

# UNLEASHING THE POWER OF DIRECT INDEXING

A COMPREHENSIVE GUIDE FOR  
INVESTORS AND ADVISORS



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**EMBRACE THE POSS/BLE™**

## INTRODUCTION

Welcome to the world of direct indexing, where innovative strategies meet the modern needs of investors who seek greater control and customization in their portfolios. We hope this brochure serves as your gateway to understanding the potential benefits and applications of direct indexing, an investment approach designed to empower investors and their advisors with a differentiated set of opportunities.

In the following sections, we will explore the fundamentals of direct indexing, discover its potential advantages, and uncover its diverse applications in various financial scenarios. Whether you are an investor looking for more flexibility and tax efficiency or an advisor seeking sophisticated tools to address your clients' unique requirements, direct indexing offers a compelling solution.

Financial markets are always evolving, and in such an environment, it's crucial to stay informed and equipped with cutting-edge strategies. This brochure is designed to provide you with the insights and knowledge necessary to confidently navigate the direct indexing landscape. So, let's dive in and explore how direct indexing can potentially revolutionize your investment approach and redefine your financial success.

### DISCOVER THE POWER OF DIRECT INDEXING: UNLOCK CUSTOMIZATION AND CONTROL IN YOUR INVESTMENTS

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Direct indexing goes beyond the traditional investment options of mutual funds and ETFs by offering investors a more personalized and tailored approach. Rather than investing in a packaged vehicle that includes a pre-determined mix of securities, direct indexing allows you to purchase a selection of the individual securities that make up an index and build a customized portfolio that aligns with your specific goals, values, and circumstances.

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## SECTION 1

# *What is Direct Indexing?*

## WHAT IS DIRECT INDEXING AND WHY HAS IT BECOME SO POPULAR?

In its simplest form, direct indexing involves directly investing in the actual securities that make up an index. This is different from investing in exchange-traded funds (ETFs) that track an index or active mutual funds that try to beat a benchmark index. Mutual funds and ETFs are commingled funds: they package underlying securities into a single vehicle that investors can buy but not modify. Everyone who buys that mutual fund or ETF gets the same combination of securities. In other words, one size fits all.

Direct indexing, on the other hand, allows investors to own the securities that make up an index and hold them in a separately managed account (SMA). This gives the investor the same market exposure as the index but also gives them the opportunity to build a customized portfolio. The investor can exclude certain securities or increase their exposure to other securities to reflect their specific goals, needs, or circumstances.

This style of investing has long been available to high net-worth and institutional investors. However, due to the rise of fractional share trading and reduced commissions on trading stocks, direct indexing has recently become more widely available to retail investors.

Since most retail investors don't usually have the funds to buy all the securities that make up an index, providers of direct indexing products use sampling. Sampling is the practice of reducing the number of securities purchased but keeping the overall portfolio exposures in line to mimic the entire index. This has also helped to lower the overall costs and made direct indexing accessible to a broader range of investors.

Direct indexing is expected to grow at an annualized rate of more than 12% over the next five years<sup>1</sup>, according to a recent report by Cerulli Associates. According to the report, direct indexing is projected to surpass \$800 billion by the year 2026.

As investors become more sophisticated and knowledgeable, and as their needs become more complex, direct indexing can help advisors offer investors far more options than ever before. Each investor has unique preferences—some are more concerned about taxes, some prioritize aligning their portfolios with personal values and beliefs, while others may not have such preferences. Additionally, some investors wish to steer clear of certain industries due to specific reasons, whereas others want to gain extra exposure to certain industries to express their belief in a theme or trend. With direct indexing, meeting those needs is possible.

<sup>1</sup><https://www.cerulli.com/resource/white-paper-the-case-for-direct-indexing>

## WHY USE DIRECT INDEXING?

There are numerous benefits to directly owning the individual securities instead of investing in a packaged vehicle like a mutual fund or ETF. When investors opt for a packaged or commingled investment, they forfeit the ability to personalize or customize their exposures according to their preferences. Moreover, investors become subject to the actions taken within the fund, which could have significant implications. For instance, if the fund sells securities during the year, the fund company is legally obligated to distribute the gains to all shareholders for that year. This distribution of capital gains has long been a source of frustration for many investors, especially in active funds where managers frequently sell positions to realize gains. On top of that, if the fund experiences net losses, not only are fund managers not required to distribute them, but they are also prohibited from doing so.

## POTENTIAL ADVANTAGES OF DIRECT INDEXING

Direct indexing offers significant advantages in managing capital gains and losses. When an individual owns securities and sells them, it leads to either a capital gain or a capital loss. The challenge arises in active SMAs where the manager's turnover or selling activities can trigger capital gains for the investor. The more frequent the turnover, the higher the likelihood of generating capital gains that must be taxed in that year.

