RBC Wealth Management

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Jar'gon / special words or expressions that are used by a particular profession or group and may be difficult for outsiders to understand.

Dear Friends,

When we started writing these letters (*aka the Sequester Series*) back in March we had no idea we would still be writing in August (be careful what you start). It was our intention to use this "opportunity" to explore some of the jargon we work with every day but which may not be all that familiar to you. One of these concepts that barged into our lives this week was the announcement that the board of Apple had voted to split the shares by a measure of 4 for 1. In other words, for every share of Apple a shareholder owns today, three additional shares will be issued and, post-split, they will own four. On the surface it seems a bit like Rumpelstiltskin spinning straw into gold. There is a hitch (of course). Along with the issuance of new shares, the price of the stock on the first day it trades post distribution will be one quarter of what it was pre-split. So, if this is a zero sum game, why do companies occasionally play it?

1.) Generally a split is announced after a stock has appreciated very substantially: trading outside of its "range." There would be at least the appearance that the stock has become very expensive and therefore less approachable to many investors. There is also a tendency for shareholders to want to own a "round lot" meaning at least 100 shares. At a price of $400 per Apple share a round lot costs a buyer $40,000. The same round lot at $100 costs $10,000. Clearly this is a matter of perception and maybe aspiration, but a soft bias does exist. The solution? A stock split!

2.) What happens to the dividend? It is also reduced in proportion to the split. However, it is not at all uncommon for the board to accompany a stock split with a boost in the rate paid per share. Apple did take such an action in conjunction with the split, raising the dividend by 6 ½%. Yet another reason for holders to engage in their happy dance.

3.) What about my cost basis? It too will be adjusted downward in proportion to the announced split. RBC will automatically make this adjustment on the first statement issued following the effective date of the split.

4.) A case can be made that there is more liquidity in the markets if more shares become available for trading and those shares are in the hands of more shareholders.

5.) If things are in reality pretty much the same post-split as they were pre-split, isn't there a bit of financial public relations going on here as in "Look at me !!!" Every successful company wants to be well thought of by their holders. Of course, the best way to do this is to operate the company well. And to do so consistently regardless of the virus du jour. Better earnings leading to higher dividends followed by richer stock prices resulting in a 4:1 stock split is certainly more than an exercise in PR. But it certainly makes for a fine and welcome equation.

6.) How does a stock split tend to impact performance of a stock in the year following the split? The Wall Street Journal reported this week in a story on Apple's split that "stocks in the S&P 500 tend to rise 5% in the year following share splits, including 2.5% immediately following the announcement according to research from Nasdaq Inc. on splits between 2012 and 2018." But there is an interesting caveat in the current case of Apple. Since the split and dividend announcement Apple has appreciated by 18%.

From our vantage point after 49 years in the investment business, the old adage of "be careful what you wish for" may apply here. Can a stock split serve to also increase the risk of ownership at least in the relatively near term? 18% in a week would certainly suggest so. Especially when accompanied by a price in relation to earnings of 35x. High expectations can be a curse but certainly a world-class problem to have.

We hope you and yours are fairing well as we continue the march to a vaccine. Keep safe and stay well.

Best regards,

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