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The Keys to Building More Tax-efficient Portfolios

Evolving strategies to help investors keep more of what they make

John Frownfelter, CFA, Managing Director, Investment Solutions, SEI

Stephen Dolce, CFA, Senior Portfolio Manager, Investment Management Unit, SEI

Rey Santodomingo, CFA, Managing Director, Investment Strategy, Parametric Portfolio Associates LLC

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Most Americans don't take the time to understand the role taxes play in achieving, or falling short of, their long-term financial goals. They don't realize that, if left unchecked, taxes can reduce returns by as much as 60% (see Figure 6 on page 17). The fact is, taxes on investment income and capital gains affect every investor—not just the ultra-wealthy. It's especially challenging for retirees who mistakenly assumed that their tax rate would be lower in retirement. Furthermore, a constantly evolving tax code may mean greater tax liability in the future for all investors.

Over the past 40 years, tax management techniques have advanced to keep pace with our ever-changing tax code. Traditional municipal bonds and low turnover equity mutual fund approaches gave rise to more efficient and sophisticated methods reflecting the growing need for globally diversified portfolios. Being mindful of after-tax performance and supplementing year-end reviews with a year-round approach may dramatically enhance investor wealth in up and down markets. At the same time, financial advisors who adopt a proactive and disciplined tax management model are better positioned to attract higher-net-worth investors and deepen relationships, resulting in more loyal and satisfied clients. Working with an experienced partner with demonstrated expertise implementing these advanced tax strategies is more important than ever.

In this white paper, we survey the tax management landscape and offer practical insights and strategies to help investors achieve greater wealth by keeping more of what they've earned.

Tax-efficient investing: It's not just for the ultra-wealthy

Most investors are aware of terms like *diversification* and *rebalancing*. And, while asset allocation and rebalancing are building blocks of successful long-term investing, even the slightest shift in portfolio composition—a change in allocation or managers, or even a client withdrawal—can generate harmful side effects: taxes. Investors may not think about or even know that every one of those transactions involves trading in their account, which in turn, creates a realized capital gain and results in a taxable event. Gains are a good thing; but while focusing solely on generating the highest investment returns, many fail to consider the factors that contribute to—or detract from—what they actually earn after taxes.

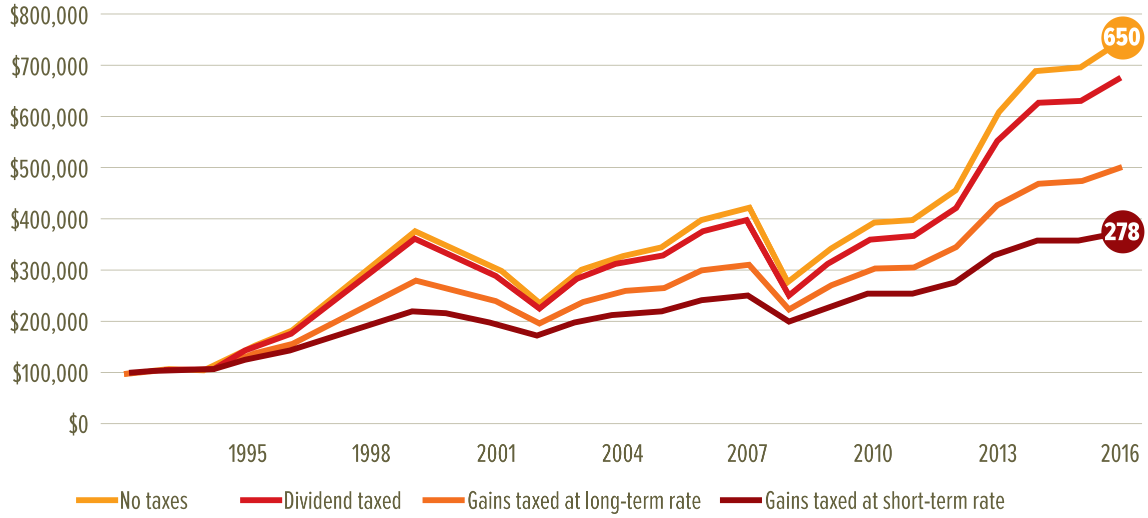
A constantly evolving tax code

The U.S. government has grappled with the challenge of raising revenue to keep pace with expenditures for more than two centuries. How investors are taxed—how much, at what rates and under what circumstances—persists as one of the most contentious public policy issues today. For investors, taxes on income are more complex than they were two decades ago. The passage of healthcare legislation and the expiration of recent tax cuts led to higher tax rates in 2013, with the top federal long-term capital gains rate increasing from 15% to 23.8%, an increase of 59%.[1] As the U.S. continues to deal with rising federal budget deficits and underfunded entitlement programs, we believe that initiating tax strategy conversations with clients will become increasingly important in the years ahead.

The impact of taxes

Taxes are the single largest drag on performance for investors over the long term.[2] Consider the different tax consequences of each approach illustrated in figure 1. In this hypothetical example, we show the growth of **$100,000** invested in the SPDR Trust Series (NYSE: SPY) from 1995–2015—an ETF that tracks the performance of the S&P 500 index—for four different portfolios. The results range from a portfolio that pays no tax for capital gains or dividends, to one that pays the highest tax rates.

FIGURE 1 **The Impact of Taxes:** Four distinct investment approaches. Four different outcomes. (1995–2015)



Hypothetical example for illustrative purposes only.

Past performance is no guarantee of future results.

*In this hypothetical example in Figure 1, the "no taxes" portfolio earned about **$650,000** in gains over 20 years; the "gains taxed at short-term rate" portfolio earned less than half of that amount, **$278,699,** after taxes. By holding the assets in the most tax-favored account type, actively monitoring the portfolio and harvesting losses the investor can keep more money working longer, as the tax savings can be reinvested and compounded over time.*

Investor	Income	Capital gains	After-tax return
No taxes: an investor whose no taxes portfolio pays 0% for cap gains and dividends.	0%	0%	8.5%
Dividend taxed: an investor who doesn't realize any cap gains and just pays taxes on dividends.	23.8%	0%	8.1%
Gains taxed at long-term rate: an investor who waits 366 days to realize all the gains in their portfolio. 100% turnover and capital gains are taxed at the long-term rate.	23.8%	23.8%	6.8%
Gains taxed at short-term rate: an investor who doesn't wait until 366 days to realize any of the gains in their portfolio. 100% turnover and capital gains are taxed at the short term rate.	23.8%	43.4%	5.6%

Hypothetical example for illustrative purposes only.

Performance reflects fund fees but does not show the effect of other fees associated with investing, including those fees your advisor charges, which would reduce performance, particularly when compounded over a period of years. The following hypothetical illustration shows the compound effect fees have on investment returns: For an account charged 1% with a stated annual return of 10%, the net total return before taxes would be reduced from 10% to 9%. A ten year investment of $100,000 at 10% would grow to $259,374, and at 9%, to $236,736 before taxes. For a complete description of all fees and expenses, please refer to each of SIMC's and the Financial Advisor's Form ADV Part 2A.

