# Year-End Tax Considerations

***e*****Research Corporation** is pleased to provide an article by Keith Richards of **VALUETREND**.

In this article, Mr. Richards reviews investment considerations for (i) year-end tax-loss selling, and (ii) possible changes in Canadian capital gains tax policy.

The article is reproduced below, beginning on the next page, or you can go directly to it at the following link: ***http://www.valuetrend.ca/take-advantage-sector-rotation-tax-policy-changes/***

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# Take Advantage of Sector Rotation and Possible Tax Policy Changes

By: Keith Richards (bio at end)

As you know, materialized capital gains must be claimed, and losses, if any, can be materialized to offset claimable capital gains on your stocks and ETFs held in taxable accounts. Normally, people use the year-end to dump their losers, and continue to ride their winners.

I think that this year, investors might want to materialize their capital gains in some cases. There is a fairly good chance that the Trudeau government, in an effort to raise tax revenue to pay for its rampant spending, will need to raise the inclusion rate for the capital gains tax level. The talk that I have heard from accountants is a possibility for that rate to go from 50% to 75% in 2018. That is a huge jump! This tax rate change is not an absolute of course, but it is a possibility that we should take into consideration.

I would like to present some thoughts below on combining a seasonal pattern with some tax considerations regarding our winning and losing stocks.

## The Seasonals

There is a strategy that makes sense for investors looking to materialize gains or losses on their marketable securities. Markets tend to be strong into the end of a calendar year from this point. The tendency is for the big movers of the year to continue being the leaders until the end of December, while the laggards continue to sell off as investors unload them and materialize the loss. Come January, stock market participants start to look at the prior laggards in an effort to uncover some oversold/ under-appreciated bargains. Thus, there can be a noticeable degree of rotation from leaders to laggards at the beginning of the year.

Note that this does not imply that the current leaders will experience losses in January – it only implies that there may be less upside on those stocks as investors focus more on the laggards during that month. Investment strategies such as the "Dogs of the Dow" strategy were born from this phenomenon. Investors following the Dogs strategy buy the 10 highest yielding stocks in the Dow Jones Industrial Average - which tend to be the prior year's lower performing stocks of the 30 stocks comprising the index.

The strategy is to take gains on anything you suspect has run too high (and may be vulnerable to a period of under-performance) as the year-end approaches. Possibly, you are concerned about the runaway NASDAQ index. In this case, if you feel that the NASDAQ market might take a breather in the New Year, you could take some profits on that sector via selling a NASDAQ ETF or a technology ETF – or individual stocks as the year comes to an end. This will materialize your capital gain at current rates of inclusion – unless the Trudeau administration enforces a capital gains tax change prior to year-end.

Remember, you can always buy your ETF or stock back after 30 days. *(BW: This rule applies only to Investment Accounts, and does not apply to RRSPs, RRIFs, and TFSAs.)* So, if the sold sectors or stocks take a breather or pull back in January, you could easily buy them back at the (hopefully) same or lower price.

It may happen that you materialized a gain at a lower tax rate in 2017 – which may indeed offset any risk of losing out on some of the upside, should the ETF continue to rise in the first month of 2018. It is a game of odds – but odds are somewhat in favor for some rotation of the guard from strong to weak sectors for the first month of the year. Some of the losing sectors that might be worthy of looking at include retail, energy, consumer staples, and precious metals for that January rotation.

Below are 1-year charts of three weak sectors noted above. There are others out there to look at, but only so much room in this blog to post their charts….Watch for a base and break-out pattern on a weak sector as the New Year approaches. The energy base break-out has already started, as **noted here**.

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## The Tax Side

True, you could materialize your losses on under-performing sectors this year and use them to offset any materialized gains. Perhaps you bought precious metals, energy, or consumer discretionary ETFs when they were higher. These losses could be used to offset your gains on the out-performers that you take profit on this year.

However, if you believe as I do, that there is a chance of higher capital gains inclusion rates in 2018 – you could instead choose to claim your losses in 2018.

A realized loss in 2017 might be more beneficial if capital gain inclusion rates go up in 2018. Conversely, a capital gain realized in 2018 could possibly be taxed at a substantially higher rate – offsetting any short-term upside gained over that 30-day buy-back period. It Is your after-tax returns that count.

## The Take-Away

- Seasonal patterns suggest that weak sectors can sometimes pop in the New Year, while strong sectors might take a pause;

- There is a potential for the Canadian capital gains inclusion tax rate to rise in 2018. This juicy source of new tax revenue for our "Spend liberal amounts of cash" government is a tempting tax grab that is more probable than some might think;

- If you feel you have stocks or sectors that are over-bought, you might save some taxes by selling them before year-end, claiming the currently lower tax rate, then either rotating into over-sold sectors that are breaking out or re-buying after 30 days; and

- If there is an increase in the capital gains tax inclusive rate, you would also benefit by deferring a tax loss sale until 2018. True, at this point we can still hold off on claiming a loss for a later year if you do materialize a loss in 2017.

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## ABOUT THE AUTHOR

ValueTrend Founder and Owner, Keith Richards, has been in the securities industry since 1990. ValueTrend manages over $100 million through a discretionary investment service for high-net-worth clients.

Keith Richards has been in the securities industry since 1990 and is a highly regarded member of the small, exclusive community of Chartered Market Technicians in Canada. Mr. Richard's articles appear regularly in INVESTORS DIGEST, MONEYLETTER, GLOBE AND MAIL, and the TORONTO STAR newspapers.

His appearances on BNN Television have inspired producers to acknowledge him as **"one of [our] most accurate technical analysts."** Mr. Richard's first book, SMARTBOUNCE: 3 ACTION STEPS TO PORTFOLIO RECOVERY, is available in bookstores and directly through his blog page **www.valuetrend.ca/blog/**. His second book, SIDEWAYS: USING THE POWER OF TECHNICAL ANALYSIS TO PROFIT IN UNCERTAIN TIMES was released in late 2011. He has been critical of the commission-based, follow-the-pack approach to investing – where brokers succeed regardless of performance.

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