

Tax-Managed Portfolios

The primary goal of any tax managed fund is to try and minimize its tax impact on investors. This is achieved by layering on additional considerations to the investment management process, such as seeking to avoid short-term gains, managing dividend payments and harvesting losses throughout the year. These management overlays are designed to reduce the overall tax liabilities of owning a mutual fund. This can be very important for investors in the highest tax bracket.

Though a tax-managed approach can potentially negatively affect portfolio performance, for some investors the desire to decrease taxes will trump the pursuit of the highest return. This is where investor preference comes into play. This can be a significant issue, especially for those who view the payment of taxes as incredibly painful. In this case, the decision to use tax managed mutual funds may make more behavioral sense than investment sense. If using tax managed funds will increase the odds that the investor will maintain their patient, long term investment horizon, that aspect alone could be enough to merit a tax managed portfolio.

With a tax managed mutual fund, all strategic moves have one goal in mind, lowering taxable income. Overall returns are still important, but come secondary to tax management. As we can see in the table on the next page, the after tax results have been mixed, in some cases the after tax return was higher on tax managed funds, in other cases it lagged. In the long run, a tax managed portfolio's lower tax bills and lower pre-tax returns should mean the portfolio's after tax returns roughly equal the after tax return of a comparable standard mutual fund. Neither portfolio should have a natural advantage on an after tax basis, but year to year differences are likely to occur given slight differences in investment philosophies and trading rules. A thorough understanding of an investor's behavioral needs, combined with a strong partnership with their CPA or tax advisor can best determine if tax managed funds are the right solution.

Tax Management at a Glance

Objective

- Deliver consistent exposure to the fund's risk dimensions while maximizing after-tax returns.

Engineering

- Tax-Lot Accounting
 - Sell highest cost lots first
 - Avoid short-term gains
- Capital Gains
 - Reduce realized gains.
 - Harvest and inventory short- and long-term losses.
- Dividends
 - Structure portfolio to manage dividends.
- Transaction Costs
 - Patient, price-conscious trading reduces transaction costs. Quantitative model evaluates trade-off between transaction costs and tax-loss harvesting.
- Diversification
 - Broad diversification is intended to minimize company-specific risk.

Performance data ending June 30, 2017

Name	Asset Class	Ticker	Gross Expense Ratio	Turnover	Post-Tax Pre-Liquidation 10 Yr Return
DFA Tax-Managed US Eq	US Market	DTMEX	0.22%	2%	10.3%
DFA US Core Equity 1 I		DFEOX	0.19%	4%	9.7%
DFA Tax-Managed US t Marketwide Value	US Value	DTMMX	0.57%	5%	10.2%
DFA US Large Cap Value I		DFLVX	0.37%	15%	9.6%
DFA Tax-Managed US Small Cap	US Small	DFTSX	0.52%	7%	8.8%
DFA US Small Cap I		DFSTX	0.37%	11%	8.3%
DFA Tax-Managed International Value	Intl Large Value	DTMIX	0.53%	25%	-2.2%
DFA International Value I		DFIVX	0.63%	15%	-2.1%

Fund Name	Ticker	Total Ret 3 Mo	Total Ret 1 Yr	Total Ret 5 Yr	Total Ret 10 Yr	Total Ret Inception	Inception Date	Std Dev 10 Yr
DFA Tax-Managed US Eq	DTMEX	9.3%	0.0%	11.1%	7.2%	7.3%	9/25/01	15.3%
DFA US Core Equity 1 I	DFEOX	9.6%	-1.4%	10.6%	7.3%	7.5%	9/15/05	16.6%
DFA Tax-Managed US Marketwide Value	DTMMX	10.9%	-2.6%	10.9%	6.5%	7.0%	12/14/98	19.4%
DFA US Large Cap Value I	DFLVX	11.6%	-2.3%	10.7%	6.4%	9.9%	2/19/93	19.3%
DFA Tax-Managed US Small Cap	DFTSX	9.7%	-2.9%	9.5%	6.1%	9.0%	12/15/98	19.9%
DFA US Small Cap I	DFSTX	10.0%	-2.6%	9.5%	7.4%	10.3%	3/19/92	20.1%
DFA Tax-Managed International Value	DTMIX	10.7%	-15.7%	-0.9%	1.2%	5.0%	4/16/99	21.2%
DFA International Value I	DFIVX	10.6%	-15.9%	-0.7%	1.0%	5.7%	2/15/94	21.7%

Source: Morningstar Direct, 2017

The performance data quoted represents past performance. Past performance does not guarantee future results and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance information quoted. Returns listed assume reinvestment of all dividend and capital gain distributions; they do not include the effect of any fees charged by an independent investment advisor or other service provider to an individual account. "One Year", "Five Year", "Ten Year" and "Since Inception" returns have been annualized. After-Tax returns are shown pre-liquidation. Tax-adjusted total return is based on the following assumptions: The investor does not sell the holding at the end of the time period, distributions are taxed at the highest federal tax-rate prevailing and then reinvested, state and local taxes are excluded.

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