Source: Parametric. The chart in Figure 1 illustrates the effect of taxes on an investment that tracks the S&P 500 Index. The hypothetical results assume the highest marginal federal tax rates, 43.4% short-term rate and 23.8% long-term rate. State and local taxes are not considered. For "Gains Taxed at Short-term Rate" all investment gains are realized immediately and taxed at short-term rates. "Gains Taxed at Long-term Rate" assumes investment gains are held until they qualify for preferential long-term capital gain rates. Finally, "No Taxes" shows the return associated under an assumption of zero taxes—the theoretical limit of tax efficiency. In all scenarios, dividends are taxed at the long-term rate, except in the assumption of zero taxes. Taxes are paid annually from the portfolio and values are presented on a pre-liquidation basis. No representation is being made any investor will achieve the tax savings presented. Actual client after-tax performance will vary according to each investor's unique tax circumstances. **These are hypothetical examples intended to illustrate the effect of taxes and tax management on a portfolio. The methodologies used are not necessarily available to all investors. Results would vary based on individual investor circumstances.**

The evolution of tax-efficient investing

Individual municipal bonds: For decades, municipal bonds have been used to help preserve capital while generating interest income that is exempt from federal, and in some cases, state and local tax. As one of the few ways available to minimize investment income tax prior to the 1970s, municipal bonds remain a viable tool. However, a single asset class approach to wealth management—with exposure to interest rate, credit and reinvestment risk—is no longer sufficient as a solo strategy. More importantly for long-term investors, a portfolio of individual municipal bonds alone offers virtually no potential to grow wealth.

FIGURE 2 An evolving tax code

1900–1945	1976–1985	1986–1999	2000–2012	2017 and Beyond
1913 Federal income tax was enacted[*] **1916** Modern estate tax implemented[†]	**1976** The Tax Reform Act of 1976[‡] - Permits creation of municipal bond mutual funds	**1986** U.S. Congress passes Tax Reform Act of 1986 to simplify the income tax code, broaden the tax base and eliminate many tax shelters[§] **1992** Morningstar introduces the "Style Box"[‖] **1993** First Exchange Traded Fund launched[**]	**2013** American Taxpayer Relief Act of 2012 became effective[††] - Capital gain taxes increased significantly for high earners	No one knows how the tax code will change in the future

* "History of U.S. Income Tax," Library of Congress, updated in 2012.
†Gary Robbins, "Estate Taxes: An Historical Perspective," The Heritage Foundation, Jan. 16, 2004.
‡Gerald Auten, "Capital Gains Taxation," *The Encyclopedia of Taxation and Tax Policy* (Oct. 1, 1999), accessed via the Urban Institute, Nov. 28, 2016.
§ The Tax Reform Act of 1986, Investopedia.com, 2016
‖Jason Kephart, "Putting Morningstar's New Style Box to Work, Morningstar, Inc., Nov. 10, 2016.
**Stephen D. Simpson, CFA, "A Brief History of Exchange-Traded Funds," Investopedia.com, 2016.
††American Taxpayer Relief Act of 2012, 112th Congress (2011–2012), Congress.gov, 2016.

Tax reform and municipal bond funds: The Tax Reform Act of 1976 ushered in the era of qualified individual tax-deferred retirement accounts and the first municipal bond mutual funds. Retirement accounts dramatically changed the investment landscape and provided substantive ways for investors to defer tax gains on long-term assets.

Municipal bond mutual funds offered investors greater diversification potential, a more consistent risk profile and significantly greater liquidity—yet the lack of growth potential limited these funds primarily to income investors. Unlike individual securities, mutual fund shareholders owe a tax in the year the fund manager makes a trade that has a gain, even if the trade was made before the investor bought into the fund.

In taxable accounts, shareholders are required to pay taxes on fund distributions, whether they are paid out in cash or reinvested in additional shares; taxes are deferred in tax-favored accounts like IRAs until the investor sells the fund shares. Eventually, responding to market demand, tax-aware mutual funds emerged in the 1990s, for which managers employed a combination of tactics to help minimize taxable gains, such as reducing portfolio turnover, avoiding or limiting dividend-paying stocks and selectively harvesting losses.

Passive equity index replication: The industry is continually refining tax-efficient solutions to meet the needs of individual investors. The first iteration replicated a passive equity index as a component or satellite of a larger investment portfolio. While there was some tracking error risk, the approach enabled portfolios to be constructed in similar composition and risk profile to an index, with a tax management approach. The idea of *active* tax management provided a vehicle to defer the realization of gains and enhance the realization of losses. The approach achieved the goal of reducing investors' year-end tax liability—enabling them to keep more of their wealth in the market, which, theoretically could grow over time.

Overlay management allows all of an investor's holdings to be integrated into one portfolio. The overlay manager then does all the coordination and customization for that portfolio.

Stephen Dolce, CFA
Portfolio Manager SEI Investment Management Unit

Separate, multi-manager and unified managed accounts: SEI and Parametric research explored new ways of minimizing the tax implications of active investing. Using simulations, we quantified the value an overlay manager could add to after-tax returns (the actual return on an investment after all applicable income and/or capital gain taxes on the earnings are paid). Research showed that a disciplined approach is often able to add 0.30% to 0.60% or more to after-tax returns each year.[3] Unlike mutual funds, the separately managed account structure shifted the ownership and control of the assets to the separately managed account investor.

The evolution from separately managed accounts—which typically contained a single type of investment instrument, such as mutual funds or exchange-traded funds (ETFs)—to multi-manager accounts enabled advisors to combine an array of investment vehicles into a single, cohesive investor account. Unified managed accounts (UMAs) took a step further, permitting multiple separate accounts and other invest instruments to be held in the same custodial account. By consolidating holdings, UMAs streamline paperwork, simplify fees and permit more sophisticated tax management, along with tax-efficient rebalancing and cash flow management.

Overlay management is an evolutionary step in the tax customization of separate accounts. Today, the added advantage of more sophisticated technology and dramatically better risk models are redefining active tax management. In addition to basic tax management techniques, the overlay manager can coordinate buys/sells across managers, implement manager and asset allocation changes, and apply rebalancing policies to the overall portfolio—all in a tax-efficient manner.

Strategies to help investors keep more of what they earn

Tax-efficient investing is a sensible strategy for most investors—especially those with high marginal tax rates or concentrated equity holdings acquired through inheritance, employer stock grants or a business buyout. **Tax efficiency is a measure of how much of an investment's return is left over after taxes are paid. The greater the tax efficiency, the more gains an investor keeps.** The goal is to defer the realization of gains and maximize overall after-tax returns. Without an active strategy to curtail the tax consequences of those transactions, those nickels and dimes can add up over time to real money—as much as 1% to 2% of portfolio growth annually, which can mean up to $2,000 a year in tax savings for a $100,000 portfolio.[4]

"There is only one investment objective: maximum total return after taxes."

