November 7, 2023

Taxable Investors: You are not dating your portfolio managers. You're marrying them. Therefore, you need excellence AND persistence.

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For taxable investors, it is not enough to get excellent long-term after-tax performance from an investment fund. *Persistence – the ability to remain good to excellent through time* -- matters just as much. Why? The journey matters.

If the road is too rocky, investors will lose faith and feel compelled to fire a fund manager. That issue is then compounded by taxes. While *tax-exempt* investors can afford to "date" their funds, flitting from one to the other frictionlessly, *taxable investors*, in contrast, usually pay a heavy tax when they sell – what we call "divorce costs ." This erodes the chances of ever banking those excellent long-term returns.

Funds showing higher *persistence* - a smoother road, on the other hand - enable an investor to stay "married."

Comparing two investment funds illustrates the point. Both provided essentially identical and excellent long-term after-tax returns. Both were in the exact same small-cap value category. One was difficult to stay married to. The other is much easier.

The first fund, Fund X[1] was recently lauded, two weeks in a row, by *Barron's.* The article highlighted an +11% return in 2022, impressive, given that US small-cap value stocks were down -15%. A week later, Fund X's manager was profiled in a flattering interview. He had what *Barron's* readers love to see in active managers: Concentrated high-conviction portfolios. "Get your hands dirty" fundamental research. A stock-picking methodology fawningly compared to Benjamin Graham, the "Father of Value Investing."

[1] The name of the actual fund is not that important to the point of the paper, as the lack of persistency of most funds is well-documented. But it was the Aegis Value I Fund (ticker symbol AFAVX). We did not cherry-pick this fund to do the analysis; quite the opposite, it was Barron's who cherry-picked it as an excellent fund; we just dug a little bit deeper in our analysis to make a different point.

Historical performance numbers also spoke to its long-term excellence. It had beaten over 90% of its peers over the last 10 years. Morningstar analysts assigned it a Silver rating.

This looked like a fund suitable for marriage.

Here's the wrinkle.

Our clients pay taxes. Typically, 85% to 95% of their investment assets are taxable. Further, many of our clients are in the highest Federal marginal tax bracket. Further still, many happen to live in high-tax states, such as New York, California, New Jersey, Massachusetts, and Pennsylvania. The combined tax bill on short-term gains, for example, approaches 57% in some states. When the 2017 tax cuts sunset, that number could approach 60%.

Taxes matter. A lot. First, almost every time an active mutual fund manager makes a trade, our clients pay a tax[2]. Every time they trim a position, our clients pay a tax. Every time a dividend gets paid, our clients pay a tax. Every time they do seemingly innocent rebalancing, our clients pay a tax. Yet portfolio managers, for over 75 years, have blithely ignored this inconvenient truth. They are not evaluated on after-tax performance. They don't care because they're not paid to care. That's problem one.

Problem two is human nature – the behavior of investors themselves. When assessing which fund manager to hire, our brains are wired to believe that good *past* performance must mean good *future* performance. The problem: *decades of research and even SEC-mandated warnings written on every mutual fund prospectus remind investors that it is simply not true.* Yet this flawed *ipso facto* logic is entrenched in the American psyche – a Federal Reserve Bank working paper[3] estimated that a fund upgrade to a Morningstar 5-star rating results in a *53% increase* in new money inflows.

The opposite behavior also holds: poor performance often leads to investor outflows. For tax-*exempt* investors, a divorce has no costs. For *taxable* investors, divorce triggers expensive taxable gains.

As it turns out, a marriage to Fund X would have been a rocky one, with periods of horrific performance.

