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ABOVE THE FRAY

Taxing Times

Isabelle Williams
Deputy Head of Investment Solutions

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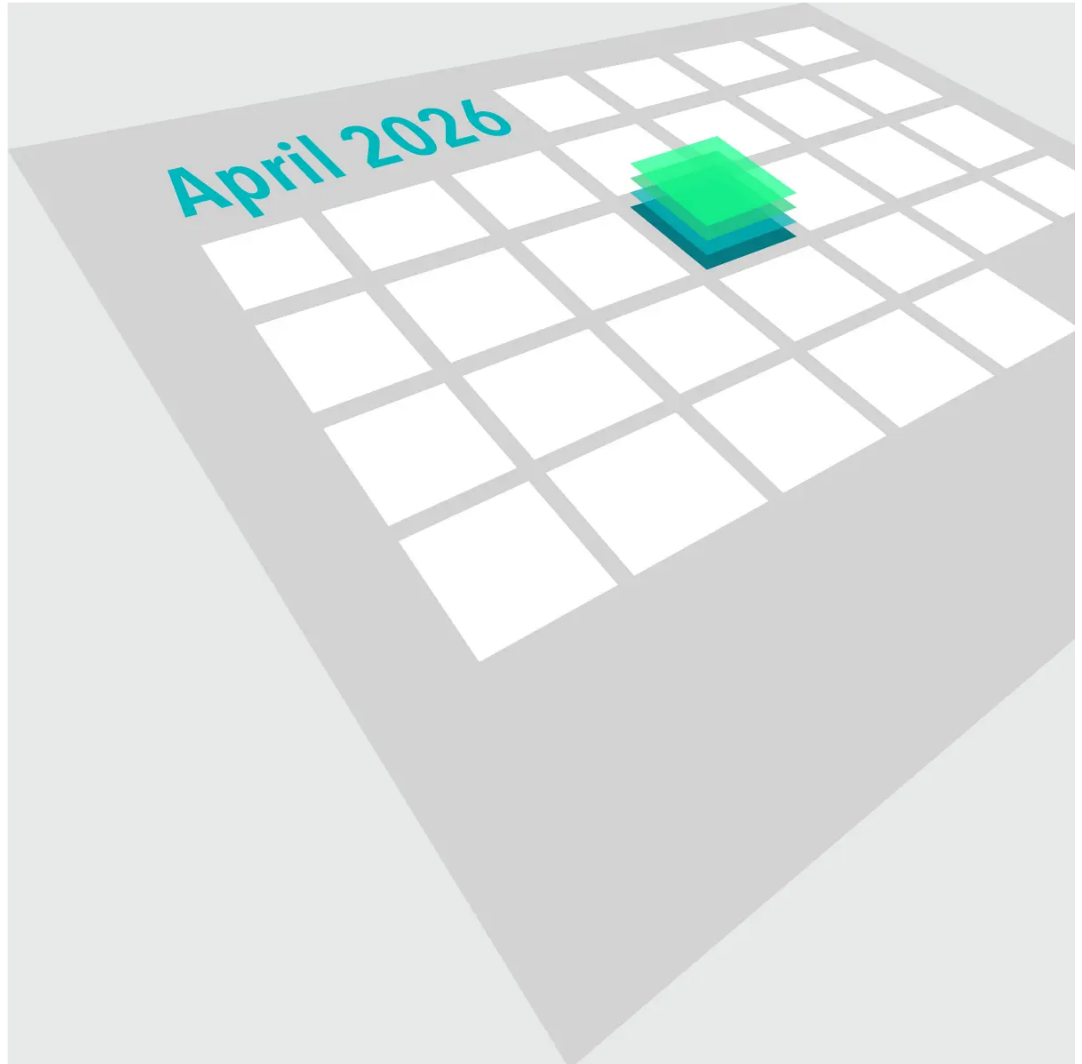
With the April 15 "Tax Day" just behind us, it's a timely reminder that taxes are often an outcome of investment success. Trying to avoid taxes entirely is probably a misguided investment mindset. Rather, investors may want to focus on the amount of their investment return they get to consume (or bequeath). Improving after-tax outcomes can result both from maximizing pre-tax returns and tax efficiency.

Tax efficiency starts with the investment strategy. A low turnover strategy managed with flexibility that considers the nature of dividend income can, by design, help reduce tax costs. Strategies that achieve these lower tax costs while keeping a focus on higher overall returns can lead to better after-tax take home returns. While investors often assume exchange-traded funds (ETFs) are inherently tax efficient, the ETF "wrapper" isn't necessarily a guarantee of low (or no) taxes, especially if the underlying strategy is tax inefficient.

An investment's relative tax efficiency also depends, in part, on the amount of control and flexibility it gives an investor about when they pay taxes. Generally, an investor must eventually pay taxes on realized gains when they choose to consume those gains. But how a fund is managed can give investors greater control over the timing of when they pay these taxes. If an ETF or a mutual fund can minimize or eliminate capital gains distributions, investors can wait to pay capital gains taxes until they sell their fund shares. While this doesn't eliminate an investor's future tax obligation, it gives more control over when they want to pay taxes, and in the meantime allows their full investment amount to compound.

Please see the end of this document for important disclosures.

Exhibit 1
Tax Day



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Capital gains distributions: Money that may be distributed to shareholders when a fund sells a security for a profit.

Turnover: A measure of the portion of securities in a portfolio that are bought or sold over a period of time, generally on an annualized basis.

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