Tis the season…for tax loss selling

US Thanksgiving landed on Thursday this week, beginning the Christmas onslaught. Canadian Tire moved the plastic pumpkins out and tinsel in. I'm a sucker for it all. Retailers seem a tad more willing in their Black Friday deals this week, perhaps signalling angst. This week saw shortened exchange trading hours. With US investors suffering turkey withdrawal it's not the best time to trade.

Clients are doing year-end tax planning. We trimmed winners over the summer , booked some losses in late September, landing at net gains for many taxable accounts. Clients showing net realized gains have asked if they should sell losers to offset some of these gains? We'll start this week's Reading with **Tax-Loss Selling 101**.

When a security is sold (disposed) above cost (adjusted cost base or ACB) , Canada Revenue Agency (CRA) treats the dollar gain as a 'capital gain'. To encourage Canadian entrepreneurship, 50% of capital gains are excluded from tax while the other 50% is included in the taxpayer's total annual income for income tax calculation purposes (50% inclusion rate). Example using a 37% average tax rate:

- ACB: $10,000.
- Sale proceeds: $20,000 ('realized' by selling to a 3rd party).
- Realized Capital Gain: $10,000.
- Inclusion rate: 50%
- Taxable Gain $5,000
- $5,000 taxed at 37% = $1,850 tax owing.
- Tax as percentage of total gain. 18.5%
- Tax as percentage of proceeds: 9.25%

Recognizing things don't always work out as planned, losses may be deducted against gains to arrive at an annual total capital gain or loss. Investors who have realized capital gains may consider selling securities trading below book value to offset those gains.

A properly diversified portfolio will have securities trading below ACB. If we hold a security trading below our original acquisition cost (it happens regularly unfortunately!) we are holding it because we like it longer term – otherwise we'd just sell it. If our future projected values remain unchanged, the lower the current price, we are less likely to sell and more likely to buy. Strange but true. With that longer-term objective of owning a current loser, what about taking the loss for tax purposes? For the loss to qualify as a gain offset, the shareholder must await a statutory 30-day stand off period prior to repurchasing. Given we like the loser (or we'd sell it outright) we have 30-days of upside price risk.

Capturing tax-losses can be a mixed blessing:

Selling for losses may offset capital gains income for this year but…if the loss is small relative to the amount of capital originally invested, an equally small move upward in price could make the opportunity cost greater than the tax offset. See the above reference to tax as a percentage of a winner. Tax offset percentage also applies for losers.

If one repurchases the security sold for the loss after 30 days <u>at the same price</u> as sold, the new 'book value' is now that repurchased lower price, meaning a larger capital gain in the future than would have otherwise been the case. CRA is patient. They know they're going to get some of your money.

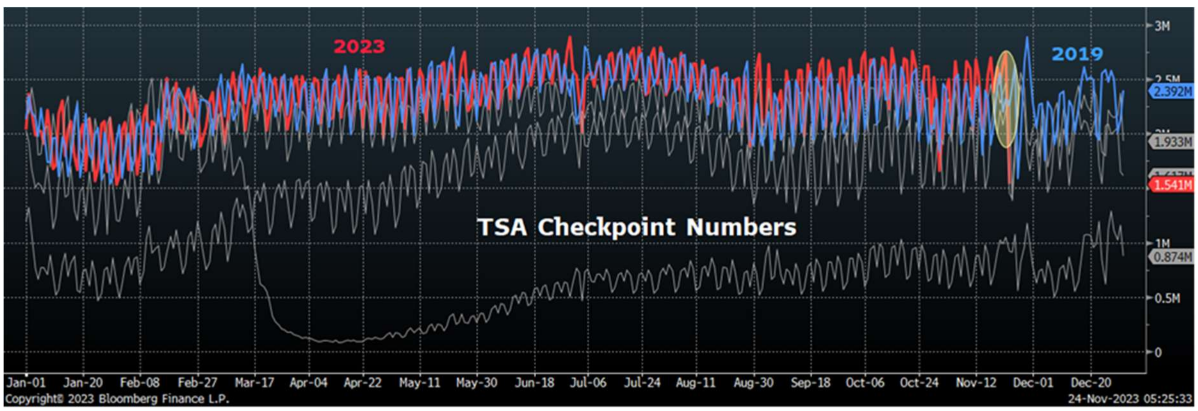
As the loss is deferring not avoiding tax, we tend to only consider tax-loss candidates with large enough losses that a subsequent rebound over 30-days is unlikely to exceed the tax loss benefit. To be clear, we don't seek large losses!

