Taxes and investing

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Important Information

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 profit or protect against loss in declining markets.

Income from funds managed for tax efficiency may be subject to an alternative minimum tax, and/or any applicable state and local taxes.

Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Past performance is not indicative of future results.

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The only difference between a taxman and a taxidermist is the taxidermist leaves the skin.

~ Mark Twain

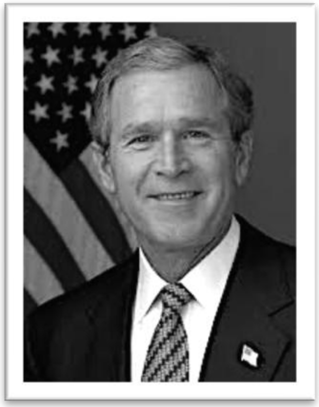
Three take-aways

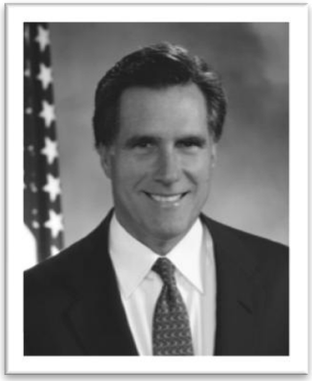
1. **Taxes and taxable assets: why it matters**
2. **Rates likely going in one of two directions (guess which way?)**
3. **Taxes can be managed**

Inflection point?

2013

Taxes…A step through (modern) history





November 6, 2012

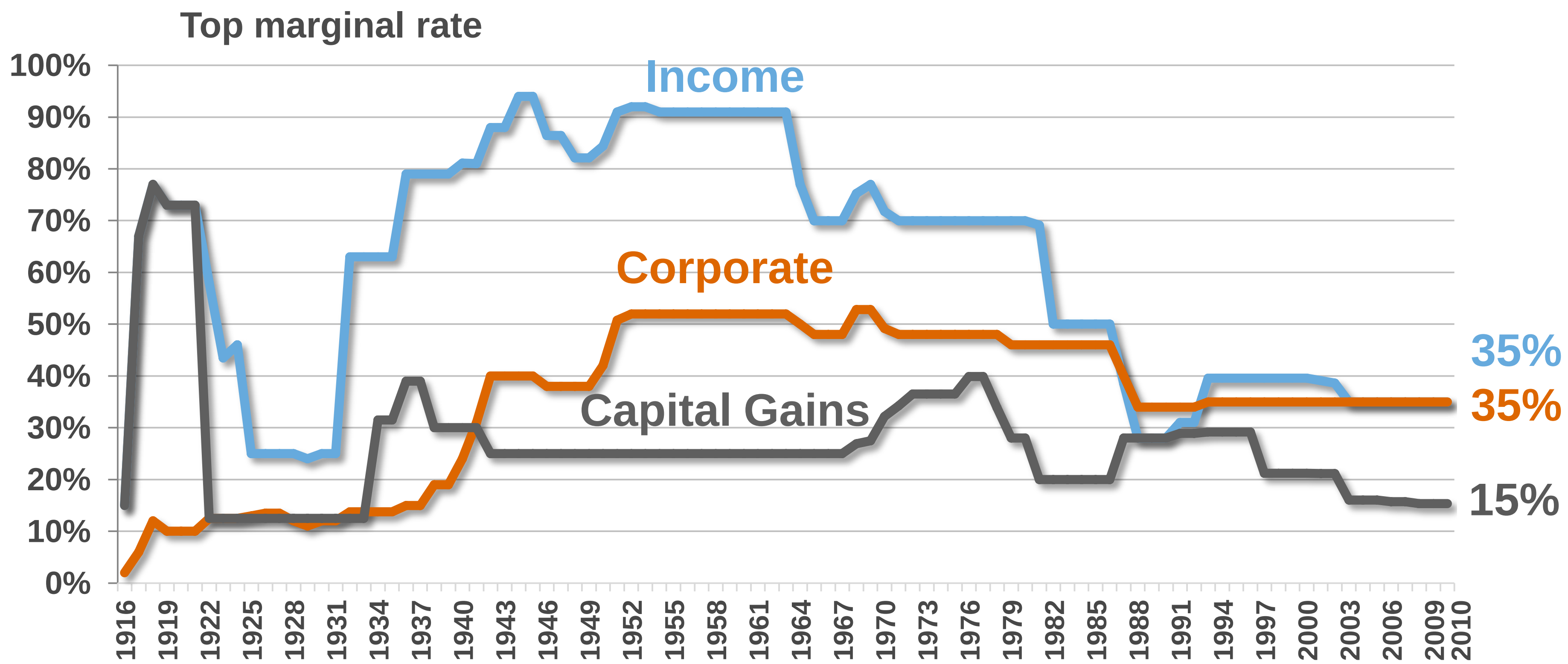
?

Why do you care?

