Green Harvest
ASSET MANAGEMENT

September 14, 2020

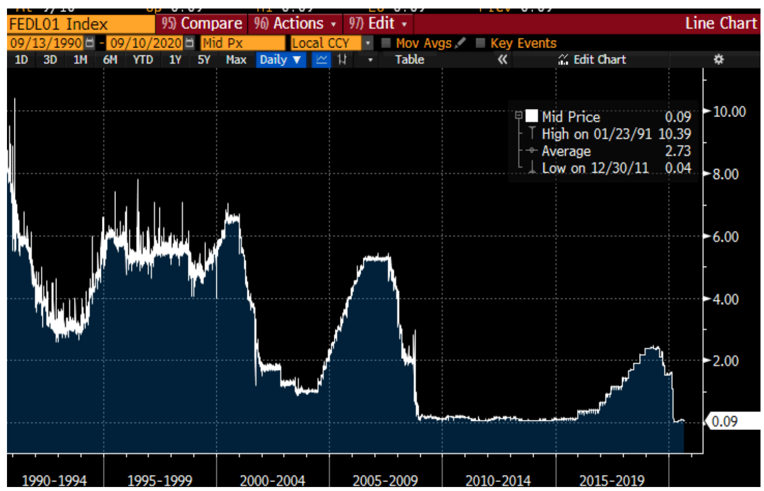
Harvesting Strategy

Take Less Risk…Pay Less Taxes…Keep it Simple

For a variety of reasons, many investors are looking to reduce stock exposure. Selling stocks is one approach to be sure, but for investors with significant unrealized gains, it could lead to undesired tax bills and lower after-tax returns. One alternative is hedging by adding a short position (a.k.a. short selling or shorting) to the portfolio. Hedging offers not only a tool to avoid realizing those gains and the accompanying tax bill, but also – to the extent stocks continue rising – a potential means for Tax Benefit Capture (TBC).[1] For prior discussion addressing the unrealized gains issue and TBC with hedging positions, see here and here.

One advantage investors have gained in the past few decades is the Exchange Traded Fund (ETF). ETFs are an increasingly popular tool for constructing low-cost tax efficient portfolios. But fewer folks may be aware that they are also an efficient way to hedge or reduce risk. The growth in ETFs has dramatically expanded the hedging tool kit, adding many different securities and exposures to both build portfolios and hedged positions. What may be even more underappreciated, is that today's market dynamics have further favored the individual use of hedging via short positions in ETFs.

For instance, broker-dealers may offer certain investor classes, such as larger mutual funds and hedge funds, a form of interest on the value of their short position, referred to as a "short rebate".[2] Investing through these types of institutional vehicles provides the opportunity of getting a short rebate, but now with Fed Funds rates so low, that is no longer a material benefit - see chart.



With rates at this level, investors should realize that the playing field has been leveled. Hedging by shorting ETFs in individual accounts may be more attractive now than hedging via investment vehicles (e.g., a fund). Shorting directly in individually managed accounts may lead to increased transparency and control, and exclusively enable the potential pass-through of TBC. Shorting of ETFs entails risk of significant loss, since the price of the ETF can increase rapidly and cause a loss when the ETF is purchased to close the short position. In addition, hedging requires careful planning and monitoring.

In today's environment, investors may want to discuss with their wealth manager the benefits and risks of hedging strategies using ETFs.

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Download Our White Paper: Future Value of Tax Benefits

[1]Tax Benefit Capture (TBC) in this context refers to the practice of purposely capturing realized losses to minimize taxes by offsetting realized gains.
[2]Depending on the broker dealer, short interest rebates may be available when the position borrowed exceeds a notional dollar threshold, often measured in the tens of millions and tied to a short-term rate such as Fed Funds or LIBOR.