Example: $100,000 original book value. $90,000 market value. $10,000 unrealized loss. Sell at $90,000 = -$10,000 realized loss. Capital gains inclusion rate 50% = $5,000 of taxable income attribution deferred (not avoided). Tax rate 37% on $5,000 = $1,850 in tax deferred that otherwise would have been paid in 2023. $1,850 in deferred tax vs. the $90,000 value received on sale implies an upside risk of price gains while we don't own it of +2.06%. IE Missing a gain of +2.06% during the 30 day stand-off period, could negate the deferral. This calculation becomes further muddled if a number of smaller % loss candidates are considered to offset gains. The more securities traded, the increased likelihood of market moves, trading spreads, FOREX impacts etc. clouding the issue.

Readers will recall gains inside tax sheltered accounts (RRSPs/ RRIFs, RESPs and TFSAs) are sheltered from these calculations.

Retail investors should be aware of the institutional tax-loss selling. Mutual funds do not pay tax on their holdings, 'distributing' all taxable income to unit holders including capital gains. To give unit holders adequate tax planning time, mutual funds often have an October year end. In a volatile year, early gains can be offset by late year price declines. Fund investors dislike paying tax in a year when the fund ended lower. Like individual investors, the mutual fund investment manager is often tasked with finding losses in the portfolio to offset previously triggered gains. To qualify for the tax year, they must do so in October. The larger the capitalization of the target company, the more fund managers are likely to hold it. The result is October often sees large capitalization stocks that have dropped hit by waves of big money selling. Once the last day for settlement in October passes, the selling magically dries up. This is why we look for bargains in October.

2023 US Thanksgiving holiday travel above 2019.

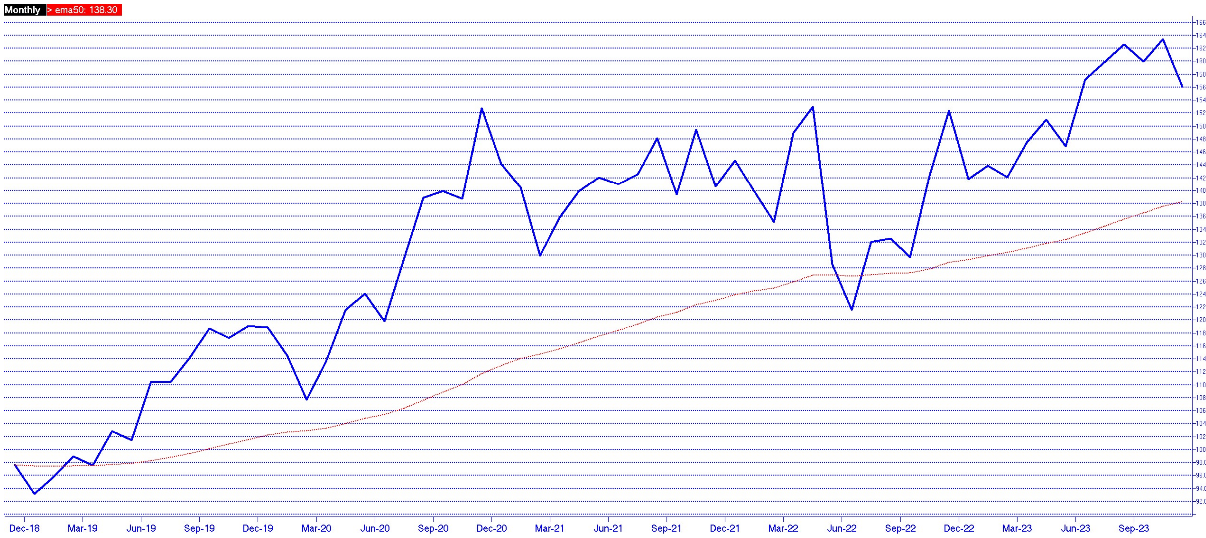


The blue line spike on the upper right-hand corner is Christmas 2019. This holiday season is on track to exceed 2019. Maybe things are as bad as we all seem to think?

