



**Parametric™**

Leaders in Structured Portfolio Management

---

## Building Better Beta

---

Fall 2010

Our Tax-Managed Core (TMC) product strives to provide “better Beta”. To us this means delivering predictable index-targeted pretax returns, superior after-tax returns, and customization benefits of many types. The combination of active tax management and flexible per-client customization is, for many affluent or high-net-worth investors, an extremely compelling alternative to mutual funds or ETFs. ▶▶

**Tyson Alexander, CFA**

Product Manager, Tax-Managed Core

**Parametric**

1151 Fairview Avenue N.

Seattle, WA 98109

**T** 206 694 5500

**F** 206 694 5581

[www.parametricportfolio.com](http://www.parametricportfolio.com)

Working with our clients to create a customized solution is often the genesis of a new offering. This was the case with our first TMC portfolio in 1992, when a family office inquired about actively managing the taxes incurred by custom growth and value, index-based portfolios. Eighteen years, and thousands of portfolios later, we are still collaborating with our clients — including that first TMC investor.

Of all the dimensions around which to customize a TMC portfolio, the most common can be generalized into customizing the tax management, customizing the investment target, and incorporating outside constraints.

## ►► CUSTOMIZING TAX MANAGEMENT

### **Transition Tax Management – Custom Analysis**

Building an index-based separate account from cash is a straightforward task. However, for investors funding with pre-existing securities, understanding current gain/loss and ST/LT holding periods is essential. Unlike mutual funds or ETF's, which force investors to raise cash to invest, a TMC portfolio can selectively utilize existing securities and raise cash tax-efficiently to reduce the impact of taxes at portfolio inception. A Parametric custom transition analysis can illustrate potential savings and trade-offs.

### **Transition Tax Management – Gain Budgeting & Staged Diversification**

TMC investors sometimes react to a transition analysis with a desire to limit the initial tax bill. In these cases, we can set a gain budget (maximum gain realized per period) and/or set up a multi-stage plan for diversification. A multi-period approach has the potential benefit of allowing loss harvesting to occur to offset some or all of subsequent gain realization. We have many clients who have fully transitioned fairly concentrated, low-basis portfolios with this type of approach.

Transition analyses can be performed and evaluated by advisors before any contract is signed, relationship is formed, or fees are incurred.

### **Ongoing Tax Management – Strategic Gain Realization**

When rising tax rates are on the horizon, it may make sense to accelerate the realization of select long-term gains to take advantage of current tax rates, reset the basis and holding period of a portfolio and create greater potential for future short-term losses. Parametric can help describe and analyze the key variables; future tax rates, ST/LT rate differences, time horizon and gain/loss realization outside the portfolio are among the most important.

**» CUSTOMIZING THE INVESTMENT TARGET****SRI/ESG**

Incorporating client values and related preferences has been part of the TMC process since the first portfolio. Parametric offers a number of ways to achieve this goal beyond the base case of targeting a SRI or ESG index. We frequently work with advisors and their clients to apply custom social screens, or focus on best-in-class companies.

**Custom Fundamental Exposures**

Sometimes advisors have strategic views they would like incorporated in clients' core portfolios: tilts to value, growth, large, mid, small-cap, low volatility, etc. In the current environment, increasing portfolio yield is a frequent Parametric project.

**Custom Target Benchmarks**

Sometimes there isn't a publicly available index target with desired characteristics. As a result, Parametric offers a variety of custom benchmarks:

*Custom Combination Benchmarks*

Parametric's proprietary portfolio management systems allow us to combine different indexes to create unique combinations. Often this means blending US and non-US target indexes to create desired global beta exposure, or blending style target indexes to emphasize growth, value, or a capitalization segment.

*Custom Exclusionary Benchmarks*

Parametric frequently responds to requests to exclude securities or industries from a target index. Often, the goal is to increase diversification relative to other holdings, or express a performance or valuation view. When exclusions are a large portion of the target index, Parametric can provide information on the diversification and tracking-error trade-offs. Performance measurement can be customized as well to measure target performance with and without exclusions.

*Custom Constructed Indexes*

The advisors we work with are among the sharpest and most creative in the industry. It is exciting for us to be involved in creating portfolios aimed in new directions. Earlier this year, this meant creating a Master Limited Partnership (MLP) target index and a portfolio with limited K1 issuance.

**» CUSTOMIZING FOR OUTSIDE CONSTRAINTS****Estate Planning Vehicles and AMT**

When clients' tax situations change from year to year, we work with advisors and adapt accordingly. Estate planning vehicles have unique tax treatments from one year to the next; clients sometimes move into and out of AMT status. Wherever practical, we coordinate with advisors to integrate new or anticipated rates and any unique, trust-related, taxable items.

### Incorporating Option Writing

Through our affiliate, Parametric Risk Advisors, we can alter, and potentially enhance, risk control and return patterns through option writing strategies. Our Index DeltaShift covered call or buy-write strategy can be managed in conjunction with a Tax-Managed Core portfolio to increase current cash flow and offer some downside protection.

Additionally clients can use Index DeltaShift to include buying puts to create a more comprehensively hedged equity experience. Called ParaHedge, this strategy helps advisors implement market viewpoints and maintain equity exposure in times of pressure. As a fully transparent strategy managed for the client as a fiduciary, this approach can have real advantages over other hedging approaches, like structured notes.

### ►► BETTER BETA FOR CLIENTS

In one form or another, Parametric customizes every Tax-Managed Core portfolio we manage. Since investors can create standard equity index exposure inexpensively and conveniently via mutual funds and ETFs, our value proposition is centered on customization. In the base case, we build a portfolio from cash, target a standard benchmark, and customize the construction as well as gain/loss recognition for each client. However, for the majority of our TMC portfolios, we extend our activities to one or more custom analyses or implementations. Whatever your unique needs, we would love hear from you.

---

### About Parametric

Parametric is an industry-leading provider of structured portfolio management, headquartered in Seattle, Washington. Parametric and its affiliate, Parametric Risk Advisors, offer a variety of structured portfolio solutions, including customized core equity portfolios (U.S., Non-U.S., global), options strategies, and overlay portfolio management.

This information is intended solely to report on investment strategies and opportunities identified by Parametric Portfolio Associates. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities. Past performance does not predict future results.

The views and strategies described may not be suitable for all investors. This material has been prepared for informational purposes only, and is not intended to provide, and should not be relied on for, accounting, legal or tax advice. You should consult your tax or legal advisor regarding such matters. Please contact your account manager for further information.

Parametric does not provide legal, tax and/or accounting advice. Clients should consult with and rely solely on their own advisors, who are familiar with the specifics of their situation, prior to entering into any transaction described herein.