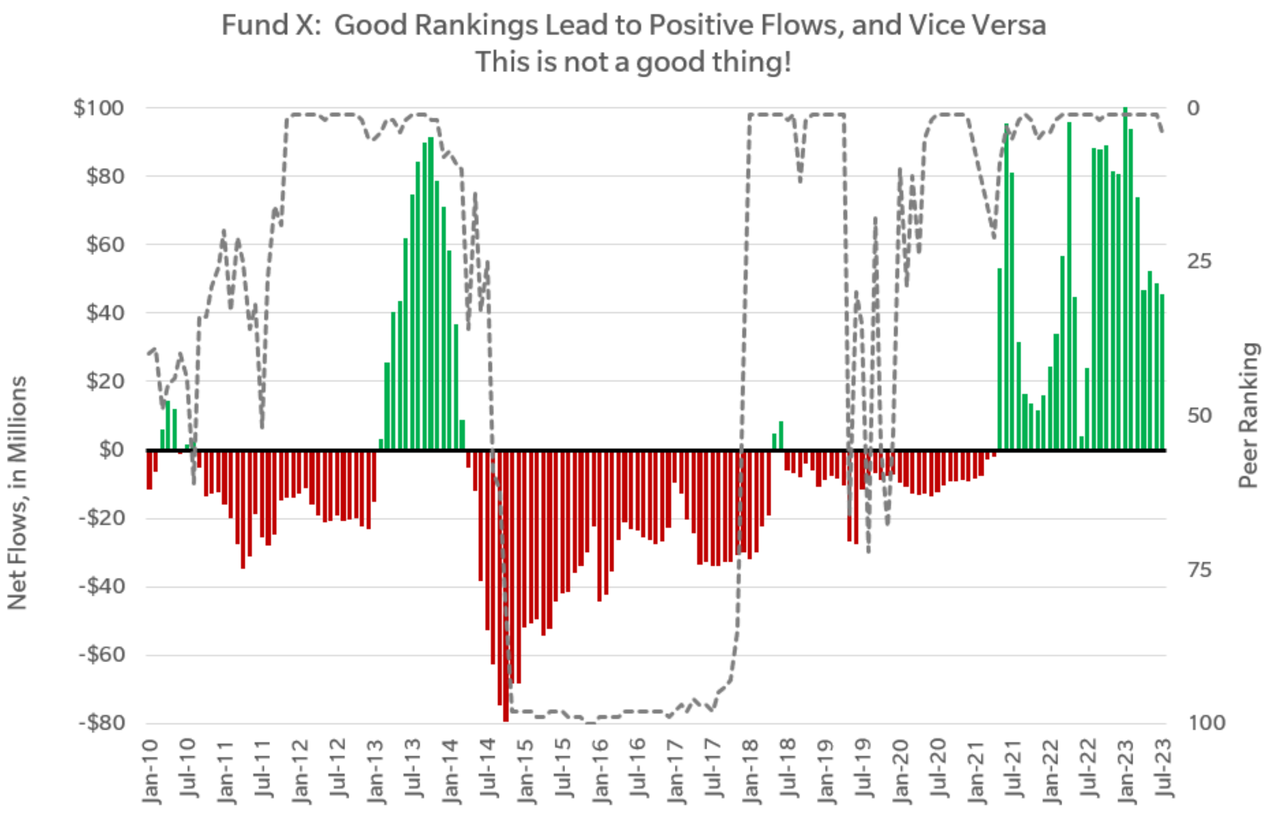
See the chart below, which shows the rolling 5-year rankings of Fund X, the dotted line. Then we layered net flows into and out of the fund, the green and red bars. The pattern is clear. Money flows in *after* the fund does well and vice versa. For example, Fund X had fantastic short-term performance in 2011 and 2012, improving to top decile. Money in. Then performance faltered badly starting in 2014, and for half a decade, Fund X hovered in the bottom quartile, at times the worst-performing fund in its class. Tough to stay married. Money out. Chasing performance by flitting from one fund to another is rarely a good idea. But for taxable investors, that bad idea is compounded: a tax to get *into* Fund X…another to get *out*.[4]

[2] I'm taking a bit of editorial license with this statement, as it's not technically true. Since markets tend to go up over time, however, it is more often than not the case that active managers are selling appreciated stocks, triggering a capital gains tax.

[3] *Star Power: The Effect of Morningstar Ratings on Mutual Fund Flows,* Diane DelGuercio and Paula A. Tkac, working paper series. The Federal Reserve Bank of Atlanta, August 31, 2001.

[4] This assumes the investor sold out of one fund to buy Fund X. In both instances, it assumes fund appreciation.

As old as time: investors marry funds after good performance, then divorce after bad



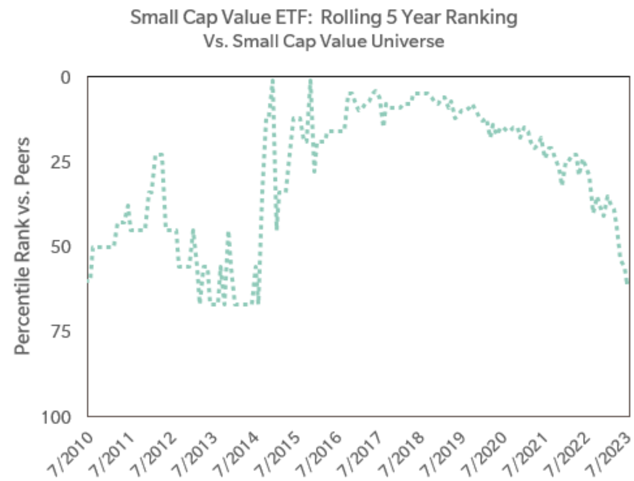
Source: Barron's, Morningstar and Ballentine Partners.
All investments involve a risk of loss. The ranking is for pre-tax performance, as rolling periods of after-tax performance is not available. Past performance is not necessarily indicative of future performance. Ballentine Partners fee will reduce the returns shown here.