John Templeton
Mutual fund pioneer and investor

Type of tax	Effect
Long-term capital gains	Up to 23.8% federal, plus state and local taxes
Qualified dividends	
Short-term capital gains	Up to a total of 43.4%, plus state and local taxes
Interest and nonqualified dividends	
Alternative minimum tax (AMT)	Disallows certain deductions and potentially increases the amount of income that is subject to taxation; potential increase of the effective marginal tax rate on long-term capital gains and qualified dividends

Source: IRS.

Make tax management a year-round undertaking

Too often, financial advisors focus only on reducing taxes in November and December, at which point options are limited because they have lost the opportunity to employ tax management in the previous 10 months. Given the potential drain on wealth, we believe that tax management should be a cornerstone of every investor's planning process. It calls for greater sensitivity to the tax consequences of portfolio implementation by employing effective tax management techniques and strategies throughout the year.

Think about asset location vs. asset allocation

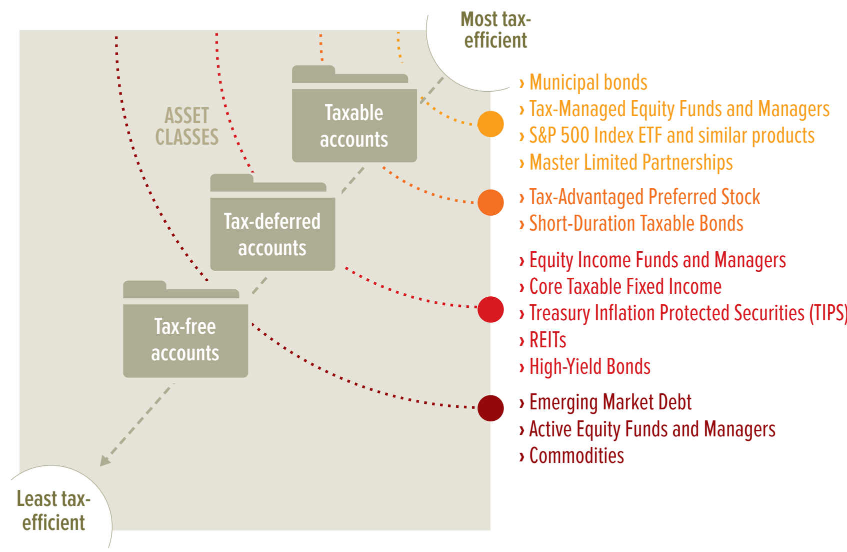
While asset allocation is one of the most important drivers of overall returns, many fail to appreciate the importance of "asset location"—the process of deciding which investments to hold in a taxable account and which to hold in a tax-favored account. The optimal choice should consider the investor's goals and marginal income tax bracket (including whether the investor is subject to the alternative minimum tax); the asset class; the tax characteristics of the underlying assets; and the types of accounts owned.

Tax efficiency is a measure of how much of an investment's return is left over after taxes are paid. The greater the tax efficiency, the more gains an investor keeps.

John Frownfelter, CFA
Managing Director, SEI Investment Solutions

FIGURE 3 Asset location priority list

This chart shows the order in which various account types—taxable, tax-deferred and tax-free— should be chosen to hold various asset classes if the objective is to maximize after-tax returns. As a rule, the most tax-efficient asset classes, such as municipal bonds and tax-managed equity funds, should be held in taxable accounts; the most tax-inefficient assets, such as REITs and active equity funds would be better placed in tax-deferred or tax-free accounts. For more insight on the asset location subject, see "Asset Location: The New Wealth Management Value-Add for Optimal Portfolio Design?" by Michael Kitces, *The Nerd's Eye View* blog, March 6, 2013.



Source: SEI.

Key takeaways

- Taxes are the single largest drag on performance over the long term
- Tax-management techniques exist and are continuously evolving
- Tax management should be a year-round process
- Managing for after-tax returns is a powerful way for advisors to deepen relationships with their clients

Tax management techniques

The building blocks of a comprehensive tax management strategy

A growing list of tools and techniques is available to help mitigate tax implications with a goal to produce higher after-tax returns:

1. **Tax-lot accounting** is a method of accounting for a securities portfolio in which the manager tracks the purchase, sale price and cost basis of each security. This allows the manager to "swap" a tax lot with a more tax advantageous lot that may have been purchased by a different manager at a different time.

2. **Tax-loss harvesting** allows the manager holding a stock at a loss to sell all or part of it to realize the loss and create an "asset" that may help offset some future gain. Effective execution of a tax-loss harvesting strategy on a daily basis can increase the after-tax value of an investor's portfolio without impacting return. In bear markets and highly volatile markets, the turnover from loss harvesting is expected to be greater; in bull and low-volatility markets, the turnover should be less.

   a. **Wash-sale rule** prohibits repurchasing the same security, or one that is substantially identical, within 30 days of sale for the purpose of realizing a capital loss.

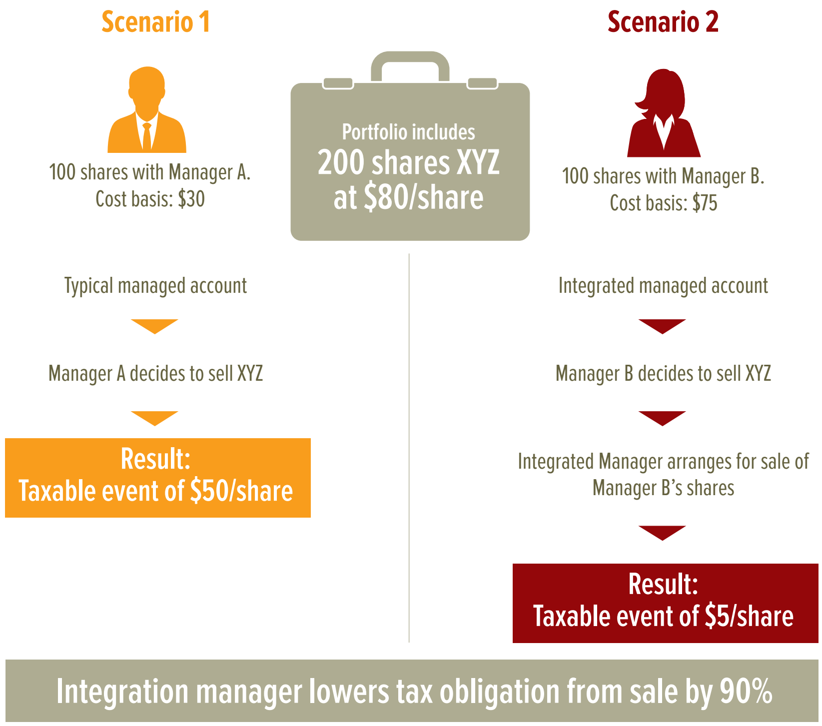
3. **Wider rebalancing ranges** can help reduce the number of trades made to a portfolio within a range of the target allocation, which may lead to lower realized capital gains and corresponding taxes.

