Tax Management and Canvas

OSAM Research, April 2021

OSAM has a long history of managing factor-based investment strategies in a manner that reduces real-world costs and delivers strong investment results. Since the inception of our firm, tax management has been an integral component of the portfolio management process because we understand how taxes can drag on investment results.

We built Canvas, a web-based platform enabling financial advisors to build Custom Indexes, on top of our factor expertise, sophisticated risk modeling, and proprietary SMA infrastructure, powering us to efficiently and effectively manage client accounts to individual tax parameters.

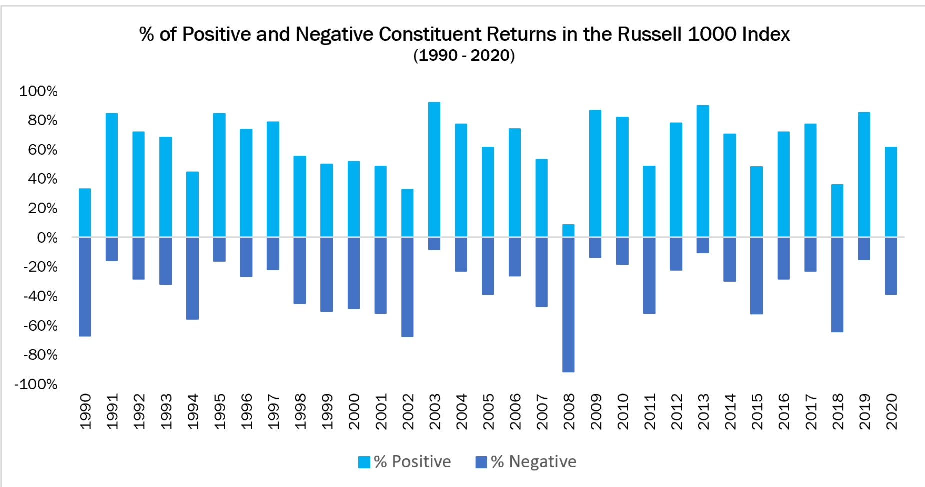
Our tax management and tax loss harvesting (TLH) process aims to reduce the impact of taxes on returns by:

- Realizing taxable gains on a long-term, as opposed to short-term, basis to benefit from the lower long-term tax rate;
- Opportunistically trading preferable tax lots that lessen the *net* tax impact—i.e. pairing gains with losses where possible;
- Avoiding wash sales;
- Having an awareness of dividend payments and their tax effects;
- Transitioning portfolios in a tax-friendly manner from a current to desired state (where applicable).

From a single separately managed Canvas account, these tax considerations can be applied to a fully passive, fully active, or blended allocation customizable by market cap, geography, factor, and include personal restrictions such as Social Responsibility, ESG, or individual stocks.

The Advantage of Separately Managed Accounts

Mutual funds and ETFs are efficient vehicles for obtaining broad market exposure but are less tax-efficient than commonly perceived. Because ETF and fund investors do not own the underlying securities, they are not able to benefit from opportunistic tax loss harvesting. Even though the stock market rises in about 71% of calendar years, roughly 36% of individual stocks deliver negative returns annually. The ability to harvest these losses accrues to a significant tax asset over time—even relative to tax efficient ETFs.



How We Tax-Manage Canvas Portfolios

Long-term investors desiring to change allocations are often caught between the immediate tax costs of an allocation change and the potential benefit from the trade (stronger future returns, lower tracking error, increased diversification, etc.). We often refer to this as the "tax tail" wagging the "investment dog." Unfortunately, the tax tail can incur formidable costs. Applying tax management *during* a transition and on an *ongoing* basis helps mitigate these costs. For Canvas accounts, we apply a simple 4-step process:

1. We **invest** the portfolio while being mindful of tax impact *during* the transition from an existing portfolio. That means providing cost/benefit analysis for the portfolio transition and creating a plan to transition over time if appropriate.

2. We **regularly evaluate** the portfolio for tax loss harvesting opportunities. Parameters can be set to manage to an annual tax budget or tolerance threshold that allows us to deviate from the portfolio's strategy model to capture as many losses as possible.

3. We **reinvest proceeds** from tax loss harvesting with an awareness of wash sale rules and to maintain target allocations, factor tilts, and risk exposures.

4. We use accumulated losses to **offset realized gains**, lowering or eliminating the client's tax bill.

Measuring the Impact of Tax Management

To put our tax harvesting strategy to the test, we ran it through our tax-lot level research framework. The framework provides daily accounting for all positions at the share and lot-level, incorporates real world transaction costs, and utilizes the elements of the management process described in the last section. Because after-tax results are highly dependent on the fluctuations in stock markets, we ran 16 ten-year simulations starting in 1994 through 2009 to see if different market environments impacted the ability to add after-tax value. For the purposes of our analysis, we applied current maximum tax rates.[1]

The Result

Our research suggests that the Canvas tax loss harvesting capabilities can potentially add somewhere between 0.5-1.0% of annual after-tax return versus passive ETF strategies[2]. Specifically, the drawdown in 2020 was a boon for tax loss harvesting and we were able to generate $250,000 of losses on a $1,000,000 U.S. Large Cap Direct Index equating to a tax offset of $100,000.

If you'd like to learn more about Canvas tax management, Click Here **to Sign-Up For Your Demo Today.**

[1] 42.4% on Short-Term Capital Gains, 23.8% on Long-Term Capital Gains, Dividends taxed at a 20% rate. State and city-level considerations are not applied to the analysis.
[2] Based on a passive U.S. Large Cap Direct Index strategy compared to the SPY ETF.

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Hypothetical performance results shown on the preceding pages are backtested and do not represent the performance of any account managed by OSAM, but were achieved by means of the retroactive application of each of the previously referenced models, certain aspects of which may have been designed with the benefit of hindsight.

