

# Smartleaf: Rebalancing Done Right

Unlimited customization and optimized tax management

Super simple direct indexing

Zero time spent by client-facing advisors reviewing, rebalancing, and trading portfolios

Daily portfolio review

## What We Do

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**Smartleaf automates the rebalancing of highly customized, tax optimized portfolios, including direct indexes and portfolios with direct index cores. We do this to make sophisticated portfolio rebalancing simple. So simple that:**

- you can provide every client of every size the highest levels of customization and tax management.
- you can work with direct indexes as easily as working with ETFs.
- you can manage every account as if it were your only account.
- your client-facing advisors need to spend zero (yes, zero) time reviewing, rebalancing and trading portfolios.
- you can document for each client their taxes saved or deferred, demonstrating your value.

## Key Features

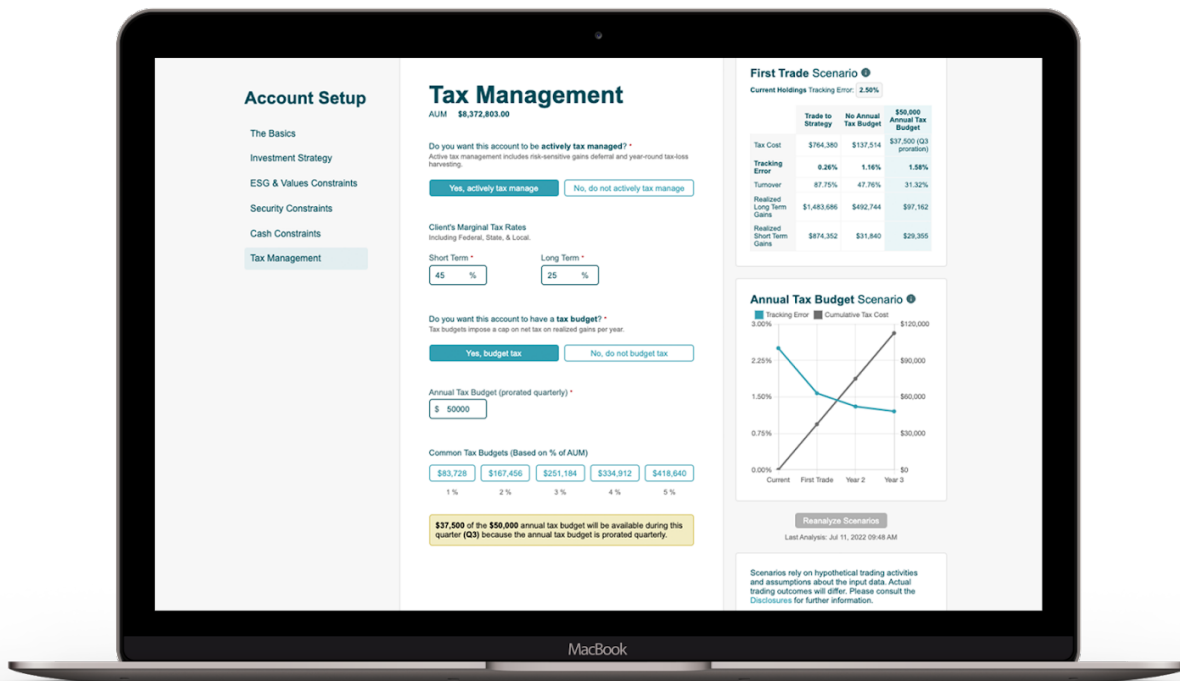
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- **Automated implementation of customization requests:** Custom asset allocations — Custom product selection — Security constraints — Environmental, social and governance (ESG) constraints — Religious values constraints
- **Automated tax management:** Tax loss harvesting — Tax sensitive transition — Wash sale avoidance — Short-term gains avoidance — Long-term risk appropriate gain deferral — Tax budgets — Optimal tax lot selection — Documentation for each client of the taxes you save or defer through active tax management
- **Easy direct indexes:** Direct indexes, including those with fractional shares, as easy to manage as ETFs — Easy access to direct index models from Smartleaf Asset Management and third parties
- **Model Distribution Service:** Asset allocation model updates — Security model updates — Alternate product choices — Access to third-party models — Access to third-party asset allocation models
- **Advanced householding:** Multiple accounts in one household jointly managed to a common target, with tax-deferred accounts used as tax-free rebalancing centers — Tax sensitivity — Wash sales — Trading and turnover optimization
- **Automated cash management:** Min cash — Max cash — Regularly scheduled withdrawals — Overdraft prevention — Reserve cash — “Accumulate cash”