Walmart Inc (WMT-NYSE-$156.06) – daily ranges – 6 months.

We follow Walmart both as an investment and as a leading indicator of the US economy. The red line is the 50-day moving average. Walmart's share prices are below that average. Most recent buyers have Buyers Remorse. Media pundits say this confirms a deep recession looms. We're not freaking out yet. Walmart's stock price has dropped from al all-time high around $165 in September to $156 today (-5.4%). That price drop is well within longer-term ranges.

Walmart Inc (WMT-NYSE-$156.06) – monthly ranges – 5 years.

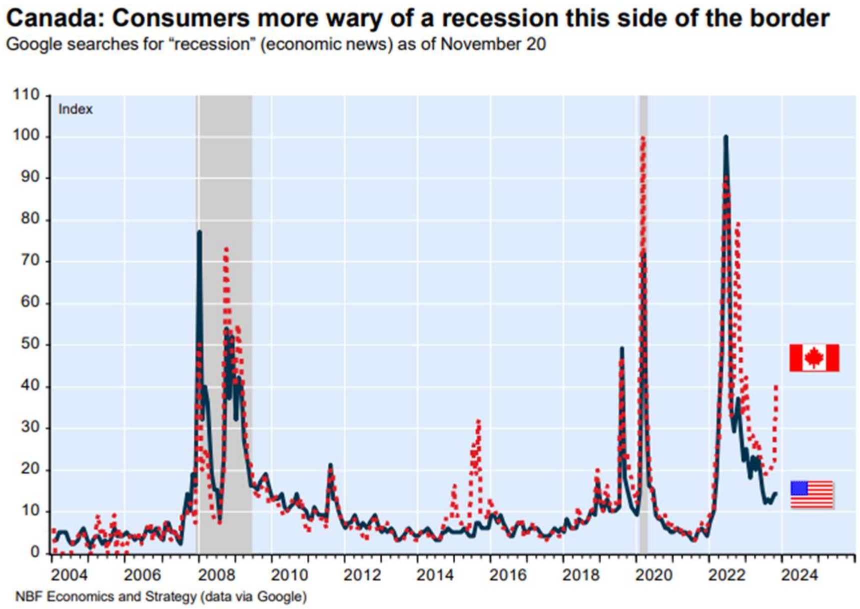


Walmart seems to be doing just fine. We're not seeing US economic disaster priced into Walmart's shares. For a sense of the company's global reach….

