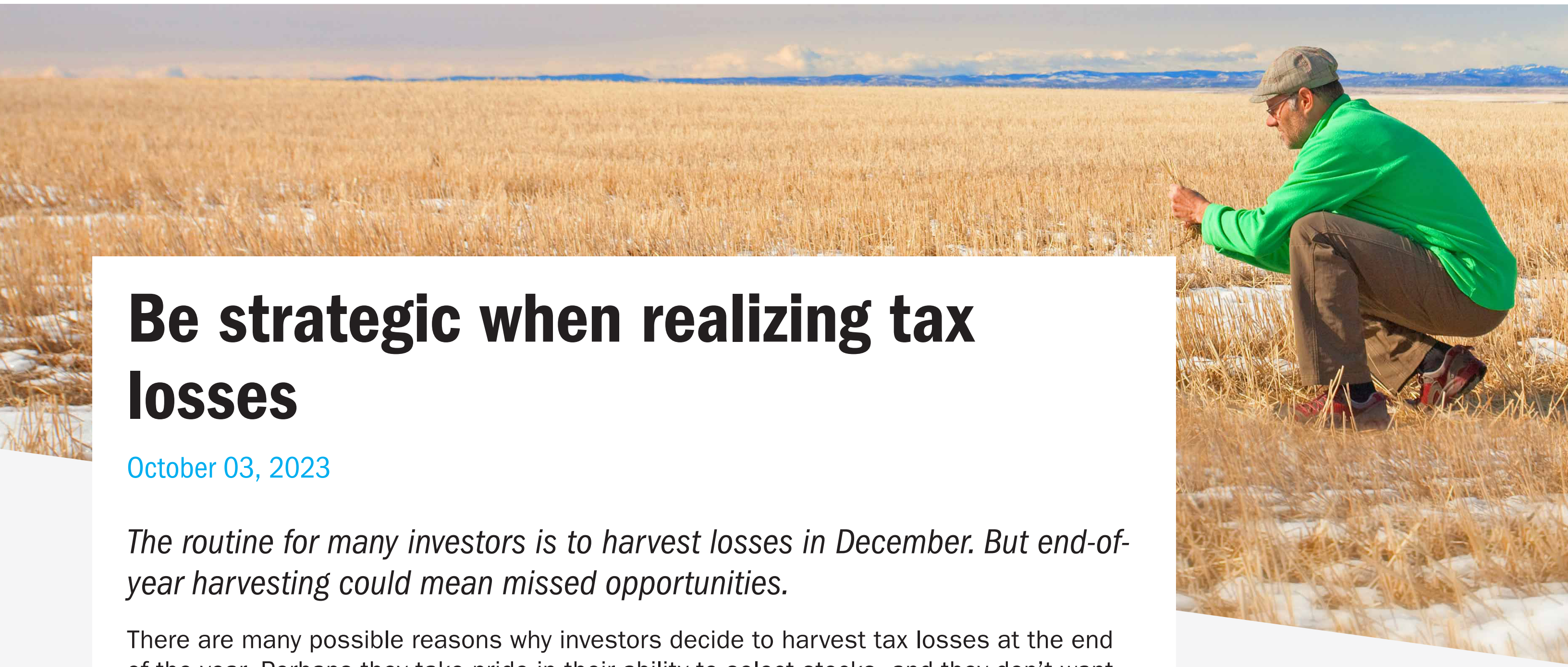

Be strategic when realizing tax losses

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The routine for many investors is to harvest losses in December. But end-of-year harvesting could mean missed opportunities.

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There are many possible reasons why investors decide to harvest tax losses at the end of the year. Perhaps they take pride in their ability to select stocks, and they don't want to regret bailing out too early. Or that it just doesn't feel "right" to sell a security for a loss during the promise of the new year. But when December rolls around, they're out of patience and their frame of reference switches: it feels like a good time to claim the tax deduction of a realized loss. The most common reasoning behind December loss harvesting is based on emotion and simple convenience, rather than strategic thinking.

Yet for a taxable investor, the value of a loss harvested in December is no greater than the value of a loss harvested in January or any other month. In fact, December has historically been one of the worst months to harvest losses:

Average S&P 500 historical returns by month (01/31/28–12/31/22)

Month	Jan	Feb	Mar	Apr	May	Jun
% of average return since 1928	1.17	–0.12	0.53	1.30	–0.04	0.69
% of standard deviation of monthly returns	4.80	4.24	5.12	6.09	5.78	5.20
% of month's return > 0	61.70	52.63	61.05	65.26	58.95	56.84
Month	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**
% of average return since 1928	1.67	0.67	–1.16	0.58	0.88	1.28
% of standard deviation of monthly returns	5.78	6.07	5.77	6.08	5.10	3.72
% of month's return > 0	60.00	57.89	44.21	60.00	61.05	73.68

Source: FactSet. Average returns are price returns for the S&P 500 and do not include dividends. The S&P 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks. It is not possible to invest directly in an index. **Past performance is not a guarantee of future results.**

As shown in the table above, consider that historically nearly 75% of the time, December experiences a positive market return, which actually gives investors the fewest loss-harvesting opportunities. Looking back, December also has the lowest standard deviation of monthly returns. This means there is a higher statistical likelihood of returns being near the 1.28% average for the month.

Loss-harvesting strategy versus loss realization

Another trap investors fall into by looking to sell losers only at the end of the year is that once the security is sold for a loss, it can be tempting to stay positioned in cash and not risk further decline, or even use the money for some other purpose. This practice is really not loss harvesting but loss realization. If the market rallies shortly after the loss is realized, the investor is out of luck on recouping his or her original value or gaining actual appreciation.

A true loss-harvesting strategy is one that tries to match the pretax returns of a benchmark (such as the S&P 500) and outperform it on an after-tax basis by systematically harvesting losses and substituting individual stocks or groups of stocks, maintaining consistent market exposure.

Bottom line

Historically speaking, December is one of the best months to stay in the market and one of the worst months to harvest losses. Indeed, tax-loss harvesting does not need to be a one-off event at the end of the year. A more systematic approach is to harvest tax losses year-round and stay fully invested in the market.

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