The Best Tool You’ve Never Heard Of
By Bob Veres
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What's the most useful tool for your advisory practice that you've probably never heard about? I nominate an online service that fills in the blanks in your client asset management system.

What blanks? Let's say you take on a new client who has a concentrated position in Exxon Mobil. You think that, for diversification purposes, it should probably make up less than 40% of her overall portfolio. There's only one problem — the client has owned the stock for a long time, and she has no idea how much she paid for it.

If you recommend selling part of the stock position, what do you do about calculating her cost basis for tax purposes?

This is exactly the situation for which an online tool called Your Old Money, from Princeton, N.J.-based Investment Archive, was designed. Amelie Escher, the company's founder and CEO, says that when she worked for an advisor who had $200 million under management, she routinely encountered clients who had no purchase price data or no clear idea of when they started owning some of their legacy stock positions. Her advisory firm had hundreds of missing cost-basis fields scattered in the portfolio files, and other advisory firms seemed to have the same problem. "I thought to myself: Didn't anybody have a way to fix this?" she says today.

Your Old Money takes daily price data from GainsKeeper (a Commerce Clearing House subsidiary) and rummages through stock data (going back to 1973) and mutual fund data (back to 1986) in a very sophisticated and helpful way.

You start by inputting a few pieces of information. The client gives you the current value and number of shares he or she currently owns. The client also has to know whether dividends were reinvested. You may have to go through a memory exercise, prodding the client to remember the approximate date that the original stock purchase was made. Can you pinpoint the year? Summer or fall? Can you remember what the weather was like when you talked with your broker?

When you finally enter a fair approximation of the purchase date, Your Old Money's calculation engine figures out how many shares must have been purchased at the average daily price within that time window, taking into account every dividend-reinvestment transaction between then and now, to reproduce today's holdings at today's market price.

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Suppose, for example, you have a client who owns 786 shares of Wells Fargo & Co. stock. She remembers buying Wachovia stock in January 2006, but she's unclear about the exact date. She's thinking about selling the position this year, but with her shares at a market value of $27,344.94 and with zero cost basis information, the transaction would cost her roughly $5,400 in taxes – or more her income exceeds certain thresholds.

To get the cost basis, you input the number of shares and their value based on the most recent trading price. If the position has been sold, you input the date of the sale and the value of the position on that date.

Then look at the trade date calendar. Your client thinks she bought the stock in early January. She remembers a news event that same day: then-Vice President Dick Cheney was released from the hospital. You input Jan. 9, 2006. The client has been reinvesting dividends, so you check this box, then push the "estimated" button.

Your Old Money performs a reverse calculation to see how many shares must have been purchased on that date in order to produce the client's current holdings. The output shows more than seven years of quarterly dividend reinvestments, the purchase price (and, therefore, the cost basis) for each of these small transactions, the date of each transaction and the number of shares purchased in each transaction down to four decimal digits. For the initial purchase and every reinvestment, you see the long-term gain or loss calculated to the penny. In this example, because Wachovia stock became Wells Fargo stock on January 2, 2009, the report tells you the conversion ratio of the one stock into the other.

The total cost basis of that position, and the gain or loss, is listed at the bottom. The entire process takes less than a minute, and the level of detail is impressive. In this example, the client's purchase long-term capital loss is $165,781.04. Instead of looking at a tax obligation if the client sells the stock, your client can book a substantial tax loss and use other gains to offset it.

Perhaps the best feature of the Your Old Money system is that it produces an IRS form for the client to sign. The form can then be used to update the cost-basis records and provide detailed evidence of the accuracy of your tax filing on the sale of this position.

Escher says that before her service came online three years ago, the best her colleagues could do was go into Morningstar or Yahoo! Finance and make some crude estimates. The biggest challenge was accounting for splits, mergers and the changing of CUSIP symbols. "What tends to be really brutal," says Escher, "is the name changes, where one company merges with another or is acquired, and the CUSIP changes. I wanted to create something more rigorous, that would be IRS-compliant," she adds. "The IRS currently
accepts 'best guess' estimates for cost basis. What the IRS wants to know is that you didn't just pull your cost-basis numbers out of thin air."

Let's look at another example. Suppose a client owns 785.9852 shares of Merck stock, which, at current prices, is worth $33,655.89. He has records that show he purchased some number of shares at his brother's recommendation on January 8, 1980. He has owned the stock ever since, and is thinking about selling. What's the cost basis?

Going back to that date, Your Old Money's calculation engine determines that he must have purchased 8.1926 shares of Merck at $73.94 – again, the average daily price on that date. The system lists out 127 different dividend reinvestments, five stock splits, one spinoff and two mergers between then and now. When everything is totaled up, the cost basis is $15,520.91, for a long-term capital gain of $18,134.98.

Advisors who have missing cost-basis fields in their client portfolio database will find that the biggest cost is the staff time. The Your Old Money search is relatively inexpensive. You pay $20 per report, which includes the IRS form.

What about more complicated holdings? Suppose a client bought some of a mutual fund, and then sold shares, and then bought some more, and then invested more at a later date? Can the system retrieve a cost basis out of a situation like that?

The short answer is yes, but you will need to provide clearer information. The client would need to know the dates of the purchases and sales and the number of shares bought and sold. Or you could input the amount paid on each of those dates, and the price the fund was sold for. This produces the same kind of report, and the cost for one lookup with current holdings and one purchase is $20 per transaction. If there were three different purchases to make up one current holding, the report costs $40.

For example, a client owns 1,375.999 shares of the Blackrock Global Allocation fund. He remembers that he purchased some number of shares of the Merrill Lynch Global Allocation Fund on Jan. 4, 2006, and thinks he paid around $18,000 for it. Working backwards, the system finds that he paid $18,007.57 for 1039.0982 shares, and he bought the additional shares through 15 dividend purchases. The cost basis comes to $24,041.22 on a holding worth $27,891.52 at recent prices.

With the new requirements that brokers must report their clients' cost bases, and an increasing focus on tax-aware investing in this higher-tax, lower-return investment environment, Your Old Money may be one of the handiest tools available to the conscientious advisor.
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