



The Tax-Aware Investing Playbook

Taxes: The Biggest Manageable Cost in Investing

What it is

Tax-aware investing integrates tax considerations into every investment decision, not just at year-end.

Why it matters

Managing them with discipline can meaningfully improve long-term after-tax outcomes.

Where it's going

Advances in technology and portfolio design are making system-driven tax management more accessible.

What Matters Most is What Investors Keep

For many high-net-worth investors, taxes represent the single largest cost associated with their portfolios. Yet taxable portfolios are too often managed with taxes as an afterthought, addressed at year-end rather than a core component of the investment process.

That approach overlooks an important reality: the tax consequences of investment decisions are often visible in advance. When taxes are considered only at certain points in the investment process, opportunities to improve after-tax outcomes may be missed. The discipline of tax economics—understanding how investment decisions interact with tax consequences—can therefore play a meaningful role in long-term wealth accumulation.

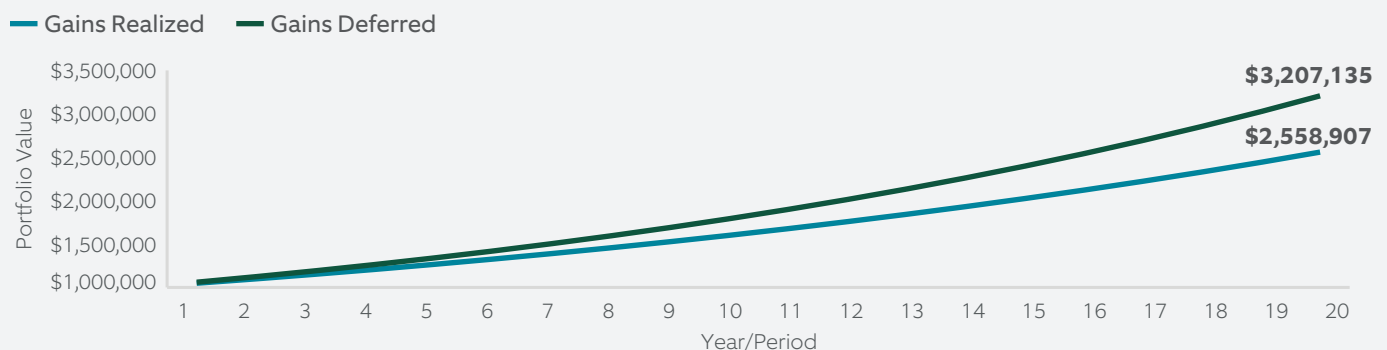
Investment results are frequently judged by pre-tax returns. But for most high-net-worth investors, the more meaningful measure is what remains after taxes.

“For high-net-worth investors, disciplined tax-loss harvesting may help turn tax savings into added flexibility for future expenses (e.g., Funding 4-year college).”

EXHIBIT 1:

Impact on Portfolio Value: Deferred vs. Realized Gains

Each portfolio had a \$1million starting value and appreciated 6% each year. One portfolio realized gains each time period equal to 5% of the beginning of period value while the other did not.



For Illustrative Purposes Only.

Source: Northern Trust Asset Management. Assumes realized gains are taxed at the 23.8% federal long-term capital gains rate.

The Shift From Reactive to Proactive Tax Management

Historically, tax management often meant manually harvesting losses in December to offset gains. Today, several developments are enabling more continuous and systematic approaches:

- Lower trading costs and commissions
- Advances in automation and technology
- The introduction of fractional shares
- Greater access to separately managed accounts

Together, these innovations have lowered the barriers to tax-aware portfolio management, making strategies once limited to very large portfolios accessible to a broader range of investors.

At the same time, competition for assets has intensified. Clients increasingly expect personalized portfolios and more holistic wealth management.

Common Tax Mistakes Investors Still Make

Several common practices can unintentionally increase tax costs:

Treating taxes as a year-end exercise	Reviewing portfolios only in December can mean missing short-lived loss-harvesting opportunities created by market volatility earlier in the year.
Focusing solely on pre-tax returns	Two portfolios with identical returns can produce very different outcomes once gains, losses and holding periods are considered.
Realizing gains too early	Selling securities prematurely can trigger unnecessary tax costs, particularly when short-term gains may face combined federal and state rates exceeding 50% in high-tax states.
Donating cash instead of appreciated securities	Contributing cash rather than appreciated investments can result in avoidable capital gains taxes and missed tax benefits.
Executing tax-blind portfolio transitions	Liquidating portfolios when changing managers or strategies can generate unnecessary tax liabilities that careful tax-lot management could avoid.
Failing to coordinate across multiple managers	When several managers oversee different portions of a portfolio, a lack of communication can lead to offsetting trades, missed loss-harvesting opportunities or unintended wash sales.

Avoiding these pitfalls is an important first step. But the larger opportunity lies in embedding tax awareness directly into portfolio management.

Where Tax-Aware Investing Creates Value

Tax-aware investing is a collection of practices that work together over time

The following strategies underpin the discipline of tax economics:

Optimizing asset location

Placing investments in the most tax-appropriate accounts can improve efficiency—for example, holding tax-inefficient assets in tax-advantaged accounts while reserving taxable accounts for more tax-efficient investments.

Deferring gains

Deferring the realization of gains allows capital that would otherwise be paid in taxes to remain invested and continue compounding.

Managing concentrated positions

Gradually diversifying concentrated holdings can help reduce risk while managing the associated tax burden. For example, an executive with a large employer stock position may

gradually diversify while harvesting losses elsewhere in the portfolio to help offset realized gains.

