

# Direct Indexing

A smarter way to index





**01** Impact of taxes on investment returns

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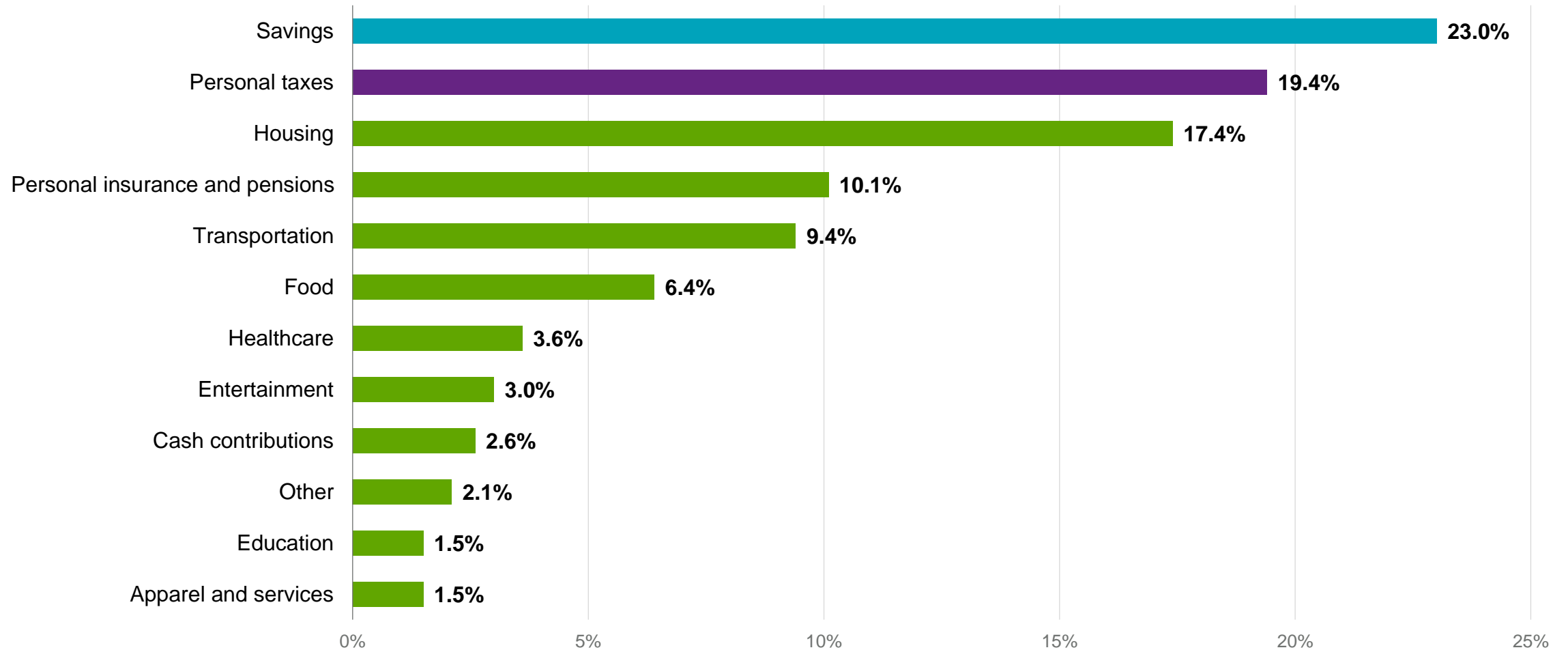
Section 01