## How We Are Different

### The Advisor Customization Portal

Smartleaf provides investor-facing advisors with a dedicated portal for setting up accounts, entering customization and tax management preferences, and notifying the trading group that the client wants to withdraw cash. As the advisor sets up the portfolio, the portal gives them and their clients real-time feedback on the tax and risk implications of their customization choices, helping clients make informed decisions. For example, if you add a social screen, the portal will tell you how much of the current portfolio would be liquidated and the tax consequences. And, for new accounts, the system will, in real time, show you proposed first trades and provide you with a projection of a multi-year tax-optimized transition plan.



### Direct Indexes as Easy as ETFs

Smartleaf makes direct indexes – where investors directly own a basket of stocks to track the performance of an index – easy. Really easy. As easy to work with as an ETF. For the investor-facing advisor, replacing an ETF with a direct-index is simply a choice on a pull-down menu. There is no separate SMA account opening or closing process; no separate communication channel; no extra steps to implement cash-in or cash-out requests; no extra steps to avoid wash sales. No extra steps at all. Just a choice on a pull-down menu.

The tax and customization choices that make direct indexing attractive are also simple menu choices. Tax budgets? Year round tax loss harvesting – all just menu choices. Implementation of all customization and tax management preferences is automated.

By making direct indexes as easy as ETFs, Smartleaf makes direct indexing available to all your clients, regardless of account size.

## **Automation, not alerts**

Smartleaf goes beyond providing advisors with rebalancing alerts; we provide rebalancing automation. We don't just tell you there are problems or opportunities; we automatically generate compliant, actionable trades that improve the portfolio. Every day, the system reviews every portfolio and suggests trades that resolve constraint violations, implement requests, reduce drift, take advantage of loss harvesting opportunities, and otherwise improve the portfolio. All of these suggested trades are actionable, constraint compliant and tax- and expense-sensitive. There isn't a separate workflow for asset-class rebalancing, implementing security swaps or loss harvesting; there's a *single* workflow for making the portfolio better.

Smartleaf is not designed to provide you with incremental improvements in compliance and scale. We are a wholly new type of platform that automates the management of highly customized, tax-optimized portfolios, including those with direct index cores.

## **Menu-driven customization**

With Smartleaf, customization and tax-management options are simply choices on pull-down menus, and implementation is automated.

For many advisors, customizing a portfolio requires making ad hoc trade decisions for each account, adding time and complexity to the rebalancing workflow. But with Smartleaf's menu-driven customization, optimized tax management and meeting the unique investment goals and values of every client become easy. Once you enter your choices, implementing and maintaining them takes no extra time or effort.

## **Whole-portfolio analytics, “True UMA”**

We manage the entire portfolio — every asset class and any combination of mutual funds, ETFs, individual equities and ADRs — holistically in a single account to achieve the optimum balance between tax and risk.

In contrast, many systems divide portfolios into sleeves or sub-accounts, managing each in semi-isolation. This creates complexity, requiring you to maintain a sub-accounting system that is reconciled to your system of record. It requires a separate asset-class level rebalancing workflow and a separate cash management workflow. And it interferes with portfolio-level management of washed sales, tax and risk. For example, suppose that you have an overweighted IBM position you can't or don't want to sell. If you're overweighted in IBM, you have to be underweighted in something else. To minimize drift, your best option is to underweight something similar, such as HP. That's easy to do when you holistically manage the whole portfolio, but not so easy when the IBM and HP holdings are in different sleeves. The term “Unified Managed Accounts (UMA)” was developed to describe an enhanced sleeved system with consolidated reporting and some cross-sleeve coordination. Smartleaf's system goes beyond UMA to “true UMA”. We don't merely do a better job of integrating sleeves; we dispense with sleeves entirely.

