Com Chapter 8:

- The happiness of those who want to be popular depends on others; the happiness of those who seek pleasure fluctuates with moods outside their control; but the happiness of the wise grows out of their own free acts.
  Marcus Aurelius

▼ Understanding Dr.Jekyll and Mr.Hyde

- The characters Dr. Jekyll and Mr. Hyde come from the novella "Strange Case of Dr Jekyll and Mr Hyde" by Robert Louis Stevenson, published in 1886. In the story, Dr. Jekyll is a respectable scientist who creates a potion that transforms him into Mr. Hyde, an evil and violent alter ego. This duality symbolizes the struggle between the good and evil aspects within a single person. The author uses this reference to illustrate the market's dramatic shift from being stable and friendly (Dr. Jekyll) to being erratic and destructive (Mr. Hyde).

- The author is using the characters Dr. Jekyll and Mr. Hyde as metaphors to describe the market's behavior. Dr. Jekyll represents the market when it is rational and calm, while Mr. Hyde represents the market when it is irrational and volatile. In this context, the market has turned from stable and predictable (Dr. Jekyll) to chaotic and punishing (Mr. Hyde), aggressively devaluing stocks that previously performed well.

Dr.Jeykyll and Mr.Market

- Most of the time, the market is mostly accurate in pricing most stocks.
- Millions of buyers and sellers haggling over price do a remarkably good job of valuing companies—on average.
- But sometimes, the price is not right; occasionally, it is very wrong indeed.
- And at such times, you need to understand Graham's image of Mr. Market, probably the most brilliant metaphor ever created for explaining how stocks can become mispriced.
    - See Graham's text pp 204 - 205.
- The manic-depressive Mr. Market does not always price stocks the way an appraiser or a private buyer would value a business.
- Instead, when stocks are going up, he happily pays more than their objective value; and, when they are going down, he is desperate to dump them for less than their true worth.

- Is Mr.Market still arount? Is he still bipolar? You bet he is.

- On March 17, 2000, the stock of Inktomi Corp. hit a new high of $231.625.
- Since they first came on the market in June 1998, shares in the Internet-searching software company had gained roughly 1,900%.
- Just in the few weeks since December 1999, the stock had nearly tripled.

- What was going on at Inktomi the business that could make Inktomi the stock so valuable?
- The answer seems obvious: phenomenally fast growth.
- In the three months ending in December 1999, Inktomi sold $36 million in products and services, more than it had in the entire year ending in December 1998.
- If Inktomi could sustain its growth rate of the previous 12 months for just five more years, its revenues would explode from $36 million a quarter to $5 billion

a month.

- With such growth in sight, the faster the stock went up, the farther up it seemed certain to go.

- But in his wild love affair with Inktomi's stock, Mr. Market was overlooking something about its business.
- The company was losing money—lots of it.
- It had lost $6 million in the most recent quarter, $24 million in the 12 months before that, and $24 million in the year before that.
- In its entire corporate lifetime, Inktomi had never made a dime in profits.
- Yet, on March 17, 2000, Mr. Market valued this tiny business at a total of $25 billion. (Yes, that's billion, with a B.)

- And then Mr. Market went into a sudden, nightmarish depression.
- On September 30, 2002, just two and a half years after hitting $231.625 per share, Inktomi's stock closed at 25 cents—collapsing from a total market value of $25 billion to less than $40 million.
- Had Inktomi's business dried up?
- Not at all; over the previous 12 months, the company had generated $113 million in revenues.
- So what had changed?
- Only Mr. Market's mood: In early 2000, investors were so wild about the Internet that they priced Inktomi's shares at 250 times the company's revenues.
- Now, however, they would pay only 0.35 times its revenues.
- Mr. Market had morphed from Dr. Jekyll to Mr. Hyde and was ferociously trashing every stock that had made a fool out of him.

- But Mr. Market was no more justified in his midnight rage than he had been in his manic euphoria.
- On December 23, 2002, Yahoo! Inc. announced that it would buy Inktomi for $1.65 per share.
- That was nearly seven times Inktomi's stock price on September 30.
- History will probably show that Yahoo! got a bargain.
- When Mr. Market makes stocks so cheap, it's no wonder that entire companies get bought right out from under him.
    - As Graham noted in a classic series of articales in 1932, the Great Depression caused the shares of dozens of companies to drop below the value of their cash and liquid assets, making them "worth more dead than alive."

Think For Yourself

- Would you willingly allow a certifiable lunatic to come by at least five times a week to tell you that you should feel exactly the way he feels?
- Would you ever agree to be euphoric just because he is—or miserable just because he thinks you should be?
- Of course not.
- You'd insist on your right to take control of your own emotional life, based on your experiences and your beliefs.
- But, when it comes to their financial lives, millions of people let Mr. Market tell them how to feel and what to do—despite the obvious fact that, from time to time, he can get nuttier than a fruitcake.

