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WEALTH MANAGEMENT

A Comprehensive Approach to Concentrated Stock Positions

Investing can be an emotional journey, especially if you have created wealth through a single stock whether it be through compensation, personal connections to a business or a fortunate early investment. Deciding when or even if to diversify can be challenging. There are multiple ways to approach a concentrated position, and considering both planning and investment angles will help you find a solution that aligns with your goals and needs.

What is a Concentrated Position?

When an investor holds more than 10% of their portfolio in a single stock, this is referred to as a concentrated position. If this single stock declines significantly in value, it can leave the investor in a vulnerable position.

Potential Risks of a Concentrated Position

When considering the potential risks of a concentrated stock position, it's important recognize several key factors that might prompt you to diversify:

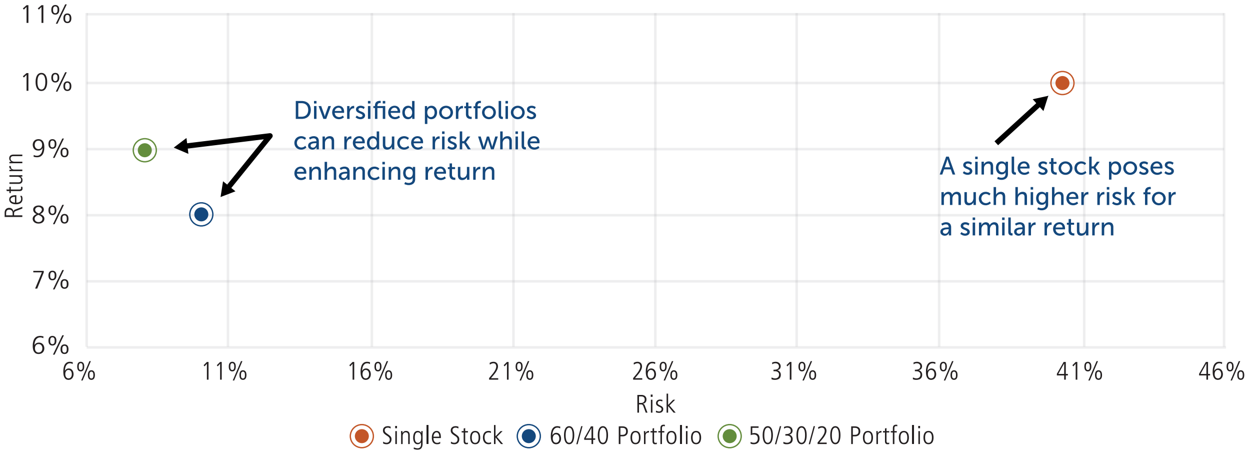
Volatility

Long-term risk

Reduced return

See below for a comparison of how diversified portfolios can dramatically reduce potential risk while keeping a compelling return within reach, versus a single stock position.

Diversification and Portfolio Risk/Return



Diversified portfolios can reduce risk while enhancing return

A single stock poses much higher risk for a similar return

Source: Calamos Wealth Management. The 60/40 portfolio is based on forward-looking long-term capital market assumptions for a diversified portfolio with 60% equities comprised of the S&P 500 and 40% fixed income comprised of the Bloomberg US Aggregate Index. The 50/30/20 portfolio is 50% equities, 30% fixed income and the 20% represents a diversified portfolio of private alternatives equally weighted among private equity, private credit, private real estate and private real assets. The single stock is based on long-term capital market assumptions of a blue-chip stock in the S&P 500.

Solutions for Managing Risk in a Concentrated Stock Position:

The chart below highlights various strategies to manage the risks of a concentrated stock position.

STRATEGY	DEFINITION	BENEFITS	CONSIDERATIONS
GIFTS TO CHARITY			
OUTRIGHT TO CHARITY	Gift directly to charity to receive charitable deductions, which can be used to help offset tax on realized gains from the sale of non-gifted stock.	» Immediate charitable impact. » Charitable deductions. » Income tax mitigation. » Reduce taxable estate.	» Maximize tax impact by gifting highly appreciated assets with low cost-basis. » Gift assets that are unencumbered.
CHARITABLE GIFT ANNUITY	Planning giving strategy in which a donor and nonprofit organization have an agreement whereby the donor receives lifetime payment until death and the assets are retained by the organization.	» Immediate charitable impact. » Retain lifetime income stream from gift donated. » Charitable deductions. » Income tax mitigation. » Reduce taxable estate.	» Maximize tax impact by gifting highly appreciated assets with low cost-basis. » Gift assets that are unencumbered.
CHARITABLE REMAINDER TRUST (CRT)	Tax-exempt irrevocable trust that provides a partial tax deduction. Donation is made by the grantor and the trust dispenses income to the grantor or named beneficiaries for specified period, after which the remainder of the trust will be distributed to designated charitable beneficiaries of the trust.	» Delayed charitable impact. » Retain income stream from gifted asset. » Charitable deductions. » Income tax mitigation. » Reduce taxable estate. » Leverage deductions to offset realized capital gains from sale of concentrated stock.	» Maximize tax impact by gifting highly appreciated assets with low cost-basis. » Gift assets that are unencumbered. » Income beneficiary of CRT receives income for life or for a specified term of years not exceeding 20 years. » Charitable beneficiary receives remainder of CRT after rights of income beneficiary ceases.
CONSERVATION EASEMENT	Voluntary, legal agreement around a parcel of land you are planning to retain long-term which restricts future land/use or development on the property.	» Preserve natural habitats and raw landscapes. » Charitable deduction. » Reduce taxable estate. » Leverage deductions to offset realized capital gains from sale of concentrated stock.	» Land trust must be used. » Physical inspection of the property at least once per year. » Property required to be "protected-in-perpetuity" under tax regulations.
INVESTMENTS			
OPTIONS	Contracts that give the buyers the right, but not the obligation, to buy or sell an underlying asset at a set price and date.	» Hedging. » Income stream. » Potential tax mitigation.	» Complexity. » Tax considerations.
EXCHANGE FUND	Pooled investment vehicle structured as a partnership allowing investors to diversify their position while deferring payment of capital gains taxes.	» Non-taxable event to invest and exit. » Diversification.	» Requires a 7-year holding period. » Minimum investment of 750K – 1M. » Net worth qualifications.

