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ClientAdvisor
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Diversified, Tax-Efficient Strategies Maximize Long-Term Growth

A diversified investment portfolio tailored to a client's risk profile is the most reliable approach for meeting long-term investment objectives—paired with unique tax-efficient growth strategies.

While a single asset class will often outperform a well-diversified portfolio in any given year, a diversified portfolio will tend to outperform over the long run, especially in risk-adjusted terms.

Furthermore, many clients don't initially take the time to understand the role taxes play in impacting their long-term financial goals. Thankfully, our constantly evolving tax strategies help our doctors keep more of what they make.

Diversification is the "boring" winner. In a world where the best- and worst-performing asset classes tend to dominate the headlines, it's easy to lose sight of the fact that a diversified investment portfolio is generally the most reliable approach for meeting long-term investment objectives. Diversification is a time-tested component of portfolio construction, especially through the lens of risk-adjusted returns in terms of Sharpe ratios.[1]

Historically, the result of a diversified portfolio is less volatility that tends to produce something close to middle-of-the-road performance year in and year out. This contrasts with the best- and worst-performing asset classes, which often generate significant media attention despite volatility in returns and market leadership—hence the sentiment that diversification is rather "boring" but clearly the winning strategy.

Asset Class Returns

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
REIT 35.1%	EM 39.8%	HG Bnd 5.2%	EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 1.8%	Lg Cap 31.5%	Sm Cap 20.0%
EM 32.6%	Int'l Stk 11.6%	Cash 1.7%	HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%	HG Bnd 0.0%	REIT 28.7%	EM 18.7%
Int'l Stk 26.9%	AA 7.6%	AA -22.4%	Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%	Sm Cap 25.5%	Lg Cap 18.4%
Sm Cap 18.4%	HG Bnd 7.0%	HY Bnd -26.4%	REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.0%	EM 11.6%	Sm Cap 14.7%	REIT -4.0%	Int'l Stk 22.7%	AA 9.8%
AA 16.7%	Lg Cap 5.5%	Sm Cap -33.8%	Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%	AA 18.9%	Int'l Stk 8.3%
Lg Cap 15.8%	Cash 4.4%	Lg Cap -37.0%	Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%	EM 18.9%	HY Bnd 7.5%
HY Bnd 11.8%	HY Bnd 2.2%	REIT -37.7%	AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%	HY Bnd 14.4%	HG Bnd 6.1%
Cash 4.7%	Sm Cap -1.6%	Int'l Stk -43.1%	HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%	HG Bnd 8.7%	Cash 0.6%
HG Bnd 4.3%	REIT -15.7%	EM -53.2%	Cash 0.1%	Cash 0.1%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 0.8%	EM -14.3%	Cash 2.2%	REIT -5.1%

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks – S&P 500 Index	9.88%	32.4%	-37.0%
Sm Cap	Small Cap Stocks – Russell 2000 Index	8.91%	38.8%	-33.8%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	4.97%	32.5%	-43.1%
EM	Emerging Market Stocks – MSCI Emerging Markets Index	6.95%	79.0%	-53.2%
REIT	REITs – FTSE NAREIT All Equity Index	7.15%	35.1%	-37.7%
HG Bnd	High Grade Bonds – Bloomberg Barclays U.S. Agg Bond Index	4.40%	8.7%	-2.0%
HY Bnd	High Yield Bonds – ICE BofA US High Yield Index	7.44%	57.5%	-26.4%
Cash	Cash – S&P U.S. Treasury Bill 0-3 Mth Index	1.11%	4.7%	0.0%
AA	Asset Allocation Portfolio*	7.02%	24.6%	-22.4%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/20.

*Asset Allocation Portfolio is made up of 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

By design, diversified portfolios hold a mix of asset classes, some of which outperform and some of which underperform in any given year. As a result, diversified portfolios will never beat the top-performing asset class any given year. However, it's notoriously difficult for investors to consistently pick top-performing asset classes.

Nevertheless, to some clients, more-stable diversified strategies lack the appeal of flavor-of-the-month champions like the high-flying technology stocks or rapidly rising emerging markets. This point of view arises from some well-known cognitive and emotional biases, which we have covered at length in Behavioral Finance papers.

[1] The risk-adjusted return, measured by subtracting the risk-free rate (91 day T-bills) and dividing by the standard deviation of a portfolio's excess return.

Jeffrey L. Taxman, MBA, PFS Consulting LLC, 1810 South 108th St., Omaha, NE 68144, jtaxman@pfsfa.com, 402.399.8820 (o), 402.397.9510 (f)

Tax-efficiency: equally important, but often overlooked. While creating a risk profile, allocating assets to a diversified strategy, and periodic rebalancing are building blocks of successful long-erm investing, focusing solely on generating returns can overlook the need for tax-efficiency. Many fail to consider the factors that contribute to—or detract from—what they actually earn after taxes. Taxes are the single largest drag on performance for investors over the long term.

In this hypothetical example in Figure 1, the "no taxes" portfolio earned about **$650,000** in gains over 20 years; the "gains taxed at short-term rate" portfolio earned less than half of that amount, **$278,699**, after taxes. By holding the assets in the most tax-favored account type, actively monitoring the portfolio and harvesting losses the investor can keep more money working longer, as the tax savings can be reinvested and compounded over time.

