

# Tax Efficient Investing

*Actively managing portfolios to maximize after-tax returns*

*“Nothing is certain but death and taxes.”*

*-Benjamin Franklin*

## **Firm Summary**

- Independent, privately owned
- Founded in 2000
- over 70% in HNW taxable assets
- 10 Investment professionals, with nearly two centuries of cumulative investment experience.

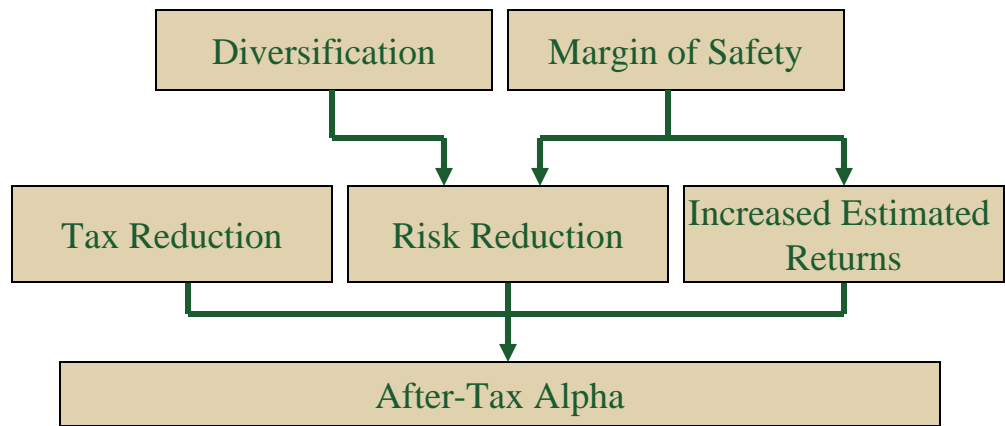
## **Portfolio Strategies**

- Tax Efficient All-Cap Core Equity
- Select All-Cap Core Equity
- Large-Cap GARP Equity
- Tax Efficient Large-Cap GARP Equity
- Products are also available as balanced strategies.

## **For More Information Contact:**

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Tradition Capital Management manages taxable portfolios to maximize the after-tax returns. The objective of maximizing after-tax returns requires the understanding and the ability to adapt to the complexity of high net worth (HNW) clients. Unlike enhanced index funds, Tradition takes an active bottoms-up approach in building a portfolio keeping in the mind the following objectives:



## **Impact of Taxes on Investment Returns**

In our experience, the impact of taxes on investment returns is too often ignored when making portfolio decisions. This is unfortunate, as active trading done without regard to taxes can lower annualized after-tax returns by as much as 20%. At Tradition Capital Management, we explicitly recognize that managing taxes is an important component to managing taxable accounts such as personal assets, trusts and partnerships. Our long-term investment strategy is specifically designed to minimize taxes. We buy a diversified portfolio of excellent companies and participate in their growth over multiple years, so our portfolio turnover is moderate. Tradition invests capital in these companies when we can find a margin of safety on our investment. Stocks are only purchased when they are at a discount to our estimate of underlying business value; this margin of safety lowers the risk of permanent capital impairment while simultaneously improving the return potential.

Since we focus on investing versus trading, our capital gains are most often long-term, which are entitled to favorable federal tax treatment. Long-term gains are currently taxed at 15% for high-income investors versus short-term gains, which are taxed as regular income, at rates up to 35%. In other words, the difference in a short-term versus a long-term capital gain of \$10,000 is an immediate savings of \$2000. Our long-term investment strategy is an integral part of running tax efficient portfolios.

There are no easy answers when it comes to making investment decisions based on after-tax terms. Tax efficient investing is often more personalized and difficult than nontaxable investing because each tax efficient client portfolio is optimized to its own tax and diversification objectives.

Through years of experience, Tradition Capital Management has developed time tested customized solutions for taxable HNW clients. Tradition welcomes the challenge of addressing your unique investment needs.

# Tax Efficient Investing

## *Integrated Comprehensive Strategy*

# 1

## Client Profile

### Client Profile

- Marginal Tax Rate
- Tax loss carry-forwards
- YTD. realized gains/losses
- Tax loss/gain information
- Risk tolerance

Tradition Capital Management's tax efficient investment process begins with the collection of information about the investor's tax situation: marginal tax rate, tax loss carry-forwards, year-to-date realized gain position, tax lot information of existing assets, risk tolerance and diversification attitude. Each holding in a portfolio is profiled by its potential risk/return, imbedded tax liability, contribution to portfolio diversification, and after-tax potential return. High cost and/or long-term holdings generate the lowest tax impact and thus the corresponding potential replacement security has a lower after-tax return hurdle.

# 2

## Strategy

### Strategy and Implementation

- Tax Efficient All-Cap Core Equity designed for taxable clients
- Flexible GARP strategy for all environments
- All-Cap allows capital to be deployed opportunistically

Tradition Capital Management's Tax Efficient All-Cap Core Equity strategy was created for taxable clients. As an All-Cap Core strategy, the portfolio can adjust to overall market conditions and capture opportunities. Our Growth At the Right Price (GARP) style forces discipline onto the selection process. We are building portfolios of growth stocks but buying these companies at the right price when they represent value. We only buy when we have a margin of safety as represented by the fact that the stock price is at a discount to our estimate of underlying business value. Our Tax Efficient All-Cap Core Equity portfolio is characterized by companies that have better financial strength, higher growth and better value. Superior companies at the right price.

