

# Separately Managed accounts:

A detailed look at a professionally managed investment program for higher-net-worth clients.

## Executive Summary

Investors can get access to professional money managers through mutual funds and separately managed accounts.

Separately managed accounts typically offer higher levels of individualized account reporting and client service than mutual funds.

Clients who use separately managed accounts own the individual stocks in the portfolio, not just shares in a fund.

Separately managed accounts allow for customization of an individual's portfolio and some flexibility with tax-planning strategies.

Separately managed accounts and mutual funds are two of the most popular methods available to access professional investment managers and create wealth. Both offer investors a professionally managed portfolio of securities (generally stocks, bonds or a combination of the two) and offer diversification as a means of reducing overall volatility and risk.

Although private accounts and pooled accounts are similar in some respects, they are two distinct vehicles with advantages and disadvantages. Determining which approach is more appropriate depends on an individual investor's needs.

A separately managed account (also known as an individually managed account or private account) is an investment vehicle that allows an individual to tap the expertise of a professional investment manager while having his or her assets segregated from the assets of other clients. Separately managed accounts can be tailored to meet the unique needs and objectives of the individual investor. The account minimums are typically at least \$100,000. Meanwhile, the minimums for many mutual funds start at \$500 or \$1,000, depending on the fund company, share class, etc.

This larger account size allows a portfolio manager to diversify without pooling the account with the assets of other investors. Individuals with private accounts own the securities directly vs. owning shares in a fund. That individual ownership provides the investor with flexibility, control and tax-planning benefits unparalleled by pooled investments. The portfolio manager has complete discretion and follows a stated investment strategy the client and financial advisor have already determined is appropriate.

### Benefits

Many clients and Financial Advisors choose private accounts due to additional levels of control, flexibility and service.

### Direct Ownership of Securities

Many investors prefer to own the securities in which they invest. It is often gratifying to pick up a newspaper and read about a new product or solid earnings report from a company of which you are a shareholder. Even though mutual funds provide investors with the list of securities they own, the information is typically given only twice a year and therefore may be outdated.

Also, since an individually managed portfolio is separate from other accounts, an investor may specify certain industries or businesses in which they do not want to invest because they find them objectionable.

### Flexibility of Taxation

For individuals who have taxable accounts, having the flexibility to better manage their tax bill is often an important distinction of a private account.

Since investors with private accounts own their securities directly, they have an individual cost basis for each security in their account. Therefore, they only pay taxes on the capital gains they actually realize. Fund clients may have to pay taxes on capital gains embedded in the fund regardless of how long they have held fund shares.

Private accounts also provide the flexibility to do year-end tax planning. In an attempt to reduce their tax liability, clients can work with their tax and Financial Advisors to implement tax-planning strategies. These strategies include directing their portfolio manager to realize gains or losses in specific securities to minimize the tax liability of the account or from other investments.

### The Service Differential

For many investors with private accounts, the additional service provided is the greatest advantage. At the top of this list is the regular reporting clients receive. These reports are typically provided on a quarterly basis and detail the status of the account.

Some of the information provided includes a list of positions (categorized by industry); cost basis and market value; income generated; schedule of realized gains or losses; and investment performance. Clients also typically receive quarterly updates from the portfolio manager that review current strategy and outlook regarding specific securities or the market as a whole. Mutual-funds make some information available on a quarterly basis while other data is available only on semi-annual and annual bases.

### The Role of the Advisor

As the adage states, change is the only constant. This applies to all areas of life, including finances. In order to manage change in a prudent and professional manner, most investors utilize the services of a Financial Advisor. Financial Advisors help investors develop and adapt investment plans that will meet their needs and navigate them through this dynamic area of their lives.

Because investors have different needs, most advisors suggest that an investment manager be

retained to manage the client's assets whether they invest in a private account or a mutual fund. Financial Advisors typically have relationships with various investment managers and an understanding of their investment disciplines, whether it is growth vs. value; large cap vs. small cap; international; fixed income, etc. Therefore, the advisor can guide the selection of an appropriate manager for the client.

Once an investment manager is hired, the advisor acts as the client's advocate. If a manager is not adhering to his or her strategy or performing poorly relative to his or her peers, the advisor can communicate with the manager to understand the reason for the change and advise the client as to what course of action is needed, including whether it is prudent to select another manager.

The increased flow of information often motivates many Financial Advisors to direct their clients to private accounts. In addition to more comprehensive reporting than a mutual fund, private-account managers are often available to advisors either at investment conferences or via telephone calls. This added level of communication allows the advisor to do a better job monitoring the account and serving as the client's advocate.

### The Cost of Service

One of the reasons many clients choose private accounts is the cost structure. Instead of paying a commission at the time of purchase (as in the case of some mutual funds), clients pay the investment manager a fee for service. Private-account fees are deducted automatically from the client's account and a statement of those costs is provided to the client. As with any other service, costs for private accounts will vary and – unlike the costs associated with a mutual fund – may be negotiable.

Whenever an investment manager makes a trade on behalf of the client, a transaction cost is incurred. This charge pays for the cost of the trade, custody of the account, reporting and the services of the Financial Advisor.

These fees for equity accounts generally range from 1.0 percent to 2.0 percent and are also reduced incrementally as the size of the account increases. Therefore, for a \$100,000 to \$500,000 equity portfolio, total fees usually range from 2.0 percent to 3.0 percent annually, and are all-inclusive. A fixed-income portfolio with \$100,000 to \$500,000 invested will have transaction fees typically ranging between 0.5 percent and 0.75 percent. The total annual fees for such a fixed-income portfolio will usually range from 1.0 percent to 1.25 percent.

## The Final Analysis

Clients who want a greater degree of individual attention are likely to prefer a private account. These accounts provide more service, control and flexibility, and individuals who work with a Financial Advisor will typically find only modest cost differences between private accounts and mutual funds.

## Differences in Managed Accounts

	Seperately Managed Accounts	Mutual Funds
<b>Ownership</b>	Investors own individual securities	Investors own shares in a pool of securities, commingled with assets of other investors
<b>Portfolio Holdings</b>	Based on an investment strategy designed specifically to meet the needs of the investor (may exclude certain businesses or industries)	Identical for all investors
<b>Expenses</b>	An asset-based fee covers all managed account services (money management, trading and custody) and may be negotiable.	Can be subject to loads or 12b-1 fees. An investor may buy shares of a load fund based on a commission-based fee structure or a no-load mutual fund.
<b>Minimum Account</b>	Typically \$100,000	Typically ranges from \$500 to \$2,000 per fund.
<b>Reporting</b>	Provide detailed statements that include account activity and performance	Typically report performance only
<b>Tax Basis</b>	Begins when individual securities are purchased for the investor	May include embedded capital gains that go back months or years before investor bought shares
<b>Tax Management</b>	Potential for client and his/her investment professional to manage taxation of gains	Under sole control of portfolio manager
<b>Asset Flow</b>	An investor can be fully invested and is not required to hold cash	May carry high cash levels to meet potential redemptions
<b>Liquidation</b>	3-5 days	Next day
<b>Portability of Holdings</b>	Yes	No



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