Direct Indexing

INVESTMENT STRATEGY

ALLODIUM® INVESTMENT CONSULTANTS

What is Direct Indexing?

Direct Indexing is a low cost, passive index investment strategy that tries to mirror the performance of a benchmark or index by retaining an investment manager to build a portfolio of individual securities. This is in contrast to purchasing pooled products such as mutual funds, index funds or exchange traded funds (ETFs) where you own a share of the fund, but you don't actually own the underlying securities of said fund. Recent advances in technology have created the opportunity for investors to build broadly diversified portfolios of individual securities using separately managed accounts (SMAs) which allows the investor some degree of control over the specific securities that appear in the portfolio. Many investors are using direct indexing to create more tax efficient portfolios that also allow for the consideration of socially responsible investment preferences. For example, instead of purchasing an S & P 500 index fund or ETF, an investor may choose to build a separately managed account that owns the individual securities that reflect this index.

Eight Benefits of Direct Indexing

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1. **Low Cost:** You can keep your investment management costs low by tracking a passive index.
2. **Diversification:** Your investment manager can build your portfolio around an existing concentrated stock position that may also have a low cost basis.
3. **Responsible Investing:** You can customize your portfolio by asking your investment manager to select or remove specific stocks to align your portfolio with your personal values or other preferences. You will also be able to influence shareholder interventions with shareholder advocacy and proxy voting.
4. **Increased Transparency:** You will see greater transparency regarding individual stock performance and the underlying tax cost basis of each individual security.
5. **Income Tax Control:** You will no longer be subject to the behavior of other investors who generate the capital gains distributions inherent in mutual funds, index funds and ETFs.
6. **Tax Loss Harvesting:** You can create "tax alpha" by generating customized tax-loss harvesting at the individual stock level which uses your losses to lower your income tax liability.
7. **Charitable Stock Gifts:** You can avoid paying capital gains income tax on specific securities that you own with large unrealized capital gains by gifting them to the charities of your choice.
8. **Estate Tax Benefits:** You can take advantage of gifting highly appreciated individual securities to family members during your life time. You will also have the advantage of a step up in cost basis on your individual stocks upon your death which may be a significant benefit to your heirs.

Is Direct Indexing Right for You?

While direct indexing has always been commonplace with large institutional investors, recent advances in financial technology infrastructure have made this approach an attractive option for a wide range of investors. If you think that you could benefit personally from some or all of the eight advantages highlighted above, then the modern approach of direct indexing may be right for you as well.