Planning for major liquidity events

Tax-aware strategies can also support planning around large future gains. Business owners anticipating the sale of a company, for example, may begin implementing tax-aware portfolios years in advance to accumulate losses that can offset future gains.

Systematic loss harvesting

Even in rising markets, individual securities often experience declines. Harvesting those losses can offset gains elsewhere in a portfolio and improve after-tax outcomes over time.

Potential Personalized Tax Benefits

EXHIBIT 2:

The strategic role of tax loss harvesting

Why are capital losses an asset?¹

- Capital losses in taxable portfolios can be a powerful tool to drive long-term after-tax returns
- Unused capital losses can be carried forward into future years
- Losses can be used to offset capital gains
- Tax deferral with compounding benefits: Ability to reinvest tax savings and let them compound over time

	Without Tax-Loss Harvesting	With Tax-Loss Harvesting
Market portfolio beginning value	\$250,000	
Realized loss from market portfolio	—	(\$25,000)
Realized gain from other investments	\$25,000	\$25,000
Taxes owed	\$10,200	\$0

For illustrative purposes only.

¹Subject to the wash sale rules in the tax code. Assumes market portfolio beginning value at \$250,000 with 10% loss in year 1. Assumes realized gain and loss occur in the same calendar year. Assumes realized gains are short term and applies highest federal tax rate of 40.8%. Northern Trust does not provide accounting, tax or legal advice. Please see additional disclosures at the end of this document. There is no guarantee that objectives will be met.

In the past, managing these dynamics systematically has been difficult in practice. A single taxable portfolio may contain hundreds of securities and thousands of individual tax lots, with tax opportunities appearing and disappearing quickly as markets move. Today, advances in technology are making it possible to manage these dynamics far more systematically.

The Rise of Personalized Portfolios

One example is direct indexing, an approach that allows investors to own the individual securities that make up an index rather than a pooled investment vehicle. Because investors directly own each security, portfolios can be managed at the tax-lot level.

This structure enables several potential advantages:

- Harvesting losses across individual securities
- Deferring gains more effectively
- Customizing portfolios to match investor preferences
- Transitioning portfolios more tax-efficiently

Direct ownership of securities can also provide greater flexibility than pooled vehicles like mutual funds or exchange-traded funds, which generally cannot distribute losses to investors. It can also make it easier to coordinate tax management across multiple accounts and investment strategies.

More broadly, technology is enabling a new generation of personalized portfolios. With direct indexing, portfolios of all sizes can now be tailored to an individual investor's tax circumstances, investment goals and constraints.

Northern Trust Asset Management has decades of experience managing tax-advantaged equity strategies and implementing direct indexing solutions for taxable investors.

Learn More

Contact your Northern Trust Asset Management Senior Market Leader to learn more about our direct indexing capabilities.

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.

IMPORTANT INFORMATION

This document may not be edited, altered, revised, paraphrased or otherwise modified without the prior written permission of Northern Trust Asset Management (NTAM). The information contained herein is intended for use with current or prospective clients of Northern Trust Investments, Inc (NTI) or its affiliates. The information is not intended for distribution or use by any person in any jurisdiction where such distribution would be contrary to local law or regulation. NTAM and its affiliates may have positions in and may effect transactions in the markets, contracts and related investments different than described in this information. This information is obtained from sources believed to be reliable; its accuracy and completeness are not guaranteed and is subject to change. Information does not constitute a recommendation of any investment strategy, is not intended as investment advice and does not take into account all the circumstances of each investor.

This report is provided for informational purposes only and is not intended to be, and should not be construed as, an offer, solicitation or recommendation with respect to any transaction and should not be treated as legal advice, investment advice or tax advice. Recipients should not rely upon this information as a substitute for obtaining specific legal or tax advice from their own professional legal or tax advisors.

References to specific securities and their issuers are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities. Indices and trademarks are the property of their respective owners. Information is subject to change based on market or other conditions.

All securities investing and trading activities risk the loss of capital. Each portfolio is subject to substantial risks including market risks, strategy risks, advisor risk, and risks with respect to its investment in other structures. There can be no assurance that any portfolio investment objectives will be achieved, or that any investment will achieve profits or avoid incurring substantial losses. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. Risk controls and models do not promise any level of performance or guarantee against loss of principal. Any discussion of risk management is intended to describe NTAM's efforts to monitor and manage risk but does not imply low risk.

Past performance is not a guarantee of future results. Performance returns and the principal value of an investment will fluctuate. Performance returns contained herein are subject to revision by NTAM. Comparative indices shown are provided as an indication of the performance of a particular segment of the capital markets and/or alternative strategies in general. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. Net performance returns are reduced by investment management fees and other expenses relating to the management of the account. Gross performance returns contained herein include reinvestment of dividends and other earnings, transaction costs, and all fees and expenses other than investment management fees, unless indicated otherwise. For additional information on fees, please refer to Part 2A of the Form ADV or consult an NTI representative. Forward-looking statements and assumptions are NTAM's current estimates or expectations of future events or future results based upon proprietary research and should not be construed as an estimate or promise of results that a portfolio may achieve. Actual results could differ materially from the results indicated by this information.

Northern Trust Asset Management is composed of Northern Trust Investments, Inc. Northern Trust Global Investments Limited, Northern Trust Fund Managers (Ireland) Limited, Northern Trust Global Investments Japan, K.K, NT Global Advisors, Inc., 50 South Capital Advisors, LLC, Northern Trust Asset Management Australia Pty Ltd, and investment personnel of The Northern Trust Company of Hong Kong Limited and The Northern Trust Company.

© 2026 Northern Trust Corporation. Head Office: 50 South La Salle Street, Chicago, Illinois 60603 U.S.A. northerntrust.com