# Impact of taxes on investment returns



# Taxes are largest expenditure for high-income households

\$200,000 and more, % of household expenditures plus taxes

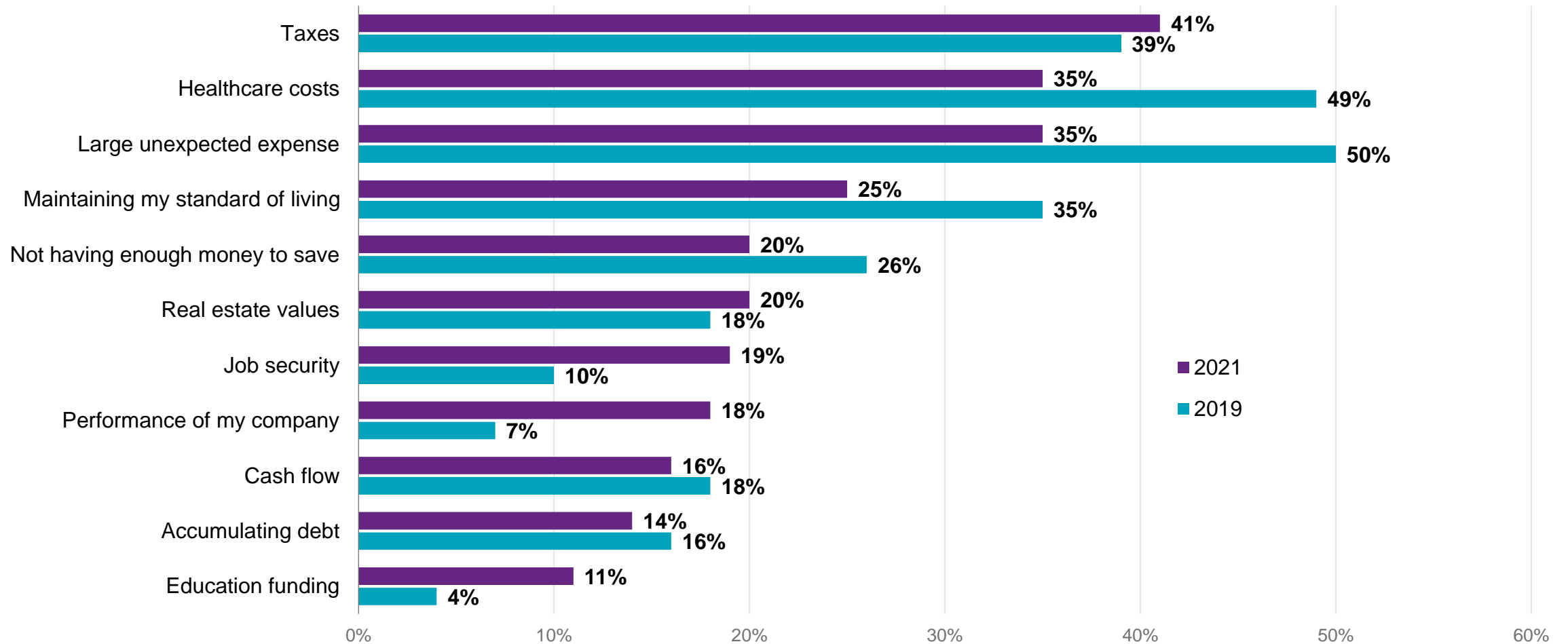


\*Top quintile households had a lower limit of \$140,363 and a mean of \$244,025.

Sources: US Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, 2022; Natixis Investment Managers Solutions.

# Investors' biggest personal financial fears

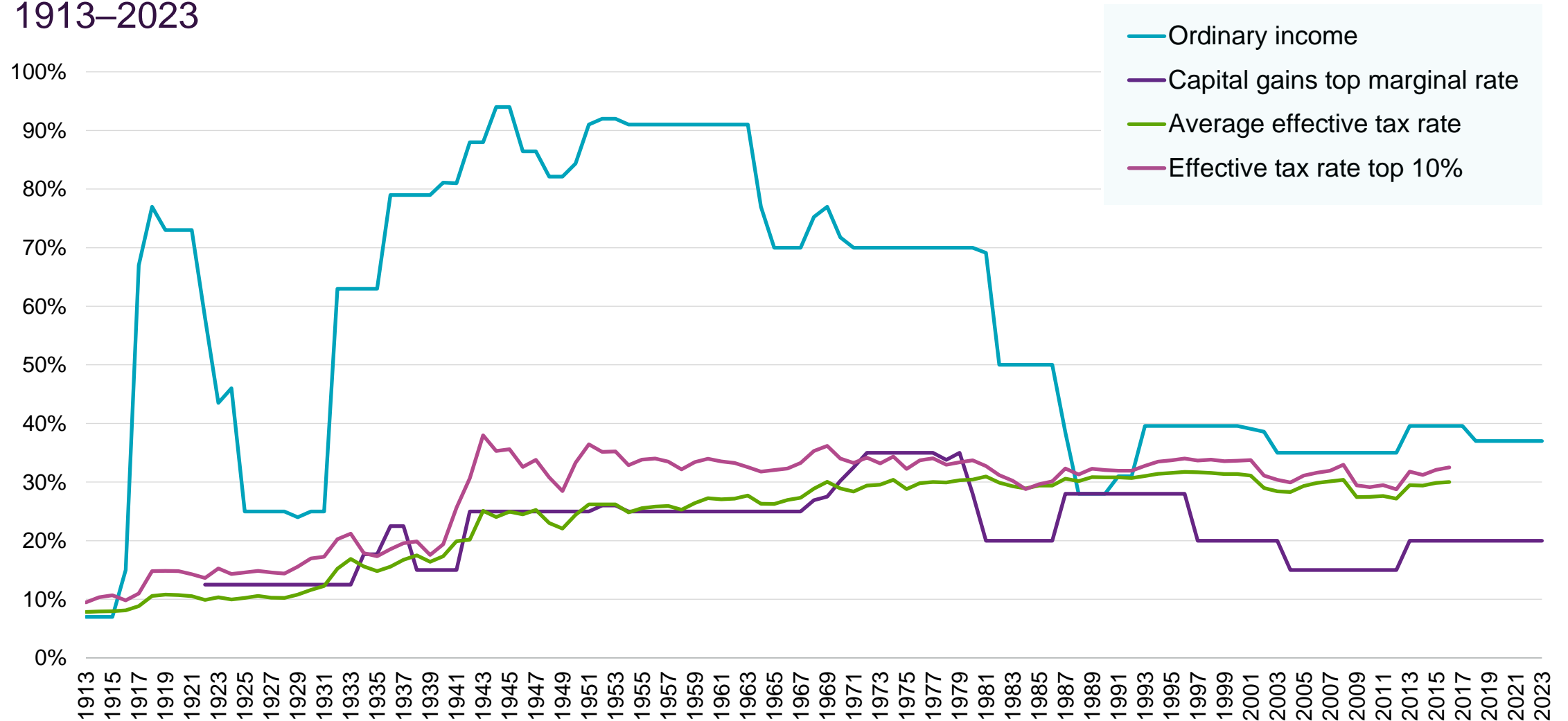
Taxes are a major concern for investors and growing in importance



Sources: US Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, 2021; Natixis Investment Managers Solutions

