

Dividends, and why your position moves at the ex-date

DIVIDEND ADJUSTMENT

A cash credit or debit applied to an index position when a constituent goes ex-dividend. A price index falls mechanically on the ex-date because the shares do, so a holder who received nothing would lose money for no reason. The adjustment exists to cancel that, and it lands separately from the price.

A day on which the index drops, nothing happened, and your position lost money. This is the explanation, and almost nobody is told it in advance.

Why the index falls

A share that pays a dividend goes ex-dividend: from that morning, buyers no longer get the payment. The share price drops by roughly the dividend, because the buyer is getting less.

A price index is computed from share prices, so when constituents go ex-dividend the index falls with them. Nothing has gone wrong at those companies. The value went to shareholders instead of staying in the price.

Why that would be unfair to a position holder

A long index position tracks the price. If the price drops for a reason that transferred value to somebody else, the holder has lost money in exchange for nothing.

So brokers apply a dividend adjustment: longs are credited roughly what the drop cost them, shorts are debited it. Net of the two, the ex-date is broadly neutral rather than a loss.

It arrives separately, which is what confuses people

The price falls in the chart and the P&L. The adjustment appears as a separate line in the account, often later in the day and sometimes the next.

For a short window the position looks worse than it is, and a stop does not know the credit is coming - the price is genuinely there. Reading a mechanical ex-date drop as a market move is the mistake.

Where it is not neutral

Withholding tax: the credit to a long is often less than the drop, because dividends are taxed at source. The gap is a real cost and it varies by market. Shorts are usually debited the full amount, so the two sides do not offset exactly. Concentrated ex-dates: many constituents go ex on the same few days, so the effect clusters rather than spreading evenly.

So the honest statement is that the adjustment removes most of the distortion, not all of it, and the residue is a cost of holding a long index position through a dividend season.

Total return indices

Some indices are published in a total return version, which reinvests dividends and therefore does not fall on ex-dates. Almost every headline index quoted in the press is the price version, and almost every wrapper references the price version too.

If a long-run chart of an index looks lower than you expected, this is usually why - the price version and the total return version diverge steadily, as module 2 lesson 8 warned.

Check your understanding

1. Why does a price index fall when constituents go ex-dividend?

- a. The provider adjusts the divisor downwards
- b. The shares themselves fall by roughly the dividend, and the index is computed from share prices
- c. Index funds sell ahead of the payment

Answer: b. Buyers from that morning no longer receive the payment, so the share is worth less. The index inherits that mechanically - nothing has gone wrong at the companies.

2. Why is the dividend adjustment not perfectly neutral for a long?

- a. Brokers keep a share of it
- b. Withholding tax means the credit is often less than the price drop
- c. It is paid in a different currency

Answer: b. Dividends are taxed at source, so the credit typically falls short of the drop. The gap is a real cost of holding a long index position through a dividend season.

3. Your stop is 15 points below the price on an ex-date when the index drops 12 points mechanically. What protects you?

- a. The stop is suspended during ex-date adjustments
- b. Nothing - the price is genuinely there, and the credit arrives separately and later
- c. The broker moves the stop by the dividend amount

Answer: b. The drop is a real price. The adjustment is a separate cash line that may not arrive until later, and a stop cannot know it is coming.