Separately Managed Accounts

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

RAYMOND JAMES | INVESTMENT MANAGEMENT

Executive Summary

Get access to professional money managers.

Receive higher levels of individualized account reporting and client service.

Own the individual securities in the portfolio, not just shares in a fund.

Customize a portfolio and gain flexibility with tax-planning strategies.

Separately managed accounts (SMA) and mutual funds are two popular methods of accessing professional investment managers. Both offer investors a professionally managed portfolio of securities. Separately managed accounts and mutual funds are similar in some respects, but they are two distinct vehicles with advantages and disadvantages. Determining which approach is more appropriate depends on an individual investor's needs.

Professional Account Management

A separately managed account (also known as an individually managed account or private account) allows an individual to tap the experience 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 distinct needs and objectives of the individual investor. Generally speaking, the account minimums are typically at least $100,000. Meanwhile, the minimums for many mutual funds may start at just $500 or $3,000, depending on the fund company, share class, etc. (although systematic-purchase plans can reduce the minimum even further).[1]

This larger account size of an SMA 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 that may not be available with by pooled investments. The portfolio manager has complete discretion and follows a stated investment strategy that the client and financial professional have determined is appropriate.

Direct Ownership of Securities

Since an individually managed portfolio is separate from other accounts, an investor may specify certain industries, businesses, or specific securities in which they do not want to invest because they find them objectionable. Mutual funds provide investors with the list of securities they own, but the fund does not allow them to select specific companies in which to invest.

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[1] Source: Investopedia, "What Is the Minimum Amount For Investing in a Mutual Fund?" last updated Nov. 26, 2024 https://www.investopedia.com/ask/answers/111714/what-minimum-amount-money-i-can-invest-mutual-fund.asp

Flexible Tax Planning

For individuals who have taxable accounts, having the flexibility to assist with managing their tax bills is often an important distinction of a private account.

Since investors with private accounts own securities directly, they have an individual cost basis for each security in their accounts. 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 professionals to implement tax strategies. These strategies include directing their portfolio manager to realize gains or losses in specific securities to potentially minimize the tax liability of the account or from other investments.

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
- investment performance

The Service Differential

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

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 may be available only on a semi-annual or annual basis.

The Role of the Financial Professional

As the saying goes, 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 use the services of a financial professional. Financial professionals help investors develop and adapt investment plans that are designed to meet their needs and navigate them through this dynamic area of their lives.

Because investors have different needs, we believe that an investment manager should be considered to help manage the client's assets whether they invest in a private account or a mutual fund. Financial professionals typically have relationships with various investment managers and an understanding of their investment disciplines: growth vs. value; large cap vs. small cap; international; fixed income, etc. Therefore, the professional can help guide the selection of an appropriate manager for the client.

This information is not intended to serve as investment, tax, legal, or accounting advice. You should consult your own investment, tax, legal, and or accounting professionals before engaging in any transaction.

Once an investment manager is hired, the professional 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 professional can communicate with the manager to understand the reason for the change and advise the client as to what action is needed, including whether it is prudent to select another manager.

The increased flow of information can motivate some financial professionals to direct their clients to private accounts. In addition to more comprehensive reporting that may not always be available with mutual fund reporting, private-account managers are often available to professionals either at investment conferences or via telephone calls. This added level of communication may allow the professional to do a better job monitoring the account and serving as the client's advocate.

The Cost of Service

One of the reasons some clients may choose private accounts is the cost structure. Instead of paying a commission and other expenses (as in the case of some mutual funds), clients pay the investment manager an ongoing periodic 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. Mutual fund costs can typically be reduced based on the amount invested.

These ongoing annual fees generally range from 1% to 3% of assets under management. They are often negotiable, and they may be reduced incrementally as the size of the account increases.[2]

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The Final Analysis

Clients who want a greater degree of individual attention and can afford the higher investment minimums may prefer a private account. These accounts provide more service, control and flexibility, and individuals who work with a financial professional should also consider the cost differences, among other things, between private accounts and mutual funds. Private accounts and mutual funds offer different advantages to investors, depending upon their individual needs, goals, and risk tolerance. Your investment professional can assist in determining this information based on your circumstances.

