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Harvesting Strategy

Crypto Could be Challenging to Loss Harvest

Can cryptocurrencies be tax loss harvested (TLH)? TLH may be possible after events such as Sunday's flash crash, but differences among products may complicate their direct substitution.

For instance, two popular (and Bitcoin-heavy) exchange traded products seem to have tracked each other fairly closely – see chart.

Source: Bloomberg. Cumulative % return of Grayscale Bitcoin Trust (GBTC) and Bitwise 10 Crypto Index Fund (BITW) from 12/31/2020 to 4/16/2021. BITW had a 75.13% weight to Bitcoin as of 4/18/21.

However, looking under the hood, there are differences, especially in exposures and premiums or discounts. Note, these are not funds with the ability to create or redeem additional shares as necessary.

Selling one and buying another as a straight replacement may lead to an outcome that is unpredictable and, well, cryptic.

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Hedged Strategies Risk
The Hedged Strategies take “short” positions by selling an index ETF that the client portfolio does not own, which exposes the portfolio to costs and risks that are not associated with owning securities long. Certain of these costs and risks are described in the margin disclosure statement provided to you by the financial institution holding your account, and we encourage you to discuss those risks and costs with your advisor. The following disclosure discusses the risks related to Green Harvest’s investment strategy.

A short position has an opposing or “inverse” relationship to a long position on the same asset. Generally, the short index position will lose money when the overall long portfolio is rising in value, and the short position will increase in value when the long portfolio is losing money. This relationship provides the “hedging” aspect of the Strategy. Green Harvest seeks to short an index ETF that is expected to have a strong inverse relationship with the strategy benchmark. If the index ETF underlying the short position deviates from this inverse correlation to the benchmark performance, then the Strategy will not perform as desired, and you could have limited tax loss harvesting outcomes as well as low or negative portfolio returns. Although the short position is intended as a hedge against negative or low returns of the markets, the Strategy’s return may be negative. Any dividends paid by ETFs underlying the short position must be paid to the institution lending the security and thus will not generate income for your account.

Tax loss harvesting opportunities exist when the long portfolio has gains and when the short position has losses. Portfolio losses may result in margin calls from your financial institution, and when you instruct Green Harvest to sell portfolio assets in response to margin calls, such sales could generate taxable capital gainmns. Alternatively, you will be required to add cash to the account in response to margin calls.

Short positions can lead to more volatile performance of the underlying security. In addition, the ETFs underlying short positions may experience periods of low trading volume or reduced liquidity, which would restrict the ability to enter short positions. In these periods, Green Harvest can seek to enter short positions through other available transactions, which may have higher transaction costs. All investments are subject to liquidity risk, especially when markets are not functioning normally. If Green Harvest is unable to acquire or dispose of holdings quickly or at prices that represent perceived market value, then the Strategy will be negatively impacted. Examples of events that can lead to heightened liquidity risk include domestic and foreign economic crises, natural disasters, political instability, and regulatory changes.