

>: How Taxes Kill Your Investment Returns

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

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

Well, yes ... and no. There are many reasons I don't trade. Perhaps the biggest are a) I do not like to pay taxes, b) it fits my emotional disposition, and c) I think it's 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 dear friends Chris and Teeka. Indeed, I've seen what they can do first hand, and it is quite impressive.

But it is important for you as investors to understand some of the key issues that make us different investors.

So, with that in mind, today I'm going to focus on my desire to avoid paying short-term capital gains taxes.

How Taxes Kill Investment Returns

Paying taxes has a devastating effect on the power of compounding returns in your portfolio.

To show you just how devastating trading stocks (and by default paying taxes) can be on your portfolio, I've prepared a table below to illustrate.

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 on to 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).

Portfolio B - Account with One Trade Each Year and Taxes Paid (Click on Table to Enlarge)

Year	Beginning Value	% Return	Pre-Tax Amount	Taxes Paid	Yr. End Value
1	\$10,000	20	\$12,000	\$800	\$11,200
2	\$11,200	20	\$13,440	\$896	\$12,544
3	\$12,544	20	\$15,052	\$1,003	\$14,049
4	\$14,049	20	\$16,858	\$1,123	\$15,734
5	\$15,734	20	\$18,880	\$1,258	\$17,541
6	\$17,541	20	\$21,049	\$1,403	\$19,646
7	\$19,646	20	\$23,575	\$1,571	\$22,003
8	\$22,003	20	\$26,403	\$1,760	\$24,642
9	\$24,642	20	\$29,571	\$1,971	\$27,600
10	\$27,600	20	\$33,120	\$2,208	\$30,912

As you can see, at the end of year 10, the initial investment of \$10,000 is worth \$61,917, for a net gain of \$51,917.

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.

period, Portfolio A has a total of \$61,917. This is in stark contrast to the \$30,912 in Portfolio B. The difference? One trade each year and the taxes associated with that.

It's no secret, then, why investing greats such as John Templeton, Warren Buffett and Ed Lampert have always preached the importance of finding great companies and holding them for as long as you can.

Having been fortunate enough to have "seen the light" (and the facts) at an early age, I've been practicing the same philosophy for years. That's why, much to the astonishment of many of my friends, I'm not glued to the screen each day waiting for news to hit the tape. Oftentimes, they're the ones who know about the news of one of my portfolio companies earlier in the day than I do.

To sum up my philosophy in one sentence, my goal is to buy a piece of a company that has great "natural" economics and receive returns commensurate with the economics of the company over a long period of time.

If I never have to sell the company and never have to pay taxes, I will be a very happy man.



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