PUREfi WEALTH

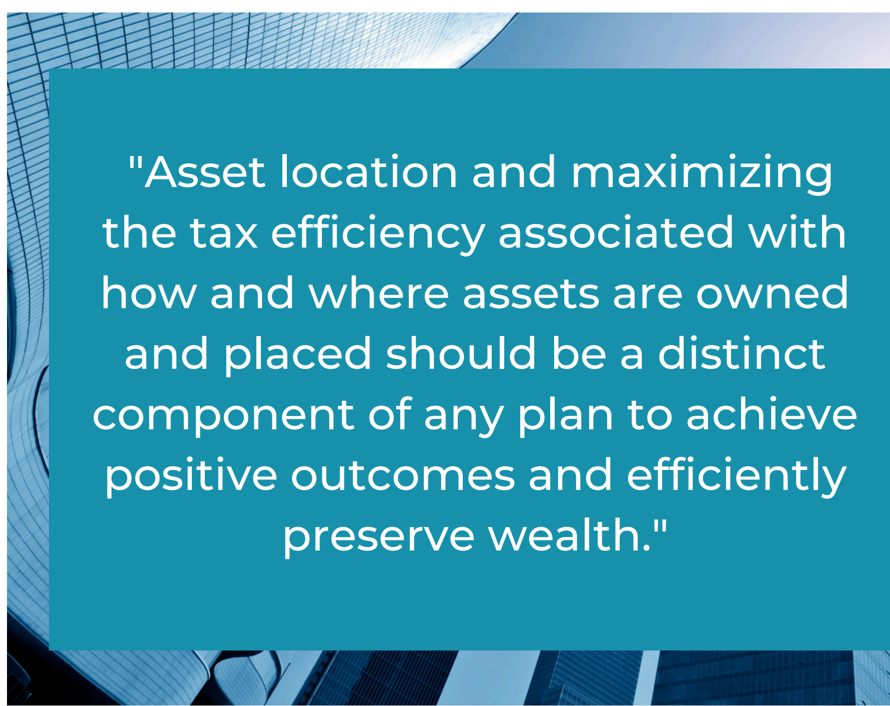
ASSET ALLOCATION VS. ASSET LOCATION

A core underpinning of our planning, investment process, and philosophy at PUREfi Wealth is that comprehensive financial planning with a focus on asset location (and tax optimization) – as distinct from asset allocation - can be a meaningful source of true performance (where true performance equals outcomes adjusted appropriately for taxes, fees, risk, and inflation).

A number of clients have asked about the precise meaning and intent of asset location in this context, so here we endeavor to provide a primer on what it is and why it matters.

Asset allocation is generally well-understood to be how advisors and investors divide portfolios among different asset classes that might include equities, fixed-income, alternatives like private equity, private credit, direct investments, and digital assets, real assets like commodities, and cash and equivalents. Asset allocation is widely accepted as a primary determinant of long-term investment performance and provides a valuable framework for balancing risk, reward, and volatility based on financial goals, risk tolerance, and an investment outlook. “Time in” the market, not “timing” the market.

Asset location, on the contrary, refers to types of accounts and legal entities and where to place the various assets that comprise your overall investment strategy. It matters for one simple reason: taxes. Tax efficiency can be critical to extending the life of a portfolio and can have a profound impact on true performance.



"Asset location and maximizing the tax efficiency associated with how and where assets are owned and placed should be a distinct component of any plan to achieve positive outcomes and efficiently preserve wealth."

It’s important to understand the basic “buckets” that may inform an asset location strategy:

1. Tax-deferred accounts

- Some common tax-deferred accounts are 401(k)’s and traditional IRA’s. Contributions to these types of accounts are tax-deductible. Contributions can grow in the account tax-free, but distributions are taxed as income.

2. Tax-exempt accounts

- Some common tax-exempt accounts are Roth IRA’s and Roth 401(k)’s. These accounts do not get a tax deduction when making contributions. Contributions grow tax-free, and distributions are tax-free.

3. Taxable accounts

- Taxable accounts include individual investment accounts, joint investment accounts, transfer on death accounts, etc. These accounts do not have an associated tax deduction, and dividends, interest, and capital gains are subject to the applicable tax rate.

4. Trusts

- Some of the more common trust types include GRATs, SLATs, Marital Trusts, Living Trusts, Testamentary Trusts, Family Trusts, etc., each of which may have distinct tax and asset location implications.

5. Charitable Vehicles

- Common charitable giving solutions include Donor Advised Funds, Charitable Lead and Charitable Remainder Trusts. The funding, timing, and security selection decisions for these vehicles are also part of an integrated asset location strategy.

Asset Location in Action

Just as you would never invest in tax-free municipal bonds in a tax-exempt or tax-deferred account, it is likely inadvisable to own shares of a high yield bond fund, for example, inside of a taxable account where the higher yields are diluted by taxes. In other words, placing a tax-inefficient investment into a tax-inefficient account is probably a bad idea.

Assuming that one has some or all of the above account types, where does it make the most sense to own small-cap or emerging market stocks, private investments, large-cap dividend stocks, a hedge fund, or venture capital? Even your business or LLC interests? Which are most optimal to gift or donate? What is the impact of strategically positioning (i.e. “locating“) these assets vs. just maintaining a traditional asset allocation strategy in each account? **This is asset location in action, and we believe it matters a lot.**

Can you benefit from an active asset location strategy?

There are several criteria that tend to indicate whether an asset location strategy may be a smart move for you. The more of these criteria that apply to your situation, the greater the potential advantage

1. You currently pay a high marginal income tax rate

- The higher the marginal income tax rate you currently pay, the bigger the potential benefits of asset location.

2. There is a likelihood you will outlive your assets and you have gifting capacity

- Any future legislative reductions to the lifetime gift and estate tax exemption could create a "use-it-or-lose-it" opportunity to potentially save millions in estate taxes.

3. You expect to pay a lower marginal income tax rate in the future

- If you expect your marginal income tax rate to be lower in the future than it is now, active asset location may allow you not only to defer your taxes but to reduce them as well.

4. You have significant assets in tax-inefficient investments held in taxable accounts

- The more tax-inefficient investments, such as taxable bonds and taxable bond funds, you're currently holding in taxable accounts the greater the potential to take advantage of asset location.

5. You are investing for the long term

- Asset location strategies generally take time to work. While small tax benefits may be realized year over year, sizable benefits may be realized by allowing potential tax savings to compound.

6. You have substantially appreciated, or low-cost basis concentrated positions and you are charitably inclined

- Donor Advised Funds, private foundations, and some trusts can offer the potential to make gifts out of your taxable estate today and grow those assets for years or decades before ultimately disbursing your gift, and any gains, to charities and other nonprofit organizations.

As you build your financial plan, or consider retaining a financial advisor, you will likely make a point of considering your asset allocation and how that squares with your goals, risk tolerance, time horizon, and market outlook. But don't forget that asset location and maximizing the tax efficiency associated with how and where assets are owned and placed should be a distinct component of any plan to achieve positive outcomes and efficiently preserve wealth.

CONTACT US

PUREfi Wealth LLC
10 Post Office Square, Suite 710
Boston, MA 02109

617-488-9320

contact@purefiwealth.com

www.purefiwealth.com

PUREfi WEALTH

About PUREfi Wealth

Headquartered in Boston, PUREfi Wealth is an independent wealth advisory boutique. The firm is deeply committed to providing comprehensive, multi-generational advice, wealth planning, and investment management to individuals, families, and their associated entities, and operating under a fiercely independent and objective fiduciary standard through a state-of-the-art open architecture investment and technology platform.