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Tax Benefit Capture Heat Map for period spanning September 7 – September 11, 2020:

Market Exposure	Sectors/Regions with GHAM Tax Benefit Capture	Total Return (%)	Weekly Max Drawdown (%)	Day of Low
Broad Market Index (e.g. S&P500)	X	**-2.5%**	**-3.4%**	**Friday**
Materials		1.0%	-2.6%	Tuesday
Energy	X	-6.5%	-7.2%	Friday
Financials	X	-2.3%	-3.2%	Thursday
Industrials		-0.3%	-2.1%	Tuesday
Consumer Staples		-1.4%	-2.5%	Tuesday
Utilities	X	-0.7%	-2.3%	Friday
Health Care	X	-1.1%	-1.9%	Tuesday
Real Estate		-1.9%	-2.6%	Friday
Info Tech	X	-4.4%	-5.6%	Friday
Consumer Discretionary	X	-0.7%	-2.2%	Friday
Communication Services	X	-3.2%	-4.3%	Friday
MSCI ACWI Ex-US		**-0.1%**	**-1.8%**	**Tuesday**
Asia Ex-Japan		-1.1%	-1.9%	Thursday
Japan		1.0%	-1.3%	Tuesday
Australia		1.7%	-1.7%	Tuesday
Switzerland		-0.6%	-2.6%	Thursday
EuroZone		0.5%	-2.0%	Tuesday
United Kingdom		-0.6%	-2.6%	Thursday
Lat America		-2.4%	-3.4%	Tuesday
Canada		-1.0%	-2.1%	Tuesday

Areas with Tax Benefit Captures (TBCs) indicates where individual tax-loss harvest trades were executed in each market exposure across all eligible accounts for period specified. Darker shaded areas contained more TBCs.
Broad Market Index (e.g. S&P500) reflects TBC in hedged positions.

Max Drawdown calculated as max decline from interim peak to Intra-Day Low.

Market Data Source: Bloomberg
Market statistics calculated using representative ETFs.

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The availability of tax alpha is highly dependent upon the initial date and time of investment as well as market direction and security volatility during the investment period. Tax loss harvesting outcomes may vary greatly for clients who invest on different days, weeks, months and all other time periods.

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Hedged Strategies Risk

The Hedged Strategies take "short" positions by selling an index ETF that the client portfolio does not own, which exposes the portfolio to costs and risks that are not associated with owning securities long. Certain of these costs and risks are described in the margin disclosure statement provided to you by the financial institution holding your account, and we encourage you to discuss those risks and costs with your advisor. The following disclosure discusses the risks related to Green Harvest's investment strategy.

A short position has an opposing or "inverse" relationship to a long position on the same asset. Generally, the short index position will lose money when the overall long portfolio is rising in value, and the short position will increase in value when the long portfolio is losing money. This relationship provides the "hedging" aspect of the Strategy. Green Harvest seeks to short an index ETF that is expected to have a strong inverse relationship with the strategy benchmark. If the index ETF underlying the short position deviates from this inverse correlation to the benchmark performance, then the Strategy will not perform as desired, and you could have limited tax loss harvesting outcomes as well as low or negative portfolio returns. Although the short position is intended as a hedge against negative or low returns of the markets, the Strategy's return may be negative.

Any dividends paid by ETFs underlying the short position must be paid to the institution lending the security and thus will not generate income for your account.

Tax loss harvesting opportunities exist when the long portfolio has gains and when the short position has losses. Portfolio losses may result in margin calls from your financial institution, and when you instruct Green Harvest to sell portfolio assets in response to margin calls, such sales could generate taxable capital gains. Alternatively, you will be required to add cash to the account in response to margin calls.

Short positions can lead to more volatile performance of the underlying security. In addition, the ETFs underlying short positions may experience periods of low trading volume or reduced liquidity, which would restrict the ability to enter short positions. In these periods, Green Harvest can seek to enter short positions through other available transactions, which may have higher transaction costs. All investments are subject to liquidity risk, especially when markets are not functioning normally. If Green Harvest is unable to acquire or dispose of holdings quickly or at prices that represent perceived market value, then the Strategy will be negatively impacted. Examples of events that can lead to heightened liquidity risk include domestic and foreign economic crises, natural disasters, political instability, and regulatory changes.