Now let's look at our second fund, a U.S. small-cap value ETF, a simple, unmanaged, low-cost option that tracks the S&P 600 Value index. SPIVA reports[5] have been tracking the performance of index-linked strategies vs. active managers for over 20 years, and their studies show that unmanaged indices show high *persistence*, that is, they demonstrate good to excellent performance over time, without oscillating too much.

See below. The chart on the left is that same rolling 5-year ranking of Fund X but without fund flows. The chart on the right shows the S&P Small-Cap 600 Value ETF. Remember that this ETF competes in the exact same universe as Fund X. The two funds, over the past decade, had essentially identical after-tax returns. Importantly, both returns ranked in the top decile. But which one was easier to stay married to:
Fund X or the ETF?

[5] SPIVA (S&P Index Versus Active) report, *U.S. Persistence Scorecard Year-End 2022,* published by S&P Dow Jones Indices.

Who would you marry? Who could you stay married to?



Source: Barron's, Morningstar, Ballentine Partners. Fund X is Aegis Value I (AVALX). The Small Cap Value ETF is the iShares Small-Cap 600 Value (IJS). All investments involve a risk of loss. The ranking is for pre-tax performance, as rolling periods of after-tax performance is not available. Past performance is not necessarily indicative of future performance. Ballentine Partners fee will reduce the returns shown here.

The table below also shows that the overall experience of owning the ETF would have been much more pleasant. It never once, over the past 10 years, dipped into the bottom quartile, while Fund X spent nearly 40% of its time there.

These two funds delivered essentially the same excellent after-tax returns, but the odds of you actually banking those returns would have increased dramatically with the ETF option if for no other reason than you would never have been tempted to divorce it.

Same excellent performance. Better Persistence. Less temptation to divorce.

	Fund X	**S&P Small Cap 600 Value ETF**
10 Year After-Tax Return:	8.6%	8.5%
10 Year After-Tax Ranking:	Top Decile	Top Decile
% of Time Spent Above Median:	61%	80%
% of Time Spent in Bottom Quartile:	37%	0%
Annualized Volatility:	28%	21%

Source: Barron's, Morningstar, Ballentine Partners. Fund X is Aegis Value I fund, The S&P Small Cap 600 Value ETF is the iShares Small-Cap 600 Value fund. Returns and volatility are for periods ending July 31, 2023. The % of Time Ranking Spent data relates to rolling 5-year ranks since 2010. Rankings come from Morningstar's small cap value universe. All investments involve a risk of loss. Past performance is not necessarily indicative of future performance. Ballentine Partners fee will reduce the returns shown here.

About Pete Chiappinelli, CFA, CAIA, Chief Investment Officer

Pete is Chief Investment Officer at the firm. He is focused primarily on Asset Allocation in setting strategic direction for client portfolios. Pete has 30 years of experience in research, investment strategy, and thought leadership regarding the management of multi-asset class portfolios, inclusive of equities, fixed income, and alternatives. His work has been featured in leading financial publications such as *The Wall Street Journal*, *The New York Times*, *Barron's*, and others in Canada, Europe, and Asia. His market commentaries have been featured at major industry conferences, in TV documentaries on capital markets history, and on social media outlets. Prior to joining Ballentine Partners in 2022, he was a Senior Portfolio Strategist on GMO's Asset Allocation team. Prior to that, he was an Institutional Portfolio Manager at a specialized unit within Fidelity Investments and was the Managing Director of Institutional Investment Strategy & Research at Putnam Investments. He is a graduate of Carleton College and holds his MBA from The Wharton School at the University of Pennsylvania. Pete holds the Chartered Financial Analyst (CFA) designation, is a member of the CFA Institute and CFA Society Boston, and he holds the CFA Institute Certificate in ESG Investing. He also holds the Chartered Alternative Investment Analyst (CAIA) designation and was the founding President of CAIA Boston. Pete lives in Hingham, MA with his wife, Cheryl, and enjoys travel, cooking (definitely not a "foodie," but a "foodie wannabe"), sourdough breadmaking, and conjuring up ways to embarrass his three children.