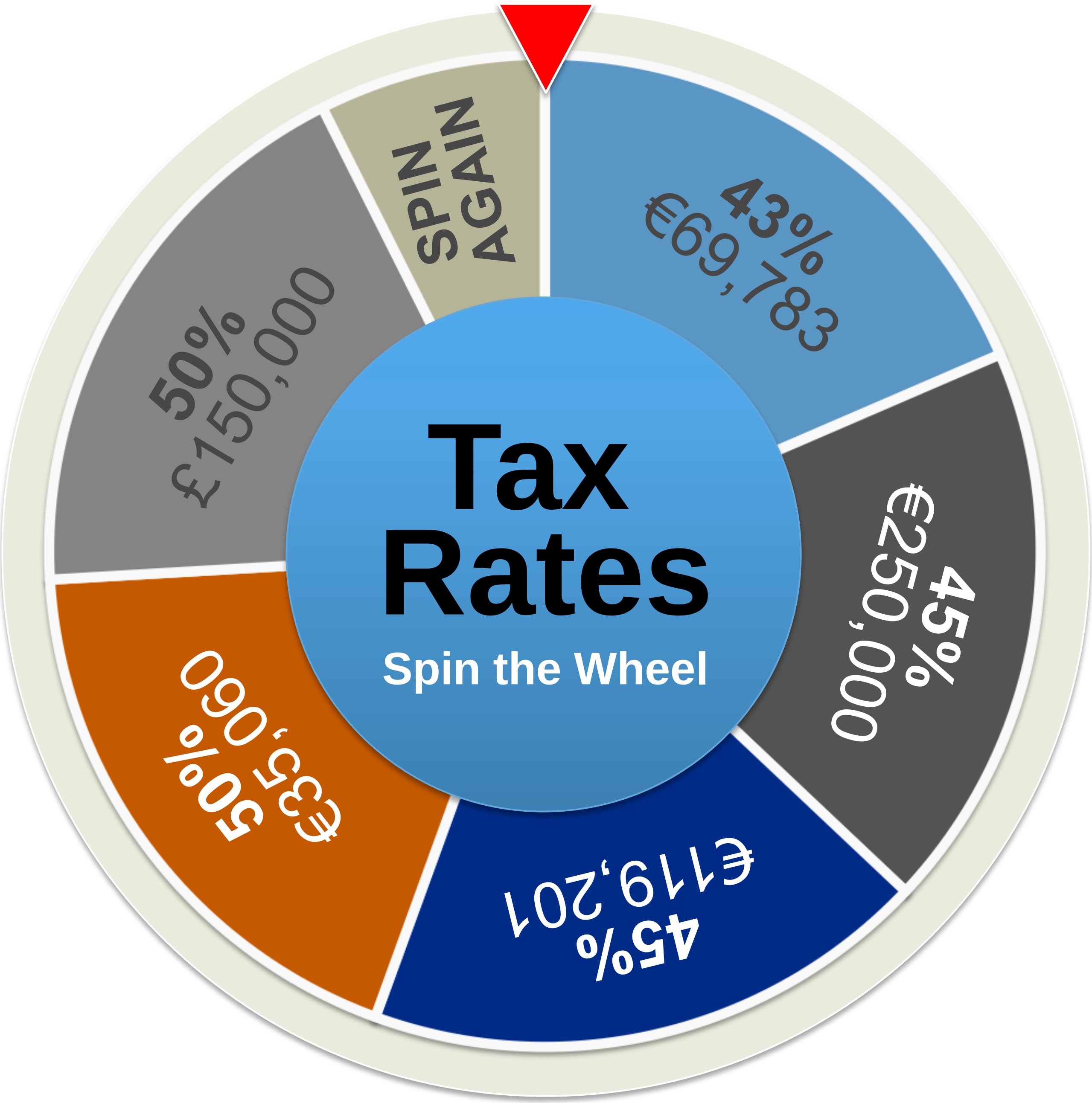
A percentage to remember

50%

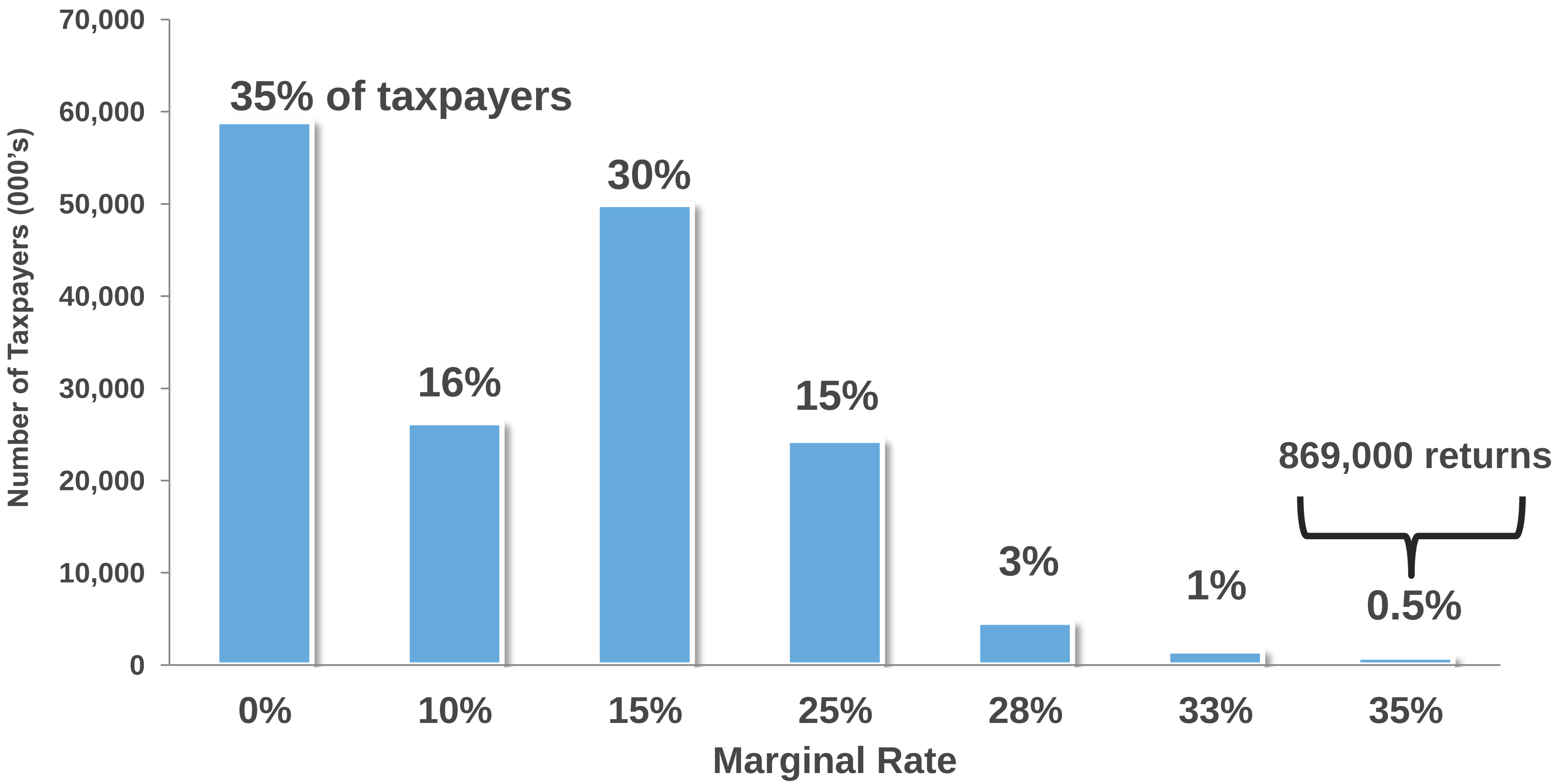
Where have Federal tax rates been?