4. **Gain-loss offset** involves selling at a loss securities that have dropped in price at year-end to help offset gains from previously sold securities that had increased in price.

5. **Tax-aware trading** involves the intelligent selection of tax lots as we trade. This is done in order to realize capital losses and position for realizing gains with long-term character instead of short-term character whenever possible. We view this as a baseline level of transactional optimization for tax rules, even if it's too often overlooked.

FIGURE 4 Integrated vs. non-integrated portfolio management

Tax-aware trading
This graphic illustrates the opportunity to save on taxes using an integration manager. In most managed accounts, the managers trading on the investor's behalf cannot see what the others are doing, which can result in unnecessary capital gains. The **integration manager** has a bird's-eye view of all activity and helps to ensure that stocks with higher cost basis are sold first, helping to defer or reduce taxes.



Not an actual investment. Hypothetical example for illustrative purposes only.

6. **Managing the holding period**: The holding period of an investment is used to determine how the capital gain or loss should be taxed because long-term investments tend to be taxed at a lower rate than short-term investments. An investment has a long-term holding period when being held longer than one year.

7. **Charitable donations**: Identify the most tax-advantaged stock gifts for the purpose of making charitable donations.

8. **Income needs**: Identifies the most tax-advantaged (high-cost basis) securities to sell for investors seeking regular income from their portfolios.

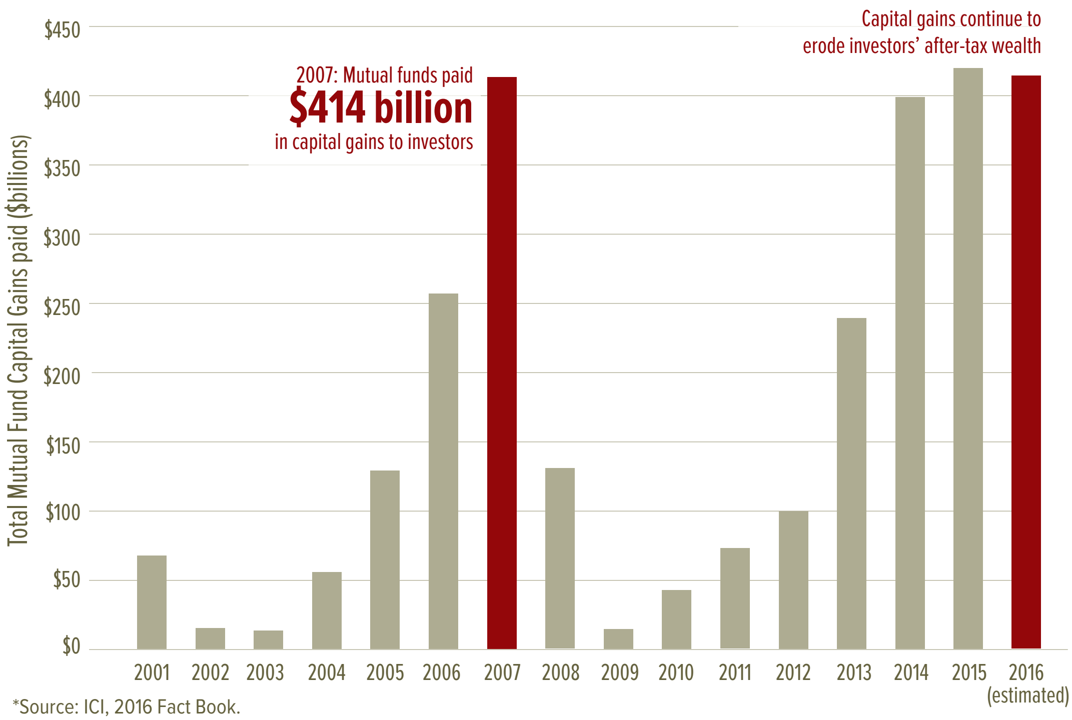
Choosing the most tax-efficient vehicles

Investment tax implications demystified

Many investors bemoaned the equity market losses of 2008–2009 but many carried over those losses in subsequent years. Now, with those losses used up, they face full exposure to long-term capital gains, which, in the top tax bracket can amount to close to 24% tax liability.*

FIGURE 5

Historical mutual fund capital gain distributions
With the robust gains of the equity markets over the last six years, capital gain distributions also caught up. Distribution payouts have increased substantially since the market meltdown of 2008. In **2015**, mutual funds distributed **$379** billion in capital gains to shareholders, as evidenced by this Investment Company Institute chart.



*Source: ICI, 2016 Fact Book.

In addition to the types of accounts available to investors, the vehicle(s) one chooses also can impact investors' tax liability. Some vehicles are inherently more tax-efficient than others, as described below.

Mutual funds

While mutual funds possess many virtues, tax efficiency generally is not one of them. Fund managers buy and sell securities with the interests of the fund in mind, without much regard for the tax consequences of the investor. If the mutual funds are held in a tax-favored account, such as an IRA or 401(k), the tax liability is deferred to a future date when the money is withdrawn. But taxable account owners are penalized because fund expenses and tax liabilities are shared across all shareholders of record, regardless of the date of purchase or length of ownership.

Tax-managed mutual fund strategies: Tax-aware mutual funds are designed to reduce shareholder tax liability by

- Purchasing tax-free (or low taxed) investments such as municipal bonds.
- Keeping the fund's turnover low, especially if the fund invests in stock. Stocks held for more than one year are taxed at a lower long-term capital gains rate than short-term transactions.
- Avoiding or limiting income-generating assets, such as dividend-paying stocks.

ETF strategies

ETFs that track an index rather than trade stocks actively typically have lower capital gains distributions.

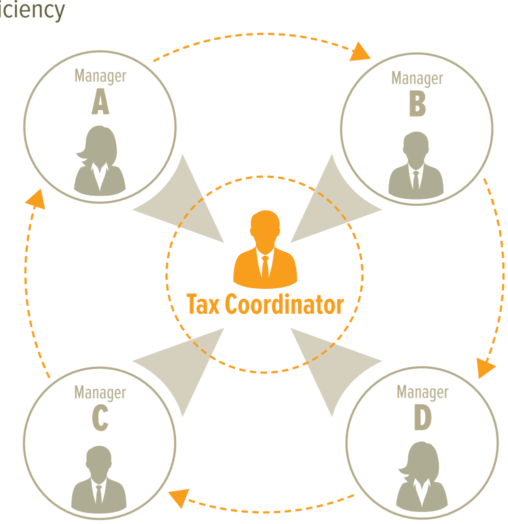
Tax-managed ETF strategies are designed to minimize the tax impact by

- Investing in best-in-class municipal fixed-income ETFs for bond exposure
- Extending short-term gains to long-term
- Valuing tax-loss harvests relative to time remaining in current calendar year
- Selecting the most advantageous tax lots
- Monitoring portfolio tracking error
- Providing individualized customization based on an investor's conditions

Managed accounts

As investor wealth increases, a greater preference for customization often follows. This may call for a more sophisticated approach. Managed accounts are constructed for and owned by individual investors and differ substantively from mutual funds, which are managed on behalf of many shareholders. The accounts may own a portfolio of stocks and bonds and/or mutual funds in a structure that affords investors greater customization, transparency and varying degrees of tax control.

