QV UPDATE

Weekly Commentary | December 18, 2015

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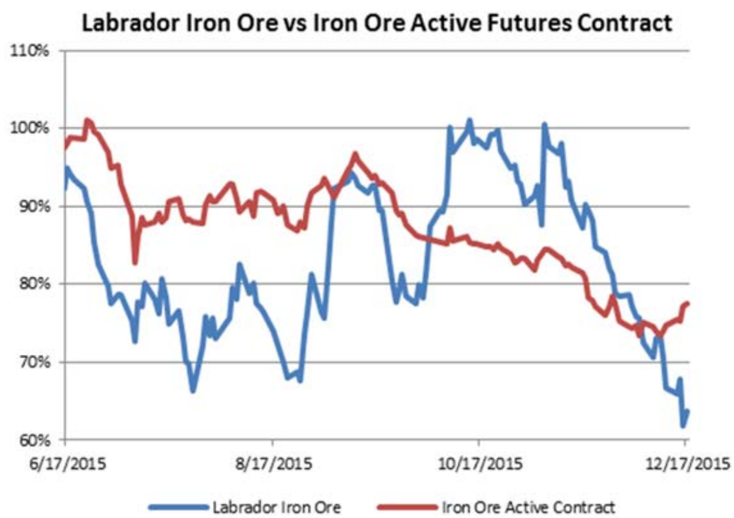
'Tis the Season (for tax loss selling)

Tax loss selling is not a very festive topic, but it is a phenomenon that comes around this time of year. It is a tax strategy where securities are sold at a loss to offset any capital gains. It may be a stretch, but it could be argued that if done properly, investors will have greater capacity to put more presents under the tree.

Many savvy investors, or traders, attempt to profit from their fellow investors who are employing this strategy. Tax loss selling usually starts in mid-to-late November. At this point, investors have a sense of their pending tax bill and may consider offsetting some gains with losses. Research papers begin to surface illustrating the year's worst performers to date as the 'best candidates' for tax loss selling. Investors are urged to sell these stocks before the majority of investors realize that they can decrease this year's tax bill by selling them. Pre-emptive pressure is applied to stocks that have already had a difficult year. Subsequently, legitimate tax loss selling of some of the year's biggest losers begins. This process takes us to about now (mid-December). The theory states that after the tax loss selling victims have taken the triple whammy of initial poor performance, trader pre-positioning, and actual tax loss selling they should be beaten down below their fair trading value and become buying opportunities. Buyers should step in and provide a Christmas boost for these stocks. Repurchasing by tax loss sellers typically continues through January as 30 days must elapse between the sale transaction and the repurchase to be recognized by the tax authorities as an actual capital loss. Although tax loss selling can be an effective trading strategy, the magnitude, direction and timing of the movement varies from year to year. Profits are never guaranteed.

Energy and resource stocks dominated the list of candidates for tax loss harvesting this year. For example, 70% of a tax loss candidate list published by Macquarie Research in early November was comprised of energy and materials stocks. Not only did tax loss selling negatively impact these securities over the last six weeks, but underlying commodity prices have been decimated. The Bloomberg Commodity Index is down over 12% since the end of October. As Ryan Watson mentioned in last week's QV Update, weakness in these sectors has provided us with some attractive buying opportunities.

Labrador Iron Ore is a fine example of a stock that has recently come under pressure despite maintaining attractive fundamental qualities. As of November 1st, the stock was down over 18% year to date, making it a credible tax loss candidate. The share price has fallen an additional 33% since then! In contrast, the active futures contract for iron ore has experienced slightly more than a 10% loss since Halloween. We feel that the market has unduly punished the company and has presented to us the opportunity to buy more.



Source: Bloomberg

We consider ourselves to be 'buy and hold' long term investors. On average, we own positions for four to five years and we only trade about 20%-25% of our portfolios per year. That being said, we recognize a bargain when we see one.

This season's tax loss selling coupled with commodity induced panic has enticed us to add to six names on Macquarie's tax loss selling candidate list in recent months.

For everyone who will be celebrating their holidays in the upcoming days we wish you all the best this holiday season and a healthy and happy New Year! Our QV Update will resume on Friday January 8, 2016.