Source: TaxPolicyCenter.org. As of June 30, 2012.


Tax Rates
Spin the Wheel
43% €69,783
45% €250,000
45% €119,201
50% €35,060
50% £150,000
SPIN AGAIN

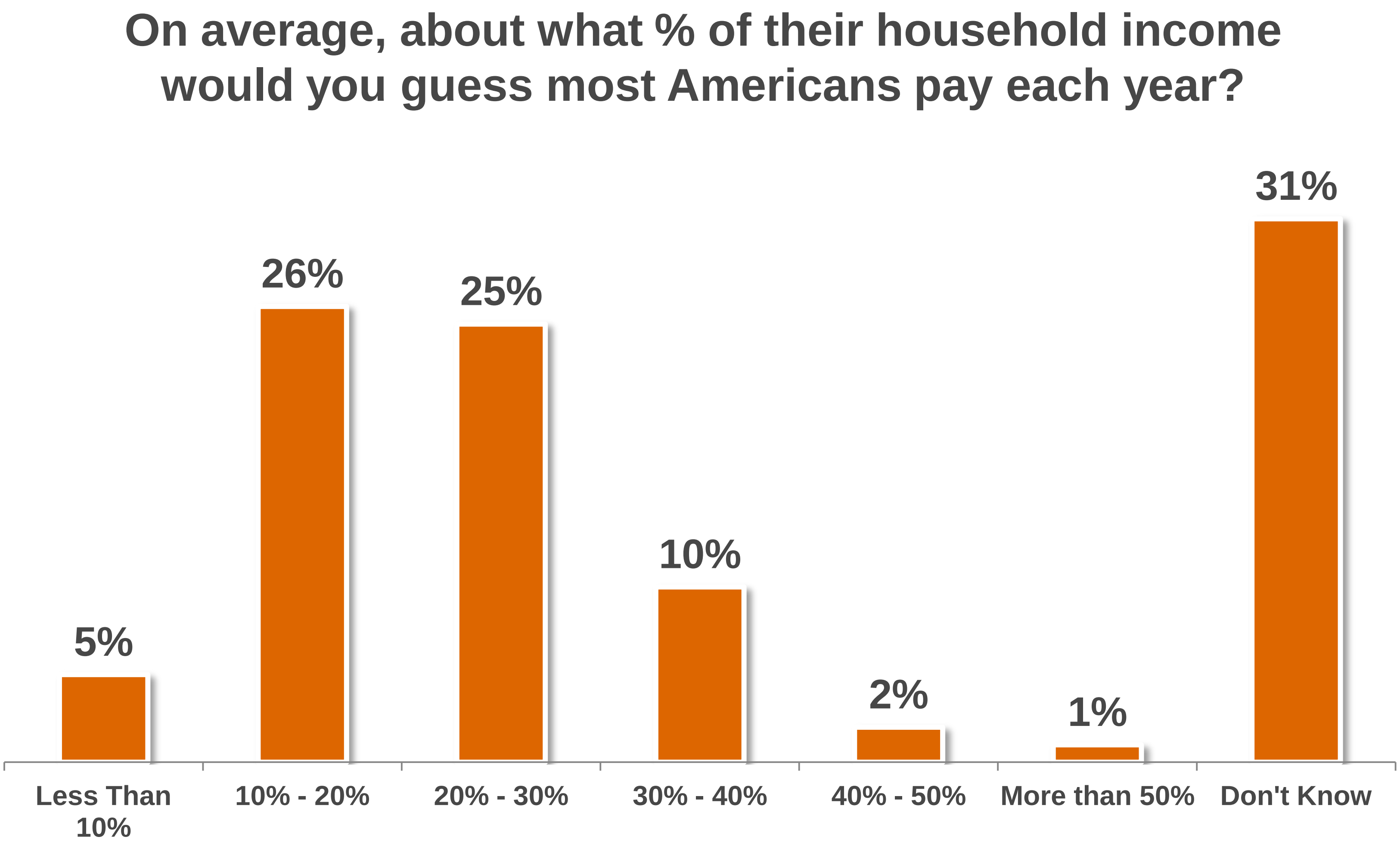
Who pays what?



