TAX AWARE

Tax-Efficient Portfolio Transition: A Tax-Aware Relaxed-Constraint Approach to Switching Equity Managers

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For a taxable investor with a highly appreciated equity portfolio, replacing the portfolio manager is likely to trigger substantial tax liabilities. We focus on transitioning an appreciated equity portfolio to an actively managed strategy. We compare transition from an appreciated portfolio to a traditional long-only tax-agnostic equity strategy with transition to equity strategies utilizing more advanced portfolio management techniques such as tax-aware rebalancing and relaxed-constraint portfolio construction. We find that transition to a tax-aware relaxed-constraint strategy results in both high implementation efficiency and tax efficiency both during and after the transition. As a result, a tax-aware relaxed-constraint post-transition strategy significantly outperforms a traditional tax-agnostic long-only strategy in its ability to preserve and grow the investors after-tax wealth over the long term. We also discuss risks and limitations of the tax-aware relaxed-constraint approach.

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