Sand Spring Advisors LLC

A Note on Taxes

by,

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As long-time readers know, July 20, 1998 was a major pi cycle date, followed 8.6-years later by February 24, 2007. The first date represented the market high just before the LTCM and Russian ruble crisis of Aug-Oct 1998. The latter date represented the historic tights in credit spreads right before the whole mortgage/housing crisis of 2007-2009 began.

Our next major date of importance that should mark a sentiment high/extreme of some sort does not hit until October 1, 2015. In between February 24, 2007 and October 1, 2015, it is more difficult to forecast when exact lows will occur, but just as late fall 2002 represented a 4.3-year low in between July 20, 1998 and February 24, 2007, so too should approximately mid-June 2011 represent a 4.3-year low midway between February 24, 2007 and October 1, 2015.

So on a big picture basis: we expect 2010-2011 to be a down period for equity markets somewhat akin to 2001-2002. It may also easily be a period when fixed income markets are showing their growing indigestion from the 2008 machinations by the U.S. government to move troubled assets from private to federal hands.

Along the way there, we first of course must finally put in an equity high to the most recent rally period which commenced back on March 6-9, 2009. Our next minor 8.6-month pi cycle date hits January 5-6, 2010. The first trading day of 2010 will be January 4th.

What exactly will flip as of the New Year?

The tax calendar – of course.

And in the current instance, when long-term capital gains taxes are set to rise again in 2011 (back to 20% from 15%) , 2010 will be in the exact "bulls-eye" for most investors to create realized gains. If you have gains from buying in Q4 2008, and even if these gains had already turned long-term, you would not sell those stocks in this calendar year and hand over tax revenues early to the government. You would try to wait until the calendar flips to 2010. And of course, those who bought in March 2009, won't have long-term gains until early March 2010.

To our thought process, all of this likely represents a "wall of tax-related selling" across Q1, 2010, starting as early as the first trading days of the New Year.

Conversely, between now and then, there is likely to be a dearth of sellers, and thus the natural path of least resistance for the market may easily be to continue its grind higher.

As recipients on our intermediate e-mail missives know, we took a trading shot at the short-side of the market back on November 25, 2009 – just before the mini-Dubai debt crisis exploded. But there was no follow-though to the downside, and we gave up on this view in early December with just a minor gain in hand.

We also caught the recent reversal lower in gold and copper as well, but temporarily at least, have also exited to flat on those positions – hoping for a bounce to reestablish these exposures.

In general, we think that it is too late to be playing this equity market from the long-side, but with our pi cycle due in early January, and obvious tax harvesting also likely due in that period, we will be ready to step up to the plate with more short-side exposure perhaps as early as December 31, 2009 – depending upon what the technicals look like when we get there.

In between now and then, it should be a perfect time to enjoy the Holiday season, and forget about the markets.

Send us your comments at information@Sandspring.com.

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