

How Custom Separately Managed Accounts (SMAs) May Be Able to Solve Investor Needs

The investment industry's adoption of custom separately managed accounts (SMAs) is well documented, with Cerulli reporting that the \$1.76 trillion in SMA advisory programs experienced 27% growth in 2021 and expects growth at higher rates than ETFs and mutual funds in the coming years.¹ We believe that this growth comes in recognition that comingled investment vehicles such as mutual funds and ETFs may not meet every individual investor's needs, while technology has enabled personalization that we have come to expect in so many areas of life. Personalization is a positive for investors, yet it can be difficult to imagine just exactly where it may be most valuable to an investor.

To help with this, we have identified examples of investor profiles that most benefit from personalization and the specific investor's needs being met.

Investors using custom SMAs may include those who:



Are in the highest tax bracket



Have in-kind, appreciated stocks and are looking to make a change



Want to align their investments with their values



Own a concentrated stock position



Need to create a custom equity exposure

Now let's take a deeper dive into each of these investor profiles:

¹ FundFire, "Personalized Strategies Set to Accelerate SMA Growth", May 4, 2022.



Investors who are in the highest tax bracket

Investors in the highest federal tax bracket can pay large capital gains taxes on securities held less than one year, currently at a rate of more than 40%. These taxes can be a substantial cost to investors and a detractor from investment returns. For these highest taxpayers, having a portfolio solution that manages for taxes year-round may reduce, or potentially eliminate, this tax burden.

A custom SMA with ongoing tax optimization offers active harvesting of positions that move to a loss in the investor's portfolio while simultaneously deferring capital gains to not create a tax liability. When an excess amount of net losses is realized and applied against capital gains realized inside the portfolio or generated elsewhere, this can potentially offset the investor's tax liability, and may allow for more investment dollars to remain invested in the market to grow over time. These tax-optimization practices can provide 1-2% annualized after-tax alpha versus an index for core exposures, and potentially greater after-tax alpha when overlain on active management portfolios compared to their model.



Investors who have in-kind, appreciated stocks and are looking to make a change

Custom SMAs can help advisors transition investor assets while being mindful of tax liabilities, portfolio risk and any other investor-specific considerations.

Common asset transition scenarios might include investors looking to diversify a concentrated portfolio held in a brokerage account, move away from their existing asset manager, or someone interested in implementing a new investment view (ex. Active to Core, Value to Growth). In each of these cases, if the portfolio has embedded gains, the taxes associated with selling may be too large of a burden for an investor to move forward, but investors don't need to feel stuck. Custom SMAs can offer a personalized plan based upon the investor's risk appetite and tax sensitivity.



Investors who want to align their investments with their values

For many investors, the impact of their portfolios is an important consideration in conjunction with investment performance. While every investor will have a different ESG objective, a custom SMA can offer a range of solutions tailored to those specific values. Examples might include:

- Investors concerned with firearms and wanting to exclude firearm companies from their portfolio can apply a "Controversial Weapons" screen.
- For investors who want to invest more capital in companies with stronger ESG characteristics, a portfolio tilt can be implemented.
- Religious institutions can remove stocks that go against the values of their faith from the investible universe.



Investors who own a concentrated stock position

Investors who have accumulated shares in a company stock over many years, often at low cost basis, may face concentration risk. Selling may incur a large tax liability. Custom SMAs allow for clients to restrict individual stocks, or entire sectors, from an investible universe in a manner that creates a completion portfolio, potentially allowing an investor to obtain diversified equity exposure without adding to their concentration risk. Should the investor wish to sell, ongoing tax-loss harvesting can also provide losses that aid clients in reducing the concentrated stock position with less, or potentially no, net tax cost.



Investors who need to create a custom equity exposure

Some investor objectives don't mesh with off-the-shelf products. For investors who want to personalize their equity exposure, say, tilt their portfolio toward Value stocks or underweight the allocation to a region, custom SMAs offer a solution within a single account.

For many advisors, their client base may be made up of many of the above investor profiles. To provide these investors with tailored solutions, it is important to find a partner with a broad array of customization offerings and a streamlined operations platform. At Neuberger Berman, our NB Custom Direct Investing (CDI)[™] platform allows for seamless integration of clients' varied objectives.

To learn more about NB Custom Direct Investing (CDI)[™], please contact your Neuberger Berman representative.

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