Less tax-efficient	More tax-efficient
Traditional managed accounts	**Separately Managed Accounts (Managed accounts with tax overlay)**
› Minimal tax efficiency › No coordination among managers › Each manager has a minimum account requirement, making maximum diversification more difficult › Multiple accounts per investor › Individual manager statements	› Better coordination for tax efficiency - Greater customization opportunity - Highest level of tax mgmt - Ability to distribute capital losses to enhance the investors' after-tax return - Harvest losses across thousands of securities in multiple strategies › Greater diversification with access to specialist money managers and tax expertise within a single account › Single account per investor affords simplification and consolidated reporting › Access to "institutional-quality" portfolio managers at lower minimums › Integration manager, or "tax coordinator," oversees and coordinates activity across all managers—in seeking to lower tax exposure and transaction costs, while potentially enhancing long-term, after-tax returns



Source: SEI.

Implementing a tax-managed solution

So how do you structure investor portfolios to reduce their tax liability and keep their earnings growing? We believe advisors should select the most appropriate vehicles in a properly diversified portfolio that align with clients' long-term goals. These include tax-managed mutual funds, ETFs and managed accounts. Each option offers varying degrees of tax efficiency and sophistication to help investors keep more of what they earn.

1. Tax-managed mutual funds

Tax-managed funds typically are designed to limit distributions of income and capital gains. Shareholders will owe little or no tax until they sell their shares of the fund itself.

- Income tax deferred
- Lower capital gain distributions
- Low turnover equities
- Emphasis on municipal bond funds
- Used for investors in higher tax brackets
- Loss harvesting is used on a daily basis within many fund structures

> *Although many types of tax management techniques exist, investors may improve their results further by implementing a holistic tax management strategy that employs a full range of tactics, tailored for particular objectives, and executed over a long horizon.*
>
> ***Rey Santodomingo***
> *Managing Director, Investment Strategy, Parametric Portfolio Associates LLC*

2. Tax-Managed ETF Solutions

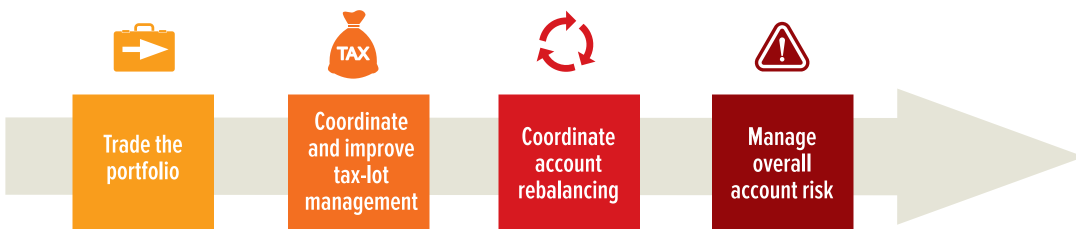
The structure of ETFs results in fewer capital gains distributions than mutual funds and the ability to delay taxes until the ETF is sold.

- **Identify and sell the most beneficial tax lot**: Most managers who pay attention to taxes will use highest in, first out (HIFO) tax-lot accounting whenever a security is sold. This will reduce the tax impact of the sale and help improve after-tax returns. In some cases, identifying specific tax lots can improve tax efficiency.
- **Harvest tax losses when the tax benefit is material**: A daily review of the portfolio must be able to identify and sell ETF positions that are in a loss and reinvest the proceeds into the selected secondary ETFs. The decision to move back and forth (buy/sell) between the primary and secondary ETFs will be based on each client's tax situation, and the strategy's goals (harvest losses, maintain model integrity, maintain tolerance levels, cash flows, etc.).
- **Defer gains from short-term to long-term**: Capital gains from the sale of a security are taxed as ordinary income unless the investment is held for longer than 12 months. By deferring short-term gains to long-term gains, taxes can be significantly reduced and taxed at the long-term capital gain rate and qualify for a lower tax rate.
- **Seek to avoid wash sales**: Avoiding wash sales can be particularly challenging in the case of multiple client accounts and as the number of trades increase within a portfolio. If not carefully managed, the same ETF sold at a loss might be repurchased subsequently for another reason. This can negate the benefit of the loss and result in adjusting the cost basis of the new security instead of recognizing a loss.

While ETFs may be appropriate for some investors, those facing high tax rates or holding a more complex investment portfolio may be better served with a customized, tax-efficient separately managed account.

3. Tax overlay manager

- Overlay management is active portfolio management through customized implementation and tax management. While active managers specialize in making model decisions that apply to all accounts, the overlay manager focuses on client-specific issues for each account. The overlay manager builds aggregate target portfolios for accounts based on the active managers' model portfolios.
- In addition to ensuring that the aggregate portfolio tracks its model as closely as possible, the manager also needs to be mindful of individual investor restrictions. One of the most crucial challenges for overlay managers is making the trade-off between tax benefits and tracking differences from active managers' target portfolios. For example, they have to identify the best tax lots to sell and may have to ask an active manager to forgo alpha to obtain tax benefits for a client. The potential benefits of an overlay portfolio manager stem both from efficiencies in implementation and from account-specific after-tax performance.



- Automation instantaneously accounts for the dates of purchase and sale, cost basis and transaction size for each security in a portfolio across multiple instruments and managers, facilitating the daily management of tax losses and tax lots—a process that brings the active managers into the tax management fold.

For example, a client may have multiple tax lots of a stock in a multi-managed portfolio, which include short- and long-term gains or losses. If the client has an overall gain in that position that we don't want to realize, we can overweight or underweight other individual stocks so we don't introduce unintended risk in the portfolio. In addition to controlling gain/loss realization, we also analyze the investor's overall exposure to the sector—in this case, technology—and may substitute other tech names to manage risk. These sophisticated strategies were available only to very large accounts previously. Today, our proprietary systems deliver highly customized solutions in a highly automated way, keeping careful track of risks across hundreds of accounts.

Rey Santodomingo, Managing Director, Investment Strategy, Parametric Portfolio Associates LLC

The future of tax-managed portfolios

In addition to the techniques presented, tax-managed portfolios of the future will involve even greater customization coupled with active strategies to deliver higher after-tax performance per year.

Technology-enabled asset location

Many advisors recognize the benefits of asset location and employ the strategy in larger client relationships to help manage for taxes. However, asset location is a time-consuming process that is difficult to set up, monitor and adjust over multiple accounts across multiple family members. New technology overlays on an investment structure, called a unified managed account, can help advisors manage asset location strategies more efficiently, therefore, allowing it to be used across all their client accounts.

As the tax code and the global investment landscape evolve, we continue to fine-tune strategies to support tax-sensitive investors' long-term goals.