The hypothetical backtested performance does not represent the results of actual trading using client assets nor decision-making during the period and does not and is not intended to indicate the past performance or future performance of any account or investment strategy managed by OSAM. If actual accounts had been managed throughout the period, ongoing research might have resulted in changes to the strategy which might have altered returns. The performance of any account or investment strategy managed by OSAM will differ from the hypothetical backtested performance results for each factor shown herein for a number of reasons, including without limitation the following:

- Although OSAM may consider from time to time one or more of the factors noted herein in managing any account, it may not consider all or any of such factors. OSAM may (and will) from time to time consider factors in addition to those noted herein in managing any account.
- OSAM may rebalance an account more frequently or less frequently than annually and at times other than presented herein.
- OSAM may from time to time manage an account by using non-quantitative, subjective investment management methodologies in conjunction with the application of factors.
- The hypothetical backtested performance results for each factor do not reflect any transaction costs of buying and selling securities, investment management fees (including without limitation management fees and performance fees), custody and other costs, or taxes – all of which would be incurred by an investor in any account managed by OSAM. If such costs and fees were reflected, the hypothetical backtested performance results would be lower. Therefore, it should be noted that on the previous pages of this presentation, any back-tested results may be reflected gross of fees. Had OSAM managed the back-tested Portfolio during the corresponding time period, the deduction of an OSAM fee would have decreased the reflected results. For example, the deduction of a 1.00% fee over a 10-year period would have reduced a 10% gross of fees gain to an 8.9% net of fees gain.
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- The hypothetical performance does not reflect the reinvestment of dividends and distributions therefrom, interest, capital gains and withholding taxes.
- Accounts managed by OSAM are subject to additions and redemptions of assets under management, which may positively or negatively affect performance depending generally upon the timing of such events in relation to the market's direction.
- Simulated returns may be dependent on the market and economic conditions that existed during the period. Future market or economic conditions can adversely affect the returns.
- Please Note: Socially Responsible Investing Limitations. Socially Responsible Investing involves the incorporation of Environmental, Social and Governance considerations into the investment due diligence process ("ESG). There are potential limitations associated with allocating a portion of an investment portfolio in ESG securities (i.e., securities that have a mandate to avoid, when possible, investments in such products as alcohol, tobacco, firearms, oil drilling, gambling, etc.). The number of these securities may be limited when compared to those that do not maintain such a mandate. ESG securities could underperform broad market indices. Investors must accept these limitations, including potential for underperformance. Correspondingly, the number of ESG mutual funds and exchange traded funds are few when compared to those that do not maintain such a mandate. As with any type of investment (including any investment and/or investment strategies recommended and/or undertaken by OSAM), there can be no assurance that investment in ESG securities or funds will be profitable, or prove successful.

Composite Performance Summary

For full composite performance summaries. please follow this link: http://www.osam.com

CANVAS® is an interactive web-based investment platform developed by O'Shaughnessy Asset Management, L.L.C. ("OSAM") that permits an investment professional (generally a registered investment advisor) to devise a desired investment strategy ("Strategy," including any combination of such Strategies) for the professional's client. At all times, the investment professional, and not OSAM, is responsible maintaining the initial and ongoing relationship with the underlying client and rendering individualized investment advice to the client. In addition, the investment professional and not OSAM, is responsible for (1) determining the initial and ongoing suitability of the Strategy for the client; (2) devising or determining the specific initial and ongoing desired Strategy; (3) monitoring performance of the Strategy; and (4) modifying and/or terminating the management of the client's account using the Strategy. The client may not look to OSAM for, and OSAM shall not have any responsibility for: (1) providing individualized investment advice or making any determination as to the initial or ongoing suitability of any Strategy for any specific investor, including the professional's client; (2) monitoring the Strategy; or (3) the performance of the Strategy. The use of the CANVAS® platform does not serve as the receipt of, or as a substitute for, personalized investment advice from the client's investment professional, for which the client must look solely to his or her investment professional. No guaranty of performance or suitability is made or may be inferred from materials at the CANVAS® web site or the use of the CANVAS® platform.

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The CANVAS® platform reports historical performance information for Strategies compiled by OSAM. These performance figures reflect hypothetical, back-tested results; thus, they represent the retroactive performance of simulated portfolios. As such, the corresponding results have inherent limitations, including that: (a) the results do not reflect actual trading using investor assets, but were achieved by means of the theoretical retroactive application of the devised Strategy, certain aspects of which may have been designed with the benefit of hindsight; (b) back-tested performance may not reflect the impact that any material market or economic factors might have had on the investment professional's use of the hypothetical portfolio if the portfolio had been used during the period to manage actual investor assets; and (c) the back-tested performance of any Strategy does not reflect trading costs, investment management fees or taxes (although, as noted above, the expenses of exchange-traded funds included in any Strategy are sought to be taken into account). Such simulated theoretical returns are provided for informational purposes only to indicate historical performance had the Strategy's portfolios been available over the relevant time period. OSAM did not offer the CANVAS® platform until April 2019. Prior to 2007, OSAM did not manage client assets.

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The risk-free rate used in the calculation of Sortino, Sharpe, and Treynor ratios is 5%, consistently applied across time.

The universe of All Stocks consists of all securities in the Chicago Research in Security Prices (CRSP) dataset or S&P Compustat Database (or other, as noted) with inflation-adjusted market capitalization greater than $200 million as of most recent year-end. The universe of Large Stocks consists of all securities in the Chicago Research in Security Prices (CRSP) dataset or S&P Compustat Database (or other, as noted) with inflation-adjusted market capitalization greater than the universe average as of most recent year-end. The stocks are equally weighted and generally rebalanced annually.

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