However, with direct indexing, any capital losses can be utilized to offset capital gains at the household level. This means the investor can balance out gains in the specific SMA, as well as gains in other parts of their overall portfolio. As a result, direct indexing can become a powerful tool to significantly reduce the capital gains distributions that often lead to substantial tax liabilities.

Since the objective of direct indexing is to track a particular index, and indexes have no turnover outside of reconstitution, the manager does not have to sell anything. Instead, the manager can strategically sell underperforming positions and replace them with other securities that help maintain close alignment with the index while realizing a loss.

As a result, when investors file their taxes, they will have these net losses that can serve two purposes. First, they can be used to offset gains in other parts of their overall portfolio, potentially reducing their overall tax liability. Second, any remaining net losses up to \$3,000 can be used in the current tax year. And if the net losses exceed \$3,000, they can be carried forward to be utilized in future years. This tax efficiency makes direct indexing a valuable option for investors seeking to optimize their tax outcomes.







## IS DIRECT INDEXING APPROPRIATE FOR EVERY INVESTOR?

Investors who closely monitor benchmark performance may not be entirely satisfied with direct indexing. Since direct indexing allows for customized exposures, the SMA's performance may deviate from the benchmark index. Anyone considering a direct indexing strategy should be comfortable with some level of tracking error.

As investors become more sophisticated and their needs more complex, direct indexing offers a diverse array of options to meet their unique requirements. Direct indexing can also be combined with active management to create a single custom SMA. Having both direct indexing and active strategies can help address different investor needs.

SECTION 2

## Top 5 Potential Benefits of Direct Indexing

Now that we've explored what direct indexing is and its growing popularity, let's delve into **the top five potential advantages** it offers investors who seek enhanced control, tax efficiency, and performance optimization in their portfolios.

1

### Tax efficiency

Tax efficiency is one of the most significant potential benefits of direct indexing. Unlike mutual funds or ETFs, which are required to distribute capital gains to their investors, direct indexing allows the investor to control when and how capital gains are realized. This means the investor can potentially reduce their tax liabilities by harvesting losses to offset gains or delaying the realization of gains until a more favorable tax year.

2

### Customization

Customization is another potential benefit of direct indexing. With this approach, investors have complete control over their portfolio. Investors can select individual stocks based on their preferences and investment goals and choose to include or exclude specific companies, sectors, or industries based on their values or beliefs. This level of personalization is not achievable with traditional investment options like mutual funds or ETFs.

3

### Risk management

Risk management is another potential advantage of direct indexing. By owning individual stocks, investors can diversify their portfolio, potentially lowering exposure to risks linked to specific sectors or companies. Direct indexing allows portfolios to be tailored to an investor's unique risk tolerance and investment objectives, granting them greater control over their investments. This level of customization ensures that their portfolios align precisely with their risk preferences and financial goals.

### DIRECT INDEXING: TRANSFORMING TAX LOSSES INTO VALUABLE TAX ASSETS

Tax-loss harvesting is essentially a way to create valuable tax "assets". We all know that capital gains are an inevitable aspect of investing. Regardless of how the overall market performs some stocks will go up while others may decline.

With direct indexing, investors own the specific stocks that mirror their chosen index. The advantage here is that any losses harvested through this approach become the property of the investor. These losses can be put to good use by offsetting future gains on federal tax returns. They can also be used to offset up to \$3,000 of ordinary income annually.

The flexibility of this strategy extends even further, allowing tax losses to be applied not only to an investment portfolio but also to gains resulting from selling a home or a business.

# 4

## **Investing with purpose**

Faith-based, values-based, or beliefs-based investing preferences are vital considerations for many investors. Direct indexing provides a solid solution for those who prioritize specific faith-based, values-based, or beliefs-based criteria in their investment decisions. Through direct indexing, financial professionals gain the flexibility to select stocks according to these particular criteria, and construct portfolios that align with the investor's values. This high degree of customization is nearly unattainable with traditional investment options, as they may not prioritize the exact faith-based, values-based, or beliefs-based factors that the investor prioritizes.

# 5

## **Impactful charitable giving**

Direct indexing provides investors a tax-efficient way to support causes that align with their beliefs and values. It allows investors to donate individual stocks that match the charity's focus and principles, resulting in a tax break while also making a positive impact on the causes they are passionate about. It's a potential win-win for investors who want to align their charitable giving with their investment goals.







## SECTION 3

# *Direct Indexing: A versatile tool for concentrated stock positions*

Sometimes, having too much of a good thing can lead to unexpected consequences. Some investors may have had too much of their portfolio in a certain popular streaming service. This service experienced impressive gains during the pandemic, and its stock soared in 2020 and 2021. However, things took a different turn in 2022, with the stock dropping significantly and remaining in a slump due to various factors, including a declining subscriber base.

