Navigating Uncertain Seas

TAX-SMART INVESTMENT STRATEGIES TO HELP YOU KEEP MORE OF WHAT YOU MAKE

In the late 1990s, mutual fund asset values skyrocketed, generating significant capital gains for investors. So when the tech bubble burst in the early 2000s, and these gains were reported to the IRS as part of routine year-end reporting, some investors found themselves in the unfortunate position of losing money AND owing taxes.

Could this scenario repeat itself?

Are investors facing the likelihood of a significant tax bill – even if the market declines?

Interestingly, investors experienced the best of both worlds in 2010 – double-digit returns along with unchanged taxes. But that situation assuredly will not last. Given the likelihood of major changes in the federal tax code in the future – and with the exhaustion of tax-loss carryforwards – investors could once again face the possibility of less-than-ideal tax management.

Taxes – especially when not managed properly – can erode investment gains and minimize progress towards your financial goals. And uncertainty around taxes can add to your psychological discomfort as well as increase the potential to make the wrong decisions.

In times like these, **every** investor needs to examine and possibly rethink investment tax management. So this article will discuss:

- The evolving tax code and what it means for you,
- Why investors may well be paying more taxes than necessary, and most importantly,
- The tools available to fight uncertainty and help you keep more of what you make – in any market environment.

Postponing the Inevitable?

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended the Bush-era tax cuts for two years. In addition, it also:

- Cuts Social Security taxes for employees for calendar year 2011;
- Extends unemployment insurance for 13 months;
- "Patches" the Alternative Minium Tax (AMT); and
- Allows families to pass on more of their estate to heirs tax-free.

The cloud surrounding this silver lining is that most of these cuts expire at the end of 2012 **and it's uncertain what will happen in 2013.**

Will Congress be more likely to raise taxes in a healthier economic climate?

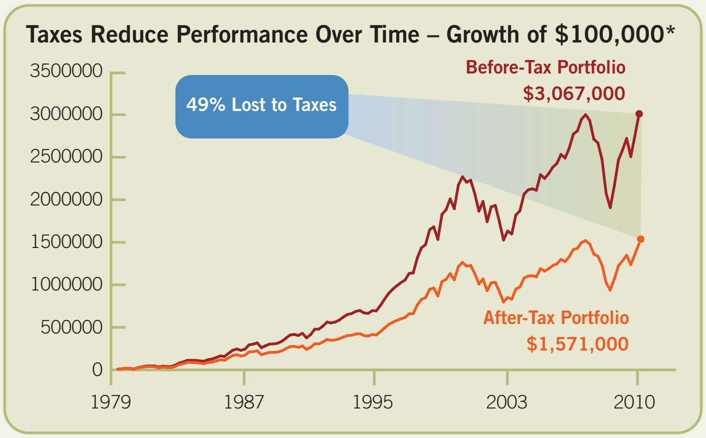
It's widely believed that most of us will see tax increases as a result of the mushrooming federal deficit. This could impact not only tax but capital gains and dividends as well.

How Much Damage Could Be Done?

It's important to keep in mind the impact of taxes on hard-won investment gains. According to the Investment Company Institute (ICI), at year-end 2008 more than 92 million shareholders (82% individuals, 18% institutions) owned the majority of the $9.6 trillion assets invested in mutual funds that year.[1] These investors paid approximately $736 million in 2009 due to short-term capital gains taxes, $149 million in long-term capital gains and $12 billion because of taxes on dividends. Basically, these investors on average gave up almost one percent (0.98%) of earnings to taxes. And while those numbers are disturbing, they came in a year when the tax burden was relatively light. Finally, consider that those taxes covered little more than holding the fund and reinvesting gains, essentially a buy-and-hold strategy.

Here's another way to assess the damage of taxes. A $100,000 portfolio invested in 60% stocks and 40% bonds in 1979 would have grown to $3.07 million before taxes by 2010. However, with no efforts to mitigate the tax effect, Uncle Sam would have eaten almost 50 percent of the gain, lowering the investor's wealth to just over $1.5 million.[2]

It's Not What You Make, It's What You Keep



Techniques Designed to Produce Higher After-tax Returns

- Tax Lot Accounting
- Loss Harvesting
- Wider Rebalancing Ranges
- Tax-Aware Trading
- Gain/Loss Offset
- Transition of Low-Cost-Basis Stocks

Source: Parametric Portfolio Associates: 60% Russell 3000; 40% Barclays Capital Aggregate; No Liquidation. Interest income and dividends are taxed annually at historical top marginal tax rates; capital gains are realized at 50% per year and are taxed at the historical long-term capital gains tax rate at the time. Past performance is no guarantee of future results.

*A hypothetical $100,000 portfolio before taxes (invested 60% in stocks and 40% in bonds) held for 30 years would have grown to about $3.1million. If the portfolio was taxed like an average mutual fund, it would have lost 50% 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.

1 ICI 2009 Mutual Fund Fact Book (Section 2, Figure 2.4).

2 Parametric Portfolio Associates: 60% Russell 3000; 40% Barclays Capital Aggregate. No Liquidation; investments are not completely sold. The portfolio is partially turned over and never liquidates a security to harvest losses. Interest income and dividends are taxed annually at historical top marginal tax rate; capital gains are realized at 50% per year and are taxed at the historical long-term capital gains tax rate.

Out with the Old, In with the New

"Taxes take an enormous bite out of an investor's return – but the good news is that you can do something about it," said Brian Langstraat, president of Parametric Portfolio Associates, whose firm helps investment managers implement tax management strategies.