- In 1999, during a time when the stock market was thriving, American employees directed an average of 8.6% of their paychecks into their 401(k) retirement plans.

- By 2002, after Mr. Market had spent three years stuffing stocks into black garbage bags, the average contribution rate had dropped by nearly one-quarter, to just 7%.
- The cheaper stocks got, the less eager people became to buy them—because they were imitating Mr. Market, instead of thinking for themselves

- The intelligent investor shouldn't ignore Mr. Market entirely.
- Instead, you should do business with him—but only to the extent that it serves your interests.
- Mr. Market's job is to provide you with prices; your job is to decide whether it is to your advantage to act on them.
- You do not have to trade with him just because he constantly begs you to.

- By refusing to let Mr. Market be your master, you transform him into your servant.
- After all, even when he seems to be destroying values, he is creating them elsewhere.
- In 1999, the Wilshire 5000 index—the broadest measure of U.S. stock performance—gained 23.8%, powered by technology and telecommunications stocks.
- But 3,743 of the 7,234 stocks in the Wilshire index went down in value even as the average was rising.
- While those high-tech and telecom stocks were hotter than the hood of a race car on an August afternoon, thousands of "Old Economy" shares were frozen in the mud—getting cheaper and cheaper.

- The stock of CMGI, an "incubator" or holding company for Internet start-up firms, went up an astonishing 939.9% in 1999.

- Meanwhile, Berkshire Hathaway—the holding company through which Graham’s greatest disciple, Warren Buffett, owns such Old Economy stalwarts as CocaCola, Gillette, and the Washington Post Co.—dropped by 24.9%.
    - A few months later, on March 10, 2000—the very day that NASDAQ hit its alltime high—online trading pundit James J. Cramer wrote that he had “repeatedly” been tempted in recent days to sell Berkshire Hathaway short, a bet that Buffett’s stock had farther to fall.
    - Cramer made a vulgar remark, saying that Berkhire’s shares were about to fall.
    - That same day, market strategist Ralph Acampora from Prudential Securities asked, “Norfolk Southern or Cisco Systems: Where would you rather invest for the future?” Cisco, crucial for the future of the Internet, seemed more promising than Norfolk Southern, which was part of the older railroad system. (However, over the next year, Norfolk Southern's stock went up 35%, while Cisco's went down 70%.)

- But then, as it so often does, the market had a sudden mood swing.
- Figure 8-1 offers a sampling of how the stinkers of 1999 became the stars of 2000 through 2002.

FIGURE 8-1 From Stinkers to Stars

Company	Business	Total Return 1999	2000	2001	2002	Final value of $1,000 invested 1/1/1999
Angelica	industrial uniforms	–43.7	1.8	19.3	94.1	1,328
Ball Corp.	metal & plastic packaging	–12.7	19.2	55.3	46.0	2,359
Checkers Drive-In Restaurants	fast food	–45.5	63.9	66.2	2.1	1,517
Family Dollar Stores	discount retailer	–25.1	33.0	41.1	5.0	1,476
International Game Technology	gambling equipment	–16.3	136.1	42.3	11.2	3,127
J B Hunt Transportation	trucking	–39.1	21.9	38.0	26.3	1,294
Jos. A. Bank Clothiers	apparel	–62.5	50.0	57.1	201.6	2,665
Lockheed Martin	defense & aerospace	–46.9	58.0	39.0	24.7	1,453
Pier 1 Imports	home furnishings	–33.2	63.9	70.5	10.3	2,059
UST Inc.	snuff tobacco	–23.5	21.6	32.2	1.0	1,241
Wilshire Internet Index		139.1	–55.5	–46.2	–45.0	315
Wilshire 5000 index (total stock market)		23.8	–10.9	–11.0	–20.8	778

Sources: Aronson + Johnson + Ortiz, L.P.; www.wilshire.com

- As for those two holding companies, CMGI went on to lose 96% in 2000, another 70.9% in 2001, and still 39.8% more in 2002—a cumulative loss of 99.3%.
- Berkshire Hathaway went up 26.6% in 2000 and 6.5% in 2001, then had a slight 3.8% loss in 2002—a cumulative gain of 30%.

Can You Beat the Pros At Their Own Game?

- One of Graham's most powerful insights is this: "The investor who permits himself to be stampeded or unduly worried by unjustified market declines in his holdings is perversely transforming his basic advantage into a basic disadvantage."
- What does Graham mean by those words "basic advantage"?

- He means that the intelligent individual investor has the full freedom to choose whether or not to follow Mr. Market.
- You have the luxury of being able to think for yourself.
    - When asked what keeps most individual investors from succeeding, Graham had a concise answer: “The primary cause of failure is that they pay too much attention to what the stock market is doing currently.”
    - See “Benjamin Graham: Thoughts on Security Analysis” [transcript of lecture at Northeast Missouri State University Business School, March, 1972], Financial History magazine, no. 42, March, 1991, p. 8.