# Historical marginal and effective tax rates

1913–2023

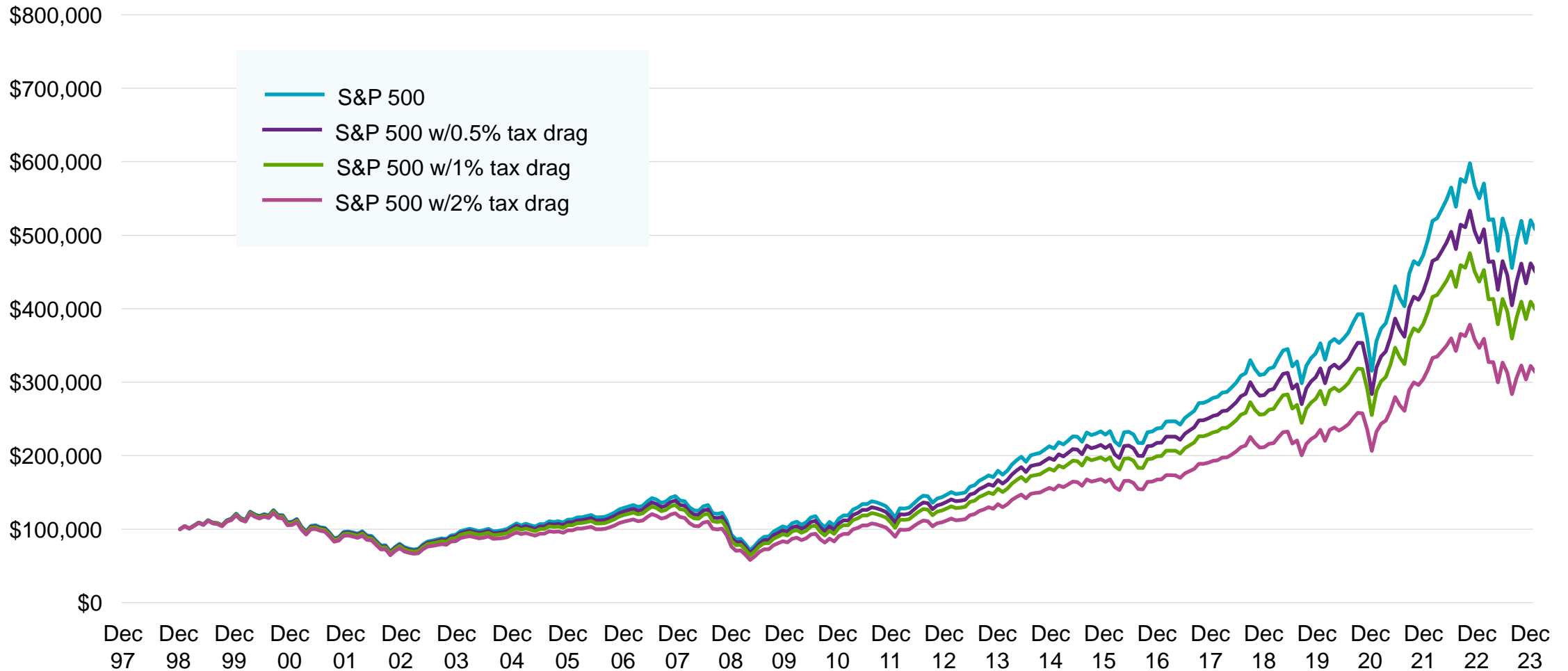


Sources: US Department of Labor, Bureau of Labor Statistics, Consumer Expenditure Survey, 2021; Natixis Investment Managers Solutions



# Impact of tax drag

Growth of \$100,000 (S&P 500<sup>®</sup> with 0%, 0.5%, 1%, and 2% Tax Drag, 12/31/1997–12/31/2023)



Performance data shown represents past performance and is no guarantee of future results.

Tax drag is a measure of how much taxes reduce investment returns after accounting for any tax liability generated by the investments. This tax liability can result from events such as capital gains, dividends, and interest income. In this analysis we've assumed the top federal tax rates apply.


















