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Tax loss selling now can help reap dividends later

Develop a strategy to benefit

Develop a strategy for tax loss selling now to reap dividends later. Tax loss selling typically occurs in the first half of December and often results in bumpy markets. The stocks most vulnerable to volatility are those trading near their 52-week lows. The best performing stocks are also affected because investors often sell winners to crystallize profits in conjunction with tax loss selling in order to minimize or eliminate capital gains. Mutual fund managers who trigger losses to avoid showing them in year-end reports exacerbate the volatility.

However, these actions open the door to opportunity. Investors who have been sitting on the sidelines are well positioned because they can acquire good quality stocks whose prices have been depressed by tax loss sellers. Unlike tax loss sellers, who must abide by superficial loss rules, investors with cash have an advantage because they can acquire the depressed stocks before the tax loss sellers can re-enter the markets.

Investors who are not sitting on cash, but need to do some tax loss selling, should act early in order to be at a cash advantage during the tax loss selling season and benefit from depressed prices too. Additionally they will have more time to assess trends, analyze potential purchases, and determine best exit points. Early action helps avoid even greater losses in the sale of losing positions, which can result from liquidation when selling pressures are at their peak.

After a less than stellar year, the markets offer investors a number of tax loss selling prospects. The TSX Venture Index is into double digit losses on a year-to-date basis. The S&P/TSX Index also has a number of losers, although on a year-to-date basis it is still slightly in the green. The S&P/TSX 60 Index's five worst performers so far this year are Research In Motion (TSX: RIM), Enerplus (TSX: ERF), Penn West Petroleum (TSX: PWT), TransAlta (TSX: TA), and SNC-Lavalin (TSX: SNC).

In order to crystallize a capital loss, investors must abide by superficial loss rules and wait 30 days before repurchasing the investment. These rules prevent taxpayers from realizing losses without actually disposing of the assets. However, there are options for investors who wish to realize losses but still want exposure. They can buy an exchange-traded fund that is linked to the desired sector, or purchase shares of a similar company.

For instance, an investor who wants to sell Barrick Gold (TSX: ABX) but is still bullish on gold could purchase the iShares S&P/TSX Global Gold Index (TSX: XGD). Alternatively, they could acquire shares of another large cap gold producer, such as Goldcorp Inc (TSX: G) or Kinross Gold Corp (TSX: K).

However, don't sell a stock just to trigger a tax loss. Investment decisions must be based on tactical thinking and careful evaluation. Be sure

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you have no reason to continue holding the stock. If your analysis suggests it can recover, you may want to make a different choice.

The concept of tax loss selling appears simple but there are intricacies to consider. Before embarking on any new strategies, investors should consult with their tax advisors.

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