DOWLING
& YAHNKE
WEALTH ADVISORS

CAPITAL GAIN DISTRIBUTIONS

Each November and December, mutual fund shareholders face the possibility of receiving capital gain distributions from their mutual funds. These capital gain distributions are the result of the mutual fund manager selling shares of one or more of the fund's underlying holdings during the taxable year at a net capital gain. The fund must distribute at least 95% of the net gains to shareholders.

ARE MUTUAL FUND DISTRIBUTIONS TAXABLE?

Yes, if the fund is held in a taxable account. Furthermore, not all mutual fund distributions are taxed the same. Distributions may be characterized as one or more of the following: qualified income, ordinary income, short-term realized gains, or long-term realized gains. Short-term realized gains and ordinary income are tax at ordinary income rates that are generally higher than long-term capital gains rates, which are applied to qualified income/dividends and long-term realized gains.

Therefore, Dowling & Yahnke Wealth Advisors (D&Y) gives thoughtful consideration to the **types** of mutual funds it selects, **when** to purchase or sell a mutual fund, and **where** (i.e., which of the client's accounts) the mutual fund should be located or sold from within the client's portfolio as part of its investment management process.

WHAT TYPE OF MUTUAL FUNDS DOES D&Y PURCHASE?

D&Y's investment philosophy prioritizes mutual funds that exhibit low turnover and are tax efficient.

- *Low Turnover* funds help reduce the potential amount of capital gains required to be paid out. The mutual fund does not buy and sell as frequently potentially reducing the distributions required to be paid out.
- *Tax-Efficient* funds help maximize the after-tax return of the investment.

WHEN?

Fund companies publish preliminary distribution estimates before the actual date of distribution. This is of particular importance because D&Y cannot control whether the gain distributed is a short- or long-term. D&Y reviews these estimates and strategically deploys capital after mutual fund distributions have been paid to avoid incurring additional taxable income from distributions at year-end in taxable accounts.

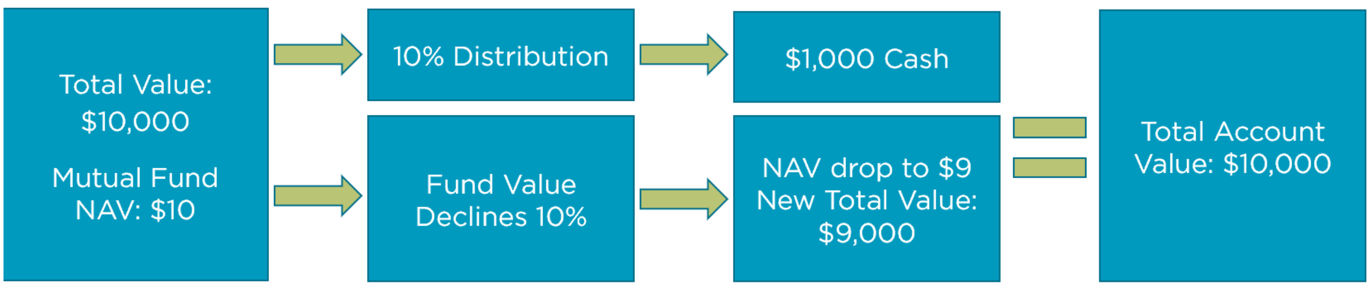
WHERE?

The implementation and ongoing management of a client's portfolio is a methodical process. Each mutual fund's characteristics will be incorporated into the decision as to which account it should be located. For example, REIT funds are required to distribute at least 90% of its taxable income to shareholders annually in dividends. Therefore, D&Y prioritizes locating REIT funds in tax-deferred and/or tax-exempt accounts.

FAQ — WHY DID THE VALUE OF MY MUTUAL FUND CHANGE?

Assume you own 1,000 shares of the XYZ mutual fund. The fund has a net asset value (NAV) of $10 per share. Net asset value represents the net value of a fund and is calculated as the total value of the fund's assets minus the total value of its liabilities on a per-share basis. Therefore, your investment in the fund equals $10,000. (1,000 shares at $10 per share).

Let's say the capital gain required to be distributed is 10% of the fund's total net asset value or $1 per share. Since you own 1,000 shares, you will receive a cash distribution of $1,000. On the day of the distribution, your mutual fund will reflect a 10% reduction in value. The example below depicts fund flows on the distribution date:



If you want to learn more about capital gain distributions and how Dowling & Yahnke Wealth Advisors manages investment portfolios for our clients, please contact one of our experienced financial advisors at info@dywealth.com or (858) 509-9500.