder of Caring for Clients, has been dealing with clients asking pointed questions about their portfolios ever since 2022 statements were issued several weeks ago. She's found a few areas where she's been able to calm clients with some context about their results.

One of these areas is frustration about the value of investments in a portfolio falling below the book value. It's quite common for investing account statements to show these numbers side by side, which suggests book value is some kind of a benchmark for comparing how you're doing.

That would be wrong. "Book value is a figure for tax purposes only," Ms. Birenbaum said. "It's not designed to help you understand the performance of your investments."

Book value sounds like the original amount you paid for your investments. But what it really reflects is the original invested amount plus reinvested distributions of income, dividends and capital gains from your mutual fund holdings. “Every time you get a distribution, your book value goes up,” Ms. Birenbaum said.

Book value is also relevant to investors using a non-registered dividend reinvestment plan, or DRIP. The book value for stocks in a DRIP will be purchase price plus reinvested dividends.

What’s the point of book value, also known as book cost? When you sell an investment in a non-registered account, your capital gain or loss is your selling price minus book value.

Using book value to assess your investing results is a mistake because it can result in the false impression that you’ve lost money. The market value of your investments could be higher than the purchase price, but below the book value. For a better comparison of current market value, check out the annual investing performance report your investment firm issued earlier this year. It’s sure to be archived online if you didn’t see it.

Ms. Birenbaum said bond funds offer a particularly tough comparison between book value and market value right now. These funds make regular distributions of interest, so book value will increase every year if the distributions are reinvested.

But in 2022, the market value of bond funds fell as interest rates moved higher. The background here is that the price of bond funds moves in the opposite direction of rates. Bonds did rebound in January, but they’ve given up those gains recently on concern that interest rates may yet have to rise to cool down inflation.

Another source of frustration for investors is that even their longer-term results have taken a hit. Ms. Birenbaum looked at one balanced fund where the average annual three-year return to the end of 2021 was 8.9 per cent and the three-year annualized return to the end of last year was 4.2 per cent. “These numbers are bouncing around like crazy,” she said. “I haven’t seen variability in compound returns like this in a long time.”

Seeing your longer-term results worsen is frustrating, but things can change quickly. Strong market returns in January meant that same balanced fund was up 5.8 per cent for the three years to Jan. 31.

A mistake people make in assessing their short- and long-term results is comparing them haphazardly to other investments that did better. Ms. Birenbaum cited the example of a client who noted that his globally diversified portfolio was down over a 12-month period while the S&P/TSX index was up. The correct point of comparison is a mix of Canadian, U.S. and international benchmarks.

One more issue in comparing returns is that results contained in annual investment reports are shown on a money-weighted basis, which factors in money flowing in and out of the account as well as the performance of underlying assets.

If you sell an investment that later rebounds, you could end up with worse results than the funds you own, Ms. Birenbaum explained. "You only getting a return on the money you have at work."

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