

Boost Bond Potential with Active Tax Management

Using year-round tax-loss harvesting
to optimize fixed income portfolios



Systematically harvest losses year-round

Many fixed income investors don't think about tax-loss harvesting until the end of the year. But yields rarely peak at the end of the year. That's also a likely time for liquidity to worsen, issuance to drop, transaction costs to increase, and potential tax alpha to fall. And if managers harvest losses manually, they often find themselves reinvesting proceeds from liquidated securities more slowly—potentially reinvesting at lower yields and making investors miss out on market rebounds.

That's why Parametric monitors bond portfolios throughout the year for losses to harvest, just as we do for SMAs in our Custom Core[®] Equity Strategy. We partner with you to find the right times to get portfolios back into the market, no matter the rate environment.

How it works



Step 1: Parametric portfolio managers work to fully invest the client's capital and align it to its duration, yield, and credit quality targets.



Step 2: Parametric monitors the portfolio regularly for losses and undesirable changes in risk exposures.



Step 3: If fixed income markets experience losses, portfolio managers sell securities to realize tax losses and buy suitable replacements, often on the same day.

Third-party research has shown that tax management
can add up to 30 bps in after-tax excess returns
for fixed income portfolios.*

*Andrew Kalotay, "Tax-Efficient Trading of Municipal Bonds," *Financial Analysts Journal* 72, no. 1 (2016): 48–57. This study did not involve Parametric or its clients. There is no guarantee that a tax-management strategy will result in increased after-tax returns. Results will differ based on an individual investor's circumstances.

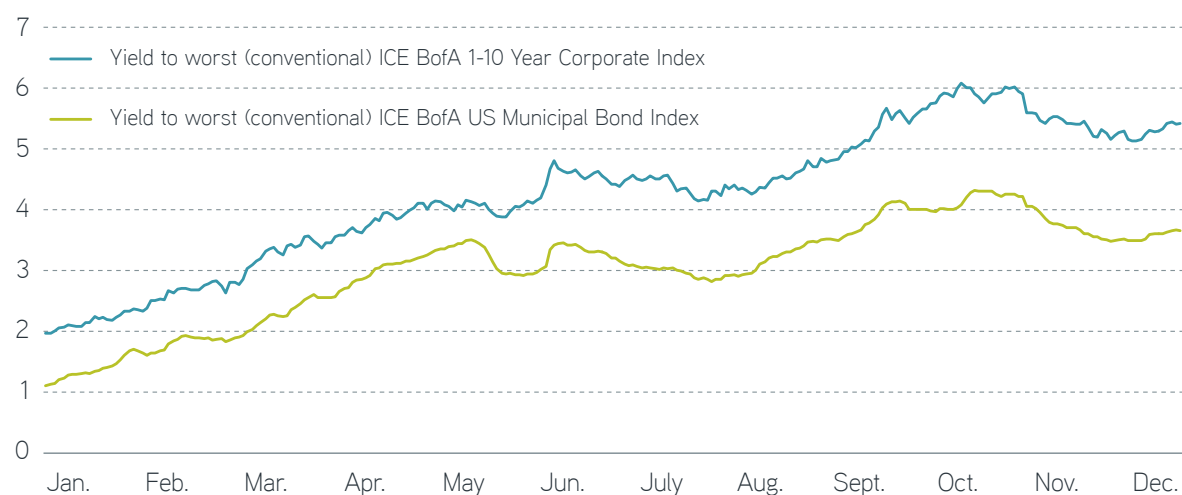
Opportunity in volatility

You aren't alone if you found 2022 challenging.

The Fed prioritized fighting inflation by hiking rates that sent yields surging and investment values plummeting—and they expect this fight to continue for some time. The market also saw periods of sharp volatility, both upward and downward. Yields rose in a historic fashion, ending the year much higher than where we started. But they didn't increase in a straight line.

Waiting until tax time or the end of the year to harvest losses may put investors at a disadvantage. Last year was no exception: Both municipal and corporate yields peaked in October, so investors who waited until December missed the best harvesting opportunities. Preparing portfolios today to take advantage of volatility on the horizon may add additional after-tax total return to fixed income investments.

