NATIXIS
INVESTMENT MANAGERS

Selling losers may help you come out ahead

We would all love to pick stocks that only go up, and even more preferably, select those which exceed the returns of our chosen benchmark. But as this can be exceptionally difficult to do consistently, many investors opt to invest in a core market strategy, through either an index mutual fund, an ETF,[1] or perhaps a separately managed account.

Tracking the pre-tax return of the market is good, but exceeding the return of the market after taxes is even better.

The benefits of tax loss harvesting[2]

A well-constructed separately managed account could conceivably track a broad market index before taxes, but by utilizing a method known as "tax loss harvesting," it could also exceed the benchmark after taxes are included in returns.

If an investor sells a stock for a gain, taxes would be owed. But when another security is sold for a loss, the amount of that loss may be used to offset the capital gain. The tax burden is thus reduced because taxes would be owed on any gains minus the losses, subject to limitations. One caveat is that tax loss harvesting can reduce the tax basis, potentially creating a larger gain in the future if eventually sold.

An index-based separate account can track the market BEFORE taxes

While an index-based separately managed account may not perform exactly like the S&P 500® index, it seeks to track it over time, providing investors with exposure to the US large-capitalization market.

An index-based separate account can exceed the market AFTER taxes

In order to achieve better returns after taxes, index-based separate account strategies may sell stocks when they fall below their purchase price, thus "realizing" losses. If the stocks are at a loss, but not sold, that unrealized loss does nothing to improve the investor's tax situation. However, realizing losses can reduce net capital gains (assuming there are capital gains from other investments), and thus reduce capital gains taxes that need to be paid.

Don't miss your window of opportunity

Even if a portfolio of stocks has increased in value overall, there may be individual stocks that have fallen. Loss harvesting regularly may add value regardless of whether the broad market is up or down. You should generally take advantage of losses when they occur, because once they turn around and become gains, you've missed your window of opportunity and they may not occur again.

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