



TAX AWARE

Loss Harvesting or Gain Deferral? A Surprising Source of Tax Benefits of Tax-Aware Long-Short Strategies

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“[Beyond Direct Indexing: Dynamic Direct Long-Short Investing](#)” showed that tax-aware long-short factor strategies, within the first three years since inception, can realize cumulative net capital losses exceeding 100% of initially invested capital, all while generating a significant pre-tax alpha. This paper explores the mechanism behind these remarkable results.

Surprisingly, in tax-aware long-short factor strategies, net capital losses arise not from an increased realization of capital losses but rather from the deferral of capital gains, especially short-term gains on long positions. Despite reducing the gain realization, these strategies still allocate most of their turnover to trading in the direction of the alpha model, which explains their strong pre-tax performance. To achieve alignment with the alpha model, these strategies mostly rely on creating new positions and liquidating loss positions while avoiding the liquidation of gain positions.

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