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Sell duds now and beat the rush

Smart investors examine their portfolios earlier

Most investors wait until December to do their tax loss selling; however, smart investors will want to examine their portfolios a little earlier this year.

The majority of tax loss selling usually occurs in the first half of December when investors examine their portfolios to determine which stocks to cut and which to keep. They then sell the duds in order to benefit from capital losses. This trend often opens the door of opportunity for others.

Investors who have been sitting on the sidelines will enter the markets looking for bargains; taking advantage of depressed prices generated by tax loss sellers. They look for good quality stocks whose prices have been driven down by the selling and scoop them up before the tax loss sellers can re-enter the markets.

By doing tax loss selling early, investors have a cash advantage during the usual tax-loss selling season. And, not only do they benefit from depressed prices, but they have had the added benefit of time to analyze potential purchases. Early tax-loss selling also helps prevent the sale of losing positions at even greater losses, which can result from selling losing positions too late when selling pressure is at its highest.

With tax-loss selling season just around the corner, disciplined investors will want to plan their trades. Generally speaking, the worst performing and best performing stocks are the most actively traded in December. Knowing which ones are likely to be affected by tax loss selling is a good start.

In 2010 the TSX Venture Index is up double digits and capital gains, rather than losses, have been the norm. Therefore tax-loss selling may not generate the usual activity this year, but there could be other sources of supply.

Near the end of the year, institutional fund managers often take profits in order to crystallize returns and lock-in the relative performance of their funds. To do so they reduce positions in their better-performing investments which, due to the volumes involved, can have a significant impact on trading activity and open up opportunity.

Fund managers will also cut underperforming stocks from the lineup in order to offset gains. Although the markets continued their upward trend in 2010, many large, blue chip companies have lagged. Manulife Financial Corp., Research In Motion Ltd., Encana Corp., Shoppers Drug Mart Corp., and Transalta Corp. are just a few that could take a further hit if fund managers deem them the best positions to sell for tax-loss purposes.

Wise investors take a tactical approach to their tax-loss selling. They do the analysis and prepare a trading plan. They don't sell a stock just to trigger a tax-loss but rather make sure they have no reason to hold the stock any longer.

They also consult with their accountant to see if other strategies apply and to be sure they are within regulations. For example, following a sale, an investor

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must abide by superficial loss rules and wait 30 days before buying back the same security.

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