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when, where and how to invest

How to benefit as mutual funds dump shares for tax losses.

Let the Bottom Fishing Begin

SPECIAL ARTICLE
REPRINT FEATURING
**ICM Asset
Management**

It's an annual event, like swallows returning to Capistrano and the Red Sox blowing the pennant. Every year at around this time mutual fund managers sift through their portfolios, searching for losers that can be sold to offset capital gains—reducing tax liability for their investors. Or they simply want to get the dogs off their books to make their portfolios look good.

Some of these stocks deserve to get dumped, but others are good businesses having a bad year. And therein lies an opportunity for bargain hunters.

"It happens like clockwork," says Duncan Richardson, who runs Eaton Vance Tax-Managed Growth. Most funds need to dump their losers before they close their books on Oct. 31 to count them against capital gains.

Jim Floyd, senior analyst at The Leuthold Group, says picking through castoffs for potential winners is "more art than science." The trick, he says, is to find stable companies that are down on their luck rather than true losers. "The other critical thing is, do not take one shot at one company," he adds. "It's best to diversify your risk."

The nasty summer downturn this year has increased the pool of tax-loss targets. "When the market deteriorates, managers become more aggressive about realizing losses and doing some window dressing as we head into the end of the year," says Peter Hable, portfolio manager of the Smith Barney Fundamental Value fund. Hable, who puts together an annual list of potential tax-loss bargains, says investors trying this strategy should seek stocks near their 52-

week lows. Then look for further dips on heavy volume—a sign of institutional selling.

Prime quarry this year: chipmakers. The Philadelphia Semiconductor index is off 26 percent, versus a 3 percent drop for the Standard & Poor's 500, on concerns about slow tech spending. Hable likes **Texas Instruments**, which is positioned to take advantage of consumer demand for electronics, since its chips are used in cell phones and many other consumer devices. The stock is down 35 percent this year.

Hable is also eyeing **Viacom**, noting its stable of strong broadcast assets, including MTV and CBS. Viacom's shares are down 24 percent this year in the wake of a management shuffle and the problems with its Blockbuster unit, which is being spun off. With \$3 billion in free cash flow, the media giant can buy back a lot of stock.

While large-cap candidates have the potential for sprightly gains, the best place to fish for tax-loss rebounders is also the riskiest: small caps. "A good-size seller here can really shake a company down to its eyeteeth," says Jim Simmons, chief investment officer at ICM Asset

Management. Small-cap funds that booked gains early this year have big potential tax liabilities to offset.

Simmons likes ***Powerwave**, which makes equipment that processes cell phone signals and should benefit as companies offer advanced mobile services. The knock on the stock is that Powerwave's biggest customer, Nortel, is in a world of hurt. But a recent acquisition broadened its customer base.

Electronics for Imaging is another beaten-down tech name that mutual fund managers may be tossing out with the bathwater. Shares of the company, which makes parts and software for high-end printers, sank on worries about demand. The company stands to benefit from shifts to color printers and to commercial digital printing, and its hefty cash hoard of \$11.50 a share makes it look pretty cheap.

Savvy investors should remember: Never buy anything just because it's on sale. "One of the dangers in this strategy," says Eaton Vance's Richardson, "is that not every dog has its day. You have to like the stock." —Nicole Bullock

BARGAIN BASEMENT

To take advantage of tax-loss selling bargains, look for stocks of companies that have characteristics like strong cash positions, good assets and strong underlying earnings and are in growing industries.

Company (Ticker)	8/17/04 Price	52-Wk. Hi-Low (\$)	Percent off 52-Wk. High	Forward P/E	Cash per Share	Market Value (mil)
Electronics for Imaging (EFIL)	\$18.70	28–18	34%	19	\$11.50	\$1,002
*Powerwave Tech. (PWA.V)	5.53	11–5	49	NM	1.42	351
Texas Instruments (TXN)	19.00	34–18	43	19	2.27	32,891
Viacom B (VIA.B)	33.68	46–32	28	20	0.99	58,914

NM = not meaningful.

DATA: ZACKS INVESTMENT RESEARCH; REUTERS FUNDAMENTALS



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