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Hidden Value: Tax-Loss Harvesting in Up Markets

Selling for tax purposes is not just viable during periods of market weakness.

A common misconception about tax-loss harvesting strategies is that they require markets to decline in order to deliver value. However, while tax-loss harvesting can indeed be executed in down markets—where any investment vehicle or investor can realize losses—we believe the real opportunity lies elsewhere. Managers who employ systematic tax-loss harvesting strategies, particularly those holding individual stocks, can add value even in upward-trending markets, provided there is dispersion among those stocks.

The Role of Dispersion in Tax-Loss Harvesting

As portfolio managers, we of course recognize that the best market environments are those where investors make money. If all the stocks in a benchmark were to rise uniformly and never revert, investors might not realize any losses, but would still be pleased with their portfolio's performance. However, markets are far more dynamic in practice: They exhibit volatility and dispersion among individual stocks, even during periods of overall positive returns. This creates opportunities for tax-managed strategies.

To illustrate, let's examine the performance of the S&P 500 Index in 2024, which was an exceptionally strong year for investors. The market delivered a pretax return of 25%. Below is the growth of a $1 million investment in the S&P 500 over the course of the year.

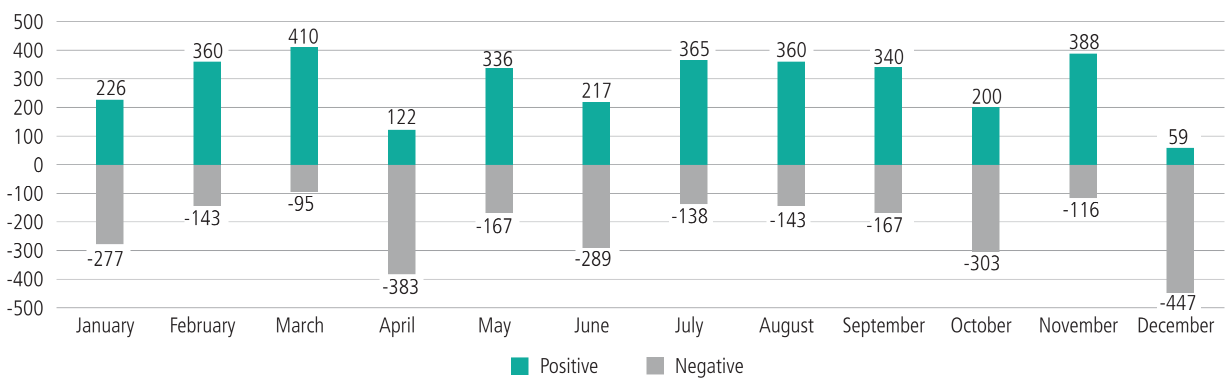
GROWTH OF $1 MILLION INVESTMENT IN S&P 500, CALENDAR YEAR 2024

Source: FactSet. As of December 31, 2024.

Volatility Within a Strong Market

Given the consistent upward trend in last year's market—positive from January 17 onward—one might assume that there was limited potential for tax-loss harvesting; however, this is where the importance of holding individual stocks becomes clear. While the overall market rose, we saw meaningful volatility across the individual stocks that comprise the index. The display below highlights the number of stocks that increased in value each month (green) versus those that declined (gray).

MONTHLY BREAKDOWN OF POSITIVE VS. NEGATIVE STOCKS IN THE S&P 500 DURING 2024



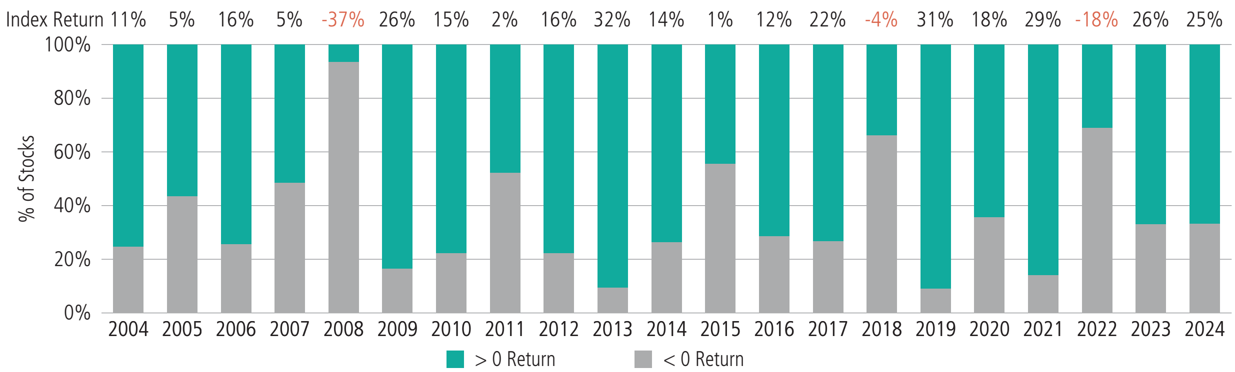
Source: FactSet. As of December 31, 2024.

Over the course of the year, 172 stocks in the S&P 500 ended in negative territory, with an average loss of 16.6%. Investors who could capitalize on this dispersion had the potential to achieve the market's full return of 25% while simultaneously harvesting losses. These harvested losses could have then been paired with realized capital gains to provide potential tax savings.

A Broader Perspective

This experience is not unique to 2024. The chart below shows annual S&P 500 market returns over the past 20 years, along with the percentage of stocks that increased (green) versus those that decreased (gray) each year.

ANNUAL S&P 500 RETURNS WITH PERCENTAGE OF POSITIVE VS. NEGATIVE STOCKS, SINCE 2004



Source: FactSet. As of December 31, 2024.

Harnessing Volatility With a Systematic Approach

A precise and disciplined approach to tax-loss harvesting is key to unlocking its full potential. For example, the Neuberger Berman Custom Direct Investing (CDI)™ platform systematically evaluates accounts for tax-loss harvesting opportunities every two weeks. By frequently looking to harvest losses, this approach can effectively harness market volatility and generate potential tax alpha for investors.

As portfolio managers, our ultimate goal is to help our clients grow their wealth through positive market returns. By incorporating active tax management strategies such as systematic tax-loss harvesting, we aim to enhance after-tax returns and deliver greater value to investors.

Key Takeaways

- Tax-loss harvesting is not limited to down markets; it thrives in upward-trending markets with stock performance dispersion.
- Even in strong years like 2024, individual stock volatility can provide opportunities for tax savings.
- A systematic approach such as biweekly evaluations for tax-loss harvesting can help generate tax alpha and maximize after-tax return potential.
- By capitalizing on volatility and maintaining a disciplined strategy, it's possible to seek long-term financial goals while minimizing tax liabilities.

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