Section 02

# Benefits of direct indexing



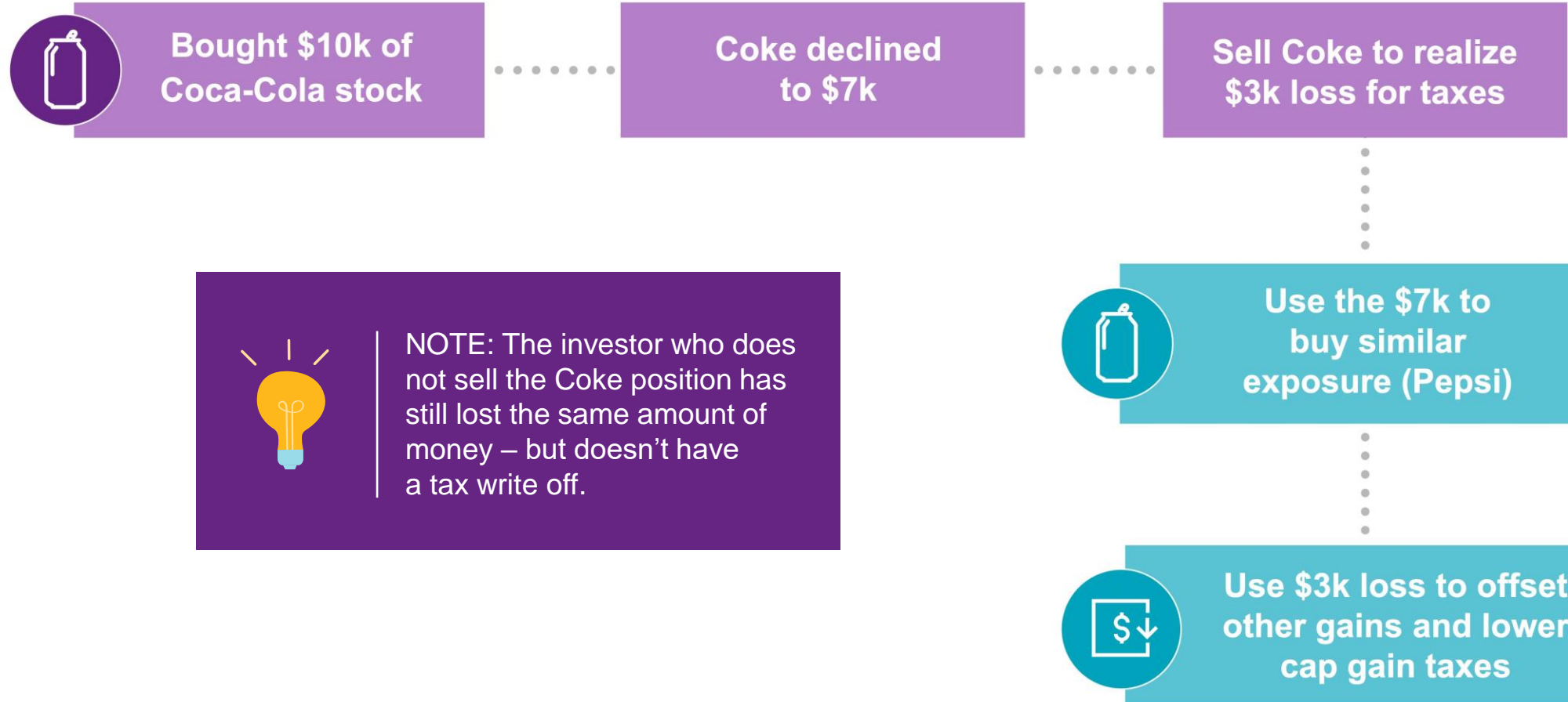


# The most tax-efficient way to index

	Index Mutual Fund	Index ETF	Direct Indexing SMA
Track Index Pre-Tax			
Dividend Taxes			
Fully Customizable			
High-Net-Worth Focused			
<b>Actively Tax Managed</b>			
<b>Capital Losses to Offset Gains</b>			

# What is a realized loss and why is it valuable?

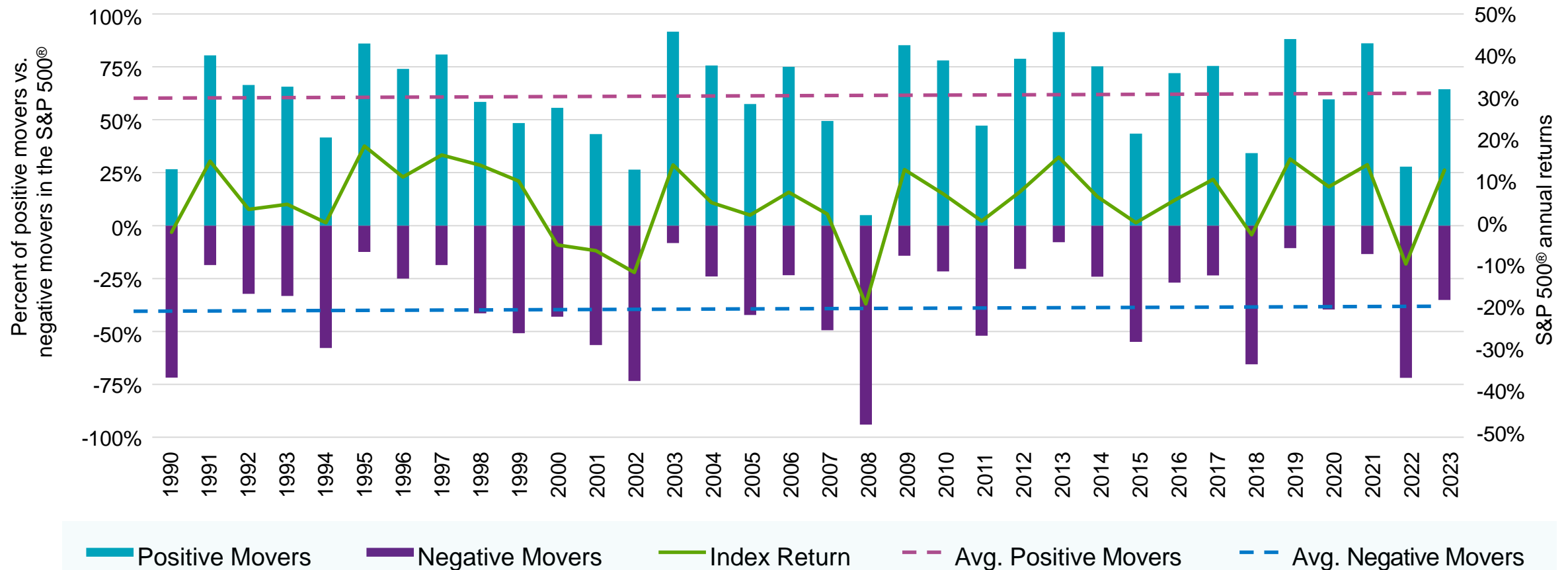
Selling a position at a loss can create a tax write off



# Opportunities for tax loss harvesting

Whether broad index performance is positive or negative, there are still opportunities to harvest losses