John Frownfelter, CFA
Managing Director, SEI Investment Solutions

After-tax benchmarks

After-tax benchmarks are necessary to put after-tax client portfolio performance in perspective and help isolate the value of active tax management. Essentially, it allows for the comparison of the value of tax management against the tax experience of a passive, single-security investment in an index, tailored for certain client-specific aspects. In constructing these benchmarks, the methodology aims to provide the best estimate of the manager's ability to improve after-tax performance, given the characteristics of the client portfolio.

The careful realization of long-term gains can also enhance loss harvesting. When the long-term tax rate is below the short-term tax rate, the investor could realize a long-term capital gain, reset the cost basis, and position the portfolio for higher short-term capital losses in the next year.

Rey Santodomingo
Managing Director, Investment Strategy, Parametric Portfolio Associates LLC

Strategic gain realization

The goal of strategic gain realization is to selectively pay taxes on long-term gains now and increase opportunities for future after-tax benefits. These gain management strategies seek to boost after-tax value by realizing long-term capital gains early. Mindful of transaction costs, market environments, the investor's time horizon, and the future tax rate of the investor, this strategy will mostly benefit investors who expect to pay high taxes on short-term capital gains. This strategy is particularly attractive when the investor expects to have future short-term gains, the short-term and long-term tax rates differ widely, or future tax rates are expected to increase.

Diversification of concentrated positions in the most tax-efficient manner

Concentrated stock holdings present a significant challenge to financial advisors and their clients. Many investors have significant wealth tied to shares of a single company—whether through stock options, inheritance, the sale of a business, etc. Such concentrated exposure to a single stock represents a significant risk to the investor's wealth and potential for future spending and charitable gifting. New techniques are in development to manage these holdings within an overall portfolio solution, including optimizing diversification, deferring gains and gradual sales.

Automated stage sale transition management

Diversifying concentrated stock positions typically becomes a multiyear ordeal managed over time by the advisor with guidance from the investor on their willingness to accept taxes in order to become more diversified. This is an onerous process for the advisor, and managing it sporadically can result in lost efficiencies. Technological advances offer the ability to set a tax budget each year, which a tax coordinator can incorporate into a comprehensive view of tax management within the context of portfolio management.

Tax management across accounts and across all holdings

Couples filing joint tax returns need to be cognizant of washing out the benefits of loss harvesting. Moving forward, a tax coordinator needs to monitor all "like" accounts to make sure that a loss harvested in the spouse's portfolio is not nullified due to an additional purchase of those shares within the next 30 days in the other spouse's account.

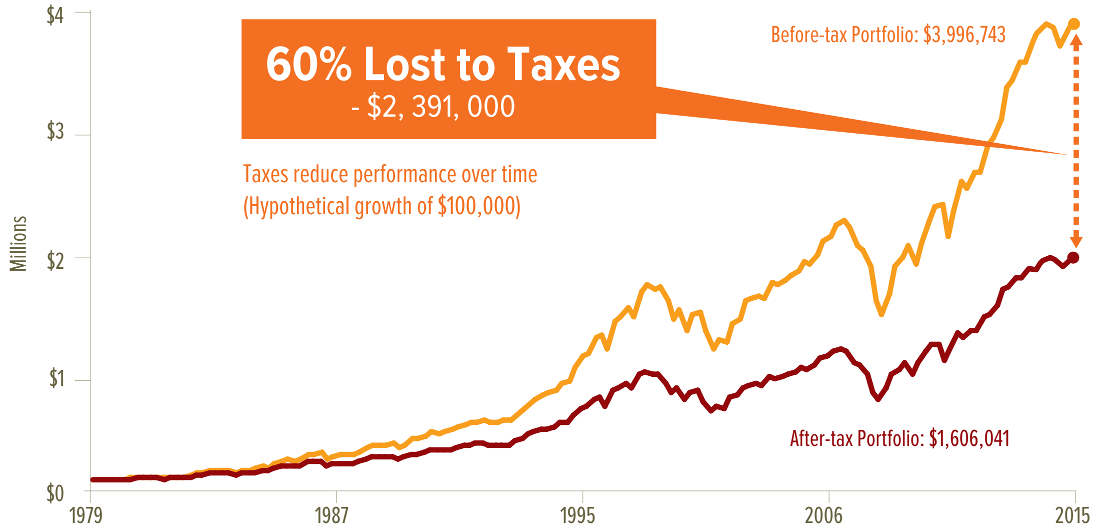
> *For individuals with positions that have significant capital gains tax potential held in custody, it is important to monitor and implement those securities when losses present themselves in the managed account. As a dollar of loss is harvested, a dollar of gain can be taken from the lower basis custodied holdings and implemented in the overall tax managed portfolio.*
>
> ***Stephen Dolce, CFA***
> *Portfolio Manager, SEI Investment Management Unit*

Summary

Saving more now means more value later

While focusing on top-level investment returns, many investors fail to consider the factors that contribute to, or detract from, what they actually keep after tax. Being mindful of after-tax performance and augmenting year-end reviews with a year-round tax management solution may dramatically enhance investor wealth in up and down markets.

FIGURE 6 Its not what you make, its what you keep



Source: Parametric Portfolio Associates. Based on a hypothetical tax-free $100,000 portfolio invested 60% in stocks (based on the Russell 3000®) and 40% bonds (based on the Barclays Aggregate) with (1) no liquidators; (2) interest income and dividends taxed annually at historical top marginal tax rates; (3) capital gains realized at 50% per year and taxed at the historical long-term capital gains tax rate; and (4) portfolio is held for 36 years from (1979–2015). The intent is to portray a worst-case scenario. The portfolio would have grown from $100,000 to about $4.0 million. If the portfolio was taxed as indicated above, it would have lost 60% of its value, due to taxes paid and earnings lost on that money. Tax-managed investment strategies are designed to minimize capital gains distributions and maximize after-tax returns. Past performance is no guarantee of future results.

