Nasdaq

Understanding

Separately Managed Accounts

Customization is everywhere in our lives today, from the personalized playlist on our phones to the tailored suggestions on our favorite streaming service. Just like how we personalize our daily experiences, investors can also customize their portfolios to suit their unique goals and situations. This is possible through 'Separately Managed Accounts' or SMAs. In this guide, we'll explore SMAs and how they bring a personal touch to investing, making it a more individual-focused experience.

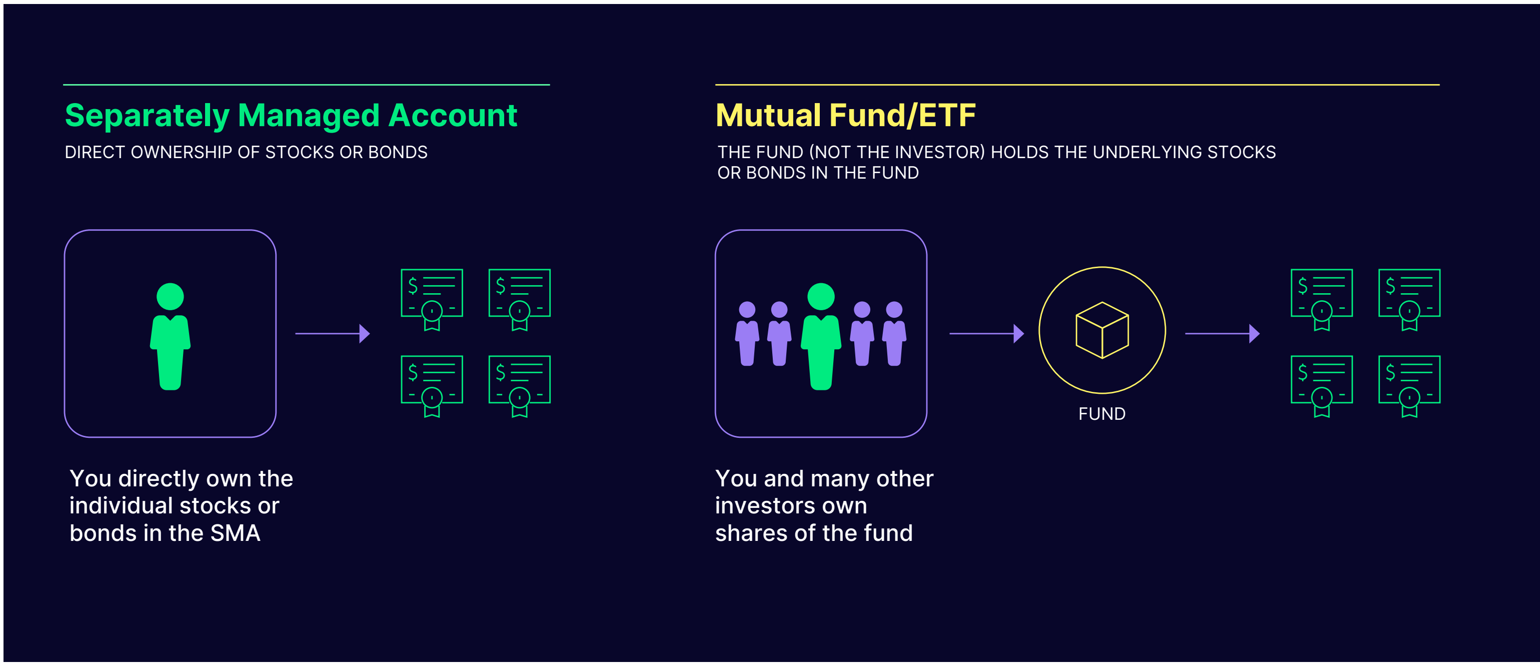
SMAs, Defined

A Separately Managed Account (SMA) is much like a customized investment portfolio. It's professionally managed, but unlike traditional mutual funds or exchange-traded funds (ETFs), where you buy shares in a collective investment pool, an SMA lets you directly own individual securities.

Think of SMAs as your personal investment shopping basket. A professional manager selects the assets based on your specific financial goals and preferences, similar to how you would choose groceries that fit your dietary needs.

SMAs strike a balance between broad market exposure and personalized investment, offering tailored portfolio management. They allow investors to shape their portfolios according to their unique preferences, whether those are related to ethical values, tax considerations, or specific investment targets.

