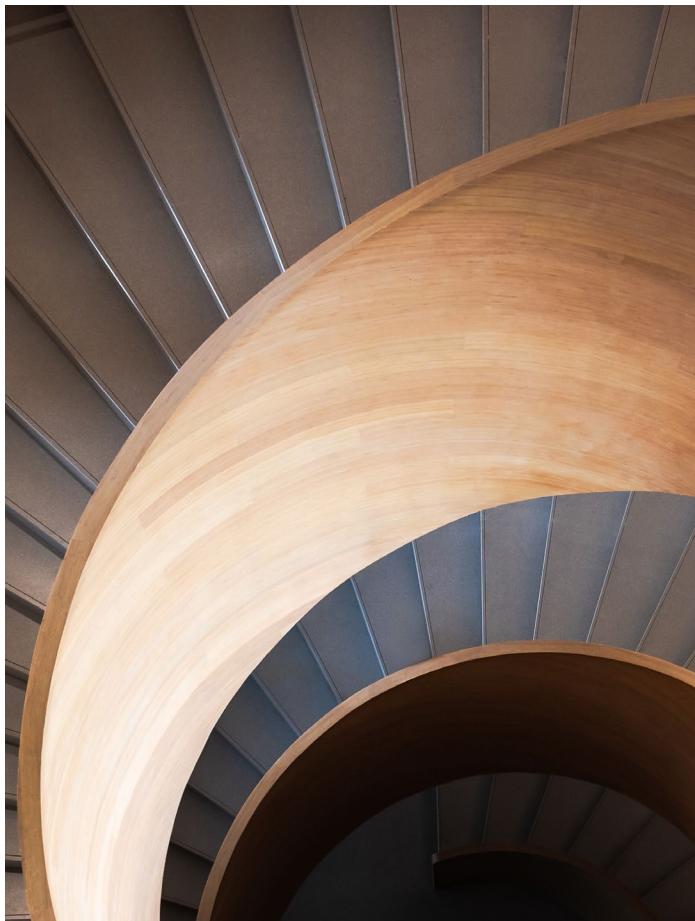


# Three Strategies for Tax-Efficient Investing

**Effective Ways To Reduce Tax  
Exposure and Maximize Returns**



Developing and managing a comprehensive, adaptable investment strategy is challenging enough on its own. When you factor in the tax implications that go hand in hand with investing, the process can be daunting for even the most seasoned investor.

## Strategies for Mitigating Tax Exposure

Providing guidance and recommendations geared toward maximizing tax efficiencies is one of the valuable (and perhaps overlooked) services that a knowledgeable wealth advisor can deliver to you. Tax-efficient investing can benefit investors at all levels and, when managed effectively, can potentially result in significant savings over time. The following are a few strategies that can help you mitigate tax exposure and maximize bottom-line net return.

### One: Asset Placement

As its name suggests, asset placement is simply a strategy for determining which types of assets get invested across different account types, and to what degree. Many investors have a mix of taxable (non-qualified) and tax-deferred (qualified) accounts into which they can allocate various portions of their investment portfolio. An effective investment plan will strategically place different types of assets in either of these buckets and make adjustments over time as needed.

We would generally advise, for example, that core, tax-efficient and long-term assets be held in a taxable account. This would include individual stocks, ETFs, MLPs, municipal bonds and any other asset that drives return of long-term capital gains versus short-term capital gains or ordinary income.

Assets that generate ordinary income or short-term capital gains, on the other hand, are considered "tax-inefficient" and should generally be held in non-taxable accounts like IRAs or 401(k)s. These assets include taxable bonds and certain alternative investments, or active funds, that have significant trading activity.

## Two: Leveraging Passive Investments

Passive investing involves "owning the market" through vehicles like ETFs or index funds. Passive investments can create significant tax efficiencies when used appropriately. Compared to active investments, they tend to incur fewer trading costs and annual capital gains distributions.

In a balanced portfolio, advisors may incorporate passive investments for efficient asset classes into taxable accounts in order to deliver tax efficiencies while still seeking a mix of active and passive investment strategies. We consider "efficient" asset classes those where there is enough public information and analyst coverage to make it challenging for an active manager to consistently "beat the market" and therefore outperform a passive investment. One application of this strategy would be to use an ETF for a portion of a client's domestic large cap equity exposure, since this represents a passive investment vehicle within a relatively efficient asset class.

## Three: Tax-Loss Harvesting

Tax-loss harvesting involves selling an asset for a loss and then using that loss to offset gains generated from other investments. Losses realized in excess of gains can be deducted from an investor's taxable income (up to \$3,000 a year), any remainder of which can be carried forward to future years. Tax-loss harvesting can be an effective strategy for reducing a tax bill, in addition to serving as a silver lining of sorts for short-term market declines.

When considering tax-loss harvesting in its simplest form, investors should consider seeking to replace any asset sold with a similar stock, fund, or ETF in order to preserve the balance of the portfolio and to maintain market exposure. However, investors must also be wary of the

"wash-sale" rule, which prohibits offsetting a loss if the same or "substantially identical" asset is repurchased within 30 days.

Many investors capture tax-loss harvesting opportunities only as the year draws to a close, but a more sophisticated investment plan can help to optimize this particular strategy by taking losses more opportunistically throughout the year as various markets or asset classes swoon.

A more complex application of tax-loss harvesting can entail a tax-managed index replication strategy, which combines a passive core holding with systematic tax-loss harvesting. The goal is to replicate the return of the specified index with minimal tracking error, while creating an economic benefit for the investor by realizing strategic losses throughout the year. The S&P 500 is the most commonly replicated index, although an experienced manager can replicate most equity indexes and customize the strategy based upon an investor's existing concentrated positions or preferences. Put in simpler terms, assume that a replication strategy owns Coca-Cola stock, which falls by 10 percent. The manager could sell the position to harvest the loss and then replace the exposure with a similar company, such as PepsiCo.

This approach can be integrated with actively managed strategies to attempt to maintain tax neutrality or used in combination with an existing concentrated position to offset gains associated with trimming the concentration. These types of tactics, needless to say, should be carefully executed in partnership with an advisor experienced in tax-efficient investment strategy and considered relative to your broader portfolio and plan.



## Uncovering Tax Efficiencies In Your Investment Strategy

A successful investment strategy is usually a multi-faceted proposition and identifying opportunity and efficiency from various angles is a great way for investors to help position themselves for success. You should not, however, have to navigate these complexities on your own. Instead, consult with your wealth advisor to weigh the benefits of these different approaches.

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