- The typical money manager, however, has no choice but to mimic Mr. Market’s every move—buying high, selling low, marching almost mindlessly in his erratic footsteps.
- Here are some of the handicaps mutual fund managers and other professional investors are saddled with:
    - With billions of dollars under management, they must gravitate toward the biggest stocks—the only ones they can buy in the multimillion-dollar quantities they need to fill their portfolios. Thus many funds end up owning the same few overpriced giants.
    - Investors tend to pour more money into funds as the market rises. The managers use that new cash to buy more of the stocks they already own, driving prices to even more dangerous heights.
    - If fund investors ask for their money back when the market drops, the managers may need to sell stocks to cash them out. Just as the funds are forced to buy stocks at inflated prices in a rising market, they become forced sellers as stocks get cheap again.
    - Many portfolio managers get bonuses for beating the market, so they obsessively measure their returns against benchmarks like the S & P 500 index. If a company gets added to an index, hundreds of funds compulsively buy it. (If they don’t, and that stock then does well, the managers look foolish; on the other hand, if they buy it and it does poorly, no one will blame them.)

  - Increasingly, fund managers are expected to specialize. Just as in medicine the general practitioner has given way to the pediatric allergist and the geriatric otolaryngologist, fund managers must buy only "small growth" stocks, or only "mid-sized value" stocks, or nothing but "large blend" stocks.
    - Never mind what these terms mean, or are supposed to mean. While in public these classifications are treated with the utmost respect, in private most people in the investment business regard them with the contempt normally reserved for jokes that aren't funny.
  - If a company gets too big, or too small, or too cheap, or an itty bit too expensive, the fund has to sell it—even if the manager loves the stock.

- So there's no reason you can't do as well as the pros.
- What you cannot do (despite all the pundits who say you can) is to "beat the pros at their own game."
- The pros can't even win their own game! Why should you want to play it at all?
- If you follow their rules, you will lose—since you will end up as much a slave to Mr. Market as the professionals are.

- Instead, recognize that investing intelligently is about controlling the controllable.
- You can't control whether the stocks or funds you buy will outperform the market today, next week, this month, or this year; in the short run, your returns will always be hostage to Mr. Market and his whims.
- But you can control:
  - **Your brockerage costs,** by trading rarely, patiently, and cheaply.
  - **Your ownership costs,** by refusing to buy mutual funds with excessive annual expenses.
  - **Your expectations,** by using realism, not fantasy, to forecast your returns.

        - See the brilliant column by Walter Updegrave, “Keep It Real,” Money, February 2002 pp 53 - 56
    - **Your risk,** by deciding how much of your total assets to put at hazard in the stock market, by diversifying, and by rebalancing.
    - **Your tax bills,** by holding stocks for at least one year and, when ever possible for at least five years, to lower your capital-gains liability.
    - and, most of all, **your own behavior.**

- If you listen to financial TV, or read most market columnists, you’d think that investing is some kind of sport, or a war, or a struggle for survival in a hostile wilderness.
- But investing isn’t about beating others at their game.
- It’s about controlling yourself at your own game.
- The challenge for the intelligent investor is not to find the stocks that will go up the most and down the least, but rather to prevent yourself from being your own worst enemy—from buying high just because Mr. Market says “Buy!” and from selling low just because Mr. Market says “Sell!”

- If you investment horizon is long—at least 25 or 30 years—there is only one sensible approach: Buy every month, automatically, and whenever else you can spare some money.
- The single best choice for this lifelong holding is a total stock-market index fund.
- Sell only when you need the cash (for a psychological boost, clip out and sign your “Investment Owner’s Contract”—which you can find on p. 225).

INVESTMENT OWNER'S CONTRACT

I, ____________ _________________, hereby state that I am an investor who is seeking to accumulate wealth for many years into the future.

I know that there will be many times when I will be tempted to invest in stocks or bonds because they have gone (or "are going") up in price, and other times when I will be tempted to sell my investments because they have gone (or "are going") down.

I hereby declare my refusal to let a herd of strangers make my financial decisions for me. I further make a solemn commitment never to invest because the stock market has gone up, and never to sell because it has gone down. Instead, I will invest $______.00 per month, every month, through an automatic investment plan or "dollar-cost averaging program," into the following mutual fund(s) or diversified portfolio(s):

_______________________________,

_______________________________,

_______________________________.

I will also invest additional amounts whenever I can afford to spare the cash (and can afford to lose it in the short run).

I hereby declare that I will hold each of these investments continually through at least the following date (which must be a minimum of 10 years after the date of this contact): ________________ _____, 20__. The only exceptions allowed under the terms of this contract are a sudden, pressing need for cash, like a health-care emergency or the loss of my job, or a planned expenditure like a housing down payment or a tuition bill.