For instance, if an investor prefers not to invest in certain sectors due to personal beliefs or because they're already overexposed in that area, an SMA can be adjusted to exclude these specific investments.



What Makes SMAs Unique

There are other important differences that set SMAs apart from pooled vehicles:

Minimum investments: ETFs and mutual funds tend to have low minimum investments (one share of an ETF, and typically $1,000 for mutual funds). With SMAs, though, $50,000 is usually the minimum account size—with many portfolio managers and Registered Investment Advisors (RIAs) requiring significantly more.

Diversification: ETFs and mutual funds are usually reasonably diversified in terms of the number of securities owned. It's not uncommon for one of these vehicles to own upwards of one hundred stocks or bonds. SMAs may still be diversified, but this can depend on the size of the account, as well as the preference of the investor. Some risk-seeking investors prefer to own a portfolio that is concentrated in fewer securities, believing this may result in outperformance.

Funding: The only way to buy an ETF or mutual fund is with cash. SMAs can be funded with cash, but they also may be funded "in-kind" with securities. To fund an account in-kind, an investor would simply transfer securities from one portfolio manager or RIA to another.

Access to Assets Throughout Trading Day: SMA investors often have real-time access to their portfolio. ETF and mutual fund shareholders, meanwhile, may only see their full holdings daily, monthly, or quarterly.

Portfolio Customization: SMA portfolios are customized for the individual account holder, whereas all of an ETF or mutual fund's investors will have exposure to the same underlying basket of securities.

Liquidity: ETFs and mutual funds have somewhat better liquidity than SMAs; ETFs can be bought and sold throughout the trading day, while mutual funds can be purchased and redeemed daily. With SMAs, liquidity of 3-5 days is normal.

Types of Assets Managed Within an SMA

SMAs offer a wide range of asset types that can be managed within the account. The selection is typically based on your investment goals, risk tolerance, and financial circumstances. Some of these assets include:

Equities: These are shares of stock in a company, which represent partial ownership. Equities often serve as the cornerstone of many SMAs due to their potential for high returns.

Fixed Income Securities: This includes bonds and other debt instruments issued by governments, municipalities, or companies. These assets provide regular interest payments and are known for their relative stability compared to equities.

Mutual Funds: These are investment vehicles managed by professionals, pooling money from multiple investors to invest in a diversified portfolio of stocks, bonds, or other securities.

Exchange-Traded Funds (ETFs): Like mutual funds, ETFs pool investor money to invest in a diverse range of assets. However, ETFs trade on exchanges like individual stocks, providing more flexibility.

Real Estate: This could be direct ownership of property or indirect ownership through Real Estate Investment Trusts (REITs).

Alternatives: This category includes a variety of less traditional asset types like commodities, hedge funds, private equity, and more. They tend to be more complex and require higher minimum investments compared to others.

Setting Up an SMA

For investors keen on establishing an SMA, the process can be outlined in the following steps:

1. Investor Profile

You, as an investor, begin by defining your investment goals, risk tolerance, and other preferences. This is usually done through a detailed questionnaire provided by the Registered Investment Advisor (RIA) or financial institution.

2. Investment Policy Statement

Based on your investor profile, the RIA drafts an Investment Policy Statement (IPS). The IPS acts as a blueprint for managing your investments, outlining strategies that align with your goals and risk tolerance.

3. Approval of IPS

Once you review and agree with the IPS, you sign off on it, giving consent for the RIA to manage your account according to the outlined strategies.

4. Portfolio Construction

With the approval in place, the RIA then constructs your investment portfolio. This could involve buying individual securities directly or delegating this task to professional fund managers.

5. Ongoing Management

From there, the RIA takes care of day-to-day management of the SMA, making investment decisions based on the agreed-upon IPS.

6. Regular Updates

You receive periodic reports detailing the performance of your SMA, changes made, and other relevant information.

