

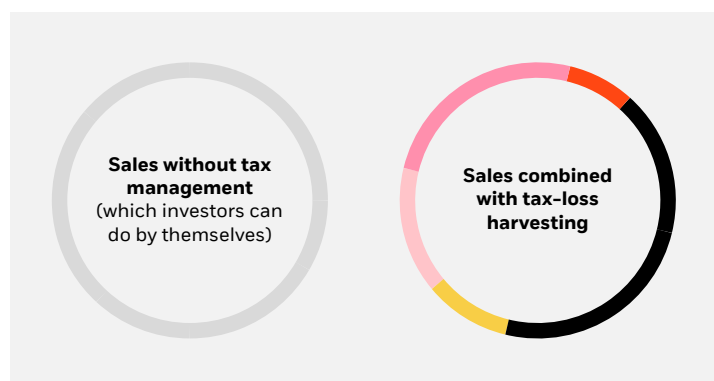
# Concentrated Stocks

## Challenge

Concentrated stock with a low cost basis is common among ultra-high-net-worth investors, including entrepreneurs and families with multigenerational wealth. However, for those investors seeking to diversify,<sup>1</sup> the tax cost can be large.

## Solution

Many strategies for dealing with the risks associated with a concentrated stock portfolio are available to investors. These include simply holding on to the stock, donating some/all to charity, contributing to an exchange fund, using options (e.g., buying put protection), benefitting from various programs,<sup>2</sup> and selling with or without tax-loss harvesting.<sup>3</sup> Here, we compare two approaches.



Aperio can be helpful with evaluating a tax-loss harvesting program, where loss harvesting can help offset some of the gains realized from reducing the concentrated stock position. Furthermore, Aperio believes that a gradual, multiyear liquidation plan may be more tax efficient than liquidating the entire position at once,<sup>4</sup> because loss-harvesting beyond the first year may help offset some of the gains realized from sales beyond the first year. There may be many complexities in dealing with each client's specific concentrated stock circumstances, such as having more than one concentrated position or additional cash, the ability to donate to charity or to use a tax budget, as well as risk and other tax considerations. We encourage investors to reach out to Aperio to discuss each unique situation.

## Hypothetical Case study

### Gradual liquidation over five years

An advisor wanted us to consider a hypothetical scenario where a hypothetical client with a \$10 million concentrated stock position with zero cost basis is facing a \$3.71 million tax cost (federal and state of California combined long-term rate of 37.1% as of October 2023) to liquidate the position. In this scenario, Aperio analyzed a five-year gradual liquidation plan where 50% would be liquidated immediately, while the other 50% would be liquidated pro rata over the next four years. Liquidated stock would be invested in an

Aperio equity SMA (separately managed account) with tax-loss harvesting, and taxes would be paid from the account. The advisor wanted us to assume a 7% flat annual return for both the Aperio portfolio and the stock position, as well as a 0.35% management fee for the Aperio portfolio. Aperio projected in this illustrative scenario that tax-loss harvesting may reduce the overall tax by up to \$743K, a 20% reduction.

### Example illustration of gradual liquidation

	1	2	3	4	5	5-yr total
<b>Liquidation – begin of year (\$)</b>	5,000,000	1,337,500	1,431,125	1,531,304	1,638,495	
<b>Stock remaining (\$)</b>	5,000,000	4,012,500	2,862,250	1,531,304	—	
<b>Aperio portfolio (\$)</b>	5,000,000	5,609,409	7,184,702	8,941,575	10,914,994	
<b>Aperio losses harvested (\$)</b>	(543,734)	(375,914)	(371,405)	(440,166)	(508,115)	(2,239,333)
<b>Gain from sale of stock (\$)</b>	5,000,000	1,337,500	1,431,125	1,531,304	1,638,495	
<b>Net gain (\$)</b>	4,456,266	961,586	1,059,720	1,091,138	1,130,380	
<b>Taxes paid (\$)</b>	1,060,591	228,858	252,213	259,691	269,031	
<b>Taxes saved (\$)</b>	129,409	89,467	88,394	104,759	120,931	532,961
<b>End of year sample portfolio value (\$)</b>	9,621,909	10,046,952	10,472,879	10,914,994	11,371,810	

This analysis is provided for illustrative purposes only and should not be considered representative of an actual portfolio.<sup>5</sup>

## Benefits

- Tax-loss harvesting may reduce the overall net tax cost of diversifying from a concentrated stock.
- A diversified equity portfolio may dramatically reduce the overall risk versus a concentrated position.
- A gradual liquidation with an annual schedule may offer a good balance between getting some diversification and acknowledging an investor's reluctance to sell.
- Aperio has the ability to customize the gradual liquidation parameters, including the liquidation percentage over time, to meet individual investor profiles.
- This strategy can be used as a partial solution in combination with other approaches.

## Costs/limitations

- The “sell with tax management” and “sell without tax management” alternatives represent only a narrow segment of the opportunity set.
- This solution is a portfolio with 100% equities—a more diversified asset allocation would require additional tax costs.
- Taxes are still paid on the liquidation—this is not a tax-free approach.
- If the account is liquidated in the future, any deferred taxes would then be owed.
- The gradual liquidation over five years can be difficult to stay committed to, as investors may forget why they selected this strategy.
- The concentrated stock may realize better returns than a diversified portfolio.

<sup>1</sup> For more information on the risk of single-stock portfolios, please see the following papers: (1) [“Do Stocks Outperform Treasury Bills?”](#); and (2) [“The Agony and the Ecstasy: The Risks and Rewards of a Concentrated Stock Position.”](#)

<sup>2</sup> For example, qualified small business stock (QSBS), life insurance retirement plans, and private placement life insurance.

<sup>3</sup> To benefit from tax-loss harvesting, investors must have eligible gains that can offset those losses.

<sup>4</sup> Within an Aperio separately managed account (SMA) and depending on the strategy and the specific stock(s), it may be possible to integrate some of the existing shares into the portfolio.

<sup>5</sup> Every situation presents a unique set of circumstances and opportunities, and investors' results may differ substantially from the illustration presented. Market conditions, timing of liquidation, and other events may cause this hypothetical example to be different than presented herein. Investment in equity securities presents investment risk, and there is the possibility of loss as well as gain. Assumptions include a 7% annual return for both the SMA and the stock and payment of taxes out of the SMA. Assumptions include a 0.35% management fee for the SMA. Assumptions do not include transaction costs.

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Three Harbor Drive, Suite 204  
Sausalito, CA 94965

415.339.4300 | [aperiogroup.com](http://aperiogroup.com)

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