

Tax Management – Client Study

Meet Alex

- 25-year-old investor
- \$100,000 in various mutual funds in a taxable account
- Long-term investor: growth focused but concerned about taxes

Alex has received large capital gains distributions in previous tax years and wants to transition out of his mutual funds into a diversified equity portfolio comprised of various SMAs for his long-term time horizon. He is concerned about selling the funds due to the imbedded unrealized gains.

Alex's Goals Include



Adjusting his portfolio to an active SMA to reduce his net expenses while invested in mutual funds



Minimizing the tax liabilities from selling legacy funds while implementing tax loss harvesting to transition his portfolio



Actively diversifying his growth weighted mutual funds into a more value broad based index

▶ How Tax Management Service can Help



- ✓ Tax Efficient Trading
- ✓ Certain Wash Sale Adherences
- ✓ Custom Tax Loss Harvesting
- ✓ Client Customization
 - ✓ Set Gain/Tax Limit
 - ✓ Active Portfolio Transition

WEALTH MANAGEMENT

Alex's Investment Approach

As a young, high-income earner, with a long-term time horizon, Alex wishes to transition his Mutual Funds that consistently pay out capital gain distributions at the end of the year. Alex is looking for a broad-based value portfolio to reduce his risk. He wants to own individual equities that follow a cadenced tax loss harvesting approach tailored to his financial goals.

A solution for Alex is to hold his Mutual Funds in a Tax Managed UMA with a target allocation comprised equity based SMAs.

Tax Management provides Alex the opportunity to set custom tax preferences increasing his loss capture on both a scheduled and opportunistic basis. Due to his tax sensitivity, he can elect to limit his capital gain exposure by adding a gain limit, so his mutual funds don't get sold.

Benefits of Separately Managed Accounts

Separately Managed Accounts (SMAs) offer several benefits to investors. One of the primary advantages is the direct ownership of the underlying securities in the portfolio, which allows investors to request reasonable restrictions on the management of their account and manage the timing of future tax liabilities. Another key benefit compared to mutual funds is that SMAs have low expense ratios. Management fees in mutual funds tend to be priced higher than the expense ratios in a SMA.

Within Tax Managed UMA, Alex can own multiple SMAs in one account. This provides highly personalized, tax-efficient, and diversified investment management, while reducing the administrative burden. This leads to streamlined reporting, consolidated performance tracking, and less statements and tax documents throughout the year.

Benefits of Tax Management Services



Set Gain Limit:

Option to set a customizable capital gain limit on taxes and/or realized gains within individual portfolios to help manage the tax burden of a sale year over year. This will allow Alex to have a specific amount of the Mutual Funds sold up to his directed limit.



Tax Loss Harvest & Certain Wash Sale Adherences:

Offset realized gains through systematic and opportunistic tax-loss harvesting,

When equity securities realize losses, they are only bought back 31 days after the sale (unless purchased by one manager and subsequently sold by another).



Transition to Target Portfolio:

By actively tax-loss harvesting and reducing the realized gains on the account, additional Mutual Funds can be sold back up to the client directed gain limit. These proceeds from the sale can now be invested into the target allocation to slowly transition over time.



COMPETITIVE FEES:

Morgan Stanley's fractional share trading technology uniquely democratizes SMAs, enabling minimums as low as \$5,000 per sleeve. This lets Alex allocate modestly to niche SMAs (e.g., \$50,000 to sustainable energy) without high entry barriers, making them viable for core and satellite strategies. SMAs used to be reserved for ultra-high-net-worth clients; now, they're accessible for anyone. Morgan Stanley "zero management fee" SMAs as well. This is cheaper than typical ETFs (0.03-0.50% expense ratios) or mutual funds (0.50-1.50%). If Alex had a \$1.25 million SMA allocation, this could save \$6,250-\$18,750 annually in fees.

Outcomes and Lessons

Over the course of the year, Alex's UMA strategically sold down his legacy Mutual Funds from 100% of the total account value to 55%.

This case illustrates how Morgan Stanley's Tax Managed UMA, balances growth, taxes, and caution tailored for discerning clients like Alex. Always consult a tax advisor, as individual results vary based on circumstances.

Disclosures

Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider their financial ability to continue their purchases through periods of low-price levels.

Morgan Stanley Smith Barney LLC offers insurance products in conjunction with its licensed insurance agency affiliates.

Annuities are long-term investments designed for retirement purposes and are subject to investment risk, including the possible loss of principal.

Withdrawals and distributions of taxable amounts are subject to ordinary income tax and, if made prior to age 59½, may be subject to an additional 10% federal income tax penalty.

Early withdrawals will reduce the death benefit and cash surrender value. Living benefits are optional and are available for an additional cost. When evaluating a living benefit there are several key factors that must be considered such as: cost investment limitations, holding periods, liquidity, withdrawals and your age and risk tolerance.

All guarantees are based on the claims-paying ability of the issuing insurance company.

If you are investing in an annuity through a tax-advantaged retirement plan such as an IRA, you will get no additional tax advantage from the annuity. Under these circumstances, you should only consider buying an annuity because of its other features, such as lifetime income payments and death benefits protection.

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Alternative investments often are speculative and include a high degree of risk. Investors could lose all or a substantial amount of their investment. Alternative investments are appropriate only for eligible, long-term investors who are willing to forgo liquidity and put capital at risk for an indefinite period of time. They may be highly illiquid and can engage in leverage and other speculative practices that may increase the volatility and risk of loss. Alternative Investments typically have higher fees than traditional investments. Investors should carefully review and consider potential risks before investing.

- Loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices;
- Lack of liquidity in that there may be no secondary market for a fund;
- Volatility of returns;
- Restrictions on transferring interests in a fund;
- Potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- Absence of information regarding valuations and pricing;
- Complex tax structures and delays in tax reporting;
- Less regulation and higher fees than mutual funds;
- Risks associated with the operations, personnel, and processes of the manager; and
- Risks associated with cybersecurity.

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Tax-loss harvesting: IRS rules stipulate that if a security is sold by an investor at a tax loss, the tax loss will not be currently usable if the investor has acquired (or has entered into a contract or option on) the same or substantially identical securities 30 days before or after the sale that generated the loss. This so-called "wash sale" rule is applied with respect to all of the investor's transactions across all accounts.

Morgan Stanley's Select UMA program is a unified managed account which is a vehicle neutral platform that simplifies the delivery of multiple investment vehicles such as separate accounts, mutual funds, exchange traded funds and individual securities through their integration within a single environment. Select UMA® is a registered service mark of Morgan Stanley Smith Barney LLC. Advisory relationships may not be appropriate in certain situations.