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MEEDER PRIVATE WEALTH

Case Study of Tax-loss Harvesting & Account Transition

Tax-loss harvesting involves the sale of a security at a loss within a taxable account, which allows an investor to “harvest” the loss for income tax purposes. The first step to understanding the value added requires shifting from measuring investment pre-tax return performance that ignores taxes and focusing instead on after-tax return. For investors in taxable accounts, that is the only number that really counts. Many of the factors that affect portfolio returns are outside of an investor’s control, such as interest rate policy, geopolitical events, market returns, and the list goes on. However, an investor has full control over the taxes in their portfolio. These costs are far greater than many investors realize yet are overlooked. Effectively managing portfolio taxes may add 1–3% annually to after-tax return.

Investors with sufficient assets qualify for separate accounts. Separate accounts can go even further by creating a tax benefit managing the client’s risk profile. Because of the legal structure of mutual funds and ETFs, losses cannot be passed through to their shareholders. Using a separate account invested in individual equities, a taxable investor may generate 1% to 3% in additional tax benefits from harvesting tax losses in the portfolio. The tax benefit incurred depends on the extent of gains and losses in the portfolio, but all taxable investors can see some advantage from this technique. Our approach to utilizing the benefits of tax-loss harvesting is explained by the graphic below.

ESTABLISH PORTFOLIO
Start with 300 Company A securities
1% expected tracking error

HARVEST TAX LOSSES
(WHEN AVAILABLE)
EXAMPLE
Sell Company A to capture $25k in losses

PURCHASE SIMILAR SECURITIES TO REPLACE
Buy Company B securities with Company A proceeds (similar industries)
Turnover 5%

ACTIVELY MONITOR
Ongoing rebalancing and minimizing over/underweight positions

We have created a case study with a hypothetical portfolio to show the process that the Meeder Private Wealth Management team follows to transition a portfolio, to take advantage of tax-loss harvesting opportunities.

We will use the following assumptions:

Current Account Value:	$1,600,000
Current Unrealized Gains:	$350,000
Portfolio Holdings:	Portfolio consists of mutual funds and individual securities

01

Analyze and identify any U.S. equity mutual funds that are expensive and/or tax inefficient. These securities will be sold to reduce the portfolio's expense and tax liability.

COMPANY	GROSS EXPENSE RATIO	1-YEAR TAX COST RATIO	TOTAL COST
Fund Company A	1.90%	3.23%	5.13%
Fund Company B	1.73%	2.34%	4.07%
Fund Company C	1.84%	1.86%	3.70%
Fund Company D	0.75%	1.83%	2.58%

02

Find positions that we **do not** want to keep in the existing portfolio, currently trading at a loss. We would then sell these positions and realize the losses to be used against any realized gains.

COMPANY	COST BASIS	MARKET VALUE	GAIN/LOSS
Company A	$65,428	$43,689	**$(21,739)**
Company B	$90,347	$48,524	**$(41,823)**
Company C	$58,695	$51,054	**$(7,641)**
Company D	$110,954	$81,378	**$(29,576)**
			$(100,779)

03

Identify positions with a capital gain that have an allocation overweight relative to the benchmark in the portfolio. Sell the overweight positions and use the realized losses (from Step 2) to offset any capital gains (from Step 3).

If we identify an existing holding that should remain in the portfolio, the weighting may be adjusted to match the respective benchmark weighting, to reduce portfolio risk.

COMPANY	MARKET VALUE	CURRENT WEIGHT	RECOMMENDED WEIGHT	RECOMMENDED VALUE	REALIZED GAIN
Company A	$81,378	**5.10%**	**1.65%**	$25,600	55,778
Company B	$73,548	**4.60%**	**1.43%**	$22,880	$50,668

04

For the remaining unrealized gains in the portfolio, we will work with the client to determine the level of capital gains they are willing to absorb. We will provide several options with varying levels of capital gains. Based on that decision, our team will establish a transition timeline for the portfolio to reach the strategic target.

	CURRENT	OPTION 1	OPTION 2	OPTION 3
Details		$120k Net Gains	$60k Net Gains	$30k Net Gains
U.S. Equity Allocation	55.04%	47.00%	55.04%	55.04%
Number of Stocks	15	150	91	49
Tracking Error (Active Risk)	5.38%	2.95%	3.89%	4.51%
Unrealized Gains (U.S. Equity)	$243,000	$123,000	$183,000	$213,000
Est. Transition Timeline (Years)	N/A	1.02	3.00	6.87

05

Use proceeds from all sales to purchase individual equities. When tax-loss harvesting, replace the securities sold with securities that behave in a similar fashion to align risk to the benchmark. In additon, investors that use tax loss harvesting strategies should be familiar with the wash-sale rule. The wash-sale rule, which is part of the IRS tax code, disallows the sale of a security that is “substantially identical” to the security originally purchased that is 30 days prior to or after the sale.

COMPANY		COMPANY
Beverage Company A	»	Beverage Company B
Oil Refiner A	»	Oil Refiner B
Automobile Manufacturer A	»	Automobile Manufacturer B

06

Monitor the portfolio daily to capitalize on any market volatility and tax-harvest losses using the same techniques outlined above.

LEARN MORE. CONTACT US TODAY.

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Past performance does not guarantee future results. There can be no assurance that any investment strategy or tax management technique will be successful or perform as described. The case study is hypothetical and is intended to illustrate the impact of tax-loss harvesting in a sample account. Each investor's tax circumstances are unique, and the impact of tax-loss harvesting will vary depending on the portfolio holdings, market appreciation and taxation situation of the investor. Investors paying lower tax rates or without taxable income may earn smaller tax benefits from these techniques.

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DEFINITIONS

Tracking Error: A measure of the risk in an investment portfolio due to active management decisions made by a portfolio manager in comparison to a benchmark index; it indicates how closely a portfolio follows the index to which it is benchmarked.

Investment advisory services provided by Meeder Advisory Services, Inc.

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