Separately Managed Accounts and Unified Managed Accounts

By Ryan Hastie, CPFA, Hastie Financial Group

Over the past several decades, investors looking to customize their investments have turned to Separately Managed Accounts (SMAs). According to Cerulli Associates, there are about $2 trillion in assets in these accounts, up 14.1% from $1.72 trillion in assets in 2022, and assets in SMAs are projected to reach $2.9 trillion by 2026.

These accounts attempt to boost earnings through active professional portfolio management and tax-efficient strategies. Unlike a mutual fund or exchange-traded fund (ETF) where the investor owns shares of a pool of stocks or bonds that is invested according to the fund's prospectus, SMAs allow the investor to own the individual stocks, bonds and other assets directly. Doing so affords the investor flexibility in tailoring their strategy to their personal preferences or tax needs.

Each SMA seeks to meet a particular objective, so it is possible to have multiple SMAs with each designed to help meet an investor's asset allocation needs. For example, one SMA may represent the large-cap growth portion of your portfolio, and another may represent the fixed income portion of your portfolio.

One of the benefits of SMAs is enhanced tax management. Since the investor owns the underlying stocks or bonds directly, there is a cost basis for each individual security. Directly owning the securities allows an investor and their financial professional more control over realizing capital gains/losses (i.e., tax-loss harvesting) to assist in reducing taxes owed and potentially increasing after-tax performance.

Another benefit to the investor is complete portfolio customization. Having increased control over the portfolio, as opposed to the mutual fund manager, allows the investor to implement guidelines in the investment process. For example, one can increase or restrict exposure to certain companies, industries or sectors. Another benefit is portfolio transparency. The individual holdings are easy to monitor to assess for potential overlap and diversification benefits.

One of the downsides to SMAs is that each strategy requires a separate account. This means the potential to have multiple account numbers, multiple 1099s, and multiple account statements — all of which can be burdensome to an investor. To alleviate the headache associated with multiple accounts, Unified Managed Accounts (UMA) were established. This professionally managed account utilizes advanced technology to create a simplified investment solution — one that allows an investor to hold multiple investments in one account, offering easier access to and transparency of their overall portfolio allocation and underlying holdings within the portfolio.

In addition, a UMA can incorporate a wide range of investments into the account, including multiple SMA strategies, mutual funds, ETFs, among others. Additionally, most managers have lowered the minimum investment threshold required to utilize UMAs (although minimums still exist), allowing investors to take advantage of many features and benefits previously available only to ultra-high-net-worth and institutional investors.

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Supercharging Asset Accumulation for Retirement

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Retirement readiness often begins with the accumulation of assets that will provide income later during retirement. There are many ways to accomplish asset accumulation, but for most people this is done with an employer-sponsored qualified retirement plan – namely the 401k plan. While internal designs of a 401k plan can vary widely from plan to plan, they are typically designed to hold salary deferrals from employees, called elective deferrals. Many plan sponsors offer some type of employer contribution, either as a flat percentage or in the form of a match.

Elective deferrals can often be made either as being income tax-deductible in the year the deferral is made (traditional) or made after income taxes are paid on the deferral (Roth), or a combination of both. The decision of the best type of elective deferral for someone to make is ideally made after consulting a CPA or financial advisor. This decision must take into consideration current and future income tax implications, as well as important estate planning issues.

The IRS establishes maximum limits each year that an employee can contribute to a 401k plan, and typically increases every year due to inflation. For 2024, the maximum elective deferral amount (either traditional or Roth, or a combination) is $23,000 for employees under age 50, and $30,500 for those age 50 and over. Another limit set forth by the IRS is the total amount of money that can be added to an employee's 401k account each year (including both elective deferrals and employer contributions), known as the annual additions limit or 415 limit. In 2024, the 415 limit is $69,000 for those under age 50 and $76,500 for those age 50 and over.