This GARP strategy allows the flexibility to invest where the best opportunities lie regardless of industry. Typical growth or value investing falls in and out of favor and has distinct sector biases. Our flexible GARP strategy will buy growth at the right price regardless of sector as it recognizes that all growth has a price that is reasonable and the stocks themselves must be purchased at a discount to this reasonable price. Overpaying for high growth is as much of a disaster as overpaying for low growth. The best stocks are growth stocks that can be purchased at low relative valuations.

This All-Cap strategy allows capital to be deployed opportunistically regardless of market capitalization. Market conditions sometimes drive differing valuations across the market capitalization. This gives Tradition the opportunity to migrate capital out of fully valued stocks in one market segment into better opportunities in another. All purchase decisions are made on a bottoms-up basis to deploy capital where the opportunity is most favorable and the risks are manageable; these opportunities will drive whether the stocks we are buying are classified as large, small or mid and growth or value. Academic studies show that an All-Cap Core strategy is ideal for taxable portfolios.

# 3

## Implementation

- Highest estimated alpha stocks are purchased
- Risk Controls implemented
- Lowest estimated after-tax alpha stocks used as source of funds
- Focus on after-tax alpha

Portfolios are built to maximize after-tax risk-adjusted returns (alpha). Stocks are included in the portfolio based on expected alpha while risk controls constrain position size, sector allocation and market capitalization emphasis. Each existing holding in a portfolio is profiled by its potential risk/return, imbedded tax liability, contribution to portfolio diversification, and after-tax potential return. High cost and/or long-term holdings generate the lowest tax impact and thus the corresponding potential replacement security has a lower after-tax return hurdle. Trades occur when a potential new stock has a higher estimated after-tax projected return than the stock being sold to fund the new purchase. The portfolio is actively managed to keep the prospective after-tax alpha high while limiting risk through diversification and margin of safety.

# 4

## Tax Loss Harvesting

### Tax Loss Harvesting

Helping to Maximize After-Tax Returns

Tax loss harvesting is an integral part of the process and is actively employed throughout the year. At Tradition, every day is part of the Tax Loss Harvesting Season. Losses harvested today can be applied against other gains in the current year or carried forward into future years to protect future gains from taxes. Tax loss harvesting is optimized by taking advantage of opportunities as they appear regardless of the time of year through several methods.

### **Straight Sale**

If we think the position is permanently impaired and the capital can be deployed in a more attractive security, we will sell the position.

### **Repurchase Transactions**

If a position has a substantial unrealized loss in a portfolio but the long-term prospects are attractive, several methods are utilized to avoid the tax loss wash sale rule. The standard repurchase transaction would be to sell the position immediately, realize the loss for tax purposes, and repurchase the stock after the 30-day wash sale window expires.

### **Double Up Positions**

Assuming a company that Tradition Capital Management wants to own for clients is currently selling at a meaningful discount to tax cost basis, we could execute a buy double up by doubling a client's position in that company. After the 30-day wash sale window expires, a "versus purchase" sale would be executed to liquidate the high cost older tax lot that was selling at a loss. This maneuver is particularly attractive if the company is poised for recovery over the near term.

### Swapping Into Similar Security

“Wash sale” rules prohibit the sale of a security for tax loss purposes and the immediate purchase of “substantially identical” securities. However, selling the security of one company and buying the security of another in the same industry is permitted. The proceeds from the sale can be deployed to buy another similar company in the same industry. There may be occasions when an existing security, which is selling at a loss, has a close substitute that is equally attractive.

### Double Swap

Assume that you have two positions in the portfolio, both of which have meaningful unrealized losses and both of which have reasonably attractive prospects. In this maneuver, we could liquidate either of the two positions, and use the proceeds to buy more shares in the other holding. Then at the expiration of the wash sale period, the original transactions are reversed, thereby locking in the realized losses of both positions.

## 5

## Advantages of Tradition

Tradition’s strategy has numerous advantages over competitive offerings. Our Tax Efficient All-Cap Core strategy is a comprehensive solution for taxable clients, not a nontaxable product with a late year tax harvesting add-on. Unlike many of the strategies focused on after-tax results, Tradition’s Tax Efficient All-Cap Core Equity strategy is not an enhanced tax managed index fund. Our goal is to provide alpha to the portfolio while maximizing after-tax returns. Although historical results are not predictive of the future, our since inception results have added value with our Tax Efficient All-Cap Core Equity strategy. Tradition is one of the few managers in the country making the effort to calculate after-tax gross composite returns. Please refer to our detailed composite performance report for full disclosure and appropriate comparative indices.

Taxable clients are often lost in the investment maze and forced to select products that are not tailored to their particular needs. Tradition Capital Management has a unique solution for taxable clients with its Tax Efficient All-Cap Core Equity strategy; a product designed, structured and built just for taxable clients. Tradition’s focus on the taxable HNW investor has served our clients well and added after-tax alpha to our clients’ portfolios.

Investing involves uncertainty and unexpected events. Tradition makes numerous forecasts when determining a company’s alpha and/or estimated fair value. Estimates include but are not limited to earnings power, growth, profitability, prospective payout ratio, relative valuation and risk assessment. These estimates are guides to organizing our investment opportunities and not are not guarantees of future results.