81% of taxpayers paid a marginal rate of 15% or less

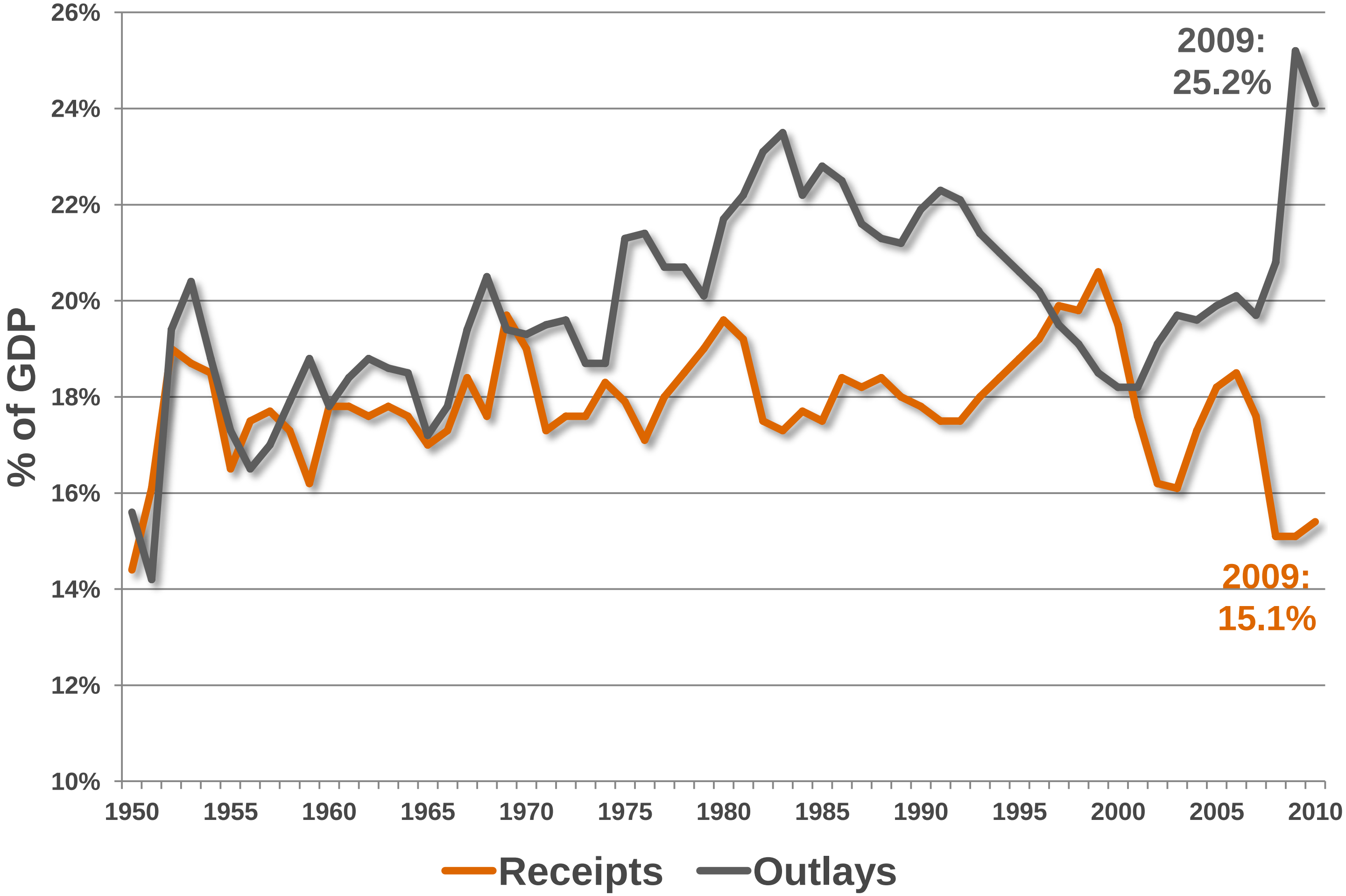
2010: Joint Committee on Taxation

What do taxpayers *think* they pay?



Source: CBS/New York Times poll (April 2010)

Imbalance between government we want and government we pay for



19.9% = 1950 – 2011 Average Receipts

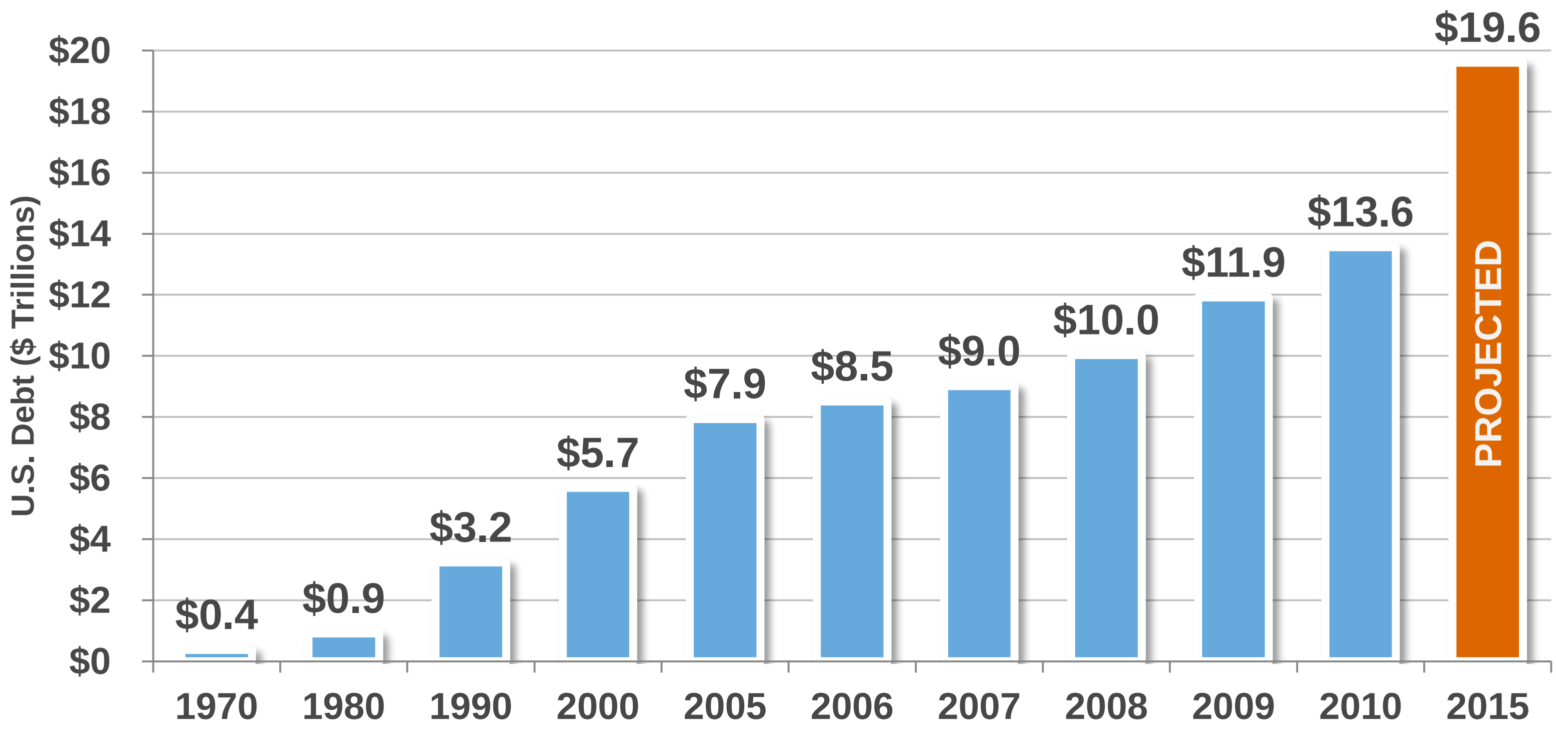
17.8% = 1950 – 2011 Average Revenue

Source: Office of Management and Budget. As of June 30, 2012.