For investors who had a substantial portion of their portfolio tied up in this stock, the earlier gains could have propelled their wealth significantly, but the subsequent decline had an equally negative impact. A concentrated position in one or just a few stocks can pose potential risks for investors.

The solution, of course, is to diversify the portfolio. But diversification has a cost for many investors with substantial wealth in a concentrated position. There may be emotional ties to the company whose stock they hold. More importantly, if there have been substantial gains in the share price, there may be serious tax implications to divestment.

This is where direct indexing can be a tax-effective and measured way to reduce a concentrated stock position and diversify a portfolio.

## WHAT IS A CONCENTRATED STOCK POSITION? HOW MUCH IS TOO MUCH CONCENTRATION IN STOCKS?

A concentrated stock position is when an investor holds more than 10% of their portfolio in a single name.

While diversification remains a mantra in the investment industry for its ability to reduce volatility and potentially boost returns, the reality is that many investors do have a lot of eggs in only one basket. This happens for many reasons:

- The investor receives part of their compensation package in stock options. Over time, as the stock options vest in a taxable account, the holding can become quite significant and the cost basis low.
- The investor jumped on a particular bandwagon early, and as the stock appreciated in value, it grew to represent a large part of their wealth. Think of some of the early investors in Apple, for example.
- The investor was given shares as a gift by a parent or grandparent, or the shares were held for a long period of time, and their value grew to represent a large percentage of the investor's—or their family's—total wealth. It's worth noting that the stepped-up basis readjusts inherited assets when passed on after death.

## NAVIGATING CONCENTRATED STOCK POSITIONS: THE POWER OF DIRECT INDEXING

When success leads to concentrated stock positions, it's time to consider diversifying your portfolio. However, emotional ties and tax implications can make this a complex challenge. Enter direct indexing—a versatile tool offering tax-efficient ways to reduce concentration and optimize your investment strategy.

### **Unlocking Diversification:**

Concentrated stock positions can leave portfolios vulnerable to market shifts. Direct indexing allows you to hold a basket of stocks that replicate an index, enabling effective diversification and risk management.

### **Minimizing Tax Impact:**

Divesting a concentrated stock position comes with tax consequences. Direct indexing allows you to offset capital gains from selling a concentrated holding with losses from other securities, helping you strategically navigate the tax landscape.

### **A Tailored Approach:**

Direct indexing offers customizable solutions to gradually reduce exposure to specific stocks or sectors. Your advisor can help you mitigate risks and enhance financial security through smart, tax-effective strategies.

With direct indexing as your ally, diversifying a concentrated stock position becomes a seamless and rewarding journey. Consult your financial advisor to explore the potential of this versatile tool.

## ARE THERE RISKS TO HOLDING A CONCENTRATED STOCK POSITION?

Concentrated stock can be a meaningful way to build wealth, but there are risks when one or a handful of names dominate an investment portfolio. This makes the portfolio vulnerable to any stock-specific news. A significant downturn in the price of that company's shares can have a major effect on the overall wealth and future financial security of the investor and their family.

This risk becomes even more pronounced for those who acquire these concentrated positions through their workplace, as their financial and human capital become closely tied to one company or industry. A major negative event affecting that company or industry could have devastating consequences.

