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TaxManaged AllCap Core Equity Strategy
“A Systematic Approach to Maximizing After-tax Equity Returns”

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The vast majority of investable assets are subject to various taxes. However, most investment management practices have generally been developed without consideration of the impact of taxes on expected rates of return. Failing to properly consider the costs of taxes upon a portfolio can lead to significant erosion to an investor's long-term rates of return.

Why the AllCap Core Strategy may be well suited for a taxable investor

The AllCap Core strategy may be particularly well suited for a taxable investor due to its simple, broad portfolio structure. Traditionally the equity universe has been separated into large, small, value and growth stocks. We believe that this segregation of the market can be inefficient for a taxable investor due to the necessary rebalancing of a client's portfolio mix in order to maintain the desired market cap and style exposure. Rebalancing leads to two specific taxable events: 1) individual manager turnover where large-cap growth assets are liquidated to purchase small-cap value assets and 2) inefficient trading among managers where one manager is potentially buying what another manager has just sold (at possibly a low unit cost) within the client's aggregate account. This type of selling within the client's account can create considerable tax liabilities.

Simplifying the client's account structure through the use of a broad, diversified core portfolio may avoid the necessary market cap/style-based rebalancing costs. The AllCap Core portfolio, which aims to provide consistent exposure along the full market cap and style spectrums, may allow rebalancing costs to be minimized while potentially adding value is sought through opportunistic, active stock selection.

In addition to the AllCap Core's portfolio structure possibly being well suited for the taxable investor, the strategy's reliance upon rigorous quantitative methods should further enhance the strategy's ability to systematically analyze and manage tax efficiency. The strategy's quantitative investment methods will aim to provide a comprehensive assessment of the expected return, risk and tax consequences of trading. Thus, an optimal balance between the portfolio's alpha, risks and tax liabilities may be established.

Tax-managed AllCap Core Strategy Overview

The Tax-managed AllCap Core strategy is based upon the Advanced Investment Partners' AllCap Core Equity strategy with special consideration of the tax situation for each individual client's portfolio. The Tax-managed strategy is designed to pursue total rates of return in excess of the Russell 3000® Index in the most tax efficient manner.

All portfolio trading aims focus on improving return expectations, maintaining and enhancing portfolio diversification, and managing tax liabilities. The strategy does not attempt to completely avoid the payment of all taxes, but instead focuses on minimizing taxes in the pursuit of maximizing after-tax returns. Therefore, some taxes will be paid as compelling valuations motivate trading activity.

There will be two potential primary sources of added value as the strategy maximizes after-tax rates of return: 1) active tax management and 2) active stock selection. The graphic below displays the choices available to the investor regarding these two dimensions of added value.

		TAX MANAGEMENT	
		Passive (Tax Indifferent Traders)	Active (Tax Aware Traders)
STOCK SELECTION	Active (Information Traders)	Typical Mutual Fund	<i>Tax-managed Active Separate Account</i>
	Passive (Informationless Traders)	Indexed Mutual Fund	Tax-managed Indexed Separate Account

The passive, indifferent treatment of the tax consequences of trading is generally best suited for tax-exempt investors. For the taxable investor, typical vehicles such as commingled mutual funds or separate accounts that are managed indifferently regarding taxes can result in considerable tax-related costs that may significantly reduce after-tax rate of returns. Therefore, we believe the taxable investor should pursue strategies that manage client's portfolios individually to maximize after-tax rates of return. Once this choice has been made, the remaining decision is again between active stock selection and passively indexed strategies.

Passively indexed strategies simply attempt to mimic the return of an index. There is no discretion available when selecting securities except for purely risk diversification objectives. The tax-managed passive indexer has to be mindful of the trading that is purely motivated by risk diversification as too often strong positions that have grown far beyond their original unit cost basis are reduced to provide adherence to strict guidelines and constraints.

The Tax-managed AllCap Core strategy aims to provide active, opportunistic stock selection along with systematic tax management while it attempts not only to diversify the portfolio, but also to raise the level of expected after-tax rates of return. The strategy will seek the opportunity to add value when making valuation decisions at the time of investment and also when assessing the return expectations of current holdings. As return expectations are judged to be poor enough, the stock will be sold, a gain will be realized, and the proceeds will be reinvested in an alternative stock with expected superior after-tax returns. Unlike a passive approach to stock selection that does not attempt to determine which stocks are expected to perform relatively better or worse, the Tax-managed AllCap strategy will expect to rigorously evaluate the investment merits of each stock being held. Therefore, the realization of justifiable gains is allowed as the

strategy identifies compelling valuations in the pursuit of its objective to maximize after-tax returns, which goes beyond just minimizing tax liabilities.

Loss Harvesting

Increasing a strategy's tax efficiency is not simply a matter of reducing trading activity within the portfolio. While reducing turnover will generally result in relatively fewer realized capital gains, the impact of portfolio turnover on tax efficiency should be viewed more comprehensively. Even low levels of turnover can be highly tax-inefficient if it is poorly managed.

The objective of active tax management is to systematically offset realized capital gains with realized capital losses. Realized capital gains can result from voluntary trading motivated by expected enhancements to expected returns and/or portfolio diversification, or involuntary activity arising from corporate actions like mergers or acquisitions. Capital losses can be proactively harvested to offset the tax consequences of voluntary or involuntary capital gain realization and to maximize the tax efficiency of portfolio activity. Therefore, it is quite possible that proactive capital loss harvesting might result in relatively higher turnover than a similar tax-exempt portfolio.

Closing Comments

The Tax-managed AllCap Core strategy will be based upon AIP's current AllCap strategy and will employ active stock selection plus active tax management in order to maximize the client's expected after-tax performance. Those clients that fund their account with cash will most closely mirror the positions found within the AllCap model portfolio. Clients that fund their account with in-kind securities will have their accounts managed in the most tax efficient manner as their portfolio is transitioned towards the model AllCap portfolio over time. The path in which these in-kind accounts move toward the model AllCap portfolio will be greatly impacted by the tax situation present at the time of the asset transfer.

The Tax-managed AllCap portfolio is expected to differ from the prevailing AllCap model portfolio in the following manner.

- Individual Tax-managed portfolios will be permitted to hold relatively more positions to better facilitate desired return and risk enhancements at a greater level of tax efficiency during initial transitions and during on going mirroring of the AllCap model portfolio
- Market cap, style and sector biases will be permitted to vary among individual portfolios and will be permitted to depart from the AllCap model portfolio in an optimized trade off between the tax liabilities and portfolio risks of individual accounts

The AIP Tax-managed AllCap Core strategy will offer a fully optimized, active stock selection product that is individually managed to maximize the after-tax rates of return for each client subject to their portfolio's specific tax circumstances.

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