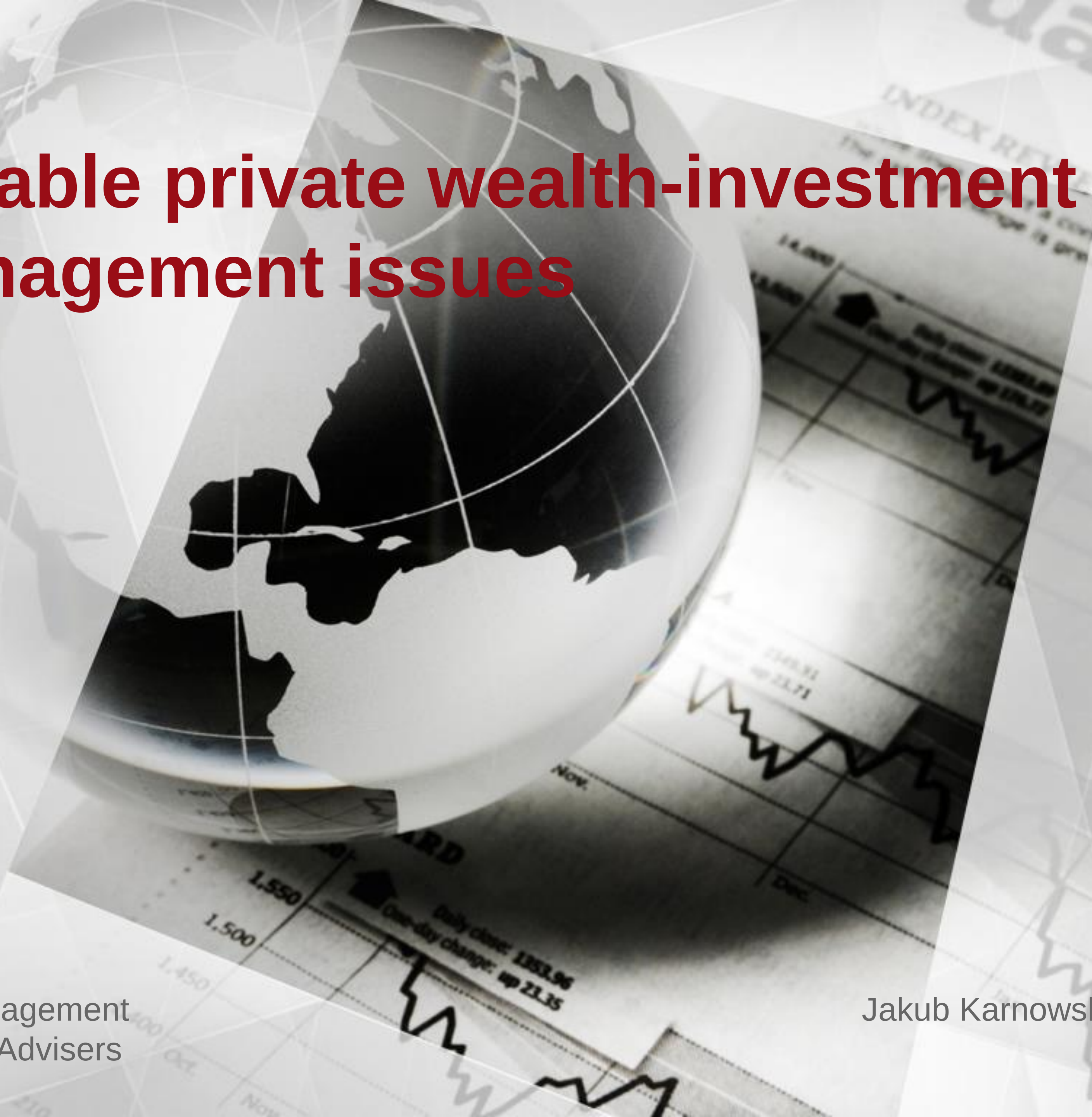
Taxable private wealth-investment management issues



Portfolio Management
for Financial Advisers

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Investment Time Horizon

- Investment planning must take into account life span (maximum number of years for a person's life) rather then actuarial life expectancy.

  EXAMPLE: the actuarial life expectancy of a person at age 5 might be less than that of a person at age 65

- Risk tolerance may decrease as the investor grows older (for very wealthy investors it can increase) and the investment time horizon shortens

- As investment time horizon shortens most investors want to minimize realized taxable gains.

Inheritance Tax and Wealth Transfer

- Assets left for spouse **need not** be taxed until the death of surviving spouse → opportunity for tax deferral

- Complete investment planning involves integrating the assets held by all the family members of investor (parents, spouse, children) and their time horizon - investments of family should be managed as integrated portfolio

- Making charitable donation allows a tax deduction equal to it's fair market value

Gross VS Net Investment Returns

Factors that can devastate purchasing power:

1. **Investment Expense** (i.e. management fees, transaction fees, custody fees).

2. **Taxes** (i.e. income and estate taxes)

3. **Inflation**. In order for investments to preserve purchaising power, they must provide returns in excess of inflation after deducting management fees, trading costs, and taxes

4. **Consumption**. For most investors, consumption represents the ultimate purpose of wealth accumulation. Consumption can only occur after the previously mentioned 3 factors have been satisfied

Return to U.S. Bonds

? Should wealthy investors ***always*** allocate a portion of their portfolio to U.S. bonds? ?

Historical returns of U.S. bonds show trends of both gaining and losing purchasing power

Fixed income investments did not always provide strong diversification benefits (especially during periods when bond returns are positively correlated with stocks – high inflation)

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Tax Implication and Techniques

<u>Main targets of taxation:</u>

1. Tax on What You **Make** (salary, earnings from investments: interest, dividends, capital gains)
2. Tax on What You **Have** (real estate tax, inheritance tax)
3. Tax on What You **Transfer** (tax on real estate transactions, gift tax)
4. Tax on What You **Spend** (value-added tax)

Most relevant to investors and investment advisors

Tax Implication and Techniques

For all mentioned targets of taxation, the primary goals of the investor for achieving higher after-tax returns are:

Change the characterisitc of the tax to get the lower applicable rate (i.e. utilize dividend paying investments instead of interest paying investments if dividends have a more favorable tax treatment)	Defer the timing of the tax payment as long as possible to allow for maximum pre-tax compounding over time

Tax Implication and Techniques

Tax techniques:

TAX LOT MANAGEMENT	involves maintaining lot-by-lot price, quantity, commission, and date of purchased securities. When selling, this information allows the investor to pick specific lots to sell, which minimize tax liability
EXTENDING THE HOLDING PERIOD	allows the investor to capture a lower tax rate on long term capital gains
TAX LOSS HARVESTING	involves the intentional sale of securities at a loss for the purpose of recognizing a loss for tax purpose
TAX DEFERRAL	adds value through the differential between compounding at pre-tax of return rather than an after-tax rate of return
PORTFOLIO REBALANCING	needs to account for the trade-offs between tax benefits and benefits derived from risk management

THANK YOU!