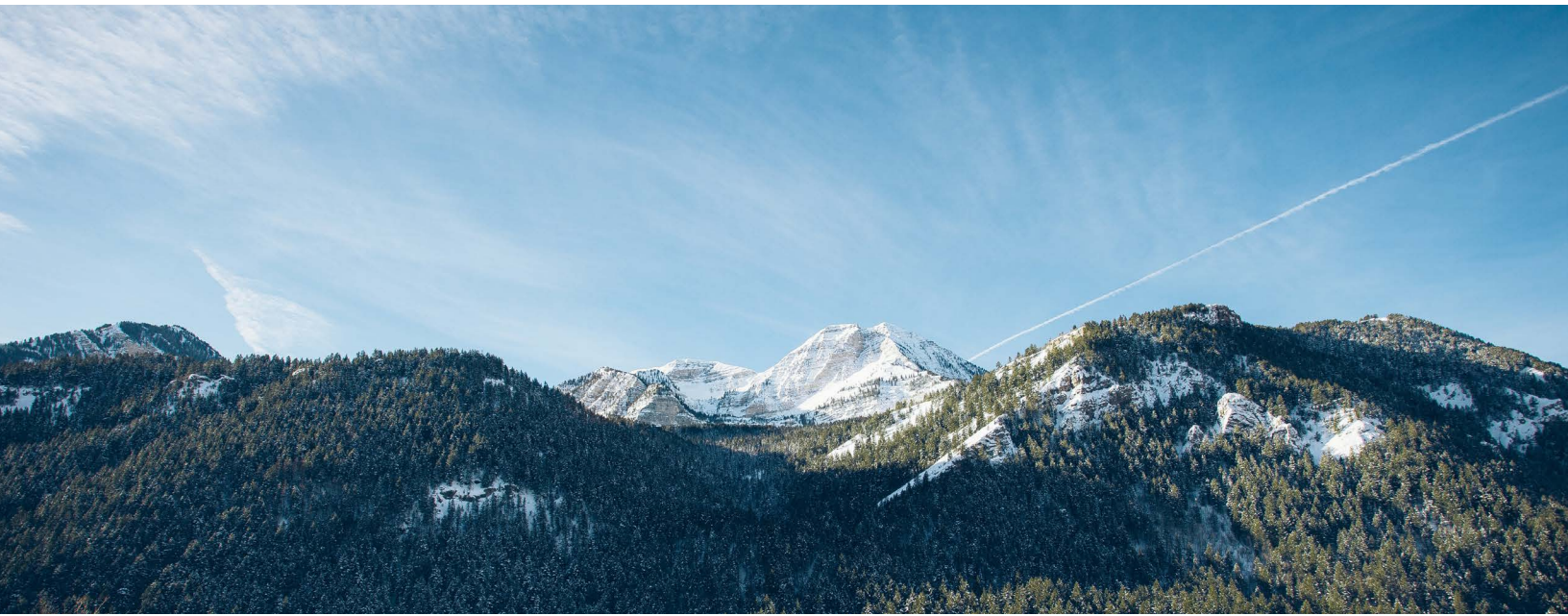
The Global Financial Crisis of 2008 serves as an illustrative example, as numerous financial institutions worldwide suffered or collapsed entirely. Many employees of these companies faced not just the loss of their job and potentially their pension, but also severe losses on their company's stock, eroding a significant portion of their savings.

It is essential for both advisors and investors to be aware of these risks and consider diversification as a means to effectively manage potential downsides.

## HOW DO YOU DIVERSIFY A CONCENTRATED STOCK POSITION?

Diversifying a concentrated stock position can present challenges for various reasons. Emotional attachment to the stock, whether because it was gifted by a beloved relative, is a long-term holding, or the investor was employed at the company, often complicates the decision-making process. Additionally, divesting a portion or all of the holdings must be carefully managed to address the associated tax costs, especially when the original cost of the shares is significantly lower than the current market value. That can result in substantial capital gains and potential tax liabilities.

One possible solution to navigate these challenges is through a direct indexing strategy within a SMA. Since direct indexing allows investors to directly hold a basket of stocks that replicate a specific index, they can offset the capital gains generated from selling the concentrated stock position with capital losses from other securities within the direct index portfolio. By employing this approach, investors can effectively manage their concentrated position, reduce risk, and optimize their tax outcomes.



## THE BOTTOM LINE

Direct indexing offers a versatile solution for reducing concentrated stock positions in an investor's portfolio. With this strategy, certain providers offer investors the flexibility to determine how much they want to take in capital gains annually until the concentrated position is reduced to a more manageable percentage. Alternatively, investors can choose to gradually reduce the exposure to the concentrated stock over a period spanning three to five years.

Moreover, direct indexing proves beneficial for investors looking to decrease their exposure to a specific sector or for those needing to reduce holdings for various reasons. For example, consider a scenario where a top banking executive joins a rival financial institution, holding a significant amount of their original bank's vested stock. In such cases, direct indexing offers a tax-efficient approach to remove that specific holding from their portfolio. Similarly, technology firm executives may also face similar situations, particularly given the substantial gains in tech stocks in recent years.

Investors with concentrated stock positions should work with their advisors to address the potential risks in their portfolios. Conducting a transition analysis can help investors explore different options to navigate a transition comfortably and optimize their investment strategies.



## SECTION 4

# *How to use Direct Indexing to Manage a Financial Windfall*

- Selling a business, property or large stock position can result in a financial windfall that may trigger a large tax liability
- A direct indexing strategy can help manage these tax burdens, either through a set timeframe or with an annual tax budget
- Advisors may benefit from happy clients who could provide a referral

Numerous high net-worth individuals have plans to sell a business, property, or sizeable stock position in the future. These types of sales often result in a significant capital gains tax liability that needs to be planned for years in advance.

With direct indexing, investors can proactively manage their portfolios to minimize capital gains taxes by strategically harvesting losses, offsetting gains, and implementing tax-efficient trading strategies. This approach can help investors navigate potential tax burdens effectively and enhance their overall financial strategies.

