Intellectual Capital Blog

A Grinch’s Guide to Gift-Giving | 26 November 2018

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It’s the season of giving—a dark time for economists, who are burdened with the knowledge that gift-giving is an inefficient transfer of resources that costs the US economy more than USD 60 billion each year. Let’s dig into a little Scroogenomics 101, and take a look at some simple steps that can help reduce the “Deadweight loss of Christmas”!

Go personal, not big.

One of the reasons why gift-giving is inefficient is due to “information asymmetry.” As much as I love my family and friends, and no matter how many hints they drop, they are simply better at knowing what they want. The act of receiving a gift can be pleasurable, and dull some of this inefficiency, but we generally get more enjoyment on a per-dollar basis when we buy something for ourselves. Gift-giving inefficiencies are highest for big-ticket gifts, and for the type of gifts that we purchase in a last-minute panic as we near the shipping deadline.

In addition to starting early and making a list (and checking it twice), I recommend focusing on smaller gifts—especially those that remind you of a shared memory. Ideally, find something that you can personalize. The best gifts that I’ve ever received have been small and thoughtful presents that were worth much more to me than the raw cost of the gift. If you’re artistically inclined, a handmade gift is often worth much more than something store-bought (advice for parents: outsource this to your kids).

Spread the love.

The “season of giving” encourages a big jump in discretionary spending toward the end of the year. For many people, this involves going into debt or tapping into investments to help pay for the gift season—steps that may enhance happiness in the short term but will ultimately reduce it in the long term. And this is doubly inefficient, because gift recipients are also less happy when their gifts come all at once.

For example, each Christmas my niece gets a gigantic pile of gifts. She is super excited at the beginning of the day—helpfully waking us all up at the crack of dawn to commence the present-opening phase as soon as possible—but after the third hour or so of opening gifts, she’s exhausted and not a little disinterested (being a kid is hard work!). Because of an economic principle called “the declining marginal utility of consumption,” that last present doesn’t add much happiness, and might not be worth the cost.

A better approach is to limit the number of gifts that you give all at once. Hannukah is intrinsically better for society because it spreads out gift-giving over multiple days, producing a more efficient gift-giving experience (more happiness per dollar) through what economists call “consumption smoothing.” Better yet, spread your gifts throughout the year. “Just-because” presents can be even better because they don’t feel like they’re fulfilling an obligation.

Put stocks in their stockings!

Cash or gift certificates are among the worst last-ditch options. Economically, they’re marginally better than an unwanted gift, but there’s a reason this is the number one ‘faux pas’ of the holiday season. Instead, consider giving investments—this is a good gift for the whole family, but especially for the younger children in your family. In addition to the direct long-term benefits (if you do this each year, it can be real money by the time the kids grow up), giving stock can be an important gateway to help children learn about investing and the benefits of compounding growth.

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It’s true that shares of stock or a mutual fund may seem like a “store-bought” gift, but it’s easy to make this a fun gift, personalized to each child. For example, you can give stock in a company that makes your nephew’s favorite toy or movie; and while investments tend to be intangible (and physical stock certificates are a hassle), you can always pair the stock gift with another related present (like a superhero action figure, or a toy truck).

As a bonus, this approach may also appeal to your inner Scrooge. As we noted in Give to others, not the IRS, giving away low-cost basis securities can be an opportunity to reduce your capital gains exposure and chip away at concentrated positions. Even though that means you'll also be gifting a tax liability, the recipient will often end up paying a much lower capital gains tax than you would, as long as they hold off on selling their stock until they reach the age of majority (or otherwise avoid the "kiddie tax").

Worst case scenario, my niece can sing “Ode to Joy” as she fills out her first Schedule D tax form.