I am, by signing below, stating my intention not only to abide by the terms of this contract, but to re-read this document whenever I am tempted to sell any of my investments.

This contract is valid only when signed by at least one witness, and must be kept in a safe place that is easily accessible for future reference.

Signed: Date:

____________ _________________ ______________ ____, 20__

Witnesses:

____________ _________________

____________ _________________

- To be an intelligent investor, you must also refuse to judge your financial success by how a bunch of total strangers are doing.
- You're not one penny poorer if someone in Dubuque or Dallas or Denver beats the S & P 500 and you don't.
- No one's gravestone reads "HE BEAT THE MARKET."

- I once interviewed a group of retirees in Boca Raton, one of Florida's wealthiest retirement communities.
- I asked these people— mostly in their seventies—if they had beaten the market over their investing lifetimes.
- Some said yes, some said no; most weren't sure.
- Then one man said, "Who cares? All I know is, my investments earned enough for me to end up in Boca.

- Could there be a more perfect answer?
- After all, the whole point of investing is not to earn more money than average, but to earn enough money to meet your own needs.
- The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan and a behavioral discipline that are likely to get you where you want to go.
- In the end, what matters isn't crossing the finish line before anybody else but just making sure that you do cross it.
    - See Jason Zweig, "Did You Beat the Market?" Money, January, 2000, pp. 55–58.

Your Money And Your Brain

- Why, then, do investors find Mr. Market so seductive?
- It turns out that our brains are hardwired to get us into investing trouble; humans are pattern-seeking animals.
- Psychologists have shown that if you present people with a random sequence —and tell them that it's unpredictable—they will nevertheless insist on trying to guess what's coming next.
- Likewise, we "know" that the next roll of the dice will be a seven, that a baseball player is due for a base hit, that the next winning number in the Powerball lottery will definitely be 4-27-9-16-42-10—and that this hot little stock is the next Microsoft.

- Groundbreaking new research in neuroscience shows that our brains are designed to perceive trends even where they might not exist.
- After an event occurs just two or three times in a row, regions of the human brain called the anterior cingulate and nucleus accumbens automatically anticipate that it will happen again.
- If it does repeat, a natural chemical called dopamine is released, flooding your brain with a soft euphoria.
- Thus, if a stock goes up a few times in a row, you reflexively expect it to keep going—and your brain chemistry changes as the stock rises, giving you a "natural high".
- You effectively become addicted to your own predictions.

- But when stocks drop, that financial loss fires up your amygdala— the part of the brain that processes fear and anxiety and generates the famous "fight or flight" response that is common to all cornered animals.
- Just as you can't keep your heart rate from rising if a fire alarm goes off, just as you can't avoid flinching if a rattlesnake slithers onto your hiking path, you can't help feeling fearful when stock prices are plunging.

- The neuroscience of investing is explored in Jason Zweig, “Are You Wired for Wealth?” Money, October, 2002, pp. 74–83, also available at http://money.cnn.com/2002/09/25/pf/investing/agenda_brain _short/index.htm. See also Jason Zweig, “The Trouble with Humans,” Money, November, 2000, pp. 67–70.

- In fact, the brilliant psychologists Daniel Kahneman and Amos Tversky have shown that the pain of financial loss is more than twice as intense as the pleasure of an equivalent gain.
- Making $1,000 on a stock feels great—but a $1,000 loss wields an emotional wallop more than twice as powerful.
- Losing money is so painful that many people, terrified at the prospect of any further loss, sell out near the bottom or refuse to buy more.

- This explains why we focus on the size of a market drop and forget to see the loss in proportion.
- So, if a TV reporter hollers, “The market is plunging—the Dow is down 100 points!” most people instinctively shudder (shake)
- But, at the Dow’s recent level of 8,000, that’s a drop of just 1.2%.
- Now think how ridiculous it would sound if, on a day when it’s 81 degrees outside, the TV weatherman shrieked, “The temperature is plunging—it’s dropped from 81 degrees to 80 degrees!”
- That, too, is a 1.2% drop.
- When you forget to view changing market prices in percentage terms, it’s all too easy to panic over minor vibrations. (If you have decades of investing ahead of you, there’s a better way to visualize the financial news broadcasts; see the sidebar on p. 222.) :

News You Could Use :

- Stocks are crashing, and you turn on the TV for market news. But instead of CNBC or CNN, imagine the Benjamin Graham Financial Network. On BGFN, there's no sour clang of the market's closing bell or frantic brokers. Instead, the screen shows the New York Stock Exchange with a huge banner reading: “SALE! 50% OFF!” Bachman-Turner Overdrive's “You Ain't Seen Nothin' Yet” plays in the background. The anchorman says, “Stocks became more attractive today as the Dow dropped another 2.5%, the fourth day in a row of falling prices. Tech stocks like Microsoft dropped nearly 5%, making them even more affordable. Stocks have already lost 50% this year, reaching bargain levels not seen in years. Some analysts are optimistic that prices may drop further in the weeks to come.” The broadcast switches to market strategist Ignatz Anderson of Ketchum & Skinner, who says, “My forecast is for stocks to lose another 15% by June. If everything goes well, stocks could lose 25%, maybe more.” “Let's hope Ignatz Anderson is right,” the anchor says cheerfully. “Falling stock prices would be great news for long-term investors. And now over to Wally Wood for our exclusive AccuWeather forecast."