Why is this important?

Increasing at an increasing rate

Growth of national debt



Source: U.S. Treasury
Source for projected data: U.S. Treasury and Reuters. As of November 30, 2011.

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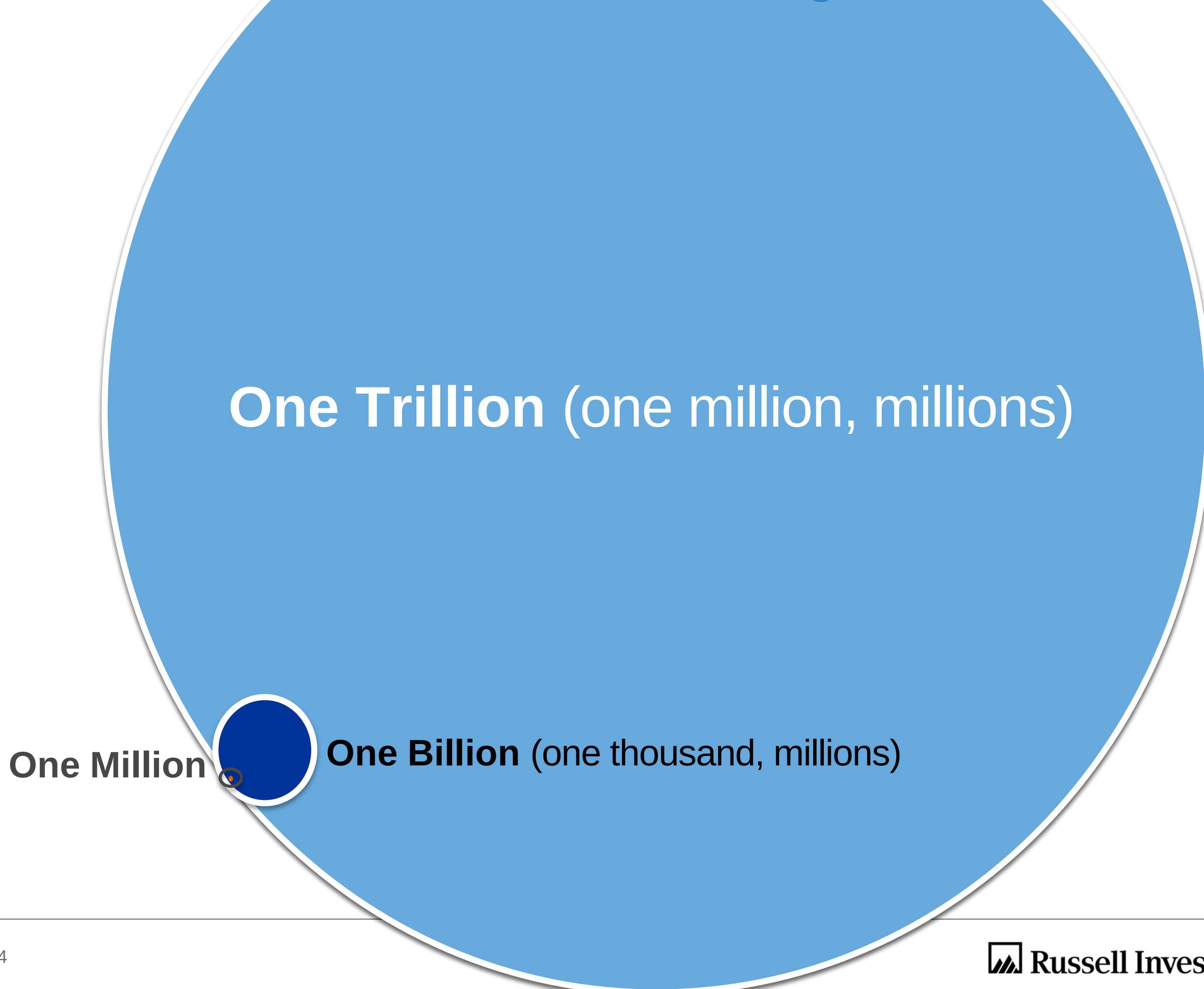
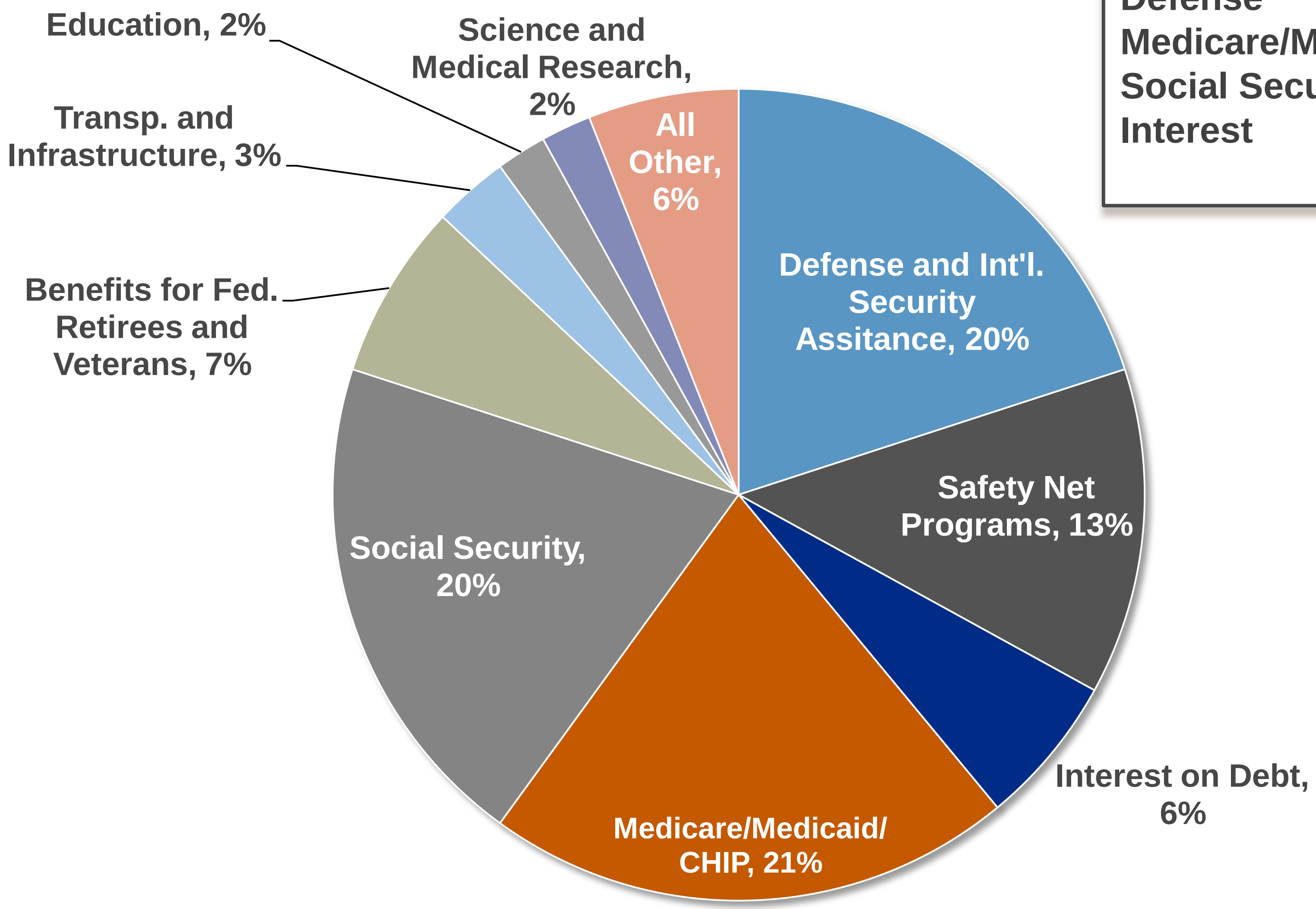
What's a TRILLION dollars among friends