Winners and losers in S&P 500® (12/31/1990–12/31/2023)





Section 03

# Case studies: investor applications



# Case study #1: A core tax engine

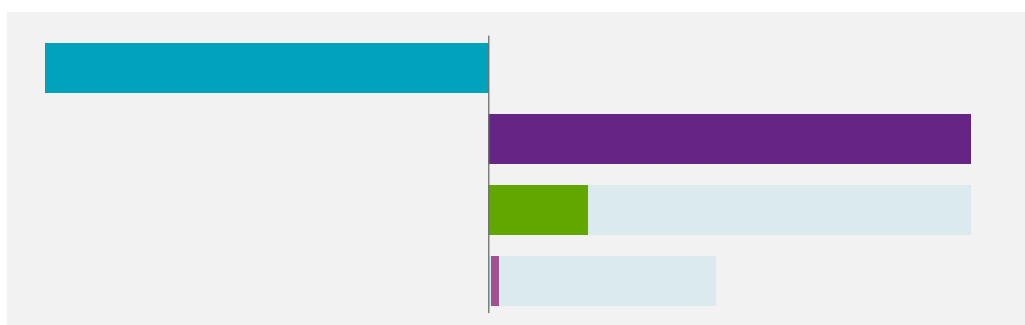
Optimize tax efficiency across all investments

- In calendar year 2020, Mr. Wilson owned a \$3 million portfolio consisting of \$2 million individual stocks, ETFs, and mutual funds and \$1 million invested in the AIA S&P 500<sup>®</sup> direct indexing strategy.
- The mutual funds paid out capital gains of \$50,000 and he had realized gains from trading activity in his stocks and ETFs of \$150,000.

## Direct Indexing Solution

He was able to offset the \$200,000 in realized gains by using \$197,000 from the realized losses in his direct indexing account, leaving a net gain of only \$3,000.

Capital losses  
Capital gains  
Net capital gain  
Tax burden



## Practical applications

- Tax-efficient index investing
- Core equity allocation with a loss harvesting engine to offset cap gains from other investments
- Passive core holding, coupled with active allocations, to pursue alpha

# Case study #2: Planning ahead for large capital event

## Bank losses now to offset future gains

- Dr. Garcia spent the last 30 years building a business from scratch, now worth ~\$10 million.
- She plans to sell her business in 5 years.
- She currently has a \$3 million cash position that she wants to invest in the equity market.

### Direct Indexing Solution

- The AIA S&P 500® Strategy has historically generated average tax losses equivalent to 20%–25% of assets over a three-to-five-year period.
- Securities sold at a loss are replaced with similar securities to maintain appropriate index diversification.
- **Net capital losses can be carried forward indefinitely to offset future gains on federal income taxes.**
- Up to \$3,000 annually can be used to offset ordinary income. State tax regulations vary.



### Practical applications

Accrued capital losses can be used to reduce the tax impact associated with:

- The sale of a business
- Real estate transactions
- Stock option conversion

2024	2025	2026	2027	2028



# Case study #3: Unwind positions, transition assets, and diversify

Minimize the tax consequences of reallocating assets

- Mr. Patel needs a tax-efficient way to sell off shares in his tech company and build a more diversified portfolio.
- His \$10 million position in his company's stock has a zero cost basis – and his concentrated portfolio is a big risk.
- He has \$2 million in cash and an annual capital gains budget of \$500,000.

## Direct Indexing Solution

- Concentrated holdings can be risky, but selling shares to improve diversification can result in a large capital gain tax, particularly with low-basis stock positions.
- With direct indexing, we can build a customized index around the concentrated position, selling shares in a tax-efficient manner.
- The proceeds are invested in other sectors, building diversification around the primary holding.
- Direct indexing can reduce or delay capital gains using a budget aligned with an investor's priorities.



## Practical applications

- For many account transitions, securities can be accepted in kind, with no associated tax consequences.
- Investors with a higher cap gains budget may be able to diversify holdings more quickly.
- For investors less willing to pay cap gain taxes up front, taxes will be lower, but the process may take longer.