Index yield to worst (1/3/2022–12/30/2022)

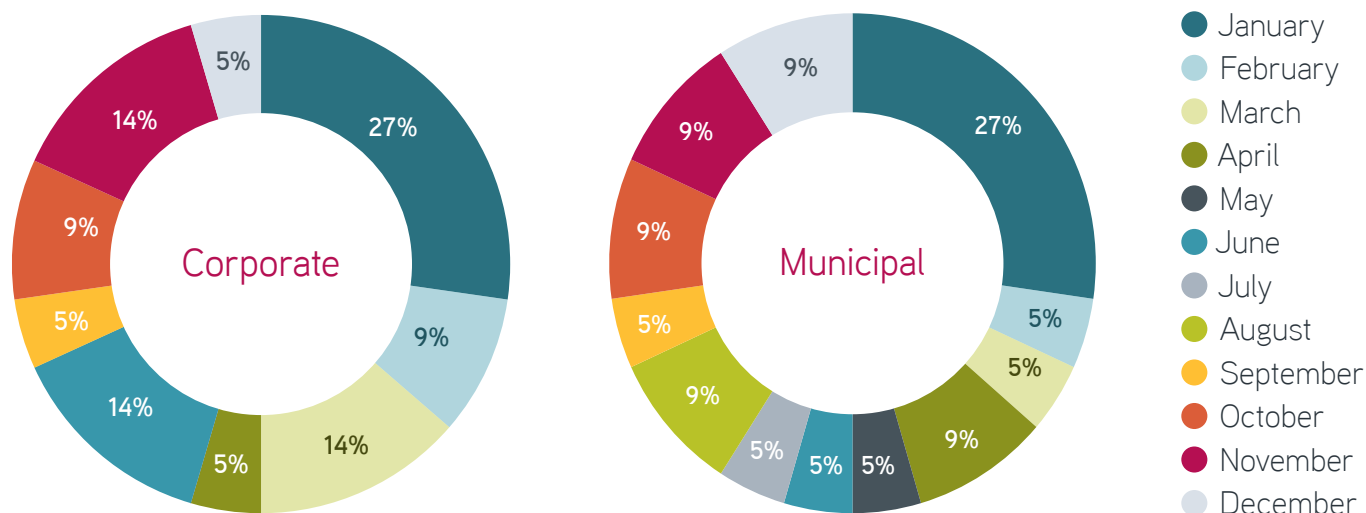


Source: Bloomberg, 12/31/2022. For illustrative purposes only. Not a recommendation to buy or sell any security. "Yield to worst" is defined as the measure of a bond's yield, assuming a bond may be called out of the market ahead of its final maturity date. It is not possible to invest directly in an index. Indexes are unmanaged and do not reflect the deduction of fees or expenses.

Parametric's systematic approach seeks to ensure that losses are realized during rate peaks—when losses are typically highest—no matter when peaks occur.

For many investors, taxes are a larger drag on performance than fees or trading costs. That tax drag can prevent or delay their ability to meet their long-term investing goals. Luckily, taxes can also be the easiest “fee” for investors to reduce. In fixed income portfolios, proceeds from maturing bonds, calls, and coupons offer opportunities for cost-basis resets—which helps investors reinvest in more favorable rate environments.

Peak months for investment-grade bond yields (2001–2022)



Source: Bloomberg, 12/31/2022. For illustrative purposes only. Not a recommendation to buy or sell any security. “Peak month” is defined as the calendar month in which bond yields peak in a given year. This information is derived from the Bloomberg Municipal Bond Index and the Bloomberg US Corporate Bond Index. It is not possible to invest directly in an index. Indexes are unmanaged and do not reflect the deduction of fees or expenses.

Under 2022’s market pressure, our advanced technology **helped investors capitalize on volatility, seeking to improve their after-tax performance and generate losses.**¹ Here’s what we made happen for our clients:

