



THE ULTIMATE GUIDE TO DIRECT INDEXING

Unlock Deeper Portfolio Personalization at Scale

Thanks to advances in technology, shifting investor demographics, and the growing consumer trend toward more customized experiences, portfolio personalization is table stakes for advisors looking to differentiate their services.

In fact, [a recent study by PwC](#) concluded that **66% of high-net-worth investors want more personalization in their wealth management relationship.**

However, only **a third of survey respondents were satisfied** with the personalization they currently receive from their financial advisor—illustrating a striking gap between investors' expectations and reality.

No financial advisor wants to underdeliver. The reality is that increased demand for personalization creates a scalability problem. Growing an advisory business requires expanding your client base or growing your current clients' assets, which both place higher demand on your time and energy. Factor in the need to be highly attentive to market volatility and tax efficiency to deliver the best possible outcomes for clients and the time demands skyrocket.

In the past, advisors who wished to circumvent these limitations would outsource their investment management. But that's not a perfect solution. Outsourcing only loosens the reins on the level of control you have over performance, adds a high cost to your balance sheet, and limits clients' transparency into the performance of their own portfolio. There's no doubt most financial advisors want to provide a high degree of personalization to all their clients, but whether they can is a different story entirely.

Thankfully, advisors are opening their eyes to a strategy that not only enhances client outcomes and strengthens relationships, but helps them create scale in their business operations and workflows. Direct indexing lets advisors break free from the limitations of outsourcing and delivers powerful in-house personalization for clients, increasing your value and helping you stand out in a crowded marketplace.

In this guide, we'll review everything you need to know about direct indexing, including how the strategy supports your goals, satisfies your clients' demand for cost-effective personalization, how to broach the conversation with your clients, and choosing a direct indexing provider.

Let's get started.





What is Direct Indexing?

At its most basic level, direct indexing allows investors to **own individual securities that track an index**—offering unparalleled control over client tax outcomes and portfolio customization.

For instance, a client could create a portfolio that mirrors the S&P 500 by investing in the underlying securities that make up that index. However, by owning each security individually in a Separately Managed Account (SMA) instead of the entire index, investors have the ability to select which investments they incorporate or leave out of their portfolio.

This provides clients with the benefits of investing in a traditional index or ETF, but with more control and flexibility. Values-driven investors tend to benefit from direct indexing, as they can replace less desirable stocks with those that underscore their closely-held beliefs and interests.

For example, an investor may choose to only invest in companies that embrace environmental-friendly practices and avoid those who do not. Direct indexing allows an investor to pick an index as a starting point, filter investments by environmental criteria, and replace stocks that do not meet the determined criteria with those that do.

Plus, unlike traditional index investing or ETF investing, direct indexing offers automated tax-loss harvesting—which offers several advantages come tax time.

So if direct indexing provides so many benefits, why is it only now having its moment in the spotlight?



Previously, direct indexing was only available to high-net-worth investors due to the high cost associated with this customized form of investing. But the emergence of technology that facilitates cost-effective direct indexing, the increased interest in [fractional share trading](#), and lower transaction fees have made direct indexing more widely available to mass affluent investors. As investor preferences change over time, investment trends follow suit.

Direct indexing clearly has appealing benefits to modern investors—but it also provides value to advisors who wish to provide the best possible service and outcomes to their clients.



The Benefits of Direct Indexing

Direct indexing brings a dual set of complementary benefits to investors and advisors alike. As investors seek deeper personalization, advisors deploying investment strategies on their behalf gain the **benefits of fulfilling a desired service at scale without adding weight to their workload.**