# Direct Indexing

from Natixis Investment Managers Solutions

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The smarter way to index

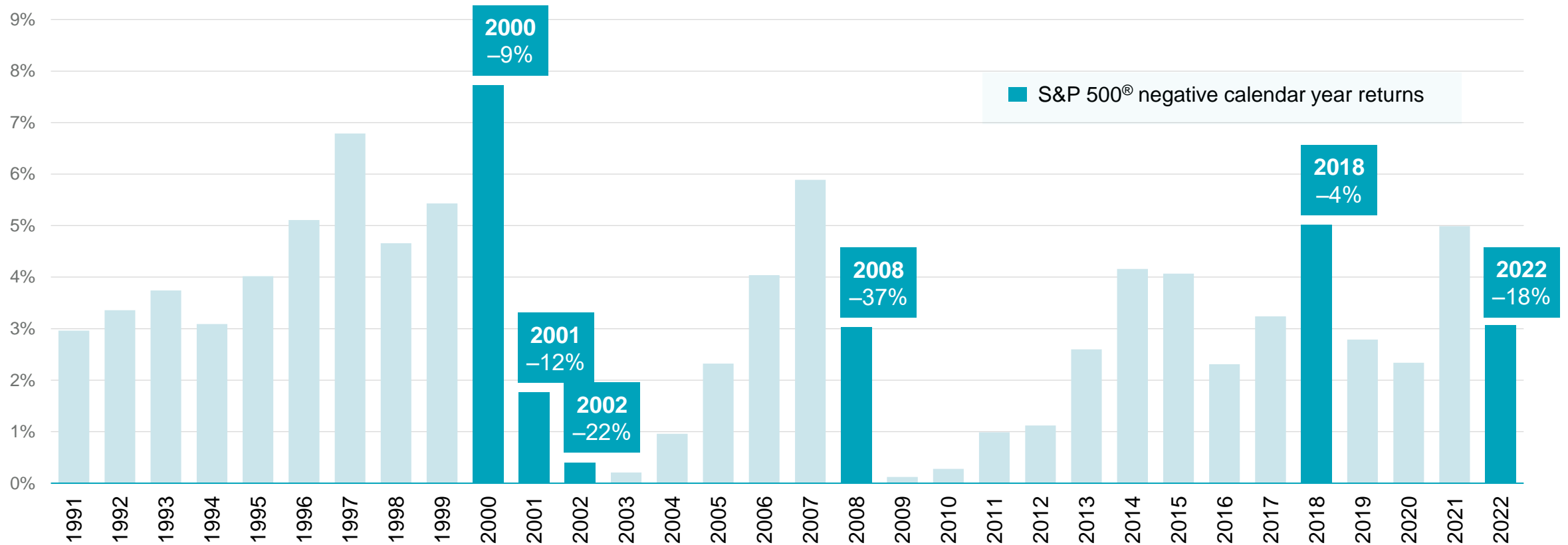
Section 04

# Appendix



# Equity mutual fund distribution trends

Equity mutual fund history: Capital gain distribution ratio (1991–2022)

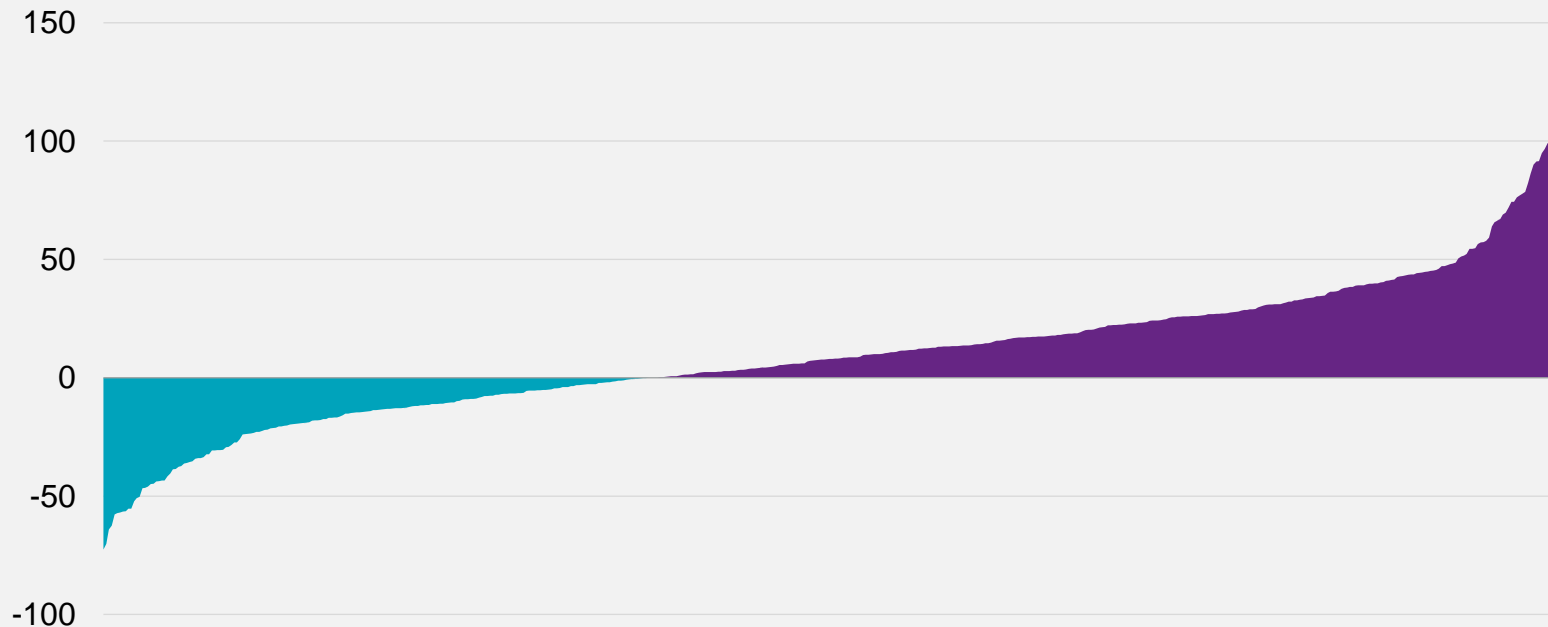


Performance data shown represents past performance and is no guarantee of future results. Note: Distribution ratios are calculated by dividing total equity mutual fund capital gains distributions by year-end net assets for each year. Sources: Investment Company Institute 2022 Factbook and Natixis Investment Managers Solutions.

# Opportunities for tax loss harvesting: 2020

Even when broad index performance is positive, there are still opportunities to harvest losses

S&P 500® Index constituents – Range of returns (12/31/19–12/31/20)



**196 stocks**  
with losses in 2020

Although the S&P 500® Index rose by 18.4% in 2020, 196 stocks within the index fell in value during the period and provided opportunities to tax loss harvest.