How do you spend $3.6 Trillion?
2011 federal expenditures

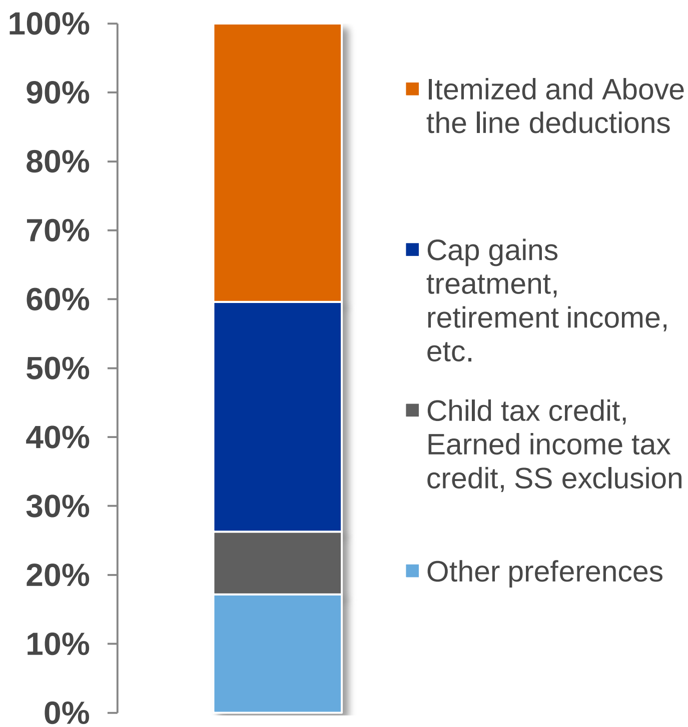
Defense	20%
Medicare/Medicaid	21%
Social Security	20%
Interest	6%
	67%



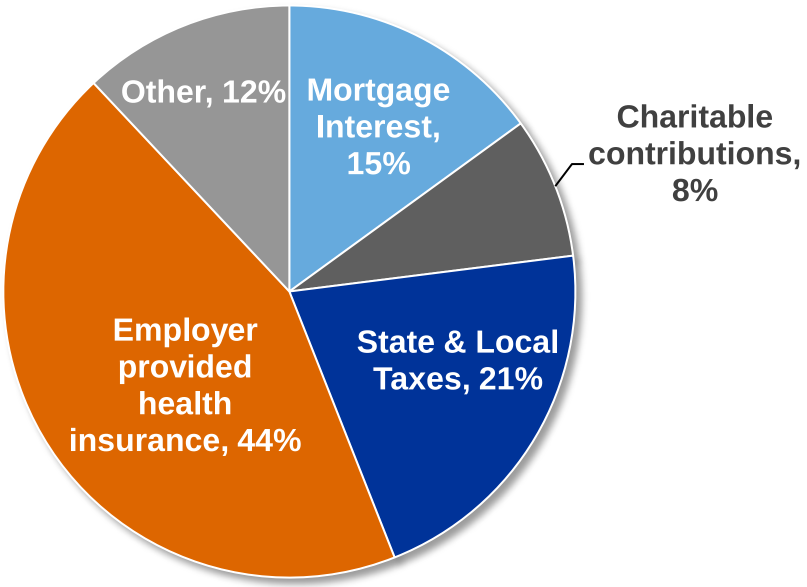
Source: www.cbpp.org/cms/index.cfm?fa=view&id=1258. As of August 13, 2012.

