

# Direct Indexing

**Speakers:** Sirion Skulpone (Managing Director, Head of Client Portfolio Management for Quantitative Equity Solutions)

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## Transcript

00:00:00 – 00:00:43 **Sirion Skulpone**

Hi, I'm Sirion Skulpone, Head of Client Portfolio Management for Quantitative Equity Solutions at Goldman Sachs Asset Management. Our team has many conversations with High Net Worth and Ultra High Net Worth clients about concentrated stock. Market dynamics have created tremendous wealth, with the equity markets up more than 200% over the last decade. Much of investor wealth is concentrated in individual sectors or stocks, and this creates significant risk for investors, particularly if they have their wealth and their paycheck dependent on a single company. Individual stocks and sectors have much higher volatility, risk of large drawdowns and permanent impairment vs. the diversified stock market.

00:00:44 – 00:00:54 **Sirion Skulpone**

Across the industry, investors have trillions of dollars in individual stocks sitting unmanaged in brokerage accounts, much of which is highly concentrated and also highly appreciated.

00:00:56 – 00:01:33 **Sirion Skulpone**

At Goldman Sachs Asset Management, we are focused on providing customized solutions for the tax-efficient diversification of concentrated stock. We have solutions that can take a number of client considerations into account, things like a client's risk tolerance, their tolerance for realizing capital gains, whether they wish to diversify immediately or more gradually, and even how to handle when they have emotional attachment to a stock. Because of the high degree of customization capabilities, Direct Indexing is a solution that can apply in many client situations, and we can also factor in complex financial scenarios and estate planning goals.

00:01:34 – 00:01:41 **Sirion Skulpone**

Ultimately, we're focused on delivering tailored solutions that are personalized to a client's unique needs and objectives.

## **Risk considerations and disclosures**

Equity investments are subject to market risk, which means that the value of the securities in which it invests may go up or down in response to the prospects of individual companies, particular sectors and/or general economic conditions. Different investment styles (e.g., “growth” and “value”) tend to shift in and out of favor, and, at times, the strategy may underperform other strategies that invest in similar asset classes. The market capitalization of a company may also involve greater risks (e.g. “small” or “mid” cap companies) than those associated with larger, more established companies and may be subject to more abrupt or erratic price movements, in addition to lower liquidity.

The portfolio risk management process includes an effort to monitor and manage risk, but does not imply low risk.

Diversification does not protect an investor from market risk and does not ensure a profit.

## **Tax Considerations**

The strategy may result in adverse tax consequences for the client including, but not limited to, wash sales. Under the wash sale rules, a loss from the sale of shares of stock or securities is disallowed if the taxpayer acquires, or enters into a contract or option to acquire, “substantially identical” stock or securities within 30 days before or after the sale. GSAM may intentionally engage in wash sales when it believes that the trades are beneficial for the client to do so. In addition, GSAM may be unable to avoid wash sales in certain circumstances given uncertainty around the “substantially identical” standard. For example, there is considerable uncertainty around applying a “substantial overlap test” to evaluate whether certain mutual funds or equity baskets are “substantially identical” to each other, the treatment of unrelated issuers engaged in a merger or acquisition, the treatment of convertible preferred equity and/or the treatment of contracts or options to acquire stock or securities. In addition, data used for portfolio management may be incomplete, will be limited to information regarding the strategy account, and will not include information regarding positions held or transactions executed outside of the strategy account including other accounts managed by Goldman Sachs or its affiliates. Transactions in two or more accounts that are deemed to be related under the relevant tax rules and regulations (“related accounts”) may be subject to the wash sales rules that disallow or defer the recognition of losses. GSAM will generally only consider positions and transactions in your Account on a standalone basis when executing the strategy. If you instruct us to treat certain accounts as related for tax purposes, GSAM may take this instruction into account in its investment management process in order to reduce wash sales across the related accounts. GSAM relies on the information provided by clients or their advisers with respect to a client’s related accounts in order to limit the likelihood of wash sales from trades executed in the strategy account and related accounts. As a result, portfolio management decisions may be based on incomplete information. To the extent that one or more accounts are managed as related for tax purposes, GSAM may limit trading across those accounts to avoid wash sales which may result in less loss harvesting for the accounts. The US tax code allows capital losses to be carried forward indefinitely until portfolio is bequeathed. The cost basis of a tax loss harvesting portfolio is driven down due to the realization of capital losses, creating a contingent tax liability. For investors who will eventually bequest their tax loss harvesting portfolio to charity or to their heirs upon death, taxes on the unrealized gains are generally avoided. However, if the tax loss harvesting portfolio is liquidated, the investor will pay taxes on the realized gains upon liquidation.

