A Case For Tax Aware Investing

- A tax aware investment strategy must continually and simultaneously balance the trade-off between risk control and the realization of capital gains and losses.
- Capital gains taxes are often the most significant expense taxable investors will face, more significant than investment management fees and transaction costs.
- Outperforming a benchmark is difficult on a pre-tax basis, but the challenge can be considerably more difficult on an after-tax basis.

A Family Office Client Wanted to Blend Active and Passive Strategies in a Tax Efficient Manor

A family office client views the equity market through the lens of a six box style matrix — large, mid and small cap on one axis with growth and value on the other. The client adds value by focusing on their strategic asset allocation (overweights to mid/small caps and value) across the six equity boxes. Furthermore, they identified several active managers as additional alpha sources. The client wanted to implement a strategy that allowed them to achieve their desired allocation targets while considering their investments with a select group of active managers.

Our approach to solving this problem

State Street Global Advisors worked with the client to design a completion mandate that enabled continued exposure to the selected active managers, while maintaining an overall equity allocation that is aligned with the client's asset allocation preferences. Figure 1 on the following page shows the derivation of the custom blended benchmark. The completion mandate manages gains and losses to help maximize tax efficiency across the entire equity portfolio. Additionally, the client was able to benefit from ongoing tax-loss harvesting and from having control over realized gain/losses when redemptions were needed.

Figure 1 **Custom Benchmark Calculation**

	Target Asset Allocation* ($)	Total Active Managers* ($)	SSGA Portfolio ($)*	SSGA Portfolio (%)
Large Cap				
Growth	68.1	21.3	46.8	20.0
Value	102.1	85.1	17.0	7.3
	170.1	106.3	63.8	27.3
Mid Cap				
Growth	68.1	17.0	51.0	21.8
Value	102.1	25.5	76.6	32.7
	170.1	42.5	127.6	54.5
Small Cap				
Growth	34.0	17.0	17.0	7.3
Value	51.0	25.5	25.5	10.9
	85.1	42.5	42.5	18.2
U.S. Equity	425.4	191.4	233.9	100.0

* Dollars shown in millions.
Source: State Street Global Advisors.

Concluding remarks

The solution presented here was both transaction cost and tax cost efficient. The client originally proposed having six individual portfolios to cover their market cap and style exposures. One portfolio with a blended benchmark allowed them to avoid wash sales, reduce trading costs, and be truly tax aware.

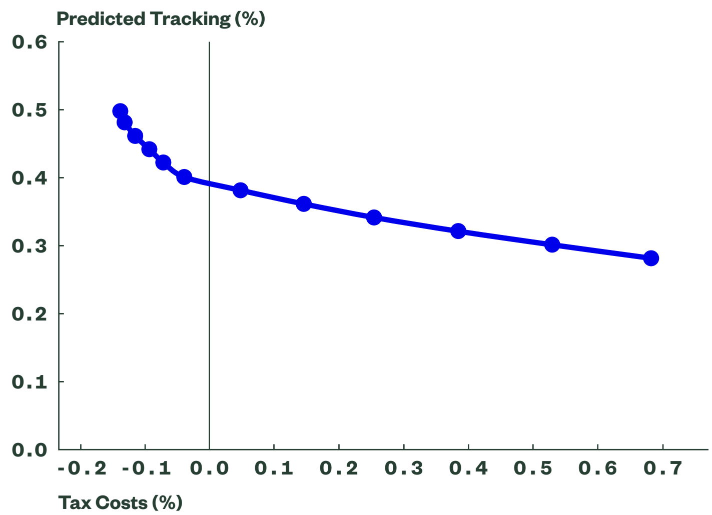
A Nuclear Decommissioning Trust (NDT) Sought to Change Investment Objective while Minimizing Tax Cost

An existing Nuclear Decommissioning Trust (NDT) client engaged State Street Global Advisors to assist in determining the potential tax impact of multiple changes to their portfolios. The client owned two domestic portfolios, one qualified and one non-qualified, and one qualified international portfolio. The client was granted permission from the IRS to pour over the holdings in the non-qualified domestic portfolio into the qualified domestic portfolio which is taxed at a more favorable rate. At the time of the pour over, the client also wished to change their domestic vs international equity asset allocation while also changing their developed international benchmark to include emerging markets.

Our approach to solving this problem

State Street Global Advisors' TABS (Tax Aware Beta Solutions) team was able to produce a tax cost vs. tracking error analysis (Figure 2) on both the effect of raising cash from the combined domestic account in order to achieve the requisite asset allocation, as well as the tax effects of reducing tracking error in the international portfolio to the new benchmark. The TABS team was also able to determine the order in which the client should proceed with the rebalance that would maximize the after-tax value of their portfolios. The analysis helped the client convince their board to authorize this transformation. All aspects of the trade were synchronized and executed on the same trading day across global markets allowing the client to be fully invested throughout the transition.

Figure 2 **Tax Cost v. Targeted Tracking**



Source: State Street Global Advisors.
Past performance is not a guarantee of future results.

Concluding remarks

This solution benefitted the client in that they were able to minimize trading while controlling realized gains and losses to reposition both domestic and international equity portfolios.

A Health Insurer was Looking to Structure a U.S. Equity Portfolio to Satisfy Multiple Needs

A health care insurance company desired a tax-efficient large cap general account equity portfolio. Within the large cap space, the insurer wanted additional exposure to value stocks, extra dividend yield, and specific stock restrictions.

Our approach to solving this problem

State Street Global Advisors' TABS team created a custom blended benchmark comprised of 50% S&P 500/50% S&P 500 Value. To capture additional yield, a yield tilt of 1.5 times that of the custom blended benchmark was implemented. Since this company is a provider of health insurance, they made a decision not to own alcohol or tobacco stocks, so the portfolio is prohibited from buying stocks that fall in those industries. State Street Global Advisors also worked closely with this client on identifying OTTI (Other Than Temporarily Impaired) stocks.

Concluding remarks

This portfolio proved to be a useful tool for the client as it delivered equity market returns with increased dividend yield while also remaining primarily realized gain/loss neutral. From time to time, the client has asked State Street Global Advisors to realize gains as they are needed.

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* *This figure is presented as of June 30, 2020 and includes approximately $69.52 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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