What if you lowered the top marginal rates to 28%, kept capital gains at 15% and repealed the AMT?

2015 Projected tax expenditures



Components of Itemized and above the line deductions



To keep tax revenue neutral, you need to cut tax expenditures by 72%. **What do you pick?**

Tax Policy Center: *How hard is it to cut tax preferences to pay for lower tax rates?* July 10, 2012

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What have investors done in prior periods of changing tax rates?

- Due to tax reform in 1986, the top marginal rate decreased in 1987 from 50% to 28%.
  - Aggregate realizations doubled from 1986 to 1987
- Top cap gains rate decreased in 1987 from 50% to 28%.
  - Realizations doubled from 1986 to 1987
- Top cap gains rate went from 29% to 21% in 1997
  - Realizations rose 3.3% of GDP to 6.5% in 2000 (helped by tech run)
- Changing the rate undoubtedly impacts investor behavior
  - Is the change perceived to be temporary or permanent?
  - Treatment will be key topic in 2013

Fiscal Cliff in 2013

- Taxes:
  - Expiration of Bush era tax rates, payroll tax cut
  - 3.8% increase on unearned income for some taxpayers to help finance health care reform
- Spending:
  $1.2 trillion of spending cuts over 10 years resulting from the Budget Control Act of 2011
- Combination of increasing taxes and reduced spending creates a “fiscal cliff” the economy must overcome in 2013

Politicians of both parties will be motivated to prevent either (or both) in the face of weak economic data

Rates – absent government action

- Absent government action, planned expiration of Bush era tax rates at the end of 2012

Maximum Federal tax rates	Current	2013
Long term gains	15.0%	20.0%
Short term gains	35.0%	39.6%
Qualified dividends	15.0%	39.6%

- Absent government action, a 3.8% increase on unearned income to help pay health care reform beginning 2013

As of August 2011.

Today's backdrop

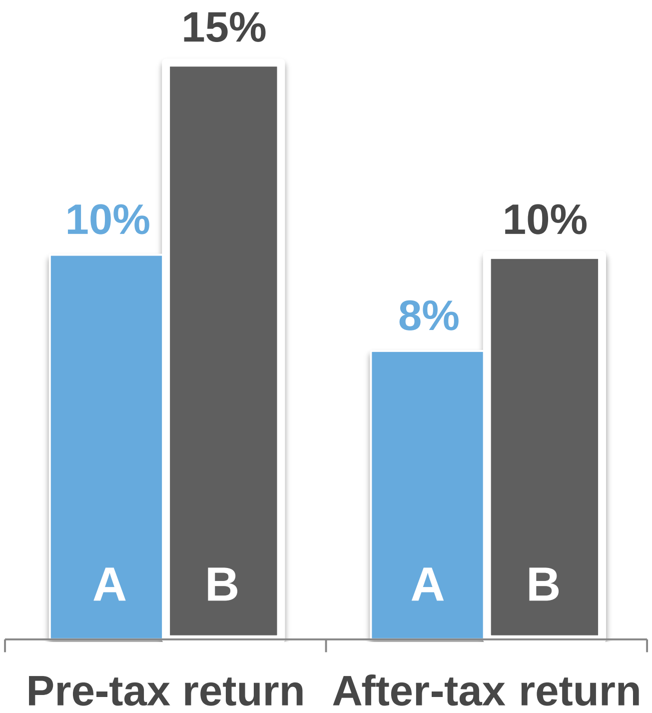
- Simpson-Bowles Commission on Fiscal Responsibility (December 2010)
- Budget Control Act of 2011
  - Bipartisan committee (12 members) to initially cut $1.2 trillion announced in November 2011
- Fiscal Cliff
- 2012 Elections
  - Republican plan, Democratic plan, Grand Bargain, Gang of Six, etc.
- Americans for Tax Reform's Taxpayer Protection Pledge (no new taxes)
  - Signatories include 236 House members / 41 Senators

As of December 31, 2011.

Lots of debate about the deficit, but when it's all said and done, likely to be…

- Reduced or modified services
- Higher retirement ages
- Expanded means testing for social services (Medicare/Social Security)
- And...higher taxes (it's already happening)

Tax-efficiency
A primer



- **Fund A is 80% tax-efficient** (8%/10%)
- **Fund B is 67% tax-efficient**
- **Which Fund do you choose?**

Fund A is "more tax-efficient"

Tax efficiency: % of return retained after taxes

It's the money in your pocket!

This hypothetical example is for illustration only and is not intended to reflect the return of any actual investment. Investments do not typically grow at an even rate of return and may experience negative growth

