Berkshire DIVIDEND STRATEGY

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"Casual Friday" Commentary

Casual Friday: Direct Indexing, What Ifs? + Elite Advisor? – March 8th, 2024

#TGICasual Friday!

Direct indexing is a hot topic in the advisory world. Advisors position the solution to "boost after-tax returns" while tracking an index. But are these products designed as a long-term solution? What if in a few years, issues arise? How do you handle objections? I'd REALLY like to hear advisor feedback on this one! We're exploring creating a strategy that pairs Berkshire Dividend Strategy with dynamic tax loss harvesting. Thoughts?

On one hand, we see some merit in advisor arguments…

"Sometimes active management disappoints, so we want the index… direct index software programs use correlation math to construct a portfolio to mirror the benchmark…auto harvest tax-losses, buy a replacement security for 31 days, rebalance and voila -- Index like returns with big tax benefits." Gee what could go wrong?

What if… The tax benefits run out?
You positioned your value on after-tax benefits, BUT the tax benefits might run out or become de-minimis over time. Theoretically, stocks go up, so eventually there may be no losses to realize. The tax benefits decay over time. No tax benefits = No value to your original proposition. Source: Direct Indexing - AQR Capital Management

What if… correlation/tracking error breaks down?
You said they'll get index-like returns, but sometimes there's dispersion. We've actually heard some anecdotal stories of pretty wide performance gaps. "S&P is down 10%, I'm down -15%. What gives?" And turnover is high, lots of confirms…do clients get irritated and nervous if it's not "working".

What if… Clients feel trapped?
They got the tax benefits early on, but now they own "the index" with potentially large unrealized gains. They're paying a much higher fee than owning the index, and your fee to boot. Higher direct indexing fees could easily exceed the client's tax benefit in time.

Despite some real benefits, we can't fully embrace direct indexing as the long-term core equity allocation across a broad client base. Over time clients would likely be better off owning the index ETF or a tax-efficient SMA. Plus, we understand the argument against "active", but investment alignment with financial goals is likely most important. Are index returns even aligned with the client's primary goal in the first place?

However, I can appreciate a few specific use cases for direct indexing:

- Gifting – If your clients want to gift to a charity, use direct indexing to gain tax benefits now and then in time donate the appreciated securities to the charity, thereby never paying taxes on the appreciation.
- Dealing with concentrated stock positions
- Estate planning – Inheritors get step up, so it's likely beneficial to take losses during lifetime

Rethinking Today's Elite Advisor?
Berkshire: "We want to work for Elite advisors or those who are committed to becoming elite."

Before you accuse us of acting ELITIST and only seeking to work with corner office folks or top producers, consider:

Compass pointing in the wrong direction? The traditional industry definition of "Elite" too often is myopically defined by ranking asset accumulation and revenue generation. Indeed, from the moment we all entered this amazing business, we are programmed to the preeminence of asset growth – sometimes at the expense of quality... Remember starting out? Many of us needed to go out and "sell, sell, sell" just to survive! And yes, these metrics often ARE leading indicators of advisor excellence: solid performance, innovative marketing, interpersonal skills, satisfied clients, and sophisticated advice administered to wealthy clients with large assets to manage.

And yes, large mandates from substantial teams are surely always welcome at Berkshire.

But this narrow definition may fail to capture the true essence of what it means to operate as an elite advisor today.

Expanding the Definition of Success?
An elite advisor practice may not view success through the narrow lens of "How big can I get?" They view asset growth as a by-product of some very specific intangibles they want their practice to embody.

The elite advisor begins with thought-provoking questions like:

1. "What type of practice do I want to create over the next 3,5,10 years and beyond?
2. "What kind of clients do I enjoy working with the most?"
3. "What special pain points does this group have that only I can solve?" (The book "Start With Why" by Simon Sinek is a great example of this mindset)
4. "How do I want to define my practice in the marketplace?"
5. "What type of unique and consistent client experience am I committed to providing?"
6. "What unique skills does my team possess to serve clients"
7. "What type of investments am I most passionate about and how can I scale them across my book of business AND realign quickly as markets change?"

8. “Do I have clients that actually take my advice, and can I maintain the discipline to let them walk if they don’t?”
9. “How do I make EVERYTHING a focused process (marketing, initial meeting, proposals, client on-boarding, reviews, appreciation events) vs. just being a collection of clients and investments?"
10. "How do I create a sustainable, enduring EDGE?"

Does Less Actually Create More?
Elite advisors filter business, investment and client acquisition decisions through those questions. And sometimes less creates more. We know some advisors who intentionally skinny down their client base, investment lineup and marketing strategies. But, almost ironically that’s driving above-average revenue growth over the long term.

Their AUM may initially be surpassed by a more sprawling book with greater AUM. But they love coming to work… they feel empowered… intentional… full of energy. They feel like they run their business -- not the other way around. And longer term above average AUM growth is usually created as a by-product of these decisions. The sum total of these decisions creates the difference between “success” vs. “significance”

Join Us?
We all want to grow. That’s what we love about this business. It’s defined by the drive and creativity of top performers who work hard and want to win. But indiscriminately taking on more and more clients for the sake of maximizing AUM and revenue shouldn’t be the only way to define “elite”.

Purpose Driven…Repeatability…Consistency…Focus…Uniqueness…Efficiency…Scalability…Technically Competent.

These are alternative ways to define elite, and Berkshire has an abundance of energy, passion and resources to helping you on your journey to the land of the elite.

‘Too Many Hours Waiting for Gelato in Capri.’
Some international Stocks may be perking up, but wealthy travelers are coming back to the U.S. Here are some of luxurious U.S. destinations. https://www.barrons.com/articles/too-many-hours-waiting-for-gelato-in-capri-americas-affluent-travelers-head-home-b078d02c

Have a great weekend!
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