As mentioned before, a direct indexing strategy can potentially earn a return similar to a chosen benchmark while actively harvesting losses. These harvested losses can be accumulated and used to offset future capital gains, aiding in managing the investor's tax liabilities and potentially reducing taxes on their future financial windfall. Initiating this process early allows the investor working with their advisor ample time to adapt and make necessary adjustments as market conditions fluctuate and the investor's situation evolves.

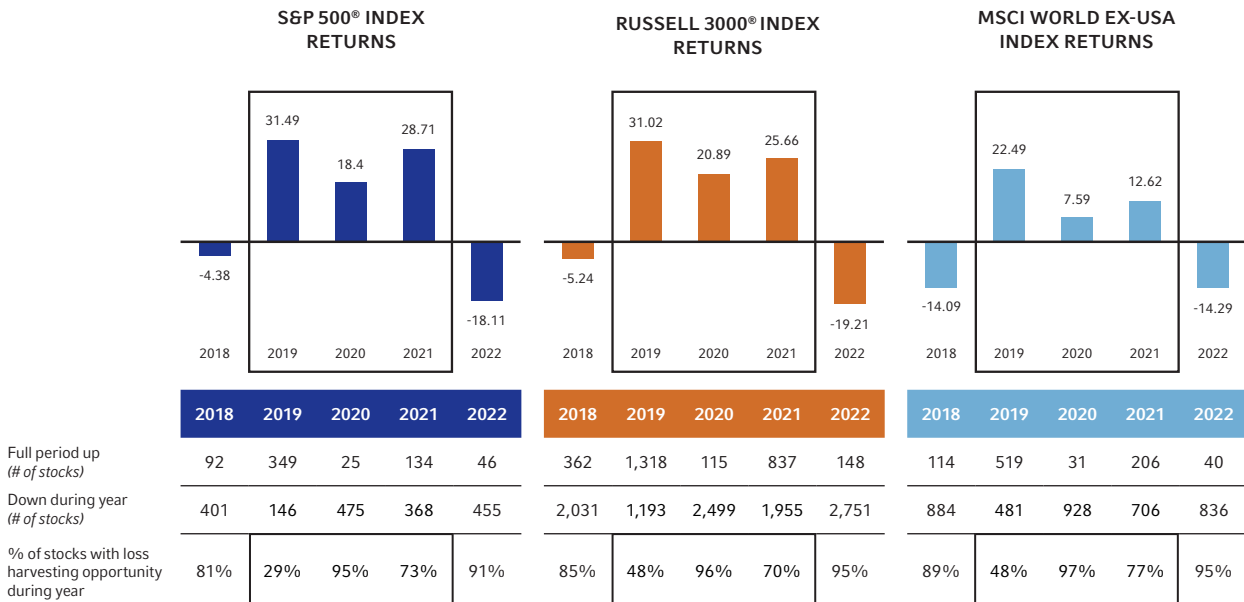
The first step should be to identify the potential for a windfall, taking into consideration factors such as their proximity to retirement or any other significant life changes. Once the source and timing of the future windfall has been determined, direct indexing can be utilized to either gradually reduce the potential tax liability or effectively manage the tax burden within a specified budget parameter. This strategic approach ensures that the investor can make the most of their financial situation while optimizing their tax outcomes.

## HOW DOES DIRECT INDEXING ADDRESS THIS ISSUE?

Since an SMA is comprised of a basket of individual securities, each with its own cost basis, investors who utilize direct indexing have the flexibility to buy and sell individual securities strategically. While the process is more intricate, essentially investors can sell stocks that have decreased in value and replace them with similar ones. This ongoing process helps build tax “assets” for future use.

A common question raised is whether tax loss harvesting is only effective during market downturns. Surprisingly, every year stock markets present investors with opportunities to harvest losses. The chart below illustrates how many individual names within three key equity indexes experienced losses at specific points in the past five years, even though the overall indexes themselves showed significant gains in three of those years. Investors who had invested in a direct indexing strategy would have had the chance to take losses in those names and use them to offset gains, all while potentially maintaining performance similar to that of the index.

## EVEN IN “UP” YEARS, THERE ARE OPPORTUNITIES FOR LOSS GENERATION



Source: Morningstar Direct. Analysis is based on S&P 500, Russell 3000 and MSCI World Ex-USA Index constituents as of 12/31/2022. “Full period up” indicates stocks that were never down YTD at the end of any month during the year. “Down during year” means stock was down YTD for at least one month during the year. Stocks that do not have full year returns were excluded. Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.



## LEVERAGING OPPORTUNITIES IN 2022'S CHALLENGING MARKET CONDITIONS

The year 2022 proved to be a tough one for the S&P 500, with the index experiencing an approximate 18% loss in value. While market outcomes are beyond our control, we can employ strategic approaches to capitalize on the market's volatility and harvest tax losses throughout the year. Direct indexing strategies offer a solution designed to generate returns akin to the S&P 500 while facilitating tax loss harvesting throughout the year.