DIRECT INDEXING BENEFITS TO INVESTORS	DIRECT INDEXING BENEFITS TO ADVISORS
<p>Highly-Customized Portfolio Construction Direct indexing provides powerful customization capabilities, allowing clients to tailor investments to their specific objectives and preferences.</p>	<p>Reduce Dependency on Outsourced Solutions Keep your investment management in-house without adding a large operational burden to your team. This lets you streamline your processes, maintain transparency and control over client portfolios, and provide a more personalized client experience.</p>
<p>Enhanced Portfolio Diversification Direct indexing combines the benefits of broad market exposure with the precision and accuracy of individual stock picking, enhancing potential returns and providing effective risk management.</p>	<p>Potentially Deliver Better Client Outcomes Diversification is an effective strategy to help client portfolios weather market fluctuations. Direct indexing inherently provides diversification benefits through exposure to an index.</p>
<p>Deeper Portfolio Insights Direct index reporting includes detailed, easy-to-understand information that makes decision-making clear and provides peace-of-mind.</p>	<p>Offer Deeper Transparency Direct indexing, with the right technology partner, enhances reporting with detailed insights into individual holdings and their performance.</p>
<p>Save on Capital Gains Taxes Investors benefit from the ability to offset capital gains through strategic selling, which can significantly reduce their taxable income.</p>	<p>Automate Burdensome Tax-Related Tasks Direct Indexing facilitates proactive tax management through automating tax-loss harvesting and other tasks that reduce tax liability.</p>
<p>More Meaningful Time Spent with Advisors Advisors that free up their time spent on back office activities have more time to spend with their clients one-on-one, answering questions and building a trusting relationship.</p>	<p>Achieve Operational Efficiency Increased efficiency allows more time for client interaction and strategic advising, rather than backend management.</p>

Direct indexing is a powerful solution to remain competitive in a crowded market, especially for those rushing to earn the trust of younger investors more interested in ESG and values-driven investing.

Plus, advisors can achieve these benefits without taking on the manual burden that comes with optimizing tax efficiency.



Direct Indexing & Tax Optimization: A Case Study

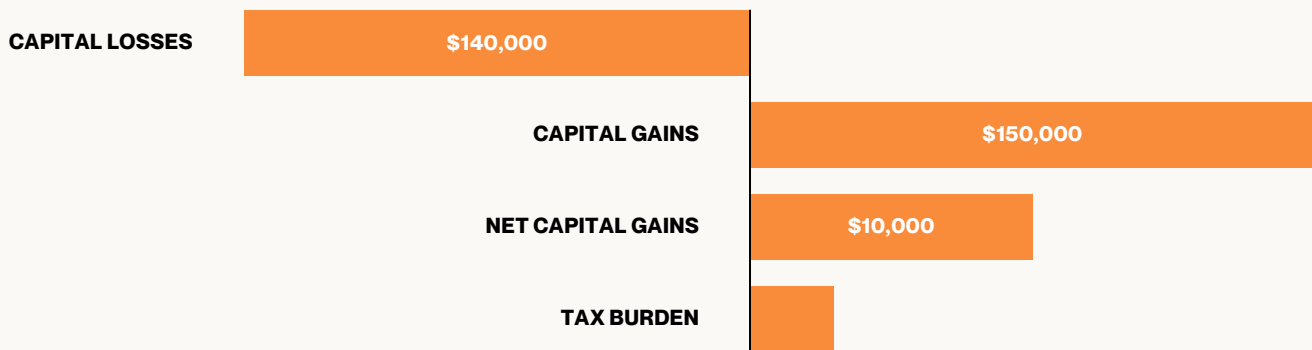
Direct indexing and tax-loss harvesting are deeply interconnected and work hand-in-hand to support advisors' workflows.

Tax-loss harvesting is the process of pruning away underperforming securities. Advisors can replace those securities with better performing investments by reinvesting funds in similar assets. Not only does this keep the portfolio in good shape, it offsets any taxable gains by accounting for capital losses in the taxation equation.

Let's take a closer look at a real-world example:

John's total portfolio value is \$5 million. Of that total, he has \$4 million allocated toward individual stocks and ETFs, and \$1 million invested in a direct indexing strategy.

In the last year, he has realized \$150,000 in capital gains from rebalancing and taking profit from his investments in stocks and ETFs. Meanwhile, tax-loss harvesting allowed him to take \$140,000 in losses from direct indexing, leaving him with a \$10,000 net gain—potentially saving him a considerable amount in taxes.



