Gresham

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# Keep Your Gains: How Tax-Managed Equities Boost After-Tax Wealth

Death and taxes may be inevitable, but wealthy families can reduce the latter. With financial gain inevitably come taxes. Minimizing this tax drag can be nearly as important as maximizing return to ensure that you keep more of what you earn. Gresham helps high-net-worth families transform entrepreneurial and business success into long-lasting personal wealth through tax-optimized investment solutions and thoughtful legacy planning. This article, the first in a series, explores tax-managed investment strategies, their tax loss harvesting benefits, and how we optimize after-tax outcomes to maximize after-tax wealth creation.

*Tax-Managed Equity Strategies*

Investors are increasingly focused not just on what they earn from their investment portfolios, but on what they are able to keep after taxes. Tax-managed equity strategies aim to optimize after-tax returns by minimizing tax liability while maintaining market-like pre-tax performance. Unlike mutual funds or ETFs, these strategies use separately managed accounts (SMAs), enabling direct ownership of securities, which offers greater transparency, customization, and potentially lower fees. Additionally, the SMA structure enhances tax-loss harvesting – selling securities at a loss to offset taxable gains – by allowing precise, investor-specific adjustments, unlike the pooled nature of ETFs or mutual funds, which limits individualized tax management.

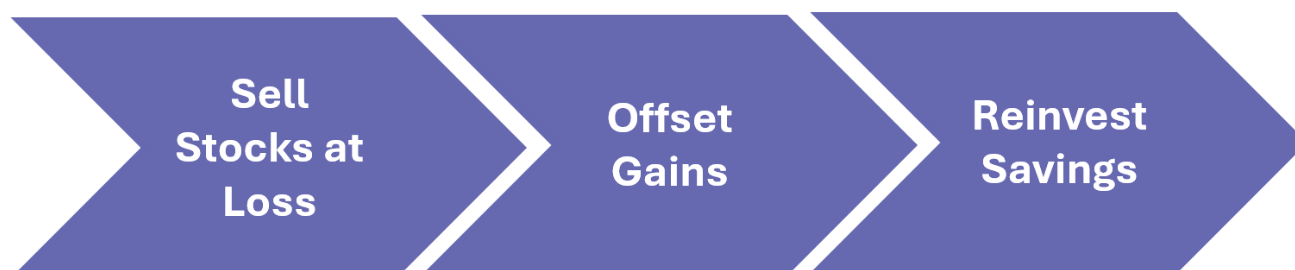
Investors select a benchmark, like the S&P 500 index (for U.S. equities) or the MSCI All-Country World Index (for global equities), and managers construct portfolios to track the index's returns. The manager will then opportunistically sell positions that have declined in value, realizing a capital loss, which the investor can use to offset gains elsewhere in their portfolio. Market volatility enhances opportunities to realize losses, enhancing tax savings without deviating from an investor's long-term strategy.

*Tax-Loss Harvesting*

In any portfolio consisting of hundreds of stocks, at any given time, some will increase in value, while others will decline. Short-term losses realized by selling positions held for less than one year can be valuable from a tax perspective, so not harvesting them is a missed opportunity. For example, $500,000 in realized short-term losses could reduce an investor's

tax liability by over $200,000 (at 40.8% tax rate, including the net investment income tax of 3.8%) when offsetting short-term gains, with these savings reinvested for future wealth compounding.

*Figure 1: How Tax-Loss Harvesting Works – Selling stocks at a loss offset gains, reducing taxes and fueling reinvestment*




If an investor's short-term losses exceed short-term gains in a given tax year, long-term gains can be offset; however, the savings from doing so are smaller due to lower tax rates on long-term gains (23.8% vs. 40.8%, both inclusive of the net investment income tax). Losses unused in a given calendar year carry forward, offsetting future gains and enhancing long-term tax savings.

*Additional Benefits of Tax-Managed Equity Strategies*

These strategies offer additional financial benefits to investor portfolios, helping to meet family-specific goals and objectives. We will explore these topics in greater detail in future articles.

**Estate Planning** – Wealthy families often transfer assets to future generations by utilizing grantor trusts which allow the grantor to pay the income taxes on trust income. Incorporating tax-managed equity strategies in the grantor's taxable portfolio can then allow for greater allocations to less tax-efficient, alpha-seeking investments in the trusts designed to benefit the grantor's descendants.

**Philanthropy** – Tax-managed equities, due to their SMA format, enable charitably inclined families to donate securities with unrealized long-term capital gains to donor-advised funds, private foundations, or charities. These contributions provide the investor with a tax deduction based on the securities' fair market value (subject to limits) and remove the capital gains from the investor's portfolio, delivering multiple layers of tax savings.

**Pre-Transaction / Liquidity Event Planning** – Entrepreneurial success often generates capital gains, which tax-managed equity strategies can offset with realized losses to enhance after-tax outcomes. These strategies, tailored to various risk profiles, effectively

support families approaching major liquidity events by minimizing tax burdens and preserving wealth.

**Concentrated Stock Positions** – Wealthy families often hold concentrated stock or ETF positions, where significant unrealized gains discourage diversification and can lead to underperformance over time. Short-term losses generated by tax-managed equity strategies can provide a valuable offset to mitigate the tax impact of actions designed to reduce large concentrations to low basis securities while enhancing overall portfolio diversification.

*Other Considerations*

Investors considering tax-managed equities should evaluate several additional factors to ensure alignment with their goals. These strategies aim to track, not outperform, benchmarks. However, performance variations (tracking error) and fees can affect returns. Balancing tax-managed approaches with active strategies can optimize portfolio outcomes, while long/short options, which use leverage to produce higher and more sustainable tax losses, increase complexity and costs. New approaches targeting ordinary income offsets may offer benefits but introduce greater tracking error and tax risk, requiring careful assessment to suit an investor's risk tolerance and objectives. Investors with multiple tax-managed SMAs must monitor trades across accounts to avoid wash sale rule violations that could negate tax benefits.

*Bottom Line*

Tax-managed equity strategies can provide wealthy investors with market-like returns while increasing after-tax wealth through active tax management. Studies by BNY and Morgan Stanley suggest these strategies can boost after-tax returns by 1-2% annually, and significantly more using long/short approaches. These strategies may be more complex relative to traditional stocks, mutual funds, and ETFs, but the compounded benefits over time can have a meaningful impact on growing generational wealth. Tax-managed strategies may also enhance the impact of a family's estate planning, philanthropy, pre-transaction planning, and management of concentrated stock exposure.

With the right team of advisors (including CPAs and attorneys), investors can use tax-managed strategies to unlock tax-saving potential while meeting long-term wealth creation objectives.

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