



Investor Pro-tip

Tax-Efficient Portfolios

Are you utilizing this investment strategy?

Reading time: 3 min

Reduce your annual tax liability and keep more of your money invested.

Tax-inefficiency?

Problem: I own a mutual fund in a taxable brokerage account. Some years I have a large capital gain along with a big tax bill, even if I did not buy or sell any shares.

Why is that?

Answer: There are two main contributors, one is specific to the individual mutual fund and the other is how mutual funds are structured in general.

- 1) **Turnover** refers to the specific amount of buying and selling that took place inside the mutual fund over the course of a year. A **high turnover ratio**, say 70%, could potentially lead to large capital gains, which are then passed along to individual shareholders.
- 2) **Mutual funds are structured differently than ETFs.** When an investor buys or sells shares of a mutual fund, the fund company directly issues or redeems shares. **This process creates gains or losses**, which again, are directly passed along to shareholders.

Solution: Exchange-Traded Funds

ETFs offer investors a solution that can offer **greater tax-efficiency** than a similar investment in a mutual fund. This is primarily owed to the difference in how ETF shares are created and redeemed. This difference means shareholders **typically receive less capital gains distributions** overall when compared to a similar mutual fund.

How Much of a Difference?

In 2021, more than 750 mutual funds had an estimated capital gains distribution of **more than 10%** of the fund's net-asset-value (NAV). And of those funds, 148 were **higher than 20%** of NAV, according to CapitalGainsValet.com (1).

All else being equal, even a **small reduction** in capital gains distributions on an annual basis can lead to a **substantial increase** in your long-term portfolio value.

Final Thought

Both mutual funds and ETFs can be a sound investment strategy given your individual financial goals. However, if you're interested in reducing your annual tax liability or would like to understand how ETFs may be a good fit for your individual financial objectives, [give us a call](#) – we're always available to discuss your options.

Have a question?

Feel free to give us a call or send us a message. We'd love to hear from you.

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