Evaluating tax efficient investments

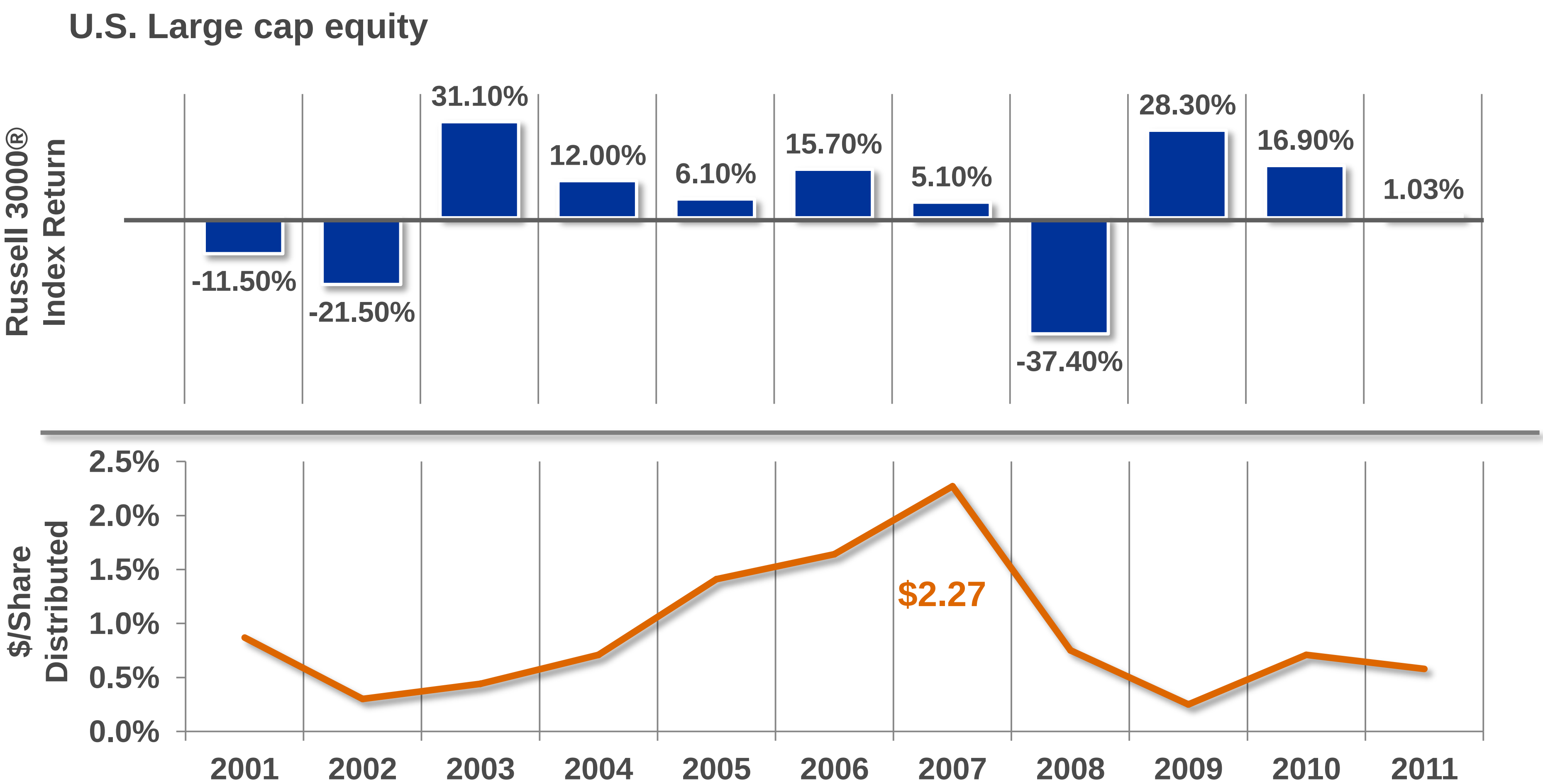
- Current tax analysis impacted by 2008/early 2009 market downturn.
- 2009 short term gains declined 51% from 2008 and long term gains declined 96%[1].
- Make sure comparing like returns (pre-tax, pre-liquidation, post-liquidation, AMT free, assumed tax rate, etc).

It's the perfect storm: Tax rates likely increasing and mutual funds are using up capital losses incurred during 2008.

(1) Lipper Research: Taxes in the Mutual Fund Industry - April 2010

Taxable distributions

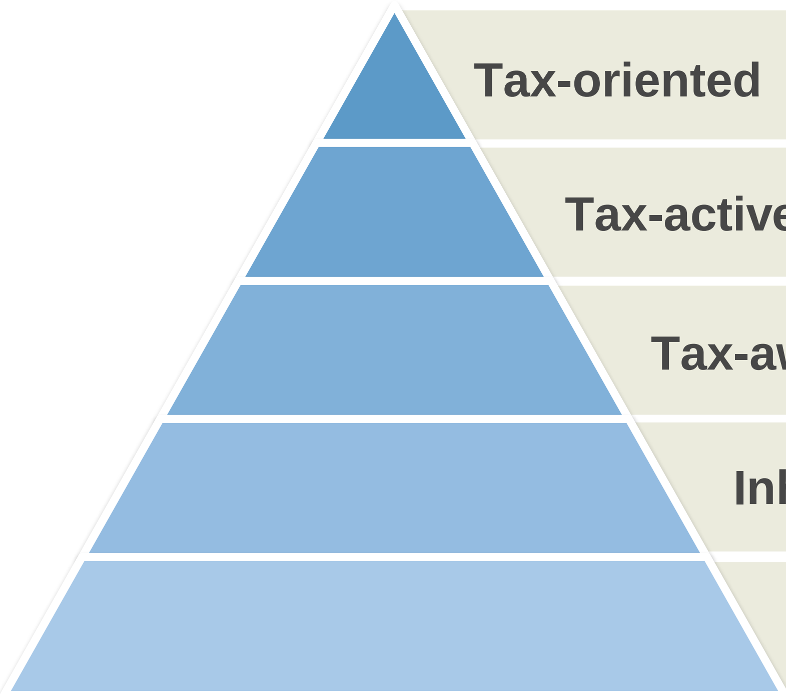
Do you see a pattern?



Large Cap Equity Average: Morningstar Large Cap Equity Blend Universe – funds with assets > $1billion as of 12/31/2011
$ of Share Morningstar's Large Cap Equity Blend Universe - funds with assets > $1billion as of 12/31/2011

Assessing tax efficiency

Tax Efficiency



Tax-oriented	Actively harvest losses throughout year—focused on active after tax returns
Tax-active	Tax aware but also looks to harvest losses
Tax-aware	Conscious of a stock's long-term gains vs. short-term gain status
Inherently efficient	Generally lower turnover; buy and hold approaches
Tax-oblivious	No concern about taxes

Tax aware investing

Not yesterday's approach

- › **Evolution of tax-managed investing**
- › **What's changed? Not Changed?**
- › **What's on the horizon?**

How can investment products strive for tax-efficiency?

- More concentrated portfolios
- Longer holding period
- More growth oriented securities
- Be active in regards to opportunistic capital loss harvesting

Summary

- Taxable assets represent large pool of dollars
- Imbalance between government spending and government revenues
- Taxes can be managed