



>: How Taxes Kill Your Investment Returns

Monday, November 20, 2006 / Dylan Jovine

This article, originally published around tax time this year, surprised us with the amount of feedback it received. It's a very simple illustration of how much money you will lose over your lifetime trading in and out of stocks. It's worth a second look as we gear up for another investing year.

As the "value investors" of this motley crew of investors who write for the Tycoon Report, I am often asked why I invest for the long term. Trading, they argue, is the most logical way to invest your money.

Isn't it smart to follow trends rather than wait for them?

Year	20	20	\$12,000	N/A	\$800	\$12,800,200
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Well yes? and no. There are many reasons I don't trade. Perhaps the biggest are:

Year	4	20	\$14,087,280	N/A	\$1,123	\$20,336,734
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- a) I do not like to pay taxes
- b) Value investing is an emotional disposition, and
- c) I think value investing is the most profitable way to invest for the long term.

Over the next few articles I write, I'm going to discuss why I am a long-term value investor, and why I never pay attention to short-term trends. This is not to argue against our dear friends Chris and Teeka. Indeed, I've seen what they can do firsthand, and it is quite impressive.

Year	7	20	\$23,575	N/A	\$1,571	\$35,832,003
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But it is important for you as investors to understand some of the key issues that make us different.

Year	8	20	\$26,403	N/A	\$1,760	\$42,928,642
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So with that in mind, today I'm going to focus on my desire to avoid paying short-term capital gains taxes.

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Year	20	20	\$29,571	N/A	\$1,971	\$51,527,600
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Paying taxes has a devastating effect on the power of compounding returns in your portfolio.

Year	10	20	\$53,120	N/A	\$2,208	\$61,330,912
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To show you just how devastating trading stocks (and, in consequence, paying taxes) can be on your portfolio, I've prepared a table below to illustrate. **As you can see, at the end of year 10, the initial investment of \$10,000 is worth \$60,912, firming gain of \$50,912.**

The Power of Compounding Returns

(Or my alternative title, "How Taxes Kill Investment Returns")

Let's say that both Portfolio A and Portfolio B each begin with a \$10,000 investment. In addition, each earns 20 percent each year. But while Portfolio A holds onto the same stock each and every single year for 10 years, Portfolio B does one trade annually (I won't even show how devastating multiple trades can be).

Now let's take a look at Portfolio B, where one trade is executed each year creating a single taxable event at a short-term tax rate of 40 percent.