[2] Source: Investopedia, "Should You Have a Separately Managed Account?" last updated August 31, 2024 https://www.investopedia.com/articles/mutualfund/08/managed-separate-account.asp

Differences between Managed Accounts and Mutual Funds

	Separately Managed Accounts	Mutual Funds
Ownership	Investors own individual securities.	Investors own shares in a pool of securities, commingled with assets of other investors.
Portfolio Holdings	Based on an investment strategy that can be designed to meet an investor's specific needs, which may exclude certain businesses, industries, or specific securities at the client's request.	A fund can exclude businesses, industries, or specific securities from its objectives, which are outlined in its prospectus. The objectives are identical for all investors in the fund.
Expenses	An ongoing periodic asset-based wrap fee covers all managed account services (money management, trading, and custody) and may be negotiable.	Depending upon the fund, share class chosen and amount invested, may be subject to a front-end or back-end sales load and ongoing distribution and servicing (i.e., 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.
Minimum Account	Typically $100,000 or more for equities, and often higher for fixed income. The minimum may be negotiable.	Typically ranges from $500 to $3,000 per fund and periodic investment plans may be much lower. Institutional class share minimums will often be higher. Minimums are usually not negotiable.[3]
Reporting	Provide detailed statements that include account activity and performance. Investment advisors also report certain information through their Form ADV that is available upon request. Depending upon the SMA or firm, the investment performance may or may not align with Global Investment Performance Standards (GIPS) set forth by CFA Institute.	Investors typically receive in-depth monthly or quarterly statements showing account activity and performance. Investors receive annual and semi-annual reports showing full fund information and disclosures as well as the prospectus and statement of additional information with complete information and disclosures. All investment performance reports for mutual funds are standardized across the industry.
Governance	Primarily under the Investment Adviser Act of 1940 and other rules/regulations.	Primarily under the Investment Company Act of 1940 and other rules/regulations.
Risks	Subject to the risks applicable to the particular securities held by the client.	Subject to the risks applicable to the particular securities held by the fund.
Tax Basis	Begins when individual securities are purchased for the investor. An investor could receive K-1 tax forms from certain SMA holdings should they apply.	The fund's tax basis may include embedded capital gains that go back months or years before the investor bought shares. An investor would not receive K-1 tax forms even if the fund invested in such applicable securities.
Tax Management	Clients and their investment professionals may manage tax exposure by offsetting gains with losses, although this can lead to diminished loss-harvesting opportunities over time due to portfolio lock-up. Purchases can also be temporarily limited during tax-loss harvesting due to regulations governing wash sales.	Under sole control of the portfolio manager, although some funds are managed for tax efficiency.
Asset Flow	An investor can be fully invested and is not required to hold cash.	May be required to hold cash for meeting potential redemption demands; the amount depends on the fund.
Liquidation	Typically takes 3–5 days, but may take longer depending on the security being liquidated.	Shares of the fund are liquidated at the closing price on the same day the request is received and distributed the next day.
Portability of Holdings	Yes, provided the adviser accepts the holdings that are requested to be transferred.	Not usually.

[3] Source: Investopedia, "What Is the Minimum Amount For Investing in a Mutual Fund?" last updated Nov. 26, 2024 https://www.investopedia.com/ask/answers/111714/what-minimum-amount-money-i-can-invest-mutual-fund.asp

Definitions

Assets under management (AUM) is the total market value of the investments that a person or entity manages on behalf of clients.

A back-end sales load refers to the money a mutual fund charges to a client for withdrawing money.

The expense ratio measures how much of a fund's assets are used for administrative and other operating expenses. An expense ratio is determined by dividing a fund's operating expenses by the average dollar value of its assets under management (AUM).

A front-end sales load is a commission or sales charge applied at the time of the initial purchase of an investment.

A K-1 tax form is an Internal Revenue Service (IRS) tax form issued annually for an investment in partnership interests. The purpose of Schedule K-1 is to report each partner's share of the partnership's earnings, losses, deductions, and credits.

A No-load mutual fund refers to a fund that charges no sales fees either on the front end (when you buy fund shares) or back end (when you sell fund shares).

A wash sale is a transaction in which an investor sells or trades a security at a loss and purchases "a substantially similar one" 30 days before or 30 days after the sale.

A 12b-1 fee is an annual marketing or distribution fee on a mutual fund. The 12b-1 fee is considered to be an operational expense and, as such, is included in a fund's expense ratio.

Disclosure

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The investment return and principal value of both separately managed accounts and mutual funds will fluctuate and sale proceeds may be worth more or less than the amount invested. Past performance is no guarantee of future results. The risks associated with either separately managed accounts or mutual funds will vary based on the particular account or fund considered and should be reviewed carefully before investing.

This is not a comprehensive list of the differences or similarities between separately managed accounts and mutual funds. The investments you choose should correspond to your financial needs, goals and risk tolerance. For assistance in determining your financial situation, please consult an investment professional.

Neither separately managed accounts nor mutual funds may be appropriate for all investors. The costs and services related to both may differ and there is no evidence to support that one is superior to another for any particular criteria. The views expressed in this material are those of Raymond James Investment Management and may change at any time.

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Contact us for more information on our active investment strategies.

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