



FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Stocks on Sale

I love to get a bargain, so I enjoy shopping various sales at the end of each year. One of those sales is in the stock market. It's the result of the combination of two artificial events. One is the end of the calendar year, and the other is the ability to generate realized capital losses (which can be applied against realized capital gains, and then up to \$3,000 of ordinary income per year) when you sell an asset in a taxable account for less than you paid for it (a practice known as *tax loss harvesting*).

Because of the deadline to generate a realized capital loss for the year, the selling pressure is artificially high, which drives the price even lower. Usually the asset being sold is already one of the year's biggest losers, so many investors who own it are eager to stop the bleeding and erase any memory of their bad decision.

The problem for investors who own the stock is that generally, these stocks are cheap relative to their underlying fundamentals, so their expected return is actually high. An investment strategy that simply buys that year's biggest losers should outperform the broad market over the long haul. But some of these stocks (such as Possible Value Traps) are cheap for a reason. Nevertheless, usually investors unwittingly surrender their right to participate in a significant potential upside in return for reducing their income tax

liability somewhat. This is an example of the tax tail wagging the investment dog.

The price of these stocks can drop even more to an artificially low level at the end of the year if they are smaller and/or more thinly traded, especially since trading volume dramatically declines from Christmas Eve through the end of the year. Investors who want to realize a capital loss have to sell by the end of the year, and the vast majority of them are not going to let a dearth of trading volume stop them. So they take whatever price they can get, which is low. I love it when the stock market is open but most investors are away on vacation, because there is much less competition. Some of the best days for shopping are when the market closes early at 1:00.

The United States is the only country I know of where this situation exists. The problem is that valuations and investor sentiment are so high for U.S. stocks that their current expected return (as a whole) is actually negative. But that doesn't mean that there aren't any bargains in U.S. stocks, especially when so many investors are investing in index funds.

This issue is going to be short because I need to use the time to look for bargains for myself and my clients. Happy hunting!

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I would love to hear from you! If you have any comments, suggestions, insight/wisdom, or you'd like to share a great article, please leave a comment.

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Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or personal trainer.