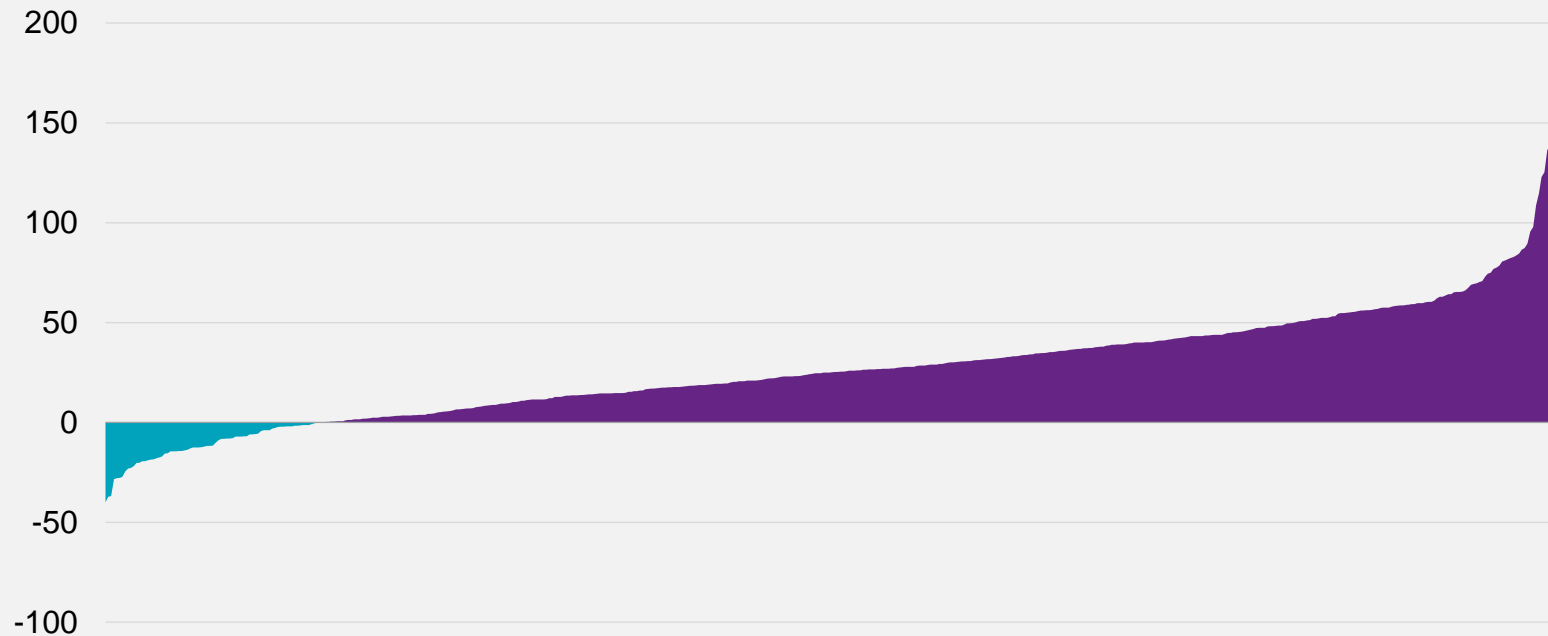
Source: Factset

Performance data shown represents past performance and is no guarantee of future results. The securities holdings of the composite may differ materially from those of the index used for comparative purposes. It is not possible to invest directly in an index.

# Opportunities for tax loss harvesting: 2021

Even when broad index performance is positive, there are still opportunities to harvest losses

S&P 500® Index constituents – Range of returns (12/31/20–12/31/21)



**77 stocks**  
with losses in 2021

Although the S&P 500® Index increased by 28.71% in 2021, **77 stocks within the index fell in value** during the period and provided opportunities to tax loss harvest.

Source: Factset

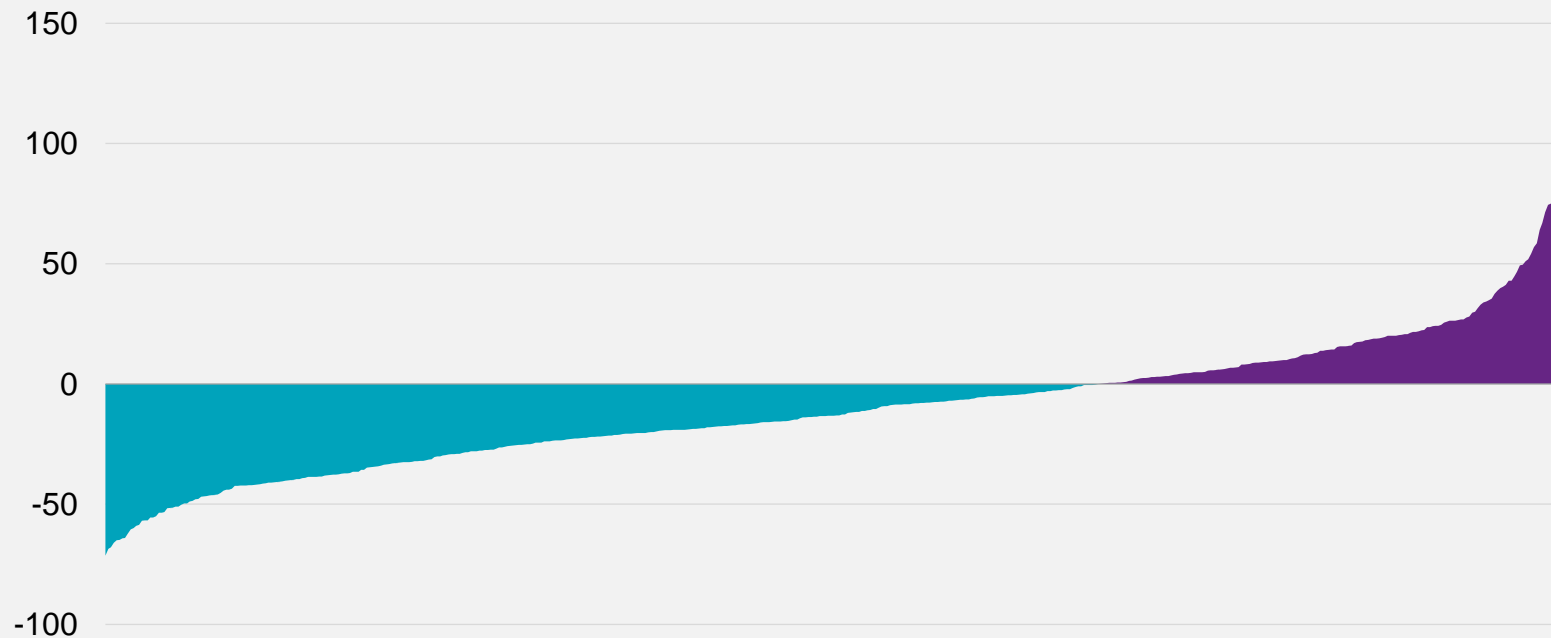
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# Opportunities for tax loss harvesting: 2022

