November 15, 2021

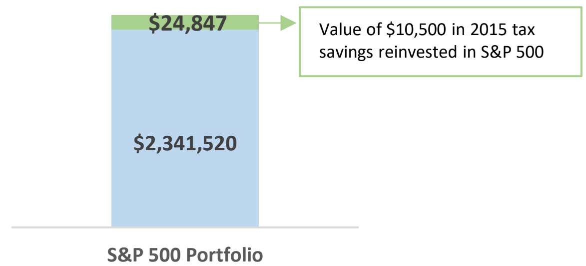
Harvesting Strategy

Harness the Power of Tax Deferral to Improve After-Tax Returns for 2022 and Beyond

As we discussed in our study, capital gains taxes are not inevitable, particularly for index-oriented investors.[1] Moreover, even if investors sell their portfolios at a gain, they can benefit from the value of tax deferral. Consider that in the last five years, the S&P 500® index has returned 138% through the end of October. This means that an investor who reduced tax cost five years ago, then reinvested those savings in the S&P 500, then deferred recognition of gains until today would have well more than doubled their initial tax savings.

To put numbers on this, in 2015, mutual funds distributed an average of 2.42% of assets in capital gains. An average $1,000,000 mutual fund portfolio would have received about $24,200 in taxable gains for a tax cost of up to $10,500 (assuming the highest federal tax bracket on short term gains at that time). By offsetting that cost using tax loss harvesting (TLH) and keeping those savings invested in the S&P 500, that $10,500 in deferred cost could have added nearly $25,000 in additional growth to a $1 million portfolio over the last 5 years – see chart. A dollar saved was more than two dollars earned, and that's without any additional tax planning.

Tax Deferral & Reinvestment Could Have Added $25,000 to a $1,000,000 S&P 500 Portfolio Over Last 5 Years



Source Bloomberg. Growth of $1 million in S&P 500 from 11.1.2016 to 10.31.2021 with additional $10,500 in reinvested Tax Savings.

More broadly, our study found that, even assuming full portfolio liquidation after each rolling five-year period over the past 20 years, a TLH strategy applied to S&P 500 portfolios could still provide an average of 0.9% per year of additional return versus the non-TLH portfolios.[2]

The power of deferral can be substantial. Harness this power to improve after-tax returns for 2022 and beyond.

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[1] Investors should understand the other components of tax-beneficial investing that incorporates TLH – see study (page 124) for details.
[2] Benefit is due to difference between short-term and long-term rates as well as value of deferral. See here for details and assumptions in study.

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