300k

Loss-harvesting trades

\$860MM

Losses realized for clients

\$17B

Market value sold

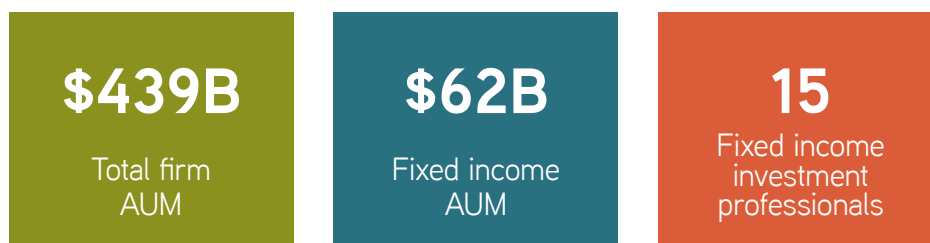
-6%

Average loss realized on a holding basis

¹ Source: Parametric, 12/31/2022. The information is provided for illustrative purposes only. Values are aggregated across all municipal laddered strategies, managed municipal strategies, and municipal total-return strategies. Only client positions with unverified cost basis were excluded from calculations. Loss calculation is based on the amortized book price minus the sell price, represents historical information, and should not be construed as future results. Loss information illustrates the effect to a portfolio and is not representative of, and should not be construed as, performance. There is no assurance that tax-loss harvesting will continue in the future. There is no guarantee that any specific account may engage in tax-loss harvesting.

Why Parametric?

Even in uncertain rate environments, fixed income exposure has always been a valuable source of diversification for investors. But the days of bond insurance, large dealer inventories, and set-it-and-forget-it allocations are gone. Parametric's fixed income solutions make it easy to navigate complex markets while customizing client exposure to fit their investment goals.



As of 6/30/2023



Winner: 2023 U.S. Markets Choice Award Best Buy-Side Fixed Income Trading Desk

Markets Media Group's annual U.S. Markets Choice Awards honor firms that are the 'best of the best in capital markets trading and technology', including buy-side traders, sell-side execution desks, exchanges and trading platforms, incumbent technology providers, and emerging fintech firms. The selection methodology factored in the opinions of market participants, including colleagues, customers, and competitors. Winners were announced on May 3, 2023. For more information, visit <https://www.marketsmedia.com/2023-markets-choice-award-winners-announced/>.

Investors and advisors rely on Parametric to harvest losses while maintaining desired risk profiles. We thoroughly analyze liquidity, yield, and structure on a bond-by-bond basis, and we support our systematic construction and management processes with cutting-edge technology. You and your clients get:

Increased scale and efficiency

Advisors enjoy a simplified tax-loss harvesting process that eliminates the need for analysis at the individual lot level.

Optimized sales timing

Investors can reap the rewards of ongoing loss-harvesting opportunities while we aim to avoid triggering wash-sale violations.

Reduced cash exposure

Investors get back into the market faster through same-day buys and targeted reinvestment at potentially higher yields.

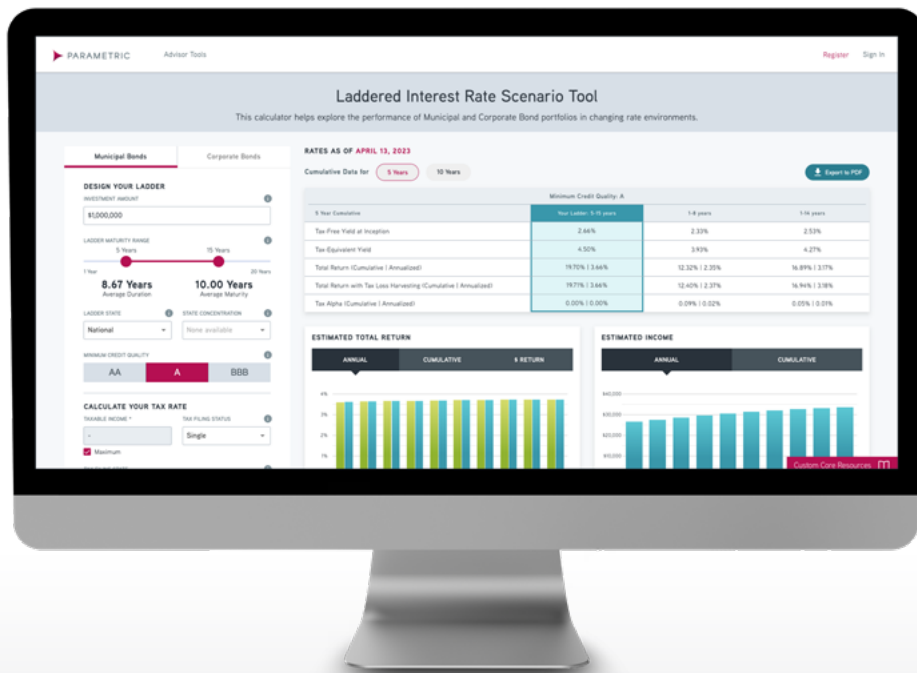
Minimized transaction costs

Investors get better liquidity and advisors get better execution as we use account aggregates to evaluate loss-harvesting opportunities.

