



Let's pay the tax now! Said no one ever...

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The last few years have been strong for equity investors. Approximate S&P 500 returns:

2023: ~26%

2024: ~24%

2025: ~15%

2026 YTD: ~ 9.5%

If you've had a diversified equity portfolio, you likely participated in a meaningful portion of those gains. That's a good problem to have. But it creates a new planning question: what do we do with it?

Most investors default to "don't sell, don't pay tax." And while tax deferral is valuable, it's not always the best long-term strategy. This is where the idea of a "capital gains budget" comes in.

Instead of avoiding gains altogether, we look at intentionally realizing some gains as warranted by your investment objectives, risk tolerance and in alignment with your financial plan. The goal is to keep your portfolio aligned with your goals, avoid unintentionally taking on too much risk, and spreading out the tax liability over multiple years rather than creating one large spike later.

If you have positions with large, unrealized gains, they can start to drive portfolio decisions for the wrong reason. You may hold onto something simply because you don't want to realize the gain, even if trimming or exiting would otherwise make sense. Over time, that can lead to concentration risk or an allocation that no longer matches your plan.

A better approach is to step back and ask, "If taxes weren't a factor, would we still own this in this amount?" If the answer is no, then we build a plan (set a capital gains budget) to adjust it thoughtfully.

That doesn't mean selling everything at once. In most cases, it means mapping out a multi-year rebalancing strategy and deciding how much gain to realize each year.

As we do that, we're considering how the income may impact your tax liability as well as other implications such as:

1. Net investment income tax exposure
2. Medicare premium thresholds (IRMAA)
3. Other items that can be impacted by income levels, like enhanced senior deductions
4. Timing relative to other income events

Also note that realizing gains and paying some tax is already built into your financial plan. When we run projections, we assume returns are not tax-free, some portion of gains will be realized over time, and taxes will be paid along the way. Planning proactively keeps those assumptions realistic.

The alternative is letting positions grow unchecked and then being forced to sell in a year when cash needs arise. That can lead to realizing a large amount of gain all at once, potentially impacting some of the items listed above, and at a time when you have less flexibility. This is why we believe the best strategy involves not trying to avoid capital gains altogether, rather trying to manage them intentionally.

If you have meaningful unrealized gains, it's worth reviewing both your allocation and your embedded tax liability. From there, we can decide what a reasonable annual "gain budget" looks like and start working through it over time. As always, we'll tailor that to your situation.

Please keep us in mind if you have friends or family that we might be able to help too. We would love to get connected with them!

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