It is the responsibility of the custodian, administrator or such other third party appointed by the client, to obtain accurate and reliable information concerning the valuation of any securities which are comprised in the portfolio. Broker tax reporting to clients may not identify all transactions that could be viewed as a wash sales. It is the responsibility of the client’s independent tax advisor to identify wash sales in the client’s portfolio. All clients are strongly urged to discuss the tax implications of any transactions, including any potential wash sales, with their independent tax adviser.

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## **After-Tax Performance Considerations**

The composite net of fee returns are calculated by adjusting each monthly gross of fee composite return by the highest possible model fee that could be charged to a client. The model fee includes all charges, transaction costs, investment management fees, custody fees, and other administrative fees. Our investment advisory fees are described in Part 2 of our Form ADV. The following is a summary of certain material assumptions made in the methodology used to calculate estimated after-tax performance but is not intended to be a complete summary of the methodology used. The methodology in this report applies a range of assumptions, including but not limited to:

- \* The calculation methodology generally uses the “highest cost” accounting convention for treatment of realized capital gains and losses.
- \* After-tax performance calculations include realized losses incurred by the portfolio but do not account for unrealized gains.
- \* The estimated after-tax performance may include disallowed losses due to wash sales, and as a result, the returns will be overstated.
- \* The estimated after-tax performance is derived from internal information regarding cost basis which will differ from the actual cost basis of the securities due to, for example, wash sales, corporate actions or depletion methodology, which results, in some instances, in returns being overstated or understated. GSAM has recently migrated information regarding realized gains and losses from its affiliated custodian into performance calculations for each composite. As a result, the after-tax performance has been restated to reflect performance based on affiliated custodial data.
- \* In addition, the estimated after-tax performance includes certain assumptions about cost basis adjustments received from unaffiliated custodians which would, in some instances, result in the performance being overstated.
- \* The methodology assumes that the tax benefit from net realized losses is recognized on the day that the realization occurs, and the hypothetical tax benefit is immediately reinvested in the account and compounded over time based on the performance of the account.
- \* The estimated after-tax performance applies a pre-liquidation methodology, where after-tax calculations only include realized gains and/or losses incurred by the portfolio but do not account for unrealized gains and/or losses. Tax loss harvesting and the realization of capital losses lowers the portfolio's cost basis, which may result in more net gains or fewer net losses in the future. For investors who will eventually bequest their tax loss harvesting portfolio to charity or to their heirs upon death, taxes on the unrealized gains are generally avoided. However, if the tax loss harvesting portfolio is liquidated, the investor will pay taxes on the realized gains upon liquidation.
- \* The estimated after-tax performance assumes net realized capital losses in the account are fully used to offset realized capital gains of the same holding period from outside of this account, which may not exist.
- \* The performance assumes that all dividend income is taxed at the maximum federal qualified dividend tax rate, which is lower than the tax rate on non-qualified dividend income. The performance applies maximum individual federal tax rates at the time the capital gains and/or losses were realized and income was received. The federal tax rates used for the current period are 40.8% on short-term gains, 23.8% on long-term gains and 23.8% on dividend income. Local and state income taxes and non-US taxes are not considered.
- \* The Portfolio Management team targets qualified dividends within this strategy and have controls in place that constrain selling tax lots held for less than 60 days. As a result of client-initiated redemptions and other factors, forced sales within these portfolios may cause portfolios to realize nonqualified dividends, which are not reflected in the after-tax calculations presented.
- \* Certain client accounts may be funded with securities that have embedded unrealized gains and/or losses that occurred prior to contribution to the strategy accounts. These gains and/or losses are included in the calculation of after-tax performance and if these gains and/or losses are realized while the account is under our management, the after-tax performance stated in this report may be higher or lower than accounts funded without embedded gains and/or losses.

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