Q&A Part Deux

Last week, I posted a great question from a subscriber that I thought was worthy of sharing with a broader audience. That led to a follow-up from a different subscriber that I also wanted to share.

To be sure, this won't be an ongoing feature. I have no plans to post other Q&A here in the coming weeks as I have other topics I want to discuss.

However, please feel free to ask me whatever you like. While I cannot provide personalized financial advice, I answer *every* question. You might not like the answer, but you will get one!

Here goes!

KC writes,

“Hi John,

As a follow-up to Don H.'s email response, I have a question about what constitutes a good problem to have, in essence. Since you bought a large amount of stocks on the dip this year, when, if ever, do you sell and take the significant profits? Are you willing to hold these positions if the market trends down towards the end of the year? Are you willing to give up these significant gains? I ask because very few ever write about taking the money off the table. Thanks for any insights on this in future updates.

Love your work, keep it up.”

KC

Hi KC,

Thank you for your email and kind words. This is also a great question!

In my taxable account, I view it mainly as a one-way street. I'm buying and planning not to sell. I pay all the taxes that I owe, but no more.

So, I want to pay virtually no capital gains taxes at this stage of my life.

Imagine if I wanted to allocate $100 a week into the market. Let's say for the first few weeks of the year, the market is neither overbought nor oversold. I might allocate $50 and hold back $50. Then, in the 10th week, the market gets very oversold. I'll start using the $500 held back to invest aggressively. If the market is incredibly overbought, I might refrain from buying anything for weeks.

In the end, though, it's going into the market one way or the other. I'm not market timing so much as doing my best to take advantage of what I see as a perfect risk/reward.

If you're in your earning years, you can afford to sit through some bumps in the road down the line, and presumably you will have cash flow to buy when the market is down. So, I don't worry too much about the future. I'm just dealing with the current market situation.

Conversely, in my tax-deferred accounts, I'm buying and selling. There's no tax impact. Additionally, I utilize numerous trend-following models. Trend following has a 200-year history that demonstrates an edge over time in following trends. Let's say that edge is 14% a year versus 10% in the market if you buy and hold. On an after-tax basis, there's no edge in trend following. It goes to taxes. So, I keep those strategies in tax-deferred accounts.

I have created an indicator that tracks trends in market sentiment. It makes four trades per year on average. It's either “risk on” and in the market or “risk off” and out of the market (into bonds). It may only be in the market 2/3 of the year. Yet, the returns are higher than the market, and the risk is lower; however, this is due to holding periods that are suited to a tax-deferred account.

So I handle things differently depending on the tax status of the account. Pay as little in taxes as you legally can. Let the investment compound. Over time, you end up ahead of almost everyone else.

Best,

John

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