



An Unwelcome Combination for Mutual Fund Shareholders

By Perry N. Burroughs, CPA

Investors may not pay much attention to capital gains distributions when their investments are performing well, like they did over the last two years. However, tepid performance combined with capital gain distributions (and a potential tax



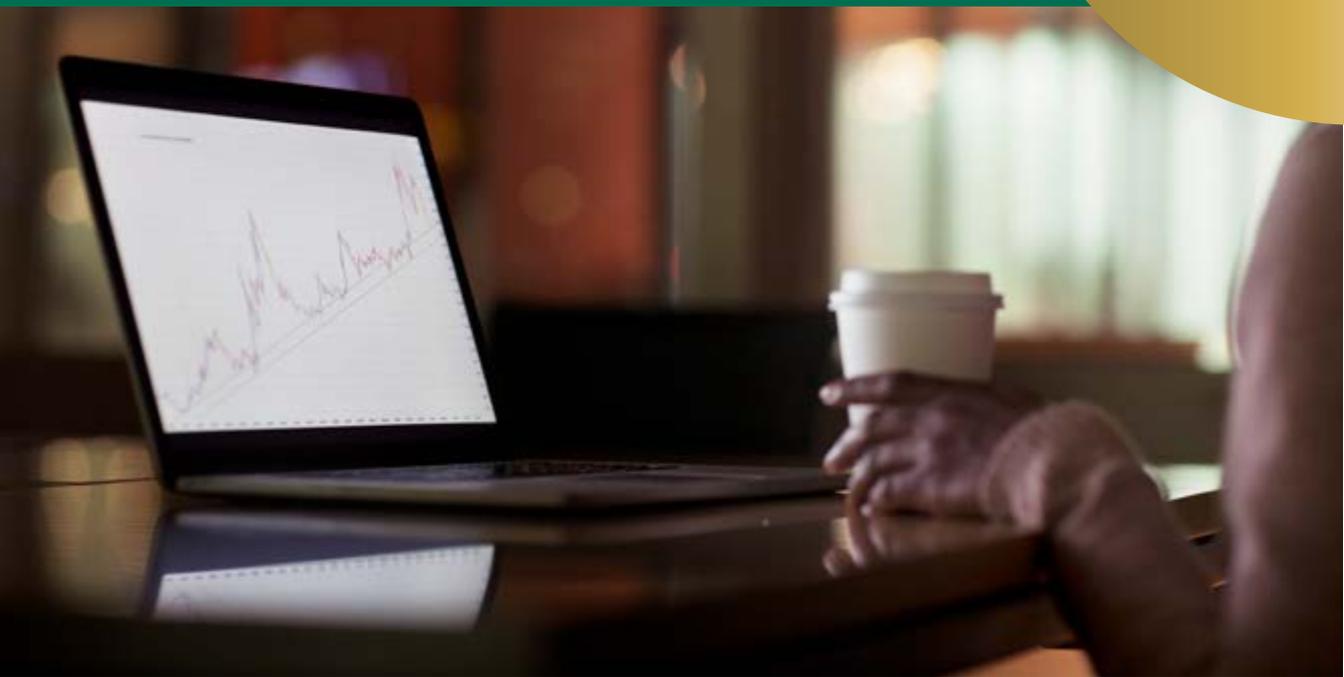
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bill) are an unwelcome combination for mutual fund shareholders. After several years of positive returns, that's the position many investors may find themselves in this year. After solid equity returns over the last two years, 2018 is turning out to be more challenging. Yet given the strength in the U.S. stock markets dating back to 2009, many of those mutual funds are loaded with highly appreciated stocks. That makes it difficult for portfolio managers to manage capital gains when they have very few embedded losses. A nice problem to have, but for mutual fund investors experiencing lackluster returns this year, well, it just adds insult to injury.

Something else that isn't helping is the thundering herd of investors galloping out of actively managed funds and into passive index and exchange traded funds. As investors pull dollars out of those actively managed funds, it forces the portfolio manager to sell something to raise cash for the distribution.



Combining that with a reduced number of shareholders makes the capital gains sting even more.

If there's anything good about mediocre performance like we're experiencing so far in 2018, it's that some investors may have some losses here and there that can be harvested to offset some of those gains.

Capital gains result when a fund sells its holdings at a profit. Mutual fund companies generally start declaring distributions and capital gains for their funds in November of each calendar year.



If your portfolio is being managed by a professional advisor, he or she might have the back-up of a research staff in moving the chess pieces within your portfolio to gain tax efficiencies. They can employ all kinds of strategies, like selecting low-turnover funds or offsetting some of these capital gains through tax-loss harvesting strategies.

It's tougher for investors who self-manage their portfolios as they have to keep up with key dates associated with fund distributions. Even after successfully navigating those dates, a second decision must be made in determining what appropriate fund will be chosen to offset the distribution.

Many other factors must be considered as the tax rates you pay depend upon how long a fund has held a stock or a bond. A short-term investment (less than a year) is taxed at ordinary tax rates and





a long-term investment of a year or more is taxed at the capital gains rate.

All of this must be done before year-end as the IRS sends out 1099s in February.

But December is a nice time to check in with your advisor to make sure he or she is on top of last-quarter action when it comes to distributions and tax efficiencies in your portfolio.

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Nick is a portfolio manager for Commerce Trust Company. Upon gaining a thorough understanding of a client's needs and goals as well as assessing the client's entire financial situation, he works with our investment research team to construct a portfolio to help clients achieve their long-term goals. Nick comprehensively represents our research- and goals-based investment process, starting with the initial assessment and creation of an investment objective to ongoing evaluation and adjustments based on changing market and life circumstances. With a deep knowledge of the market and experience in investment management, he serves clients with thought leadership, insight, and consulting services. He received his bachelor of business administration degree in accounting from Wichita State University in 1986 and earned the designation of Certified Public Accountant in 1989.



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