For instance, a direct indexing strategy in 2022 could have yielded returns similar to the S&P 500 while taking advantage of market volatility to tax loss harvest. Consequently, the portfolio could have realized a substantial percentage in losses that could be used to offset future gains. Interestingly, as much as 91% of the stocks in the S&P 500 presented tax loss harvesting opportunities in 2022.

While this doesn't fully compensate for the challenges faced in 2022, it certainly mitigates the impact.



## SECTION 5

# *Helping High Net-worth Investors with Direct Indexing*

For financial advisors, increasing revenue is a key goal in their annual business plans. There are three primary avenues to achieve this: attracting new clients, expanding wallet share from existing clients, or relying on favorable market conditions. However, most advisors prefer generating the same revenue from a smaller, high net-worth client base rather than managing a larger pool of clients.

The challenge lies in the fact that many high net-worth individuals or organizations already have established relationships with financial professionals, making it difficult to reach out to them. Aside from seeking referrals from existing high net-worth clients, the best approach to connect with these individuals is by offering something truly unique.

Direct indexing presents a compelling solution that can help set you apart from the competition. By providing this innovative investment strategy, you offer high net-worth investors a personalized approach to managing their portfolios, while proactively harvesting losses and optimizing tax outcomes. With direct indexing as a unique value proposition, you can capture the attention of high net-worth clients and position yourself as a forward-thinking advisor.

This is where direct indexing can come into play. Despite being a well-known strategy among financial advisors, many have yet to incorporate direct indexing into their practices. This strategy allows advisors to manage their clients' investment tax liabilities while also personalizing their portfolios to align with unique values and preferences.

Interestingly, even though many high net-worth clients could benefit from direct indexing, they may not be aware of this approach. By integrating direct indexing into your services, you can introduce a fresh idea to these prospects, potentially winning them over as new clients. Emphasizing the advantages of direct indexing as a tailored and tax-efficient investment approach can help you stand out in the market and attract high net-worth clients seeking innovative strategies to manage their wealth.

## HOW TO START A CONVERSATION WITH HIGH NET-WORTH INVESTORS ABOUT THE BENEFITS OF DIRECT INDEXING

Describing direct indexing is relatively straightforward. In its simplest form, direct indexing allows an investor to own a basket of stocks that is designed to generate a benchmark-like return while allowing for customization and tax loss harvesting—with those losses available to offset gains elsewhere in the client’s overall investment portfolio. The question some advisors struggle with is how to approach the conversation. It’s a straightforward process that involves asking three key questions to an investor.

### **1. Are you expecting a substantial financial windfall in the future?**

Many high net-worth individuals have plans to sell a business, property, or significant stock holdings down the line. Such transactions often trigger considerable capital gains taxes that require careful planning well in advance. Unfortunately, not all advisors are proactive in helping clients address this future tax liability effectively.

This is where direct indexing comes into play. You can explain to your client that by adopting a direct indexing strategy, they can pursue benchmark-like returns while simultaneously engaging in loss harvesting. The losses harvested during this period can then be set aside to offset the future capital gains, providing a powerful tax management solution. By starting this process early, both you and your client will have ample time to adapt to market fluctuations and the client’s evolving financial situation.

By offering a solution, you may find yourself with a new high net-worth client who will likely be very relieved to have such a forward-thinking advisor by their side.

### **2. Do you currently own mutual funds that are generating capital gains taxes?**

For high net-worth individuals currently facing capital gains taxes due to their mutual fund holdings, direct indexing presents an appealing alternative. Unlike mutual funds, direct indexing strategies offer separately managed accounts, avoiding the need to distribute capital gains. This feature alone can be highly advantageous for investors looking to minimize their tax liabilities.

### **3. Do you have a concentrated stock position?**

Many high net-worth investors have a concentrated stock position that has accumulated over years. It may be a result of numerous equity grants, employee stock purchase plans or from exercising stock options. Often, financial advisors do not have a plan to work out of these positions in a tax-efficient manner. Many times, the position sits in an unmanaged, non-revenue-producing brokerage account, creating unnecessary financial risk for the client and a potential compliance liability for the advisor.

A direct indexing strategy can help the investor offset their estimated annual capital gains tax liability annually until the concentrated stock position is whittled down to a more manageable percentage of the portfolio. Alternatively, the exposure to the concentrated stock position can be pared down by taking gains over a period anywhere from three to five years. Those capital gains can be offset with tax-loss harvesting, keeping any related taxes to a minimum.

In summary, direct indexing offers a compelling investment strategy with clear benefits for high net-worth individuals.

SECTION 6

# Key Criteria to Consider When Choosing a Direct Indexing Provider

When seeking a reliable direct indexing provider, we believe there are 10 essential criteria that advisors and investors should carefully evaluate.

