Investing In Equities In A Changing Tax Environment

(NAPSA)—As the tax environment changes, so too should investment strategies.

That's the word from experts who warn that the current capital gains tax laws are changing. Additionally, studies have shown the "tax drag" to be cyclical, meaning there are certain times when it's bigger than others. Right now, a new and potentially harsher cycle appears to be under way.

"While tax-managed investing is important in any environment, it's particularly important today because investors are going to be hit hard by both rising capital gains distributions and higher tax rates moving forward," says Duncan W. Richardson, Chief Equity Investment Officer for Eaton Vance Management.

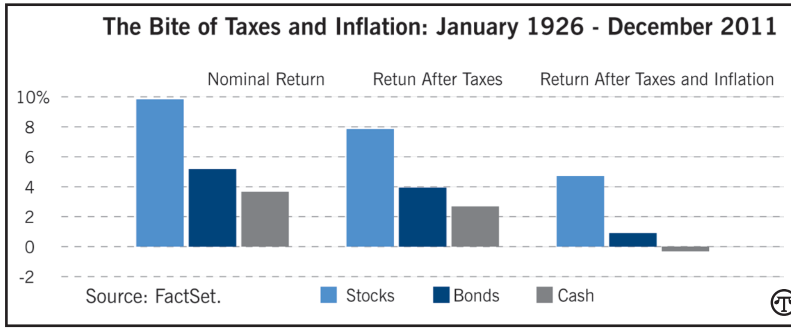
Richardson

He believes understanding the potential risks and rewards associated with these changes can offer investors a number of strategic benefits.

Historically, equities have provided a higher after-tax (and inflation-adjusted) return than any other asset class. They have been one of the best defenses against taxes and inflation.

Yet active tax management remains an important factor to consider. The growth of tax-deferred vehicles in the 1980s led many investment managers to change how they managed portfolios. "There was no tax cost for tax-deferred investors of having a high portfolio turnover rate, so little attention was paid to keeping turnover low," says Richardson. "For the large number of investors who have assets in taxable accounts, that can translate into a significant tax drag."

One of the best ways to effectively manage taxes is to maintain a long-term perspective. Richardson says he prefers a holding period of "five years to forever" to let winners run and help ensure gains are taxed at the lowest possible rate. He recommends keeping "bad" or unnecessary turnover low to minimize transaction costs and short-term capital gains. Additionally, harvesting capital losses in a disciplined fashion, following "wash sale" rules, following holding period rules to have any dividends taxed at the lower qualified dividend income rate, and using tax-advantaged hedging techniques may all improve after-tax returns even further.



Historically, equities have been one of the best defenses against taxes and inflation.
Source: Standard and Poors

This may seem like a lot of extra work, but according to Lipper (a mutual fund services company), the average taxable equity mutual fund investor can lose as much as a quarter or more of every dollar of their annual returns to taxes. Employing equity mutual funds managed with after-tax returns as their objective may help investors "keep the quarter," as Richardson says, thanks to the tax-efficient techniques these funds practice.

Tax efficiency is particularly important in today's environment, he says, because the market has more than doubled over the last three years, increasing the likelihood of more capital gains distributions from mutual funds.

"Regardless of tax cuts or extensions, massive deficits at the federal, state and local levels suggest that taxes may eventually have nowhere to go but up," Richardson says. "That's a risk most investors can't afford to ignore."

Navigating this changing tax environment can be challenging, making it more important than ever for investors to seek professional guidance. Eaton Vance has a decades-long history of offering mutual funds and wealth management solutions designed to help maximize investors' after-tax returns.

"We sharpened our focus on tax management and significantly expanded our tax-efficient equity fund lineup in the late 1990s and early 2000s to fill what we saw as a big void in the industry, and most importantly, to help our clients maximize their after-tax returns," Richardson says.

Today, Eaton Vance offers a strong lineup of tax-managed equity mutual funds that cover multiple asset classes and market capitalizations, along with a broad range of tax-exempt municipal and tax-advantaged bond strategies. To learn more, visit www.eatonvance.com.