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TAX-EFFICIENT TRANSITIONS: A TOOL FOR WINNING NEW CLIENTS

Advisors face many challenges in converting prospective clients. Even after you persuade a prospect that your investment approach meets their needs, a major roadblock can emerge: the tax costs associated with liquidation. These costs are painful and often emotional—frequently enough to lead to inaction.

We offer customized, tax-efficient transition advice to give advisors and their clients the information they need to make decisions. The result: one less roadblock to winning new business.

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THE PROBLEM: APPRECIATED SECURITIES

Convincing a prospective client that your firm is right for them is only the first step in winning new business. Prospects often have portfolios spread across several investment managers, complicating their willingness to make a transition. They may also have appreciated securities, highly concentrated holdings, and trust structures that complicate transition planning further.

At the same time, advisors frequently need to free up cash from the existing portfolio to re-allocate to hedge funds, private equity, fixed income, and other asset classes. To many clients, contemplating the resulting tax bill can grind the process to a halt.

TAX COSTS ARE INCREASING

The passage of health care legislation and the expiration of recent tax cuts led to higher tax rates in 2013. The top federal long-term capital gains rate went up from 15% to 23.8%, an increase of 59%.

APERIO+YOUR TAX EXPERTS = OPTIMUM RESULTS

Many advisors have tax experts who focus on tax minimization. We work with your experts to bridge a common gap—connecting the knowledge of tax laws with investment expertise – to construct better portfolio strategies.

ARE ALL YOUR PROSPECTS IDENTICAL AND SIMPLE?

If so, terrific. We are not for everyone.

THE APERIO SOLUTION: TAX-EFFICIENT TRANSITION ANALYSIS

We create custom scenario reports that compare trade-offs in a portfolio transition, including taxes, tracking error, and the number of remaining securities. Reports are created with a 48-hour turnaround and our team works with advisors one-on-one to supplement the analyses and address unique challenges.

Follow this 3-step process to receive an analysis:

1. Advisor sends us the client/prospect's current portfolio tax lot and cost-basis information.

2. We create trade-off scenarios—e.g., selling more appreciated securities will incur greater taxes but less tracking error to the benchmark; selling fewer securities will incur less taxes but more error.

3. We work with advisors to deep-dive as needed, in person or over the phone, on unique tax or risk challenges. We specialize in complexity—including state taxes, AMT status, estate step up complexities, trust structures, and tax-efficient gifting.

The benefits: More clients. A more efficient use of your time. Less taxes.

IS THERE A FEE FOR THIS TRANSITION ANALYSIS?

No. There is no fee or obligation. Like other investment managers, we charge for implementing portfolios. However, we believe the best way to understand how we can add value is to "taste the cooking"—with no obligation to buy the meal.

CAN I JUST CALL YOU?

Yes. A tax-efficient transition analysis is just one tool. Many challenges, including complex gifting, trust, or cash inflow/outflow strategies are better discussed with our team directly. Give us a call.

CLIENT CASE STUDY: A $37MM OPPORTUNITY

CONCENTRATED STOCK AND EXCHANGE FUNDS

These present unique risk diversification challenges for advisors. We offer additional help in analyzing very concentrated positions, diversifying exchange fund distributions. and building offset portfolios.

Opportunity

An advisor had a prospect with $37MM in equity assets across nine separate investment managers. The combined portfolio contained 405 securities with various gains and losses, four concentrated positions that represented over 20% of the wealth, and embedded gains that would cost $2.2MM in taxes to liquidate. In addition, the advisor wanted to shift some to-be-determined portion of the assets into hedge funds and fixed income.

Aperio transition analysis

We provided six different scenarios to the advisor. The scenarios included different amounts to withdraw for re-allocation and a range of options for tax cost versus tracking error.

aperio **Portfolio Analysis for Client** ***Benchmark: Russell 1000***

Existing Portfolio Details

Value ($000)	36,929		
# of Securities	405		
Tracking Error (%)	5.94	***ST tax rate***	35%
Beta	0.99	***LT tax rate***	15%
Unrealized Gains ($000)	11,612		
Unrealized Losses ($000)	2,160		
Liquidation Tax Cost ($000)	2,218		

Portfolio Rebalancing Scenarios

Scenario Name	Scenario #	Tracking Error %	# of Holdings	ST Capital Gain ($000)	LT Capital Gain ($000)	Portfolio Turnover	Total tax paid ($000)
Withdraw $15M - Higher TE - Lower Tax	1	1.85	397	-676.4	-175.9	4.4%	-263.1
Withdraw $15M - Lower TE - Higher Tax	2	1.00	450	-621.0	2,000.2	19.7%	82.7
Withdraw $20M - Higher TE - Lower Tax	3	1.94	335	-614.4	1,166.1	2.2%	-40.1
Withdraw $20M - Lower TE - Higher Tax	4	1.09	450	-574.2	3,020.6	13.8%	252.1
Withdraw $25M - Higher TE - Lower Tax	5	1.99	284	-539.0	3,096.4	1.2%	275.8
Withdraw $25M - Lower TE - Higher Tax	6	1.01	450	-520.8	4,907.1	12.2%	553.8

Result

After several phone consultations with Aperio, the advisor worked with the prospect to choose option 4, resulting in a tax savings of almost $2MM. In addition, the prospect chose to consolidate all $37MM in assets with the new advisor.

Disclosures

The information contained within this paper was carefully compiled from sources Aperio believes to be reliable, but we cannot guarantee accuracy. We provide this information with the understanding that we are not engaged in rendering legal, accounting, or tax services. In particular, none of the examples should be considered advice tailored to the needs of any specific investor. We recommend that all investors seek out the services of competent professionals in any of the aforementioned areas.

With respect to the description of any investment strategies, simulations, or investment recommendations, we cannot provide any assurances that they will perform as expected and as described in our materials. Past performance is not indicative of future results. Every investment program has the potential for loss as well as gain.