NATIONAL POST
FINANCIAL POST

OCTOBER 27, 2009

Kim Inglis, BCom, CIM

Start your tax-loss selling now

Raise cash to buy bargains after markets correct

Even though the markets have rallied significantly, many stocks are still trailing their rolling one-year returns, giving pause to investors examining losses in their portfolios. With tax-loss selling season just around the corner, they are presented with some interesting challenges.

It's usually December when investors take a hard-nosed look at their portfolios and decide which stocks to cut from the lineup. They then sell in order to benefit from capital losses on their tax returns. This time around, different timing might be in order.

Not only are the markets expected to experience the usual price reductions due to significant tax loss selling, but many investors are also anticipating a near-term correction. Worried that we are in the midst of a secular bear market, they fear the likelihood of a prolonged rally is slim and expect a pullback, which would further deepen any downturn.

Therefore I believe that this year, as part of a disciplined strategy, investors should start their tax-loss selling early. They should decide which losses they wish to crystallize, determine the best exit points, and take advantage of the recent market rally to pare down their holdings and raise cash.

For investors planning to repurchase their positions, this strategy puts them in an excellent position because they will have abided by the superficial loss rules (waiting 30 days before buying back the same security) and the timing of the strategy will place them on the leading edge of the tax-loss selling season.

They will also be better positioned to look for other bargains. When the usual selling pressure begins, they can take advantage of cheaper prices while enjoying the added benefit of time to analyze potential purchases, without the distraction of having to focus on tax-loss decisions.

In searching for other bargains, they join those who want to take advantage of depressed prices before the so-called ‘January Effect’. While there has been much debate about the 'January Effect' and whether markets have priced it in over the years, the reality is that rallies depend on the right conditions.

If the bears are correct, and the markets experience a near-term correction, we'll have a pullback greater than the effect of tax-loss selling. This will create improved buying opportunities, generating the potential for a price rise as bargain hunters take advantage of the lower prices.

Many of these bargain hunters will be investors who are currently sitting on the sidelines with a lot of cash, eagerly waiting for a dip in the markets because they missed this year’s rally. It’s quite likely that they have planned ahead and already earmarked the usual December tax-loss selling season as a time to invest.

This group will be even more motivated to buy if the downward pressure of tax-loss selling is increased by a correction. The markets should then respond positively as their money is deployed.

There is another important advantage to thinking early about your tax-loss selling. It can help prevent the sale of losing positions at even greater losses, which can

Start your tax-loss selling now

Continued from Page 1

result from doing it too late when the selling pressure is at its highest.

Taking a tactical approach to your tax loss selling is always wise and, in our current uncertain environment, it is particularly important because it adds necessary discipline while defensively positioning your portfolio.

Kim Inglis, BCom, CIM is an Investment Advisor. The views in this column are solely those of the author. www.kiminglis.ca