How to Talk to Clients About Direct Indexing

While direct indexing certainly offers financial advisors several benefits, it's important to make sure clients understand why it's beneficial to them. When entering into conversations about shifting their investment strategy, keep these key talking points in mind:

CORE BENEFIT	EXPLANATION
We tailor your portfolio to your unique needs.	Direct indexing allows me to create portfolios that align with your specific values without incurring high management fees that come with investing in mutual funds or ETFs.
We can reduce your tax burden through strategic selling.	Direct indexing allows me to more directly harvest your losses to offset gains elsewhere in your portfolio. This reduces your overall tax burden.
Gain the benefits of investing in an index with the precision of stock picking.	Pursue returns similar to index benchmarks while gaining the ability to pick and choose individual stocks based on values, performance, and your unique goals.

What to Look for in a Direct Indexing Solution

In today's highly saturated technology landscape, it can feel overwhelming to identify a direct indexing solution that fits your exact needs, but it doesn't have to be difficult. **Here are five of the most important factors you should consider when choosing a direct indexing technology solution.**

- 1 Comprehensive Personalization Capabilities:** Your provider should empower you to create and manage in-depth, tax-optimized direct indexing portfolios in minutes. Incorporate your clients' values and financial goals into fully customized portfolios while removing the complexities of manual construction and management.
- 2 Custodian-Agnostic Integrations:** Leveraging a platform that's turnkey will save you time and effort. Plus, look for platforms that integrate directly into your custodian to ensure your investors' assets always stay under your control.
- 3 Advanced Optimization Tools:** Your direct indexing solution should balance clients' personalization requirements with benchmark performance. Only tools with advanced optimization features will allow you to create highly personalized strategies precisely aligned with your clients' desired benchmarks.
- 4 AI-Fueled Workflow Enhancements:** Too often, new technology doesn't fit seamlessly into advisors' existing tech stacks or workflows. Look for a provider that understands your unique needs and leverages APIs to help you create the day-to-day functionality you need.
- 5 End-to-End Lifecycle Management:** Providers that offer comprehensive lifecycle management—from design, investment, transitions, tax-loss harvesting, rebalancing, and ongoing management needs—free you up to focus on building strong client relationships.

Choosing a direct indexing provider requires careful evaluation of your needs and providers' capabilities. **Thankfully, investing the effort upfront is worth the payoff.**

Meet Alphathena

Recognized as the "Fintech of the Year" at Morningstar's 2023 Investor Conference, Alphathena empowers financial advisors to deliver highly personalized investment experiences to their customers using direct indexing, tax-loss harvesting, and tax-efficient portfolio transitions.

With Alphathena, advisors can incorporate client preferences, such as ESG factors, tax implications, and industry exposure, into a customized investment strategy, ensuring **portfolios reflect the unique values and financial goals** of each investor while enhancing the advisor's ability to deliver exceptional, personalized service.



Meet Alphathena

 <p>PERSONALIZED DIRECT INDEXING Create and manage tax-optimized portfolios in minutes.</p>	 <p>IMPROVED PRODUCTIVITY Use natural language search to find new equities, check for ESG preferences, and filter for 100+ other factors.</p>	 <p>TRANSPARENT ANALYSIS Gain access to detailed, easy-to-understand reports on client portfolio transitions.</p>	 <p>PRECISE TARGETING Minimize tracking errors and provide clear insights for informed portfolio decision-making.</p>	 <p>EASY ONBOARDING & TRANSITIONING Streamline the onboarding process for new and existing clients into direct indexing strategies.</p>
 <p>SIMPLE SETUP Seamlessly integrate with your existing systems to enhance the investment experience.</p>	 <p>TAX-LOSS HARVESTING Achieve tax efficiency by automating the process of tax-loss harvesting.</p>	 <p>AUTOMATE TASKS Eliminate time-consuming tasks, such as rebalancing and ongoing management, so you have more time to serve your clients.</p>	 <p>SMART WEIGHS ALLOCATION Synthesize any index or portfolio down to a fraction of its size with optimized allocations.</p>	 <p>API-FIRST DESIGN Integrate directly into your custodian with full lifecycle support for personalization.</p>

Alphathena is a leading fintech platform that empowers advisors and institutions to deliver personalized investment experiences through real-time direct indexing.

Discover Personalized Investing with Alphathena.

Our cloud-based solution seamlessly integrates with existing workflows to deliver personalization with features such as tax-loss harvesting and AI-powered portfolio optimization. **Schedule a one-on-one demonstration to see Alphathena in action.**

SEE A DEMO

Visit us at www.alphathena.com for more information.

