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Time to sell?

How to offset your gains by swallowing your losses

Despite positive performance in the broad markets many stocks remain in negative territory. Gold, materials, and mining sectors have been especially hard hit, with declines into double digits. The positive news is that there are more gainers than losers. If any winners have been sold and generated reportable capital gains, investors can offset them by selling losers.

Generally speaking, most retail investors conduct tax loss selling during the latter part of November and the first two weeks of December. After taking a hard-nosed look at their portfolios, and deciding which stocks to cut from the lineup, they sell in order to apply the capital losses to their tax returns.

Mutual fund managers also discard their losers. Known as ‘window dressing’, some managers sell their biggest losers so they are not reported as part of the fund’s holdings in year-end reports. According to Credit Suisse, approximately 50% of U.S. mutual funds have a fiscal year end between October and December.

If a large number of retail investors and fund managers conduct tax loss selling in December, it is reasonable to expect some market volatility. This puts investors, who conduct tax loss selling early, in a cash position and able to take advantage of potential buying opportunities before the later sellers can re-enter the markets. They also enjoy the benefit of time to analyze potential purchases,

without the distraction of having to focus on tax-loss decisions.

According to Canaccord Genuity U.S. Portfolio Strategist Tony Dwyer, the combination of near-term overbought conditions with positive investor sentiment means a greater likelihood that investors may be able to buy equities cheaper over the coming weeks. This is positive news for those doing their tax loss selling now.

In order to crystallize a capital loss, investors must abide by superficial loss rules and wait 30 days before repurchasing the investment. Losses in non-registered accounts are applied against current year capital gains. Excess losses are either carried forward or applied to capital gains accrued in the past three years.

There are options for investors who wish to realize losses but still want to maintain 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 a different gold producer.

Investors who plan on selling an exchange-traded fund (ETF) and then repurchasing in the same

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asset class should be careful. It is not enough just to replace one ETF with another. Investors must be sure they aren't selling and purchasing ETFs based on the same index.

A stock that is down shouldn't be sold just to trigger a loss. It isn't crystallized as either a winner or a loser until it is sold so, if you believe it will

recover, you may want to keep it. There should always be a good reason to part with a stock.

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