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# DouglasBradley's MONEYWISE

Financial News and Insight from an Independent Advisor

August 2010

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### Personal Notes

**Doug** - July was a busy month for us. Fourth of July parties and days at the pool for Patty and the kids to escape the heat. (Speaking of which my front lawn looks like someone took a flame thrower to it) Towards the end of July, Patty and I drove out to Chicago to visit some clients and get a weekend away from the kids. We stayed at the Hotel Monaco downtown on Wacker Drive. We had a nice view of the Chicago River and Trump International Tower. After returning from dinner Friday night, we were surprised to see a huge corner of the building across the street on the ground below our window. Our first reaction was that they had to be filming a movie - a quick internet search and we learned it was the action movie Transformers 3. The next morning we awoke to the whole block looking like a battle scene - which it was. Over the course of the weekend, we watched stunt doubles throw themselves off piles of rubble, a helicopter fly low between the buildings and actors Patrick Dempsey and Shia LeBeouf earn their millions. It was very interesting to watch the whole process. And it's no wonder movies cost so much to make considering all the work involved...very little of which

### The Basics of Investment Performance

A quick look at what goes into investment performance - and what doesn't.

As you can imagine, we've had a number of conversations with clients (and prospects) about investment performance over the years. We can appreciate that what seems so familiar to us confuses many others.

Reporting investment performance is a big deal - it's what many people use to determine where they will invest their money. Without stringent reporting rules, investment managers might be tempted to paint their numbers in the best light or outright lie about them.

Fortunately, strict standards called the Global Investment Performance Standards (GIPS) have been adopted worldwide to ensure that all performance data are reported using the same principles. In simple terms, the GIPS are a set of uniform, industry-wide ethical principles that provide investment firms and advisors with guidance on how to calculate and report their investment results to clients and the public. DouglasBradley adheres to these standards and utilizes sophisticated portfolio management software to properly handle the complex performance calculations.

Investment returns are technically Total Returns in industry parlance. A Total Return number is really just a description of what has happened between two dates - specifically a description of the growth between the two dates. This is a critical point to reinforce up front: Total Return is a measure of the growth **IN** a portfolio - not the growth **OF** a portfolio.

Start with the most basic scenario. A Savings account:

1. The starting point is the value of the account on the Start Date. Say \$100.
2. Next we take the value of the account on the End Date. Say \$125.
3. Subtract the End Date Value from the Start Date Value to find the Change in Value and divide by the Start Date Value.  $\$125 - \$100 = \$25$  in interest.  $\$25/\$100 = 25\%$  Total Return

That's a great return. But what if you made a deposit or withdrawal? Those shouldn't be included in the Total Return calculation because they're not growth **IN** the portfolio. Let's take a look:

1. Start Date Value of \$100.

involves the actors I should note.

**Brad** - As I write this I am preparing to attend the 30th annual National Sports Collectors Convention. The show is taking place in nearby Baltimore for 2010. This is the largest sports card and collectibles event held each year and will draw 30,000 collectors from around the world for five days of fun. Mahesh and I used to travel to the show as dealers; going to cities ranging from Anaheim, CA to Atlanta, GA. This year we are going for the pure enjoyment.

**Mahesh** - My family and I are quietly winding down the summer. We are taking our annual trip up to Michigan to visit my wife's family and celebrate a surprise 70th birthday. With the thought of the new school year on the horizon, we've beaten the crowds by already securing all of the required school supplies for both of my children. The one big, fun event left this summer is a visit to a theme park which is currently scheduled for the third week in August.

2. You make a Deposit of \$20.
3. End Date Value is \$125.
4. The account is still \$25 greater at the End Date, but most of it is the deposit. You have to subtract out the Deposit before calculating the performance - or more accurately, isolate the interest from deposit. \$5 in interest divided by \$100 Start Value for a 5% Total Return.

As we just saw, to calculate the growth **IN** a portfolio, one needs to isolate the investment gains from the contributions and withdrawals. To be explicit - contributions and withdrawals are never included in the Total Return - only the investment gains.

Investment Gains are comprised of a few different items:

1. Interest - from any source: money market funds, bond interest, CDs, etc...
2. Dividends - stock dividends and distributions from mutual funds - regardless of whether the dividend is reinvested or not.
3. Unrealized Gain - these are "paper gains and losses". They exist only on paper. You buy a share of Apple stock for \$100. A month later it's worth \$125. Two months later it's worth \$95. It's not "real" profit or loss. But these fluctuations in the value of the investments - whether they are gains or losses - have to be included in the Total Return calculation.
4. Realized Gain - this is what you have when you sell an investment. The gain or loss becomes "real". You either made money or you didn't. Maybe you took your proceeds and left them in a money market fund - or maybe you immediately bought another investment. It doesn't matter.

Obviously, this can get complicated when you've got money coming in and out of a portfolio, investments being bought and sold, interest and dividends being paid. This is why investment advisors rely on portfolio management software to keep track of it all and accurately report the performance for us.

Curiously, not all financial advisors choose to report portfolio performance to their clients. This is particularly the case with the big brokerage firms. Rather, they simply report Start Value and End Value and maybe the change in value over time. But as we saw above, that isn't an accurate reflection of what's going on **IN** the portfolio.

We believe that Total Returns should be reported by all financial advisors to all clients for all investments under management - if for no other reason than transparency. It allows the client to truly see how their advisor's investment recommendations stack up. We find calculating Total Return critical to measuring our efforts towards helping the client meet their SecureRetirement goals.

Lastly, we should point out that Total Return can be calculated with or without management fees. It's common practice that advisors report their Total Returns to clients net of all fees and expenses.

A dry subject no doubt, but hopefully we've been able to provide a better understanding of the numbers we publish on client reports. So when we report a 10% Total Return, that doesn't include the money you contributed to your 401(k).

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## The DouglasBradley Team

**Douglas O. Robinson**  
President  
(443) 451-1884  
doug@douglasbradley.com

**Bradley D. Loper**  
Chief Investment Officer  
(301) 576-0872  
brad@douglasbradley.com

**Mahesh P. Desai**  
Senior VP Retirement Planning  
(301) 233-1261  
mahesh@douglasbradley.com

Visit us on the Web at:

[www.DouglasBradley.com](http://www.DouglasBradley.com)

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