- In the late 1990s, many people came to feel that they were in the dark unless they checked the prices of their stocks several times a day.
- But, as Graham puts it, the typical investor “would be better off if his stocks had no market quotation at all, for he would then be spared the mental anguish caused him by other persons' mistakes of judgment.”
- If, after checking the value of your stock portfolio at 1:24 P.M., you feel compelled to check it all over again at 1:37 P.M., ask yourself these questions:
    - Did I call a real-estate agent to check the market price of my house at 1:24 PM? Did I call back at 1:37 PM?
    - If I had, would the price have changed? If it did, would I have rushed to sell my house?
    - By not checking, or even knowing, the market price of my house from minute to minute, do I prevent its value from rising over time?

        - It’s also worth asking whether you could enjoy living in your house if its market price was reported to the last penny every day in the newspapers and on TV.

- The only possible answer to these questions is of course not!
- And you should view your portfolio the same way.
- Over a 10- or 20- or 30- year investment horizon, Mr. Market’s daily dipsy-doodles simply do not matter.
- In any case, for anyone who will be investing for years to come, falling stock prices are good news, not bad, since they enable you to buy more for less money.
- The longer and further stocks fall, and the more steadily you keep buying as they drop, the more money you will make in the end—if you remain steadfast until the end.
- Instead of fearing a bear market, you should embrace it.
- The intelligent investor should be perfectly comfortable owning a stock or mutual fund even if the stock market stopped supplying daily prices for the next 10 years.
    - In a series of remarkable experiments in the late 1980s, a psychologist at Columbia and Harvard, Paul Andreassen, showed that investors who received frequent news updates on their stocks earned half the returns of investors who got no news at all.
    - See Jason Zweig, “Here’s How to Use the News and Tune Out the Noise,” Money, July, 1998, pp. 63–64.

- Paradoxically, “you will be much more in control,” explains neuroscientist Antonio Damasio, “if you realize how much you are not in control.”
- By acknowledging your biological tendency to buy high and sell low, you can admit the need to dollar-cost average, rebalance, and sign an investment contract.

- By putting much of your portfolio on permanent autopilot, you can fight the prediction addiction, focus on your long-term financial goals, and tune out Mr. Market's mood swings.

When Mr. Market Give You Lemons, Make Lemonade

- Although Graham teaches that you should buy when Mr. Market is yelling "sell," there's one exception the intelligent investor needs to understand.
- Selling into a bear market can make sense if it creates a tax windfall.
- The U.S. Internal Revenue Code allows you to use your realized losses (any declines in value that you lock in by selling your shares) to offset up to $3,000 in ordinary income.
    - Federal tax law is subject to constant change. The example of Coca-Cola stock given here is valid under the provisions of the U.S. tax code as it stood in early 2003.
- Let's say you bought 200 shares of Coca-Cola stock in January 2000 for $60 a share—a total investment of $12,000.
- By year-end 2002, the stock was down to $44 a share, or $8,800 for your lot —a loss of $3,200.

- You could have done what most people do—either whine about your loss, or sweep it under the rug and pretend it never happened.
- Or you could have taken control.
- Before 2002 ended, you could have sold all your Coke shares, locking in the $3,200 loss.
- Then, after waiting 31 days to comply with IRS rules, you would buy 200 shares of Coke all over again.

- The result: You would be able to reduce your taxable income by $3,000 in 2002, and you could use the remaining $200 loss to offset your income in 2003.
- And better yet, you would still own a company whose future you believe in—but now you would own it for almost one-third less than you paid the first time.
  - This example assumes that the investor had no realized capital gains in 2002 and did not reinvest any Coke dividends.
  - Tax swaps are not to be undertaken lightly, since they can be mishandled easily.
  - Before doing a tax swap, read IRS Publication 550 (www.irs.gov/pub/irspdf/p550.pdf).
  - A good guide to managing your investment taxes is Robert N. Gordon with Jan M. Rosen, Wall Street Secrets for Tax-Efficient Investing (Bloomberg Press, Princeton, New Jersey, 2001).
  - Finally, before you pull the trigger, consult a professional tax adviser

▼ Let’s understand this better :

Concept Overview

The text talks about an investment strategy called "tax-loss harvesting." This involves selling a losing investment to offset taxable gains and potentially reduce your overall tax bill. Here’s the detailed breakdown:

Key Definitions

1. **Bear Market**: A market condition where prices are falling, typically by 20% or more.
2. **Realized Loss**: A loss incurred when you sell an investment for less than what you paid for it.
3. **Ordinary Income**: Income earned from wages, salaries, tips, bonuses, and other sources that is taxed at the standard rate.