## Specialization



Client-facing Advisor



Investment Policy Committee



Central Rebalancing Group

Smartleaf is more than a rebalancing engine. It is an enterprise platform that enables firms to divide responsibility for managing portfolios among different groups, allowing each to focus on what they do best:

The client-facing advisor, the person who knows the client best, sets the risk, customization and tax-management preferences for each account.

The investment policy committee (IPC), the group responsible for the investing views of the firm, sets default asset allocations, product choices (including 3rd-party models, if desired), alternate product choices, and compliant boundaries on customization.

The central rebalancing group, the one- or two-person trading group that reviews all accounts daily for fidelity to the customization parameters of the client-facing advisor and the investment parameters of the IPC, trading accounts that are out of alignment with either. They also act on cash withdrawal requests and implement tax optimization strategies.

This specialization is key to creating a scalable workflow. Advisors spend *zero* time reviewing, rebalancing or trading portfolios. This allows advisors to *both* spend more time with clients and prospects, *and* increase the level of customization and tax management they provide.

(See “Using Smartleaf” for a more detailed description of these roles)

## Standardized, uniform, daily rebalancing workflow

Smartleaf enables firms to implement a consistent and efficient rebalancing workflow, even for highly customized and tax optimized portfolios. This enables firms to offer clients higher levels of service, at lower cost and with enhanced compliance.

Here’s how it works. The Smartleaf system analyzes every portfolio daily and, as appropriate, suggests trades. These trades seek to ensure that the portfolio is compliant with all mandates (cash-out requests, security restrictions, ESG/SRI screens, etc.), while minimizing taxes, transaction costs and risk (asset class-, sector-, industry- and security-level drift).

Accounts are typically traded in batch, with manual review of outlier accounts. Each firm applies custom “filters” (queries) to determine which accounts are traded in batch (e.g. accounts with cash-out requests, high drift or loss harvesting opportunities), which accounts shouldn’t trade at all (e.g. “accounts with unknown securities”), and which accounts are slated for review before trading (e.g. “accounts where the system is recommending high turnover”). Firms can customize this workflow to suit their investment program, and then, once they’re set up, efficiently implement the *same workflow, the same set of filters, every day*.

## “Target Templates”

“Target Templates” are patented asset allocation models that support scalable, compliant account-level customization of asset allocation weights and product choices. In every asset class, you can offer investors multiple options – ETFs, actively-managed mutual funds, direct indexes, actively managed equities – with no increase in operational complexity. The same is true of custom asset allocation, such as removing real estate as an asset class for clients with outside real estate investments.

We can do this because a custom asset allocation is simply one customization instruction among many. So is a custom product choice. And these customization preferences get implemented automatically, just like security constraints and tax preferences.

In contrast, with other systems, custom product mixes or custom asset allocations can only be implemented by creating new, standalone models. This approach makes it difficult to implement tactical asset allocation shifts or updated product choices – it requires manually updating each custom model one at a time. With Smartleaf, no extra steps are required. Firms implement changes in one place, and these changes cascade down automatically to every account – in a way that preserves each account’s custom asset allocation or custom product choices. In this way, top level investment policy decisions – say, a tactical asset allocation shift – takes one day to implement across the book of business, rather than weeks or months.

## Documenting Value to Clients: The Taxes Saved or Deferred Report

Smartleaf’s account-level Estimated Taxes Saved or Deferred Report enables advisors to document for each account the value they are adding through active tax management. In 2021 Smartleaf users saved their clients an average of 3.20% of the value of assets that were actively tax-managed. This is more than most advisors charge in fees. [View a sample copy here.](#)

## Householding

Smartleaf enables advisors to jointly manage a group of accounts — say a 401K, an IRA and a taxable account — to a common asset allocation, even when each individual account has a different asset allocation, none of which look like the *household’s* target asset allocation. That is, Smartleaf’s system ensures that the holdings of multiple accounts, if combined, mimic the target asset allocation for the household as a whole, and Smartleaf leverages the tax-deferred accounts to implement asset-class rebalancing in a tax-free manner.