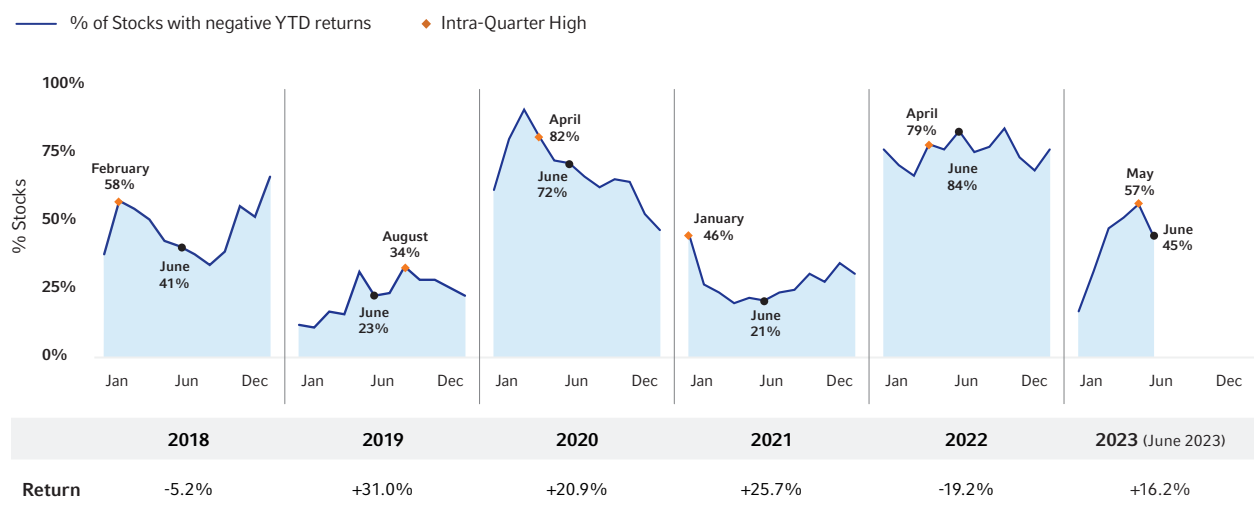
## 1. TAX MANAGEMENT EXPERIENCE.

First and foremost, consider their expertise in tax management. Direct indexing’s main advantage lies in tax optimization through strategies like tax-loss harvesting and capital gains management. It is crucial to partner with a provider who has proven capabilities in implementing these tax-efficient techniques.

## 2. TRACK RECORD AND EXPERTISE.

Consider the provider’s experience in managing indexed portfolios, the performance of their strategies over time, and their understanding of tax-management techniques. For example, many providers only do tax-loss harvesting quarterly. While that’s better than not doing it at all, providers who only tax-loss harvest four times a year may be missing out on numerous opportunities.

## MONTHLY TAX LOSS HARVESTING OPPORTUNITIES



- Even in up markets, opportunities to tax-loss harvest have been attractive
- A more frequent approach prevents opportunities from slipping through the cracks

Source: Morningstar Direct. Stocks: Russell 3000 Index constituents based on beginning of the year weights. Returns are year-to-date using year-end index weights.

### **3. FLEXIBILITY.**

Flexibility is another crucial aspect to contemplate. Can the provider seamlessly integrate with the investor's other investment accounts or holdings? An effective partner should be capable of managing various aspects, including concentrated stock positions, regardless of size or percentage of the overall portfolio.

### **4. TRANSITION MANAGEMENT.**

Transition management support is vital in smoothly shifting an investor's portfolio to the new direct indexing solution. Look for providers who offer structured and well-developed transition analysis to manage the migration process while minimizing the tax burden. This can be a powerful tool to determine the optimal process for migrating a concentrated or unmanaged portfolio while managing the related tax burden.

### **5. ACCOUNT MINIMUMS.**

When you look at direct indexing offerings, consider the account minimums. Although direct indexing was initially built for high net-worth investors, it can appeal to a wider investor base. Many providers using a purely passive approach require higher minimums. An active manager typically has fewer holdings than passive managers, meaning their minimums are often lower, which makes them more accessible to a larger group of investors.

### **6. RESEARCH AND INVESTMENT METHODOLOGY.**

Understand the provider's research and investment approach and look for transparency regarding their investment methodology, the factors they consider when constructing portfolios and their approach to risk management. A sound investment philosophy and disciplined approach to portfolio construction are essential.

### **7. CUSTOMIZATION OPTIONS.**

Direct indexing allows for more customization options compared to traditional mutual funds or ETFs. Look for a provider that offers a wide range of customization options such as the ability to exclude specific stocks or sectors, implement tax optimization strategies and align the portfolio with an investor's values, preferences, or beliefs.