4. **Tax-Loss Harvesting**: The strategy of selling a security at a loss to offset a capital gains tax liability.

Concrete Example with Numbers

Let's use the example provided:

1. **Initial Investment**:
    - You bought 200 shares of Coca-Cola in January 2000.
    - Purchase price per share: $60.
    - Total investment: 200 shares * $60/share = $12,000.
2. **Value at Year-End 2002**:
    - Stock price fell to $44 per share.
    - New value of your 200 shares: 200 shares * $44/share = $8,800.
    - Total loss: $12,000 - $8,800 = $3,200.

What Can You Do?

1. **Standard Reaction**:
    - Whine about the loss or ignore it.
2. **Proactive Strategy (Tax-Loss Harvesting)**:
    - Sell all your Coca-Cola shares by the end of 2002 to lock in the $3,200 loss.
    - This $3,200 loss can be used to offset your taxable income.

Tax Benefits

1. **Offset Ordinary Income**:
    - The IRS allows you to offset up to $3,000 of your ordinary income with realized losses.
    - By selling and realizing the $3,200 loss, you reduce your taxable income by $3,000 in 2002.
    - The remaining $200 loss can be carried over to 2003.

Buying Back Shares

1. **Wash Sale Rule**:
    - The IRS has a rule called the "wash sale rule" which states that you cannot buy back the same or substantially identical stock within 30 days before or after the sale to claim the loss for tax purposes.
    - So, you wait for 31 days after selling your Coca-Cola shares.
    - After 31 days, you buy back 200 shares of Coca-Cola at the current market price.

Scenario Outcome

1. **Initial Position**:
    - 200 shares bought at $60 each.
    - Total investment: $12,000.
2. **After Selling and Rebuying**:
    - Sold shares at $44 each: received $8,800.
    - Realized loss: $3,200.
    - Reduced taxable income by $3,000 in 2002.
    - Remaining loss of $200 to offset income in 2003.
    - After 31 days, rebuy 200 shares (assuming the price is still $44):
        - New investment: 200 shares * $44/share = $8,800.
3. **End Result**:
    - You still own 200 shares of Coca-Cola.
    - Your cost basis is now $8,800 instead of $12,000.
    - You’ve reduced your taxable income, potentially lowering your tax bill.

Tax-Loss Harvesting Benefits

When you sell your Coca-Cola shares and realize a $3,200 loss, you use this loss to offset your taxable income. Here's a step-by-step breakdown of how this affects your taxes:

1. **Realized Loss**: You sold your Coca-Cola shares and locked in a loss of $3,200.
2. **Offsetting Ordinary Income**:
   - The IRS allows you to use realized losses to offset up to $3,000 of ordinary income per year.
   - By realizing a $3,200 loss, you can reduce your taxable income by $3,000 in the year you sold the shares (2002).

Understanding the Tax Benefit

1. **Reducing Taxable Income**:
   - Suppose your ordinary income for 2002 was $50,000.
   - By applying the $3,000 loss, your taxable income is reduced from $50,000 to $47,000.
   - This reduction lowers the amount of income on which you have to pay taxes.
2. **Tax Savings Calculation**:
   - Let's say your tax rate is 25%.
   - By reducing your taxable income by $3,000, you save $3,000 * 25% = $750 on your tax bill for 2002.
   - The remaining $200 loss can be carried over to the next tax year (2003) and used to offset income or gains in that year.

Final Scenario Breakdown

- **Initial Investment**: $12,000 (200 shares at $60 each).
- **Value at Sale**: $8,800 (200 shares at $44 each).
- **Realized Loss**: $3,200.
- **Taxable Income Reduction in 2002**: $3,000.
- **Tax Savings at 25% Tax Rate**: $750.

Where the $3,000 Goes

The $3,000 doesn't go anywhere physically. Instead, it represents a reduction in your taxable income. Here's the effect in simple terms:

1. **Before Tax-Loss Harvesting**:
    - Taxable income: $50,000.
    - Tax at 25%: $50,000 * 25% = $12,500.
2. **After Tax-Loss Harvesting**:
    - Taxable income: $47,000 ($50,000 - $3,000).
    - Tax at 25%: $47,000 * 25% = $11,750.

Summary

By realizing a $3,200 loss and using $3,000 of it to offset your ordinary income in 2002, you reduce your taxable income and save on taxes. The actual money saved is $750 in this example, which is the amount of tax you would have paid if your taxable income wasn't reduced by the $3,000 loss.