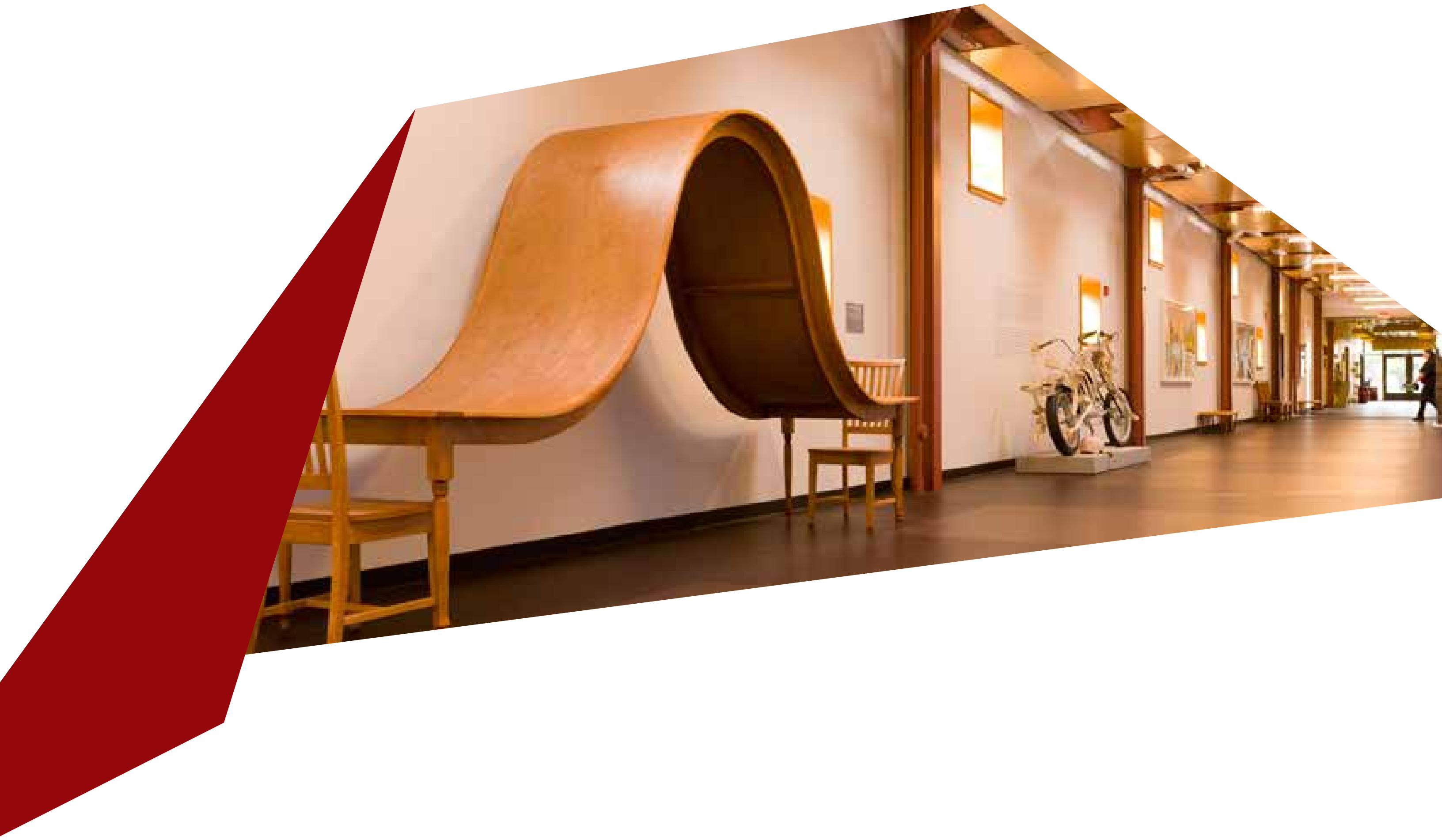
There are risks involved with investing, including loss of principal. Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

Financial advisors and investors show a growing interest in industry-leading tax-managed solutions, including tax-aware mutual funds, ETFs and managed accounts. Implementing a goals-based approach helps frame investors' long-term goals and set priorities based on specific time horizon and personal circumstances.

The value of these and other techniques may shift over time in response to market and client-specific factors, but our combined decades of expertise indicate that a comprehensive active tax management strategy can improve after-tax returns by 1% to 2% compared to a passive, tax-oblivious investment.[4]

- Tax management is an area advisors have generally neglected.
- Tax management has evolved and can easily be implemented with mutual funds and managed accounts.
- Select a good partner that has the experience, the technology and the expertise to help your practice and your clients.

Next, we offer steps you can take now to help build more efficient portfolios. These solutions serve as a significant differentiator to proactively offer a leading-edge solution for the tax challenges every investor faces.



Build better, more tax-efficient portfolios

6 steps you can take now to help investors keep more of what they earn

1 **Supplement year-end reviews** with a year-round tax strategy that can deliver meaningful results in every market condition.

2 **Examine client tax returns** paying special attention to the Form 1099, Form 1040 and Schedule D, to assess the capital gains and losses reported.

3 **Evaluate clients' asset *location*.** Take inventory of all financial accounts, including mutual funds, annuities, retirement plans, life insurance policies and savings accounts.

a. Assess how assets are allocated: what percentage is invested in taxable accounts; what percentage is invested in tax-favored accounts.

b. Determine which assets are the most tax-efficient and where are those assets located.

4 **Re-examine client goals** to reflect significant events (e.g., birth of a child, job change, marriage or divorce, inheritance, stock options awards, etc.), as well as any changes in their viewpoint on saving taxes, budgeting or other financial issues.

a. Consider potential impact on overall investment goals or tax situation.

5 **Create value by differentiating your service model.** Rather than waiting for your clients to initiate a conversation about tax liability, explore the myriad ways an effective solution can maximize after-tax returns for all—not just some—of your clients. They will appreciate your willingness to delve deeper to assess their entire financial picture and to initiate solutions designed to meet their unique goals.

6 **Consider working with a third party to augment your capabilities.** Technology-driven solutions from experienced tax management specialists can dramatically enhance the tax efficiency of an investor's total portfolio.

Closing thoughts

We have built a range of innovative solutions over the past two decades to help investors keep more of what they've earned. Capitalizing on the robust computing power of smarter technology, our research and development efforts have produced more systematic and reliable ways to navigate an ever-changing investment and tax landscape. More importantly, our solutions work in context with investors' long-term goals, risk tolerance and tax bracket at every level to implement strategies that seek to produce more effective outcomes.

About John Frownfelter, CFA

John Frownfelter is the managing director of Investment Solutions within the SEI Advisor Network. John is responsible for creating investment solutions and products for SEI's advisors for use in meeting the investment objectives of high-net-worth individuals. He coordinates and liaises with SEI's Investment Management Unit in order to align SEI's investment solution with the SEI Advisor Network's needs. Previously, John was a senior investment analyst within SEI's Investment Services Team and also served as a portfolio solutions specialist within SEI's Investment Management Unit.

About Stephen Dolce, CFA

Stephen Dolce serves as a senior portfolio manager for U.S. Large and Small Cap equity portfolios. In this role, he is responsible for the management of the portfolios, capital market research, and ongoing evaluation and allocation of equity managers for the SEI Funds. Before joining SEI, he was partner, portfolio manager, analyst and investment committee member at Philadelphia International Advisors LP (PIA). Previously, he was a sector portfolio manager and senior analyst at DuPont Capital Management (DCM). He also served as a Global Equity and Derivatives trader at Grantham, Mayo & Van Otterloo & Co. LLC (GMO) in Boston.

About Rey Santodomingo, CFA

Rey Santodomingo is the managing director of Investment Strategy and a member of the Research and Product Development team for Parametric Portfolio Associates LLC. Before joining Parametric in 2008, Rey was a vice president in Product Management at MSCI Barra where he developed risk and portfolio management solutions for asset managers and institutional investors. He holds an M.S. in financial engineering from the University of California, Berkeley and a B.S. in chemical engineering from the University of California, Santa Barbara. He is a board member of the CFA Society of Seattle and an adjunct instructor at Seattle University's Albers School of Business and Economics.