There are situations when individuals, often business owners, professionals, etc., want and have the ability to defer much more each year. When this person is reaching the maximum annual additions limit in their 401k plan, they can consider a cash balance plan. A cash balance plan works in addition to, not in place of, a 401k plan. While 401k plans are defined contribution plans, cash balance plans are technically a defined benefit plan. The design of cash balance plans and their integration with 401k plans is quite technical and well beyond the scope of this article. The purpose here is to illustrate the vast amount that can contributed to a 401k/cash balance combination.

Let's use the example of a 55-year-old business owner with 30 employees. She is reaching the $76,500 annual maximum additions to her 401k account and is asking what else she can do to save more for retirement. There are then two critical questions – are you willing to contribute additional amounts to certain employees, and are you willing to commit to maintaining the cash balance plan and its contributions requirements for at least 3 years? If the response is "yes" to both, further discussion is warranted. Two key points also to consider is that the plan must cover at least 40% of all eligible employees, or 12 employees in this case, and the owner has the ability to choose those 12 employees. The real carrot of a cash balance plan is the maximum annual contribution she (as the employer) can make - $274,000 for a 55-year-old, and this is addition to the $76,500 in the 401k plan, for an annual maximum of $350,500. The current lifetime maximum accumulations limit is $3,400,000.

A great deal of consulting time goes into the proper design of a cash balance plan based on the intent of the owner, number of employees, and the amount of annual employer contributions desired, among other factors. The investment structure of a cash balance plan is quite different than that of a 401k plan, which is also taken into consideration during the design process. Cash balance plans are not for every company, but in the right situation with the right design, they can be amazing!

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Mutual Funds vs. Exchange-Traded Funds

By Ryan Hastie, Hastie Financial Group

For a large majority of individual (retail) investors, buying shares of mutual funds or exchange-traded funds (ETFs) is more economical and beneficial. Mutual funds and ETFs allow investors to pool their money with other investors to buy stocks, bonds and other investment assets.

As retail investors typically do not have the amount of cash or assets that institutional investors (i.e., hedge funds) have, mutual funds and ETFs allow investor money to go further in that they have the ability to own to hundreds, if not thousands, of securities rather than buying individual securities themselves. Purchasing individual stocks or bonds can not only require many hours of research and investment knowledge, but it can also be quite expensive.

Both types of funds are "baskets" of individual securities that can offer investors exposure to a wide variety of asset classes. Because there are many securities within a fund, they generally provide better diversification than a single stock or bond. This can minimize overall risk within a portfolio and significantly decrease certain types of risk, specifically concentration risk. Although mutual funds and ETFs are similar in many ways, there are several differences between the two.

One of the main differences between the fund types is how they are traded. Mutual funds are purchased directly from the fund company rather than on an exchange (e.g., New York Stock Exchange). Orders are executed once per day at the end of the trading day, with investors who invest on the same day receiving the same price. ETFs, however, trade on an exchange just like a stock and experience intraday price fluctuations. As such, investors will pay a different price for the fund depending on when the purchase order is executed.

The two funds are purchased differently. ETFs, like stocks, are purchased as shares with no minimum investment. However, ETFs must be purchased as whole shares — no partial shares allowed. Some mutual fund may require a minimum investment and can be purchased in fractional shares or fixed dollar amounts.

Regarding costs, the two fund types differ as well. ETF costs are more explicit, in that they have trade costs/commissions to enact the trade in the market. An ETF can also trade at a discount (below) or premium (above) its new asset value (NAV), which is the value of the investments within the fund minus its liabilities, divided by the number of shares outstanding in the market. Since mutual funds do not trade on an exchange, there are no associated commissions. Instead, mutual funds carry an expense ratio, a percentage of fund assets that are taken out annually to cover fund-operating expenses.

Mutual funds and ETFs can be passively or actively managed. Passively managed funds are designed to track the performance of an index, such as the S&P 500. The fund will seek to own all of the same stocks within the particular index. Passive funds, by definition, cannot "beat the market," because their objective is to track the underlying index. Conversely, actively managed funds attempt to beat the underlying index or benchmark. Fund managers will buy and sell securities more frequently to take advantage of price inefficiencies to ultimately outperform the index.

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