

Breakaway Advisors: How does Direct Indexing help a breakaway advisor?



KEY TAKEAWAYS

- The path to independence is hard but rewarding work. Building something with your own two hands ensures you have control over every aspect of your business and the client experience that you provide.
- Transition – Direct Indexing allows an advisor to seamlessly and tax-efficiently transition their clients legacy SMA portfolios from their old firm to their new independent practice.
- Customization – Direct Indexing allows customization and flexibility to meet the personalized needs of each individual portfolio and investor. This includes legacy securities, tax consequences, investment philosophy, and many other client-specific aspects.
- Cost – Most large wirehouses and banks impose penalties on advisors who leave by raising the cost of their in-house SMA solutions. Surprisingly, some Direct Index managers do the same thing.

THE PATH TO INDEPENDENCE

As any advisor that has transitioned from a large wirehouse or bank to an independent practice will tell you, it's a wide range of feelings; exciting, scary, fun, intimidating, but also some of the most rewarding work time ever experienced. We here at SmartHarvest are cut from the same cloth. We made the same decision to "breakaway," from the big wirehouse and bank-owned direct index managers to form the last truly independent direct index firm. Just like a breakaway advisor, we sought a better direct index solution that would benefit all advisors, not just the largest banks and wirehouses. To this day, we remain the only 100% independent direct index manager in the industry. "For Advisors By Advisors," is not just a catchy motto for us, it's our guiding philosophy and passion.

When going independent, there are a lot of different tasks to complete and systems to setup. These to-do items can vary depending on whether the advisor is joining an existing independent firm, partnering with a TAMP, or creating their own business. At SmartHarvest, we work with many advisors that transitioned from the industry's largest wirehouses. Some of the many topics communicated to us by these breakaway members of our advisor community include team selection, office structure, technology stack, and of course clients.

The list above is in no particular order, but we can all agree that putting Clients first throughout the entire transition process should be the highest priority. So, how can Direct Indexing help a breakaway advisor put their clients first through this transition? We're glad you asked, because that's what we intend to discuss.

HOW CAN DIRECT INDEXING HELP BREAKAWAY ADVISOR CLIENTS?

When we surveyed our advisor community of breakaway advisors, we found there were three recurring topics/themes mentioned when asked, "how did direct indexing help make your transition to independence easier?"

Tax Sensitive Transition

- Wirehouse firms frequently utilize their own proprietary individual separate accounts (SMAs) with clients. Consequently, advisors exiting a wirehouse commonly find themselves with several in-house managed SMA portfolios with embedded gains. So, what should an advisor do with these client portfolios when they leave?
- A Direct Index strategy can be a perfect home for an SMA portfolio previously managed by an advisor's former wirehouse. Direct Indexing allows an advisor to transition the portfolio, with little to no tax consequence, so it remains professionally managed with same/similar investment objectives.
- Direct Indexing constructs portfolios with the intent of tracking a selected index, benchmark, asset class, allocation, etc. It can do this by building around the legacy securities in the old wirehouse portfolio. Consequently, the advisor doesn't have to realize unnecessary gains, but can still provide a broadly diversified, index-tracking, professionally managed portfolio.

Customization & Flexibility

- Historically, transitioning breakaway advisors were limited in the types of direct index strategies they could transition their clients to. For a long time, the options only consisted of S&P 500 or S&P 500!
- Developments in technology (and portfolio theory) have created many more options for breakaway advisors. Now advisors can track (1) a particular asset class (US Large Cap, US Total Market, Global, etc), (2) a factor tilted portfolio, (3) an SRI/ ESG theme, (4) an allocation/model, or (5) some combination of these options.
- A breakaway advisor can even customize the tax experience for their clients. This year isn't good for taxes? No problem, let's defer some gain realization until next year. Client has a loss elsewhere in their portfolio this year? Great, let's use some of those losses to offset gains in the transitioning portfolio.

Cost & Pricing

- The cost of a direct index solution is typically less expensive than the management fee charged by an advisor's legacy wirehouse. In some cases, the former wirehouse won't even make those strategies available to the breakaway advisor.
- As is the case for all investment solutions, the cost of direct indexing can vary significantly depending on which provider you're using. We here at SmartHarvest, pride ourselves on offering one of the lowest cost direct index solutions in the industry.
- Most direct index managers charge higher non-enterprise pricing for advisors leaving large organizations. SmartHarvest offers institutional pricing for *all* advisors. We believe in supporting advisors, not penalizing them.

NEXT STEPS

To summarize, leaving a wirehouse and going independent can be a lot of work, but the risk is worth the reward. Direct indexing can help make part of the transition process much easier. Tax managed, direct index SMA accounts allow an advisor to transition their legacy bank and/or wirehouse SMA portfolios tax efficiently to their new firm without incurring unnecessary capital gains or gaps in management. If you're thinking about going independent or recently went independent, our team is happy to be a trusted partner and resource. SmartHarvest has helped breakaway advisors transition from most, if not all, of the industry's largest wirehouse organizations. We even have a network of breakaway advisors using SmartHarvest willing to speak with other firms contemplating making the switch. SmartHarvest; by advisors for advisors!

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