Make tax alpha reporting easier

Parametric's account-specific reporting helps you manage your fixed income SMAs hands-on. Our easy-to-understand account reports summarize tax-loss harvesting activity and measure potential taxes saved. Use our powerful technology to see the value of active tax-loss harvesting in fixed income portfolios.





For illustrative purposes only.

Preview performance when rates rise and fall

Our Laddered Interest Rate Scenario Tool can help design an optimal portfolio based on investor goals, risk considerations, and tax circumstances. Estimate how your portfolio will perform in different interest rate environments, including when systematic year-round tax-loss harvesting is applied in rising rate scenarios.



Visit parametricportfolio.com/ladders to see what ongoing tax-loss harvesting can do for your fixed income portfolio.



Want to learn more about fixed income?

[Visit parametricportfolio.com](https://www.parametricportfolio.com)

About

Parametric Portfolio Associates® LLC (“Parametric”), headquartered in Seattle, is registered as an investment advisor with the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed income, alternative, and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay, and centralized portfolio management. Parametric is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley, and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York, and Westport, Connecticut.

Disclosures

This material may not be forwarded or reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

This information is intended for informational purposes and details investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. 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. The views and strategies described may not be suitable for all investors. Past performance is not indicative of future results. Investing entails risk, and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Parametric and Morgan Stanley do not provide legal, tax, or accounting advice or services. Clients should consult with their own tax or legal advisor prior to entering into any transaction or strategy described herein. Additional information is available on request.

Charts, graphs, and other visual presentations and text information were derived from internal, proprietary, or service vendor technology sources or may have been extracted from other firm databases. As a result, the tabulation of certain reports may not precisely match other published data. Data may have originated from various sources, including, but not limited to, Bloomberg, MSCI/Barra, FactSet, or other systems and programs. Parametric makes no representation or endorsement concerning the accuracy or propriety of information received from any third party.

Corporate debt securities are subject to the risk of the issuer’s inability to meet principal and interest payments on the obligation and may also be subject to price volatility due to such factors as interest rate sensitivity, market perception of the creditworthiness of the issuer, and general market liquidity. When interest rates rise, the value of corporate debt securities can be expected to decline. Debt securities with longer maturities tend to be more sensitive

to interest rate movements than those with shorter maturities. Company defaults can impact the level of returns generated by corporate debt securities. An unexpected default can reduce income and the capital value of a corporate debt security. Furthermore, market expectations regarding economic conditions and the likely number of corporate defaults may impact the value of corporate debt securities.

An imbalance in supply and demand in the municipal market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads, and a lack of price transparency in the market. There generally is limited public information about municipal issuers. As interest rates rise, the value of certain income investments is likely to decline. Longer-term bonds typically are more sensitive to interest-rate changes than shorter-term bonds. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments.

There is no assurance that a separately managed account (SMA) will achieve its investment objective. SMAs are subject to market risk, which is the possibility that the market values of the securities in an account will decline and that the value of the securities may therefore be less than what you paid for them. Market values can change daily due to economic and other events (natural disasters, health crises, terrorism, conflicts, social unrest, etc.) that affect markets, countries, companies, or governments. It is difficult to predict the timing, duration, and potential adverse effects (portfolio liquidity, etc.) of events. Accordingly, you can lose money investing in an SMA.

Investment strategies that seek to enhance after-tax performance may be unable to fully realize strategic gains or harvest losses due to various factors. Market conditions may limit the ability to generate tax losses. Tax-loss harvesting involves the risks that the new investment could perform worse than the original investment and that transaction costs could offset the tax benefit. Also, a tax-managed strategy may cause a client portfolio to hold a security in order to achieve more favorable tax treatment or to sell a security in order to create tax losses. Prospective investors should consult with a tax or legal advisor before making any investment decision.

All contents ©2023 Parametric Portfolio Associates® LLC. All rights reserved. Parametric Portfolio Associates® and Parametric® are trademarks registered in the US Patent and Trademark Office and certain foreign jurisdictions.

Parametric is located at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of the firm’s Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.