So, the $3,000 "goes" towards lowering your taxable income, resulting in tax savings rather than being a physical amount you receive.

Important Considerations

1. **Tax Rules**: Always check the latest IRS rules and consult IRS Publication 550 for detailed guidance.
2. **Professional Advice**: Consult a professional tax adviser to ensure you're correctly implementing this strategy.
3. **Market Risks**: Prices can change, and waiting 31 days might mean buying back shares at a different price.

By understanding and potentially using tax-loss harvesting, you can optimize your tax situation and make better-informed investment decisions. This strategy can be a powerful tool in your financial toolkit, helping you to become a more astute and strategic investor.

Scenario Overview

1. **Income and Tax Situation**:
    - Your annual income as a data science engineer: $125,000.
    - Your marginal tax rate: 40% (just for this example; actual rates may vary).
2. **Investment and Loss**:
    - You bought 200 shares of Coca-Cola for $60 each, totaling $12,000.
    - By the end of 2002, the value dropped to $44 per share, totaling $8,800.
    - You realized a loss of $3,200 by selling the shares.

Tax-Loss Harvesting Benefit Breakdown

Before Tax-Loss Harvesting

1. **Income**:
    - Annual income: $125,000.
2. **Taxes Without Losses**:
    - Taxable income: $125,000.
    - Tax at 40%: $125,000 * 40% = $50,000.

After Tax-Loss Harvesting

1. **Income**:
    - Annual income: $125,000.
    - Realized loss from selling shares: $3,200.
2. **Offsetting Ordinary Income**:
    - You can use $3,000 of the loss to offset your taxable income for 2002.
    - Remaining $200 can be carried over to the next year.
3. **Taxes With Loss Offset**:
    - Taxable income after offset: $125,000 - $3,000 = $122,000.

- Tax at 40%: $122,000 * 40% = $48,800.

Tax Savings Calculation

1. **Tax Before Offset**: $50,000.
2. **Tax After Offset**: $48,800.
3. **Tax Savings**: $50,000 - $48,800 = $1,200.

Summary of Benefits

By utilizing tax-loss harvesting:

1. **Lower Taxable Income**: You reduce your taxable income by $3,000.
2. **Tax Savings**: At a 40% tax rate, this results in a tax savings of $1,200.
3. **Carryover Loss**: The remaining $200 loss can be used in the next tax year to reduce taxable income further.

Key Points to Understand

- **The $3,000 loss doesn't mean you get $3,000 in cash.** Instead, it reduces your taxable income, which lowers the amount of tax you owe.
- **Tax savings depend on your tax rate**: With a 40% tax rate, reducing your taxable income by $3,000 saves you $1,200 in taxes.
- **You still own the investment**: After 31 days, you can buy back the same shares, potentially at a lower cost basis, setting you up for future gains.

Concrete Example Revisited

1. **Initial Investment**: $12,000.
2. **After Selling**:
    - Sold for: $8,800.
    - Realized loss: $3,200.
3. **Tax Impact**:
    - Offset $3,000 against taxable income.

    - Save $1,200 on taxes (40% of $3,000).

4. **Buying Back**: After 31 days, you buy 200 shares again, potentially at $44 per share, costing $8,800.
5. **New Cost Basis**: $8,800 instead of $12,000.

This strategy helps you optimize your tax situation by reducing taxable income and saving on taxes while maintaining your investment position in the stock.

But is this just for 3000$?

Great question! Let's clarify how the tax-loss harvesting limits work and explore what happens if your losses exceed $3,000.

Tax-Loss Harvesting Limits

1. **Annual Limit**: The IRS allows you to use up to $3,000 of realized capital losses to offset ordinary income per year.
2. **Carryover Losses**: If your realized losses exceed $3,000, the excess can be carried over to future years.

Example with Larger Losses

Let’s modify our example to include larger losses and see how it affects your taxes over multiple years.

Scenario

1. **Initial Investment**:
    - You bought 200 shares of Coca-Cola for $60 each, totaling $12,000.
2. **Value at Year-End**:
    - The stock price fell to $30 per share, so the new value of your 200 shares is $6,000.
    - Your total loss: $12,000 - $6,000 = $6,000.

Tax-Loss Harvesting with Larger Loss

1. **Realize the Loss**:
    - Sell your 200 shares for $6,000, locking in a $6,000 loss.
2. **Offsetting Ordinary Income**:
    - Use $3,000 of the loss to offset ordinary income in the year you sell (let's say 2023).
    - Remaining $3,000 loss is carried over to the next year (2024).

Tax Impact for 2023

1. **Income**: $125,000.
2. **Offset**: $3,000.
3. **Taxable Income**: $125,000 - $3,000 = $122,000.
4. **Tax at 40%**: $122,000 * 40% = $48,800.
5. **Tax Savings**: $50,000 (without offset) - $48,800 (with offset) = $1,200.

