

CASE STUDY: DIVERSIFYING A CONCENTRATED STOCK POSITION

CLIENT CHALLENGE – Help Mitigate Concentration Risk While Managing Potential Tax Implications



CLIENT PROFILE

Consider this strategy for clients who hold large, concentrated stock positions with significant appreciation.

Many clients hold large, concentrated stock positions acquired by investing in a company that has done well over time or by accumulating a significant amount of employer stock. However, holding substantial wealth in just one or a small number of stocks can be risky, providing the potential for a large loss. Diversification is an obvious solution, but such clients likely have unrealized capital gains that could generate a hefty tax bill if the concentrated positions were sold outright.

GOOD to KNOW:

The median stock in the Russell 3000 Index was

3X riskier

than the Russell 3000 Index itself and had greater potential for significant negative return outcomes.¹

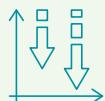
So, how can you reduce both potential concentration risk and taxes?

SOLUTION: DIVERSIFY WITH DIRECT INDEXING

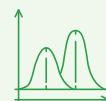
Direct indexing offers the opportunity for active, year-round tax-loss harvesting, enabling investors to offset capital gains incurred from selling a concentrated position with losses realized in the portfolio.

Furthermore, because direct indexing portfolios are separately managed accounts (SMAs) that provide direct ownership of individual securities, they can be customized to balance investment, risk and tax objectives.

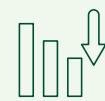
Potential client benefits include:



Reduce the risk of a substantial loss.



Align the account more closely with the desired index or strategy.

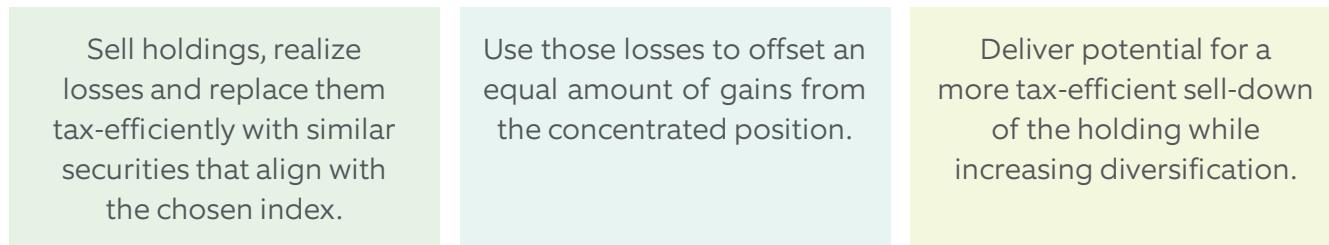


Reduce the tax impact of realizing capital gains.

¹Source: Northern Trust Research, Morningstar, Factset

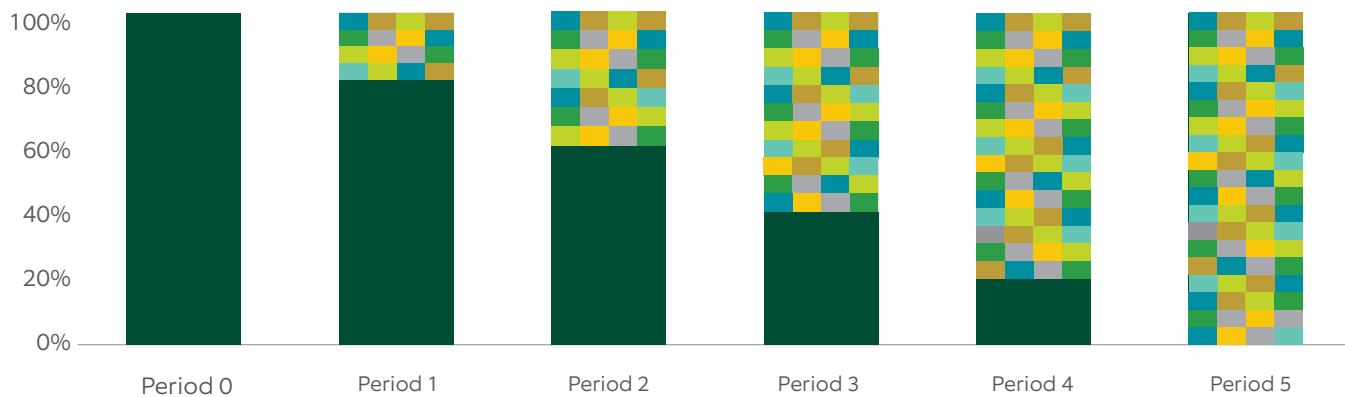
THE NORTHERN TRUST ASSET MANAGEMENT (NTAM) PORTFOLIO DIVERSIFICATION PROCESS

As illustrated in the bar chart below, with direct indexing, the portfolio management team can:



HYPOTHETICAL DIVERSIFICATION OVER TIME

■ Concentrated Stock ■ Diversified Portfolio



Diversification and tax implications can be customized according to each client's risk tolerance and tax goals.



CLIENT BENEFITS

A simple solution for de-risking a concentrated position:

With NTAM Direct Indexing, you gain access to a team of experts and leading-edge technology. This enables you to navigate tax challenges, personalize portfolios and enhance client outcomes. Our solution allows you to create a direct indexing account designed to diversify concentrated holdings while managing tax implications and tracking your client's selected index or strategy.

Advisors can create a plan for the timing of the divestiture and the trade-off between taxes and risk. For example, the concentrated security can be flagged as "Do Not Buy," excluded from the portfolio and/or liquidated over time to pursue a tax-neutral sell-down. Divestiture will likely occur gradually as the portfolio management team seeks to match gains with losses.

POTENTIAL CONSIDERATIONS FOR DIRECT INDEXING ACCOUNTS

The ability to generate losses may be lower than expected, especially in markets that are rising significantly. Furthermore, the continuing benefits may not be fully realized in flat or falling markets because reinvested tax savings could potentially be low or negative.

3 KEY TAKEAWAYS

- 1 Holding an outsized position in a small number of equity securities increases the risk of considerable loss.
- 2 A direct indexing account can track a chosen index or strategy while accommodating the concentrated position.
- 3 **Client outcome:** Working down concentrated positions can diversify the portfolio while reducing tax impacts.

QUESTIONS?

Learn how cutting-edge technology can help solve investing challenges.

Find out about NTAM's direct indexing capabilities by contacting your NTAM sales professional (or by emailing ntam_direct_indexing_sales@ntrs.com).

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