### **8. PASSIVE? ACTIVE? OR BOTH?**

Most investors would likely see the value of having a choice between passive and active management. They may want a blend of the two approaches. Finding a provider that offers a selection of completely passive, completely active or the ability to combine benchmarks, is critical in allowing investors to make the appropriate choices. Active management and direct indexing each have their own benefits and can complement each other. Having both also provides optionality for different investor needs.



## 9. COST STRUCTURE.

Direct indexing typically involves separately managed accounts, and the fees associated with these services can vary. Understand the provider's fee structure, including management fees, overlay costs, and any additional charges, to ensure it aligns with the investor's goals and budget.

## 10. INDUSTRY RECOGNITION.

Finally, assess the provider's industry recognition and experience. Longer tenure and peer recognition can provide a sense of comfort, indicating a provider's ability to handle the complexities of direct indexing effectively.

In conclusion, selecting the right direct indexing partner requires a keen eye for detail. Evaluating these 10 criteria will help select the partner that aligns with the investor's goals and provides a personalized and tax-efficient investment experience. Start by examining the asset manager's background in tax management to identify a provider with a tried-and-true process in place.

## NEXT STEPS

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Congratulations! You've now embarked on a journey to unlock the full potential of direct indexing. The knowledge and insights gained from this brochure may help you make informed decisions that can potentially lead to significant advantages in your investment approach. As you move forward, we encourage you to leverage the power of direct indexing to its fullest.

For investors, seize the opportunity to customize your portfolio, align it with your values, and potentially enhance tax efficiency—all while maintaining a high level of control over your investments. Empower your financial future with direct indexing and see how this approach can reshape your path to success. Contact your financial professional for more information.

For advisors, harness the potential of direct indexing to offer tailored solutions to your clients, addressing their unique financial goals and challenges. As a sophisticated tool in your arsenal, direct indexing can set you apart in the advisory landscape and help your clients achieve their goals.

So, whether you are an investor or an advisor, now is the time to act. Embrace the power of direct indexing and take charge of your financial destiny. Embrace innovation, seize control, and potentially elevate your investment strategy with direct indexing. Your journey to a more empowered financial future begins now.

## ABOUT PERSONALIZED MANAGED ACCOUNTS

Direct indexing is offered through Russell Investments' Personalized Managed Accounts (PMA) program. PMA is a distinctive solution of customizable Separately Managed Accounts tailored to investors' unique and specific needs. The PMA program allows you and your advisor to take control of your holdings while simplifying and streamlining your portfolio. This includes advanced tax management, customization for personal needs as well as personal wants, transition management as you move an existing account or holdings into PMA, right on down to transparency into your portfolio's holdings and trading activity. Russell Investments also offers active SMAs within its PMA structure. PMA leverages Russell Investments' extensive investment manager research, selection and monitoring process. This process is our trademark, forming the cornerstone of our advice to global institutional investors for more than 50 years.

## ABOUT RUSSELL INVESTMENTS

Russell Investments is a leading global investment partner providing tailored solutions and services to institutions and individuals through financial intermediaries. Russell Investments is dedicated to improving people's financial security. Our approach incorporates in-depth manager research to select some of the world's leading institutional investment managers and strategies, offering the best ideas of each manager within well-diversified separately managed accounts and mutual funds.

## QUESTIONS?

If you're an investor, ask your Financial Professional for more information on direct indexing options available to you.

If you're a Financial Professional, your Russell Investments representative can help you build the right direct indexing strategy for your clients.

**IMPORTANT RISK DISCLOSURES:**

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Diversification and strategic asset allocation do not assure a profit or guarantee against loss in declining markets. Please remember that all investments carry some level of risk. There are no assurances that the objectives stated in this material will be met. Investment in one or more separately managed accounts is not a complete investment program and involves risk; principal loss is possible. The principal value of the account is not guaranteed at any time.

Personalized Managed Accounts ("PMA") is a program of Russell Investment Management, LLC (RIM) and offers customized portfolio management services.

Each Personalized Separately Managed Account is a product of RIM and offered through PMA program. It represents a composite of model portfolios provided by RIM, in which each composite reflects model portfolios of RIM and third-party investment advisors selected by RIM.

When the model is implemented, PMA is a separately managed account program of individually owned securities that can be tailored to meet investor's investment objectives. RIM partners with third-party money managers to offer diversified, single or multi-asset managed accounts that can be customized to the investor's investment objectives, circumstances and preferences, such as (but not limited to), market exposure, risk management, tax management, environmental, social and governance considerations, and return objectives. Excluding any allocations to pooled investment vehicles, if any, each investor's account is managed separately from other investor accounts, allowing for a personalized experience to deliver unique investment outcomes.

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