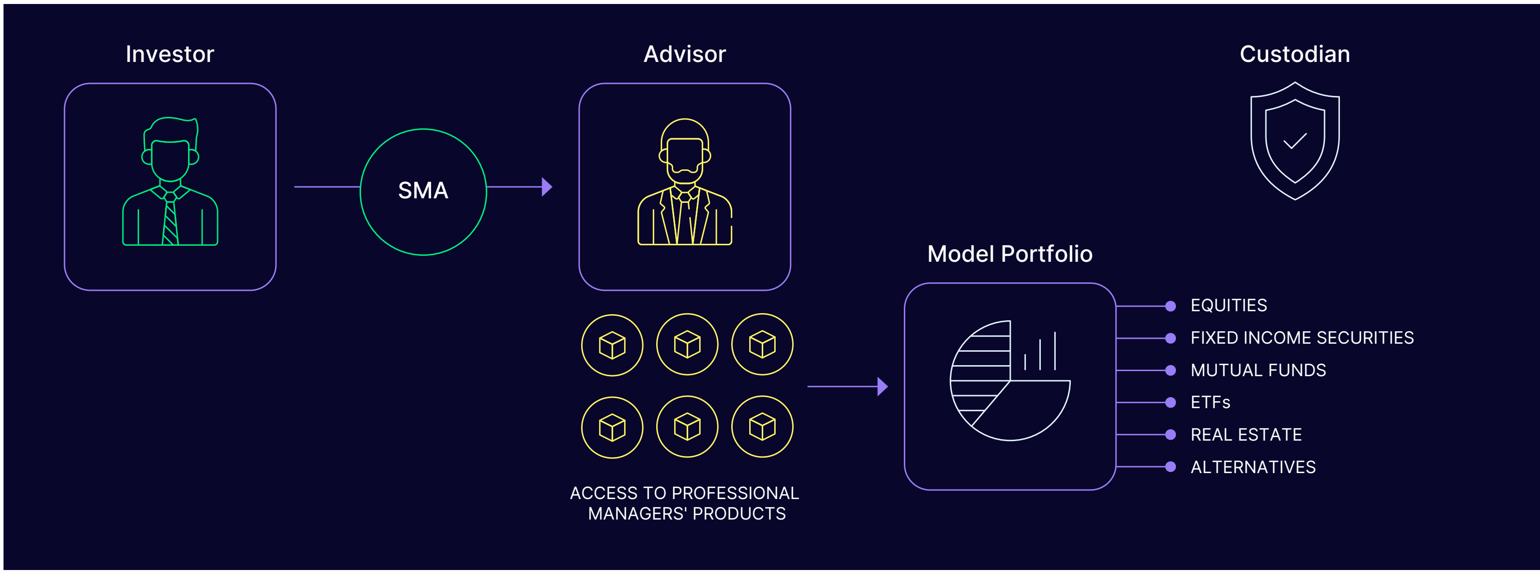
The Key Stakeholders in SMA Management

There are three key players for every SMA:

The investor: This is the individual who owns the underlying portfolio. All decisions taken regarding an SMA are ultimately made for the benefit of the investor.

The advisor: This is the person or firm hired to oversee the management of the SMA by the investor.

The Custodian: This is a third-party firm that holds and reports the assets to the investor. The role of the Custodian is to safeguard the assets of the investor and ensure that he or she receives accurate information concerning the value and concentration of the portfolio.



Considerations for Investing in SMAs

Investors thinking about opening an SMA may wish to give some thought to the following:

Understanding your risk tolerance and investment goals	Do you see yourself as a conservative investor whose priority is capital preservation, or are you comfortable taking on a fair amount of risk in search of potentially better gains?
Costs associated with SMAs	Advisors and portfolio managers that offer SMAs typically charge an annual management fee as a percentage of the assets they manage on your behalf. This can be anywhere from 0.5%-1.5%. Some firms offer tiered fee structures, where you pay a lesser percentage on assets above certain thresholds. If keeping fees very low is important to you, you may wish to weigh whether low-cost ETFs or index funds are a better option. However, some investors prefer to have a professional manage their portfolio and provide them with personalized service.
Monitoring and evaluating SMA performance	If you decide to go the SMA route, you'll want to keep an eye on how your portfolio is doing over time. You can compare your performance to benchmark equity and bond indices, for example, to see if your Advisor or portfolio manager is delivering value for the fees you pay.

Conclusion

SMAs used to be reserved for people with a significant amount of money. But fee compression and technological innovation have democratized this investment vehicle. Now, millions of investors can open an SMA and have a direct say in how their investments are managed. With tax efficiency, control, and the ability to shape a portfolio that reflects one's values, it's easy to see why SMAs are gaining in popularity.

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