ON COURSE

Tax Loss Harvesting: Don't Let a Loss Go to Waste

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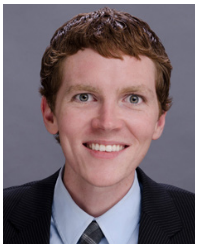

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Most people are familiar with traditional means of mitigating tax such as contributions to Roth and traditional IRAs. One underutilized strategy is intentional tax loss harvesting, which refers to realizing a loss on an individual investment and turning it into an asset by using it to offset a future gain. Technology and other investment vehicles are increasingly allowing for tax loss harvesting to become an investment tool itself.

Tax Loss Harvesting

As mentioned above, tax loss harvesting is the practice of realizing a loss by selling an underperforming holding, then using that loss to offset a future gain. With tax loss harvesting, a loss can be used to lower tax liability and better position a client's portfolio going forward. While realizing the loss makes that specific loss permanent, it does not make it a permanent loss of capital. Instead, it frees up remaining capital to be reinvested elsewhere; into a holding with equivalent risk and potentially better future appreciation potential. This means the capital remains in the market and has the opportunity to perform better than it was previously, and allows wealth managers to take advantage of market dislocations. The loss can later be used to offset future capital gains tax, such as a sale made on another stock or on the sale of a private business. Tax loss harvesting is, in brief, turning a loss into an asset.

Tools for Tax Loss Harvesting

The first half of tax loss harvesting –

realizing the loss – can be easy, especially if you have tools like trading software to support the strategy. The harder part is accepting that it's not a permanent loss of capital. It's better to think about it as an opportunity to redeploy the money to an investment with potentially equal or better opportunity for appreciation.

While any investable asset can be used for tax loss harvesting, some work better than others. ETFs (Exchange Traded Funds) and individual stocks, for example, often provide the best vehicles for reinvestment under this strategy.

Direct Indexing

While loss harvesting is most often executed with individual stocks, new technology and product offerings have allowed investors to incorporate it with ETFs. We believe the use of ETFs is an effective tool in building a well-diversified portfolio, and the advent of direct indexing has made this investment vehicle an available tool in loss harvesting. Direct indexing is the process of selecting an index to invest in, then buying a representative amount of stock on an individual level. Buying into 200 of the stocks on the S&P 500 index, for example. The goal of direct indexing is to mimic the performance of the index at large, but with more flexibility. Purchasing components on an individual basis allows losses to be realized (and reinvested) on a smaller level – while still taking advantage of overall trends in performance. It affords more flexibility than buying into a single line item and opens the door for strategies such as tax loss harvesting. During market surges, direct indexing or tax loss harvesting can generally be supported by ongoing deposits to create an opportunity for money to be invested at different price levels. On the flip side, during a downturn, it provides a quicker opportunity to take advantage of a tax loss harvesting strategy.

loss harvesting requires you to change your mindset and reframe a loss from a negative occurrence to an opportunity. When looked at through this lens, a loss is simply a "bump" along the road that is your long-term investment journey.

For wealth managers, tax loss harvesting can be an efficient tactic. It capitalizes on the insight that there's an equal, or better, place to redeploy money, rather than wait for a relatively underperforming investment to recover. Sometimes pivoting is necessary and recognizing that an investment isn't performing to expectation or standard can be a smart tactic (in these instances, "staying the course" might not be). Tax loss harvesting is only used in situations when booking the loss fits within a client's

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Emotions and Changing the Course

One of the challenges associated with tax loss harvesting is often emotional. For many, it's hard to accept a loss; making an investment then selling it for less than you bought it for can feel like a failure. Many times, clients struggle to wrap their heads around this, and emotions can serve as a barrier to using this strategy. Tax overall investment path. It isn't a change in investment strategy, but an action within a strategy that supports maximizing wealth in the long term.

Tax Loss Harvesting in Practice

Tax loss harvesting requires maintaining focus beyond the gross return of assets, and instead focusing on the return after tax as most important. At the end of the day, our goal at Richard P. Slaughter Associates is to maximize the after-tax return on our client's investments – through whatever approach is most appropriate for the individual client. We actively work to help clients feel comfortable with all aspects of their strategy and illustrate how tax loss harvesting can provide a positive impact on performance in the long run. It's important to keep in mind that tax loss harvesting is just one of many tools that may comprise a long-term investment strategy. While it's not commonly used today, it's becoming more popular in conversation – and we expect, ultimately, in practice.

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