## Using Smartleaf

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Smartleaf's platform integrates the activities of three groups within the firm: the Advisor, the Investment Policy Committee, and the Central Rebalancing Group. By dividing responsibility, each group can focus purely on what it does best. Most importantly, the client-facing advisor is free to spend 100% of their time with clients and prospects, while still being able to provide those clients with optimized tax management and unlimited customization.

### The Client-facing Advisor

Working through the Smartleaf Advisor Portal, client-facing advisors create customized solutions for each client. They also enter cash-withdrawal requests, check on account status, and obtain reports.

The advisor's core function is designing a customized solution for each client. Customization options and settings include:

- Asset allocation selection (example: "for the Smith account, use the XYZ taxable aggressive growth asset allocation")
- Asset allocation customization (example: "track the firm's aggressive growth allocation but remove real estate, because the client has outside holdings in real estate")
- Product choice customization (example: "use a direct index for US Large Cap, an ETF index fund for US Mid Cap, and an actively managed mutual fund for US Small Cap")
- ESG and social value screens (example: "apply a Catholic Values screen, and no companies with a poor Environmental/Spills record")
- Security constraints (example: "don't buy IBM")
- Cash management settings (example: reserve cash from dividends and interest up to \$15,000 to support \$5,000/mo withdrawals")

The Advisor Portal is interactive, enabling the advisor to share with clients the impact each customization choice would have on their portfolio, thereby helping them make more informed customization decisions. Advisors also have access to reports, such as the Taxes Saved or Deferred Report that documents, for each account, the amount of taxes the client has saved or deferred through active tax management.

Advisors are free to spend 100% of their time with clients and prospects. They spend no time on daily portfolio review, rebalancing or trading portfolios.

### The Investment Policy Committee

Investment Policy Committees (IPCs) construct (or select from third parties) the firm's investment solutions: asset allocation models, product selection for each asset class, compliant boundaries on permitted customization, and more. They also design the firm's daily portfolio review and rebalancing workflow. Specifically, the IPC:

- Creates (or selects from third parties) "Target Templates" —flexible asset allocation models that support compliant, scalable product choice and asset allocation customization
- Creates (or selects from third parties) security models, e.g. a 50-stock US Large cap model
- Develops a standardized workflow for daily review, rebalancing and trading

The IPC is free to strictly focus on developing the best investment thinking of the firm, without having to worry about the tax implications or implementation costs of their decisions. These considerations take place downstream. Tax

optimization and customization preferences are implemented automatically. The IPC spends no time designing customized solutions for each client, or in daily portfolio review, rebalancing and trading.

## The Central Rebalancing Group

The one- or two-person central rebalancing group (CRG) is responsible for rebalancing and trading, ensuring that every portfolio is faithful to the joint instructions of the advisor and the IPC. Smartleaf's automated rebalancing platform makes this possible. It goes beyond providing alerts; it provides the CRG actionable, customized, tax-optimized trades for every account (with a few exceptions, noted below). The CRG selects *which* accounts to trade, but it doesn't need to generate the trades themselves.

To make this selection process efficient, the Smartleaf provides the CRG with an advanced query system to identify accounts of interest. The typical CRG workflow has at least four steps:

- Step 1: suspend – in one step – all accounts where there are identified data issues, such as a security that is unknown or undergoing a corporate action.
- Step 2: approve – in one step – the trading of all accounts that *need* to trade in order to satisfy a mandate, like a cash withdrawal or an ESG screen.
- Step 3: approve – in one step – the trading of all accounts whose system-suggested trades have a “cost-benefit score” above some preset threshold. (Every set of proposed trades comes with a system-generated “cost benefit score” quantifying how much the portfolio would benefit from trading, net of taxes and transaction costs. Benefits of trading include drift reduction, loss harvesting opportunities and improvements in security rankings. Costs include transaction costs and taxes on realized gains).
- Step 4: Before actual trade execution, manually review outlier accounts, such as accounts where the system is proposing unusually high turnover, or very large, key client accounts.