Carryover to 2024

1. **Remaining Loss**: $3,000.
2. **Income**: $125,000.
3. **Offset**: $3,000.
4. **Taxable Income**: $125,000 - $3,000 = $122,000.
5. **Tax at 40%**: $122,000 * 40% = $48,800.
6. **Tax Savings**: $1,200.

Summary Over Multiple Years

- **2023**: You use $3,000 of the $6,000 loss to reduce taxable income, saving $1,200 in taxes.
- **2024**: You carry over the remaining $3,000 loss, again reducing taxable income and saving another $1,200 in taxes.

Important Points

1. **Annual Offset Limit**: You can only use $3,000 of your losses to offset ordinary income each year.
2. **Carryover Mechanism**: Any excess loss above $3,000 can be carried forward indefinitely, applying $3,000 each year until the loss is exhausted.
3. **Capital Gains**: If you have capital gains in any year, you can use your losses to offset those gains without the $3,000 limit. Losses offset capital gains first before reducing ordinary income.

Additional Considerations

1. **Consult a Tax Professional**: Tax rules can be complex, and professional advice ensures you maximize your benefits while staying compliant with IRS regulations.
2. **Monitor Market Conditions**: Timing your sales and repurchases requires careful consideration to comply with IRS rules and to manage investment risks.

In essence, while the immediate benefit is capped at $3,000 per year for offsetting ordinary income, the ability to carry forward excess losses means you can continue to gain tax benefits in future years. This makes tax-loss harvesting a powerful tool for long-term tax efficiency.

Strategy with the remaining 3000$:

Yes, you can buy back shares of Coca-Cola (or any other stock) after selling them for a loss, as long as you comply with the IRS wash sale rule. Let's break down how you can handle the remaining $3,000 loss and ensure you still get the offset for taxable income in 2024.

Wash Sale Rule

1. **Definition**: The wash sale rule states that if you sell a stock at a loss and buy substantially identical stock within 30 days before or after the sale, the loss cannot be claimed for tax purposes.

2. **Waiting Period**: To claim the loss, you need to wait at least 31 days before buying back the same stock.

Strategy with Remaining $3,000 Loss

1. **Initial Sale and Loss Realization**:
    - You sold 200 shares of Coca-Cola, realizing a $6,000 loss.
    - You use $3,000 to offset your 2023 taxable income.
    - You carry forward the remaining $3,000 to 2024.
2. **Buying Back Shares**:
    - After waiting 31 days to avoid the wash sale rule, you buy back 200 shares of Coca-Cola.

Offset Taxable Income in 2024

1. **Carryover Loss**: The remaining $3,000 loss carried over from 2023 can be used to offset your taxable income in 2024.
2. **New Purchase**: Buying back Coca-Cola shares after the 31-day waiting period does not affect your ability to use the remaining $3,000 loss to offset income in 2024.

Scenario with Numbers

1. **2023**:
    - **Sale**: Sold shares for a $6,000 loss.
    - **Offset**: Used $3,000 to offset 2023 taxable income.
    - **Carryover**: $3,000 carried over to 2024.
    - **Buyback**: After 31 days, buy back 200 shares of Coca-Cola.
2. **2024**:
    - **Carryover Loss**: $3,000 from 2023.
    - **Income**: $125,000.
    - **Offset**: $3,000 loss reduces taxable income to $122,000.

- **Tax Savings**: $1,200 at a 40% tax rate.

Important Considerations

- **Wash Sale Rule Compliance**: Ensure you wait at least 31 days before buying back the same shares to avoid disallowing the loss.
- **Tracking Losses**: Keep detailed records of your transactions and the dates to ensure compliance with tax regulations.
- **Professional Advice**: Consult a tax professional to ensure you are maximizing your tax benefits and staying compliant with IRS rules.

Concrete Example Revisited

1. **Initial Sale**:
    - Sold 200 shares for $6,000 (realized loss: $6,000).
2. **2023 Tax Impact**:
    - **Offset**: $3,000 loss reduces taxable income to $122,000.
    - **Tax Savings**: $1,200 at a 40% tax rate.
    - **Carryover**: $3,000 to 2024.
3. **Buying Back Shares**:
    - After 31 days, buy 200 shares at the current market price.
4. **2024 Tax Impact**:
    - **Offset**: $3,000 carried over loss reduces taxable income by $3,000.
    - **Tax Savings**: $1,200 at a 40% tax rate.

By following these steps, you can successfully utilize the remaining $3,000 loss to offset your taxable income in 2024 while continuing to hold shares in Coca-Cola, ensuring compliance with tax rules and maximizing your financial benefits.

- When the government helps cover your losses, selling and accepting a loss can be a good idea.

- If the government aims to seem more logical than the market, why should we complain?