First Trust

Direct Indexing

Aligning Tax Advantaged Solutions with Personalized Goals

What is Direct Indexing?

Direct indexing seeks to closely track the performance of a market index while creating tax savings to increase after-tax returns. Investors own individual securities in a portfolio via a separately managed account ("SMA"). Holding individual securities rather than a single fund allows investors to customize their exposure to the initial index according to their needs while allowing for greater tax efficiency.

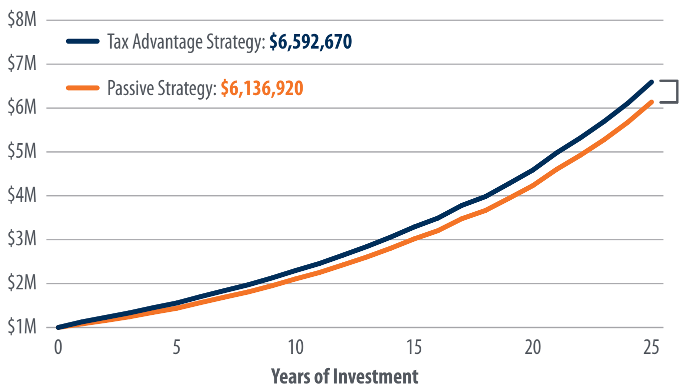
- » **SMA Chassis**
- » **Fintech**
- » **Index Replication**
- » **Continuous Tax-Loss Harvesting**
- » **Tax-Efficient Transitions**
- » **Customizable**

Tax-Advantaged Investing

Enhanced After-Tax Returns

Excess After-Tax Return – Excess Pre-Tax Return = Tax Alpha

Direct indexing utilizes tax-loss harvesting to generate tax alpha, which increases after-tax returns. While alpha is a measure used to evaluate portfolio returns in excess of a benchmark index, tax alpha is a measure of after-tax account return that exceeds pre-tax return in excess of a benchmark. The example below illustrates the tax alpha that may be achieved by the growth of an initial investment over a 25-year period.



Total Tax Benefit
$455,750

Assumptions:

Initial Investment Amount: **$1 Million**

Annualized Equity Market Return: **8%**

Dividend Tax Rate: **23.80%**

Long-Term Capital Gains Tax Rate: **23.80%**

Short-Term Capital Gains Tax Rate: **40.80%**

This sample provided does not reflect the investment results of actual securities and is not a guarantee of future results. Changes to the assumptions will drastically change the results. See complete methodology on the following page.

First Trust Tax-Advantaged Strategy Simulator

Use this tool to run a simulation that illustrates the potential tax benefit of a tax-advantaged strategy versus a passive strategy.

Tax-Efficient Transitions

Liquidation vs. Transition Tax Savings = Transition Alpha

Proper tax management is especially important when exiting securities with appreciated gains. When transitioning securities into a direct index SMA, the account can be funded in-kind without creating a taxable event. The tax management tools available through direct indexing can be used to achieve a tax-efficient portfolio transition and potentially minimize, delay, or avoid net taxes.

Personalization

Whether prioritizing traditional factors, risk management strategies, thematic positioning, or values-based investing, advisors can completely customize their clients' exposure to selected benchmarks based on their investment goals and personal values.

Choose a Benchmark
- U.S.
- Global
- International

Personalize
- Align personal values
- Account-specific needs
- ESG

Customize
- Portfolio Tilts
- Factor / Sector

Your Portfolio

The personalization and customization screens shown above are examples. The direct indexing platform provides a menu of 70 levels of customization from which to choose.

Mutual Funds, ETFs, and Direct Indexing – What's the Difference?

There are many similarities among mutual funds, exchange-traded funds (ETFs) and direct indexing. Typically, investors use ETFs and mutual funds to gain indirect exposure to the securities in a benchmark. Although ETFs and mutual funds can deliver broad market exposure, direct indexing does so with a key difference: a portfolio can be tailored to an investor's specific needs and tax-loss harvesting strategies. This portfolio of the optimal component stocks of a benchmark, held directly in a direct index SMA, can be funded with either cash or with an existing portfolio of securities (in-kind), including appreciated stock, which provides the potential to create tax alpha beyond what ETFs and mutual funds may offer.

Potential Benefits	Mutual Funds	ETFs	Direct Indexing
Seeks to match (or exceed) the returns of a benchmark index	✓	✓	✓
Tax efficiency*	X	✓	✓
Potential to create tax alpha	X	X	✓
Potential to create transition alpha	X	X	✓
Portfolio customization	X	X	✓
Ability to fund in-kind	X	X	✓

*A mutual fund's tax inefficiencies come from the frequent payout of embedded gains. ETFs lower the frequency due to their in-kind exchange mechanism. With SMAs, clients own securities directly and can tax-loss harvest/pass-through losses.

An Alignment of Strengths

Over its 30-year history, First Trust has worked alongside financial professionals to provide tools, resources, and trusted investment products, many of which are designed to minimize the effect taxes have on a portfolio. Direct indexing delivers customized investment solutions with more opportunity for tax-efficiency and values-based personalization, providing a platform that allows advisors to align the investment objectives, values, and interests of their clients with tried-and-true methodologies offered by First Trust.

This summary is not intended to be tax or legal advice. This summary cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. This summary is being used to support the promotion or marketing of the transactions herein. The taxpayer should consult an independent tax advisor.

Investors or financial professionals should consult with a tax professional regarding the potential application of loss deferral regimes, such as wash sales and straddles, to these securities and potential transactions along with other securities and transactions in the broader portfolio.

Chart Methodology: The sample provided assumes a starting basket of 300 equally-weighted hypothetical securities. Returns are randomly simulated monthly with the annualized mean chosen above and annualized standard deviation of 30%. It is assumed that the portfolio's 2% annualized dividend yield is subject to income tax and is reinvested monthly into a new tax lot. The "Passive" strategy simulates a buy-and-hold strategy over the investment horizon. The "Tax-Advantaged" strategy simulates a tax-loss harvesting strategy. In any period that a tax lot's cumulative loss exceeds 5%, the tax lot is sold, and the proceeds are immediately reinvested, plus any tax benefit, into a new tax lot. Tax benefit calculations assume that the capital gains offset by the harvested loss are 50% short-term and 50% long-term. The Monte Carlo simulation takes an average across 2000 iterations for each set of return, risk, and tax assumptions. The sample presented does not represent actual trading of securities and is not indicative of actual investment strategy performance. The impact of market factors is not included in this simulation which may cause the results to be over-or-under stated. This should not be construed as a representation that any account will, or is likely to, achieve profits, losses or tax savings similar to those reflected in this example.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

The strategy was previously managed by First Trust Direct Indexing ("FTDI"). Effective October 31, 2024, FTDI merged into First Trust Advisors L.P. ("FTA"). All business activities, including portfolio management and business records are now performed under FTA.