Historically, according to Langstraat, most investors and their financial advisors have focused only on cutting taxes in November and December or only in years where investors have capital gains.

Firms like Parametric argue that there is a better way to help protect the investor's return throughout the market's ups and downs. It begins with the admission that tax management cannot be a part-time endeavor. Given the potential damage of overpayment, the management of taxes must be a cornerstone of an investor's planning process. It calls for employing new techniques and strategies from investment managers and more sensitivity to the tax consequences of portfolio implementation.

"Investment return is number-one, tax management is one-A," said Steve Konopka, Senior Investment Analyst with SEI. Konopka admits to being frustrated when investors and their advisors ignore tax management until year-end, at which point options are limited.

"If the investor only does tax management at year-end and the market goes up, there's not much that can be done at that point," he said. "But managing taxes throughout the year means the investor can take advantage of the ups and downs of the market and benefit from that volatility."

Parametric's Langstraat believes that "Investors need a consistent, systematic, year-round approach to tax management in their portfolios." However, there are minimal opportunities with traditional mutual funds, where tax management is mostly limited to deferring capital gains or minimizing dividend distributions.

More to the point, the manager of a traditional mutual fund buys and sells securities with the interests of the fund in with the interests of the fund in mind, and not necessarily the tax consequences of the investor. It's for this reason that we offer tax-managed funds and tax-efficient separate account strategies.

Tools to Ease Your Uncertainty

The list of tools available to managers of tax-managed portfolios and other tax-advantaged investments reflects their growing popularity. Think of each as navigational tools to help the investor stay on course to his or her investment goal. While none of these tools are guaranteed, they can be very helpful in managing tax consequences.

Tax-lot accounting: A method of accounting for a securities portfolio in which the manager tracks the purchase, sale price and cost basis of each security. This allows the manager to "swap" a batch of stocks with long-term gains for a batch with smaller, short-term gains.

Loss harvesting: Allows the manager holding a stock at a loss to sell all or part of it to realize the loss and create an "asset" that may help offset some future gain.

Wider rebalancing ranges: A wider rebalancing range can help reduce the number of trades made to keep the investor's portfolio within a range of the target allocation, say a 60% equity and 40% bond allocation, which may lead to lower realized capital gains and corresponding taxes.

Gain-loss offset: Involves selling securities at a loss that have dropped in price at year-end to help offset gains from selling securities that have increased in price.

There are other tools that fall within the category of "tax-aware" trading: delaying the sale of stocks that are about to become a long-term holding; identifying the most tax-advantaged stock sales for the purpose of making charitable donations; identifying the most tax-advantaged (high-cost basis) stocks to sell for investors seeking regular income from their portfolios.

Knowledge is Only Power if You Use It.

Now that you know more about managing taxes on your investments – and the benefits you can reap from it – what can you do to take advantage of that knowledge?

- **Involve your advisor.** Set up an appointment to review your account's tax efficiency, the effects (good and bad) of your current tax management process, and what short- and long-term steps you need to take.
- **Keep taxes top of mind.** Unlike the holidays, successful tax management is not seasonal. If you wait until year-end to consider tactics, you'll never get the most benefit. You should be "tax-management-minded" on your investments all year round and in every market condition. Your advisor will make sure it happens so you don't have to worry.
- **Stay on top of changes.** The tax situation changes almost daily. Keep up (both directly and through your advisor) with changes – or potential changes – that could affect you. Plan accordingly. Again, your advisor can be of invaluable assistance.

An uncertain tax structure can cause significant harm. But different situations can be anticipated, and their harm minimized. Staying aware, and working with your advisor, will give you the best chance of sailing through uncertainty with minimal damage.

This material represents an assessment of the market environment at a specific point in time and is not intendedto be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding the funds or any stock in particular, nor should it be construed as a recommendation to purchase or sell a security, including futures contracts.

To determine if the Funds are an appropriate investment for you, carefully consider the investment objectives, risk factors and charges and expenses before investing. This and other information can be found in the Funds' prospectuses, which can be obtained by calling 1-800-DIAL-SEI. Read them carefully before investing.

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.

Neither SEI nor its affiliates provide tax advice. Please note that (i) any discussion of U.S. tax matters contained in this communication cannot be used by you for the purpose of avoiding tax penalties; (ii) this communication was written to support the promotion or marketing of the matters addressed herein; and (iii) you should seek advice based on your particular circumstances from an independent tax advisor.

For those portfolios of individually managed securities, SEI Investments Management Corporation (SIMC) makes recommendations as to which manager will manage each asset class. SIMC may recommend the termination or replacement of a money manager and the investor has the option to move the account assets to another custodian or to change the manager as recommended. For a complete description of all fees and expenses for separately managed accounts, please refer to SEI Investments Management Corporation's ADV Part II.

SIMC is the adviser to the SEI Funds, which are distributed by SEI Investments Distribution Co. (SIDCo.) SIMC and SIDCo are wholly owned subsidiaries of SEI Investments Company.

Neither SEI nor its subsidiaries are affiliated with your advisor.

Moneywise - Wealth Management
8800 Stockdale Hwy, Suite 100
Bakersfield, CA 93311
www.MoneywiseGuys.com
(661) 847-1000

Securities offered through SCF Securities, Inc. - Member FINRA/SIPC Investment Advisory Services offered through SCF Investment Advisors, Inc. 155 E. Shaw Ave. Suite 102, Fresno, CA 93710 (800) 955-2517 Fax (559) 456-6109 SCF Securities, Inc. and Moneywise Wealth Management are not affiliated