STRATEGY	DEFINITION	BENEFITS	CONSIDERATIONS
DIRECT INDEXING	Use losses generated in direct indexing strategy to offset the taxable gains on the sale of the concentrated stock. Can also be used to mirror the composition of an index.	» Tax mitigation. » Diversification/reduction of concentrated position. » Customization for goals and values. » Can be built around legacy position.	» Minimum level of assets for customization. » Potential for higher tracking error.
PREPAID VARIABLE FORWARD CONTRACTS (PVFC)	Receive 75 to 90 % of the current market value of the stock in a contractual arrangement to receive prepaid payments in exchange for a variable number of stocks at a specified future date.	» Provide immediate cash or liquidity with no immediate taxation on realized gains of stock subject to a PVFC. » Tax liabilities on capital gains are not due until the transaction is settled at a future contract date. » Allows for cost-effective diversification of concentrated stock.	» A type of stock transaction that is a collateralized loan contract. » Stock ownership is only transferred to the other party of the PVFC at the end when the PVFC contract expires. » PVFC strategy will likely attract IRS scrutiny because of the amount and nature of the parties involved.
INCOME TAX			
TAX-FREE EXCHANGE	Exchange unencumbered, highly appreciated non-stock assets (i.e., real estate, life insurance, Delaware Statutory Trust) for other like-kind assets to facilitate diversification.	» Tax deferral resulting in no immediate tax pursuant to a tax-free exchange, if rules are followed. » Tax-free exchanges may facilitate portfolio diversification. » Certain types of tax-free exchanges may facilitate gifting and estate planning strategies.	» Tax free exchanges result in deferred tax liability until the acquired property is sold in the future. » Cost basis in the exchange property is "carried over" to the newly acquired property. » Strict IRS rules, timelines, and limitations apply.
TAX-LOSS HARVESTING	Tax mitigation strategy that offset the realized taxable gains on the sale of the concentrated stock with the realized loss of the sale of other securities.	» Facilitates stock rebalancing in a tax-efficient manner. » Stock losses realized in the tax year from sale of stock can be used to offset realized gains from other stock sold in the same tax year.	» Realized stock losses in the current year can be utilized to the extent of realized gains from the sale of other stocks in the same year. » Unused realized losses in the current year can be used in future years, but up to $3,000/year. » Adherence to the wash-sale rule is important, especially with a tax-loss harvesting strategy.

STRATEGY	DEFINITION	BENEFITS	CONSIDERATIONS
TAX BASIS "STEP-UP"	Appreciable assets held by an individual at death receive a tax basis 'step-up" to the fair market value of the appreciated assets as of the deceased owner's date of death.	» Assets receiving a tax basis "step-up" reduces potential tax liability on the subsequent sale of those assets. » If an irrevocable grantor trust holds highly appreciated stock or other appreciated unencumbered assets with low cost-basis, the grantor may wish to discuss with his/her tax advisor on the benefits of exchanging or "swapping out" the low basis asset in the trust for other assets owned by the grantor outside of the trust that have the same economic value but a higher cost-basis.	» Complex planning that requires guidance from qualified wealth and tax advisor. » To establish fair market value, the services of an independent appraiser may be required for certain assets, such as real estate and business interests.
ASSET-BASED LENDING	Use concentrated stock as collateral and invest the proceeds.	» Liquidity provided without selling concentrated stock. » Mitigate tax liability. » Facilitates diversification.	» Restriction on use of assets used as collateral. » Reduction in underlying value of the assets, such as valuation impacted by market volatility or interest rate change, may require additional collateral to be added to further secure the loan.
STRUCTURED SALE	Systematic sale of concentrated stock over time.	» Tax mitigation by incurring smaller tax liability from the sale of small positions over a specified period, instead of from a large lump-sum sale. » Systematic and gradual diversification.	Although diversification may be achieved over time, concentration risk still persists in the short to intermediate time frame.
NET UNREALIZED APPRECIATION (NUA)	NUA, itself, is the difference between what you initially paid for the employer stock in your company's retirement plan and its current market value. The NUA tax strategy allows you to reduce overall taxes otherwise owed on company stock owned inside an employee's qualified retirement account.	» NUA tax strategy allows you to pay ordinary income tax only on the cost basis of the employer stock in your company's retirement plan. » The NUA tax strategy allows you to pay lower capital gains tax on the employer stock distributed outright to you and subsequently sold by you in the future, versus ordinary income tax treatment that would otherwise incur on the sale and distribution of proceeds from your IRA had employer stock been rolled over into your IRA, instead.	» NUA treatment of company stock held in a qualified plan requires that there must first be a triggering event, such as termination of employment, retirement, death, disability, or turning age 59½. » In general, a lump-sum distribution of company stock in the company plan is taken by the employee, with the balance of plan assets consisting of non-company stock rolled over into the employee's IRA. » NUA tax planning is a complex planning strategy that requires guidance from qualified wealth and tax advisors.

It's important to consider both planning and investment strategies, individually and together, as they may effectively reduce risk, mitigate tax impact and help achieve your goals.

Reach out to an advisor at Calamos Wealth Management to learn more at 888.857.7604 or cwmwealthadvisors@calamos.com.

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