When broad index performance is negative, opportunities to harvest losses increase

S&P 500® Index constituents – Range of returns (12/31/21–12/31/22)



**368 stocks**  
with losses in 2022

The S&P 500® Index decreased by -18.11% in 2022, and **368 stocks within the index fell in value** during the period and provided opportunities to tax loss harvest.

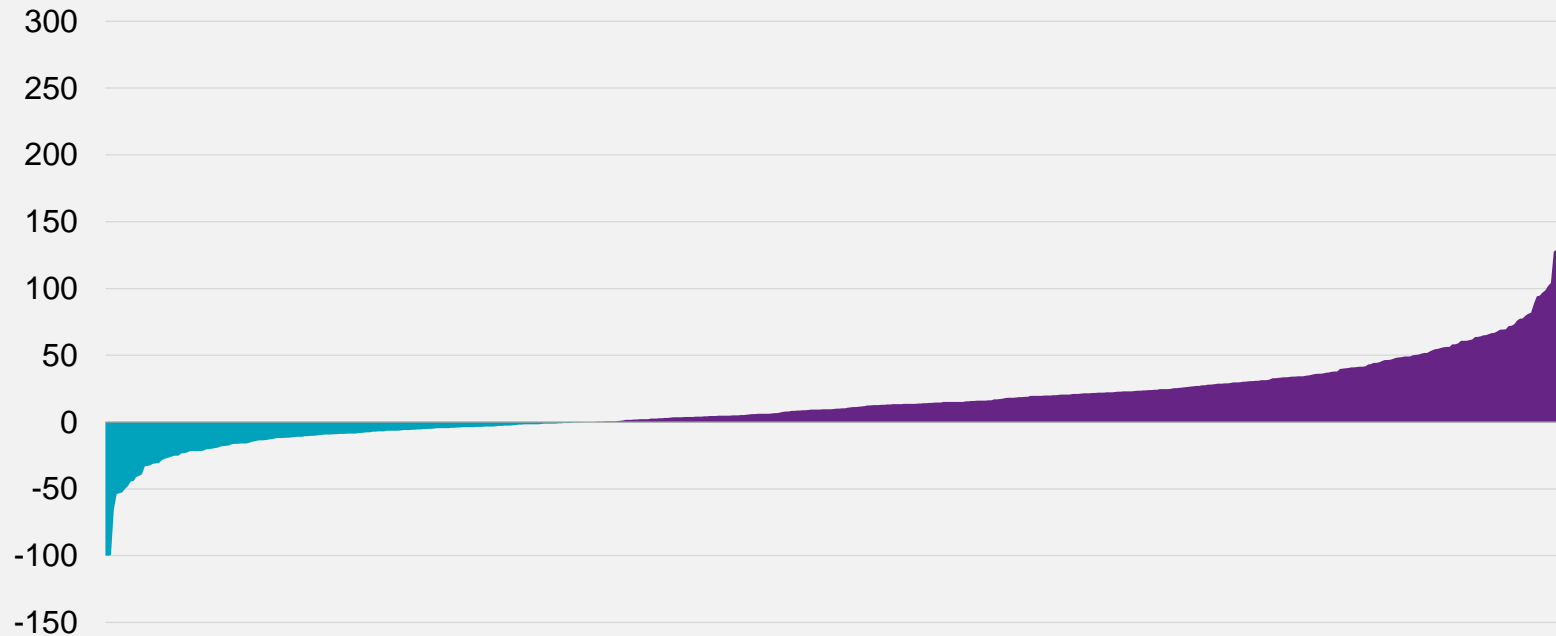
Source: Factset

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# Opportunities for tax loss harvesting: 2023

When broad index performance is negative, opportunities to harvest losses increase

S&P 500® Index constituents – Range of returns (12/31/22–12/31/23)



**171 stocks**  
with losses in 2023

The S&P 500® Index increased by 26.29% in 2023, and **171 stocks within the index fell in value** during the period and provided opportunities to tax loss harvest.

Source: Factset

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