Walmart's World Chart R Nov 19, 2023

https://read.chartr.co/newsletters/2023/11/19/walmarts-world

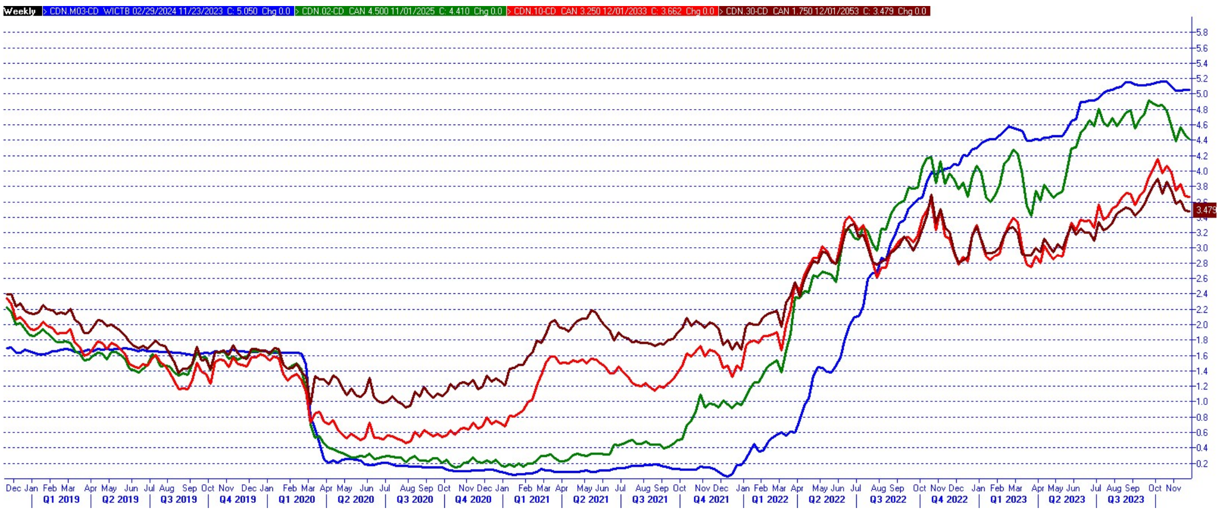
NBF Hot Charts Nov 20, 2023



https://nbf.bluematrix.com/sellside/EmailDocViewer?encrypt=67635505-a1fd-47bf-b63f-c7e2b97623f3&mime=pdf&co=nbf&id=steven.hilberry@nbc.ca&source=mail

The next big move in interest rates is down

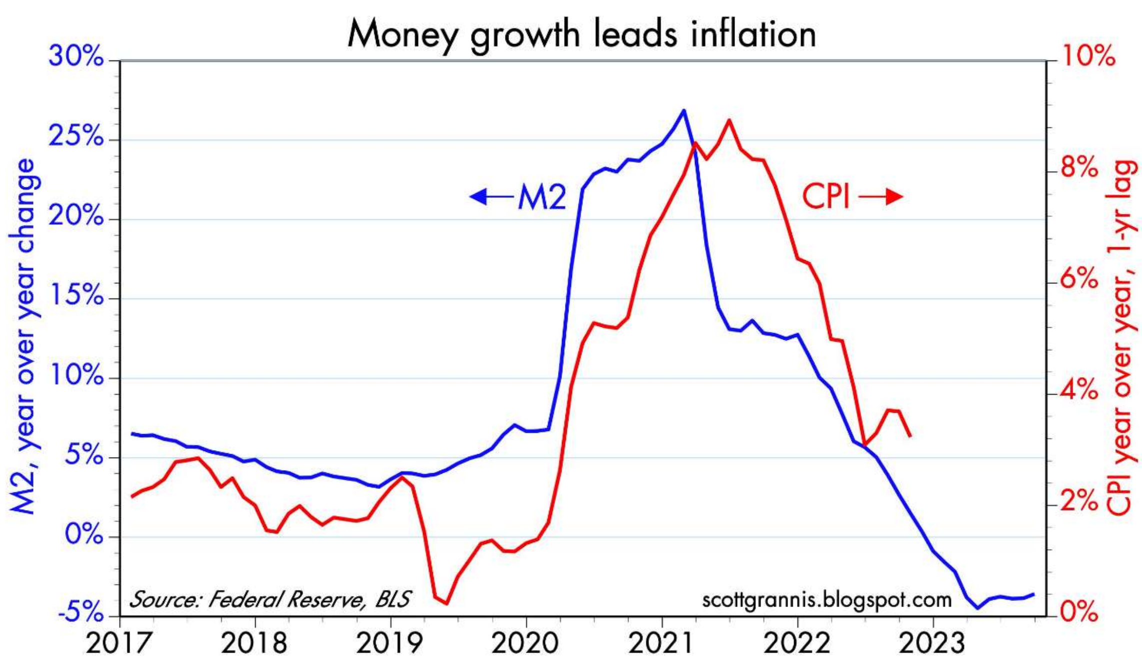
Govt Cda Yields: 90-day (blue) 2-year (green), 10-year (red), 30-year(burgundy) – 5 years.



Note the 90-day T-Bill yield rose from 0.10% to over 5.2% and has flat-lined (top right). 2 to 30-year rates are starting to fall. So far, the declines are within the mid-2022 to current ranges so it's a tad early to call it a down trend. We think that trend is building. Here's why.

Inflation RIP – Scott Grannis

US money supply is contracting sharply. Inflation will decline.



https://scottgrannis.blogspot.com/2023/11/inflation-rip.html

We believe Mr. Grannis is correct. Thankful indeed!

Have a Great Weekend

Steve & Anna Hilberry

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FOR THE RECORD November 24, 2023

DOW INDUSTRIALS:	35,390
S&P 500:	4,559
S&P/TSX COMP:	20115
WTI:	$75.15
LOONIE IN $USD:	$0.7338 $US

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