About SEI

SEI (NASDAQ:SEIC) is a leading global provider of investment processing, investment management, and investment operations solutions that help corporations, financial institutions, financial advisors, and ultra-high-net-worth families create and manage wealth. As of September 30, 2016, through its subsidiaries and partnerships in which the company has a significant interest, SEI manages or administers $751 billion in mutual fund and pooled or separately managed assets, including $281 billion in assets under management and $470 billion in client assets under administration. For more information, visit seic.com.

About Parametric Portfolio Associates LLC

Parametric, headquartered in Seattle, WA, is a leading global asset management firm, providing investment strategies and customized exposure management to institutions and individual investors around the world. Parametric offers a variety of rules-based, risk-controlled investment strategies, including alpha-seeking equity, alternative and options strategies, as well as implementation services, including customized equity, traditional overlay and centralized portfolio management. Parametric is a majority-owned subsidiary of Eaton Vance Corp. and offers these capabilities through investment centers in Seattle, WA, Minneapolis, MN, and Westport, CT, (home to Parametric subsidiary Parametric Risk Advisors LLC, an SEC-registered investment adviser).

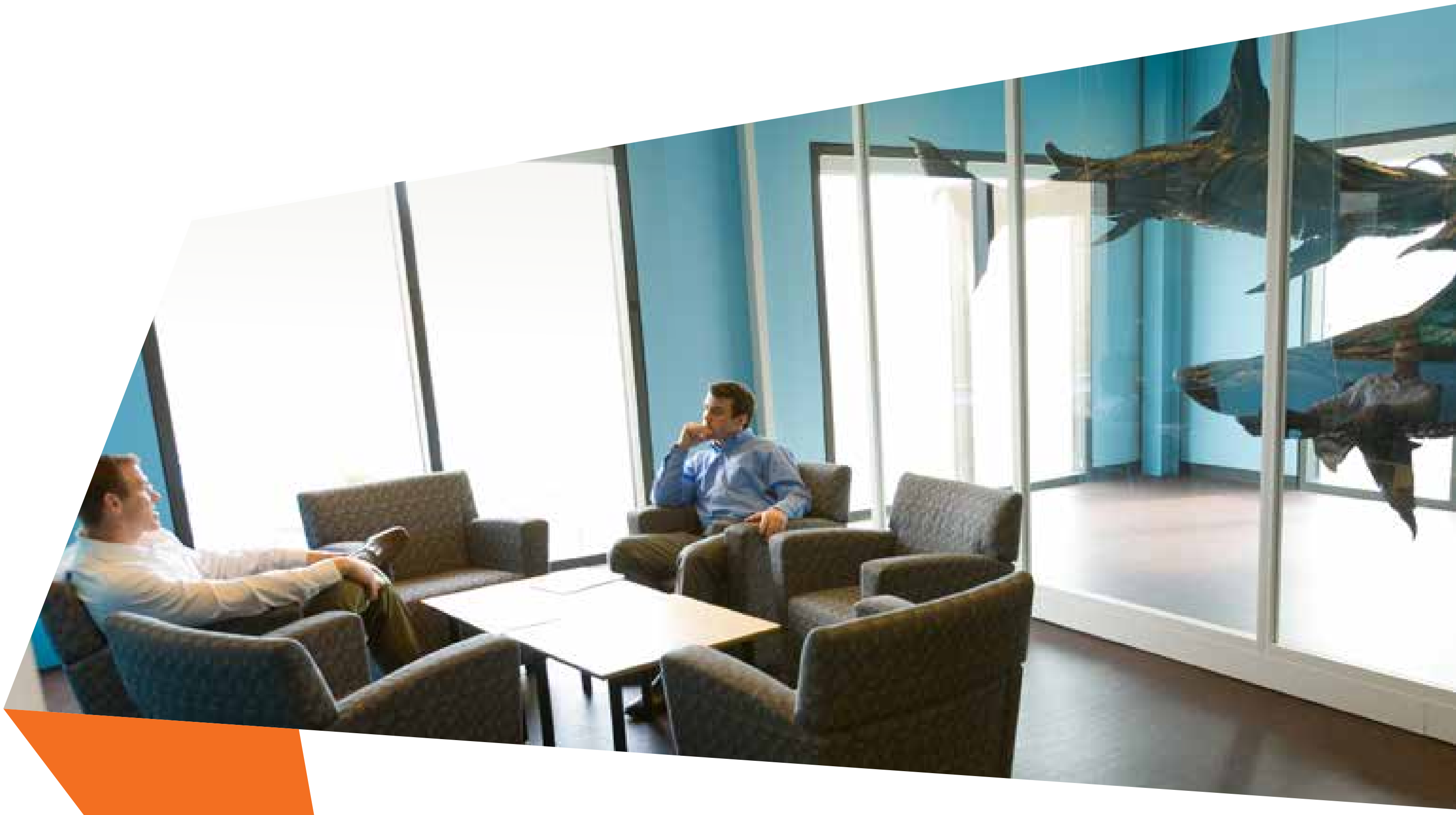
Performance–SPY

Inception Date 01/22/1993

	Monthly End As of 10/31/2016	Quarter End As of 9/30/2016
1 Month	-1.82%	0.01%
QTD	-1.82%	3.83%
YTD	5.74%	7.70%
1 Year	4.41%	15.29%
3 Year	8.73%	11.04%
5 Year	13.41%	16.21%
10 Year	6.60%	7.14%
Inception	8.90%	9.02%

Performance quoted represents past performance, which is no guarantee of future results. Investment return and principal value will fluctuate, so you may have a gain or loss when shares are sold. Current performance may be higher or lower than that quoted. Visit spdrs.com for most recent month-end performance.

Returns shown are based on NAV. ETFs are bought and sold on an exchange at market price which may result in materially different performance from that shown. Mutual funds are redeemed directly from the fund at NAV on a daily basis. Index-tracking ETF fees are typically lower than mutual fund and separately managed account fees. Amount of taxes, fees and distributions will vary depending on the investment vehicle used.



Sources

[1] American Taxpayer Relief Act of 2012, Affordable Care Act of 2010, IRS.

[2] Arnott, R; Berkin, A; Bouchey, P. "Is Your Alpha Big Enough to Cover Its Taxes? Revisited." *Investments & Wealth Monitor*, January/February 2011.

[3] Stein, David; McIntire, Greg, "Overlay Portfolio Management in a Multi-Manager Account," *Journal of Wealth Management*, Spring 2003.

[4] Bouchey, P; Santodomingo, R; Sireklove, J. "Tax-Efficient Investing: Tactics and Strategies," *Investments & Wealth Monitor*, January/February 2015.

SEI New ways. New answers.®

We invite you to learn more about how our tax-efficient investing solutions can help you implement a strategy that meets your clients' needs. **Call 888-734-2679 or visit seic.com/advisors**.

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