Roth conversions paired with charitable offset. As the country continues to deal with rising federal budget deficits and underfunded entitlement programs, increased taxes on portfolio withdrawals in retirement are one of the greatest risks and uncertainties for our clients and the investing public. Accordingly, many of our doctors take advantage of a Roth conversion of money in qualified accounts to remove this uncertainty and lock in tax-free growth. There are no income limits for a Roth conversion and, while they may trigger a taxable event, our doctors can mitigate their tax bills by pairing tax strategies. For instance, a client could utilize charitable deductions and other unique strategies we offer to offset the tax liability from their one-time Roth conversion.

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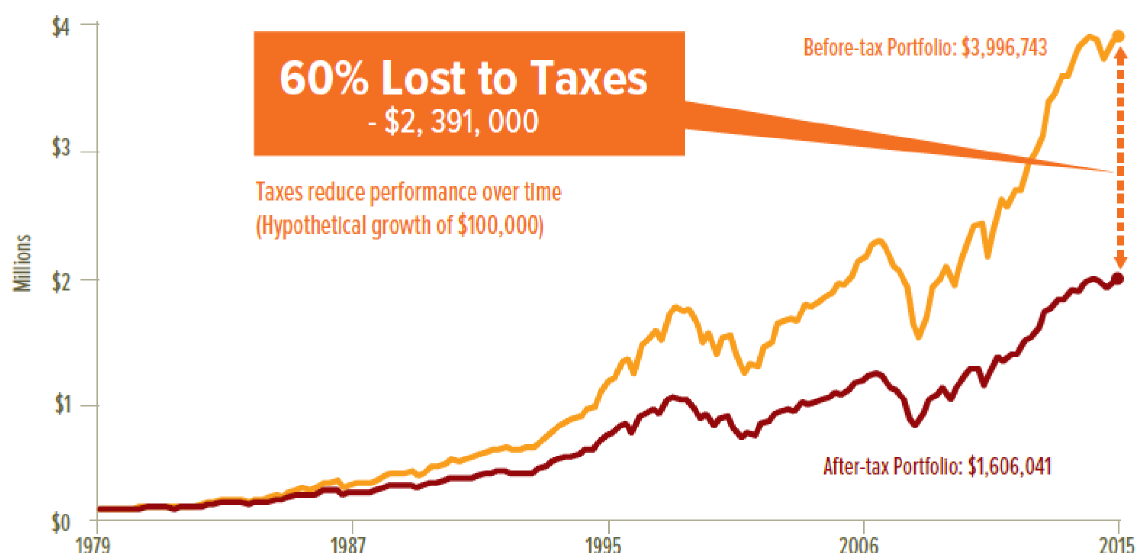
Saving more now means more value later.

While focusing on top-level investment returns, many investors fail to consider the factors that contribute to, or detract from, what they actually keep after taxes. Being mindful of after-tax performance and augmenting year-end reviews with a year-round tax management solution may dramatically enhance investor wealth in up and down markets.

FIGURE 6 Its not what you make, its what you keep



Source: Parametric Portfolio Associates. Based on a hypothetical tax-free $100,000 portfolio invested 60% in stocks (based on the Russell 3000®) and 40% bonds (based on the Barclays Aggregate) with (1) no liquidators; (2) interest income and dividends taxed annually at historical top marginal tax rates; (3) capital gains realized at 50% per year and taxed at the historical long-term capital gains tax rate; and (4) portfolio is held for 36 years from (1979–2015). The intent is to portray a worst-case scenario. The portfolio would have grown from $100,000 to about $4.0 million. If the portfolio was taxed as indicated above, it would have lost 60% of its value, due to taxes paid and earnings lost on that money. Tax-managed investment strategies are designed to minimize capital gains distributions and maximize after-tax returns. Past performance is no guarantee of future results.

While focusing on top-level investment returns, many investors fail to consider the factors that contribute to, or detract from, what they actually keep after tax. Being mindful of after-tax performance and augmenting year-end reviews with a year-round tax management solution may dramatically enhance investor wealth in up and down markets.

We have built a range of innovative solutions to help our doctors keep more of what they've earned. Capitalizing on the research and development efforts from industry partners, we have produced more systematic and reliable ways to navigate an ever-changing investment and tax landscape. Our solutions work in context with our doctors' long-term goals, risk tolerance and tax bracket to implement strategies that seek to produce more effective outcomes.

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PFS Consulting LLC
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Omaha, NE 68144
402.399.8820 (o)
402.397.9510 (f)
jtaxman@pfsfa.com
www.pfsfa.com

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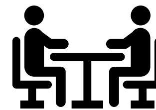

Schedule a Consultation **Schedule a Client Review**

Strategies to Help Investors Keep More of What They Earn

Tax-efficient investing is a sensible strategy for most investors—especially those with high marginal tax rates or concentrated equity holdings acquired through inheritance, employer stock grants or a business buyout. Tax efficiency is a measure of how much of an investment's return is left over after taxes are paid. The greater the tax efficiency, the more gains an investor keeps. The goal is to defer the realization of gains and maximize overall after-tax returns. Without an active strategy to curtail the tax consequences of those transactions, those nickels and dimes can add up over time to real money—as much as 1% to 2% of portfolio growth annually, which can mean up to $2,000 a year in tax savings for a $100,000 portfolio.

Asset Allocation v. Asset Location

While asset allocation is one of the most important drivers of overall returns, many fail to appreciate the importance of "asset location"—the process of deciding which investments to hold in a taxable account and which to hold in a tax-favored account. The optimal choice should consider the investor's goals and marginal income tax bracket (including whether the investor is subject to the alternative minimum tax); the asset class; the tax characteristics of the underlying assets; and the types of accounts owned.

Index Return Assumptions; Inherent Investment Risks

There are risks involved with investing, including loss of principal. Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.

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