

# What is the Unit Valuation System?

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by Joe Pulizzi

Want to totally confuse the new members in your club? Try talking to them about the unit valuation system. Truthfully, it's not a difficult concept, but it seems many investment club members cannot grasp it. Hopefully, this article will make some sense out of it.

## Think Mutual Funds

Do you have any mutual funds? Do you ever check their price? When I first began investing, I could not understand how mutual funds could assign a dollar amount. I would ask, "How can you assign a number? They have hundreds of stocks, and none of the stock prices in the fund's portfolio seem to have anything to do with the mutual fund price." OK, those weren't my exact words, but it was something like that.

Mutual funds operate with something called Net Asset Value, or NAV. The NAV price is what it would cost you, the investor, to purchase one share of the mutual fund. For example, I own Fidelity Aggressive Growth. The current NAV for this mutual fund is around \$13. It would cost me \$13 to buy one share into the fund. When the stocks in Aggressive Growth go up, so does the NAV of the fund. If the stocks go down, the NAV goes down.

OK, that makes sense, but how did they come up with the \$13? Each time money is added to the fund, more shares are automatically added. To make some more sense of this, let's move on to your investment club.

## Unit Value

Most investment clubs operate their accounting with something called the unit valuation system. Think of the unit value of an investment club as being the same as the NAV in a mutual fund. The unit value of the club is a representation of how the club is doing. It's best to give an example.

Let's say there are only two people in your club, you and John. You initially give \$100 into the club, while John gives \$200. Most clubs start out with a unit value of 10. Where you start the unit value really means nothing; 10 is just a nice round number to start at.

If the unit value of the club is 10, John bought 20 units (or shares), while you bought 10 units.

$$\text{John} - \$200 \div 10 = 20$$

$$\text{You} - \$100 \div 10 = 10$$

So, you have \$300 in your club. You decided to buy Cisco (CSCO). 10 shares of Cisco cost you exactly \$300 with commission. Cisco has a great month, and rises to \$40 by your next meeting. Let's check the club valuation:

Total Net Worth of the Club = \$400 (\$40 times 10 CSCO shares)

Total Units in the club = 30 (You have 10, John has 20).

To find the current unit value, divide the Net Worth of the Club by the total units.

$$\$400 \div 30 = 13.33$$

The club has done well, so the unit value of the club has risen. Next month, you give \$200 to the club, while John gives \$100. Let's see how much we can buy.

$$\text{John} - \$100 \div 13.33 = 7.5 \text{ units}$$

$$\text{You} - \$200 \div 13.33 = 15.0 \text{ units}$$

John now has 27.5 units in the club, while you have 25, even though you both gave the same amount of money. This is because John put more money in when the unit value was cheaper, thus buying more units. You put more money in when the unit value was more expensive, thus buying fewer units.

As your club evolves, the unit value will fluctuate every day, depending on how the stocks you own perform. Hopefully, if your club does well over the long-term, your unit value will rise. The unit value will never change when members make payments. It will only change due to stock performance, interest, club expenses, and/or dividends from stocks. Let's check back to our example.

Now there are 52.5 units in the club, and the net worth of the club is \$700 (\$400 plus the \$300 just added). The unit value remains at 13.33 because making payments never changes the unit value. Using a unit value system is a great way to dollar cost average as well.

Remember, the unit value is priced for purchase only on the valuation date of the club. My club's valuation date is always the meeting date. Be sure to state a specific valuation date in your bylaws (monthly meeting date, 1st Sunday of every month, etc.)

### Unit Value vs. Equal-share

Unit-based accounting is almost universally replacing the "Equal-share" system. Why? Equal-share systems can work when a club is just starting out, but when a club matures, the buy-in for new members becomes too high. For example, if each member of an equal-share club owns \$5,000 in the club, that means that a new member must contribute \$5,000. Most experienced equal-share clubs end up converting to a unit-based system.

Unit-based systems are fair, and allows members to start out giving very small amounts, even \$20 to start. Some clubs don't like unit-based clubs, stating that the difference between what an experienced member owns and what a new member owns can be divisive. True. If one member owns \$10,000 in the club, and another owns \$200, the newer member may not be as willing to work. This could happen no matter what a club does, but it is important to put a cap on what one person can own. Our club states that no member can own more than 25% of the club. Besides, with the popularity and acceptance of mutual funds, the unit-based system seems here to stay.

## **Where to Start?**

Some clubs have set up spreadsheets that compute the unit value. Today, there are many programs that will do the work for you. We recommend getting your club started with [NAIC Online Club Accounting \(NOCA\)](#). A secure, private website for your entire investment club, NOCA allows enables full online tax accounting, message and file sharing, and much more!