DUNHILL FINANCIAL

STRATEGIES FOR DEALING WITH CONCENTRATED POSITIONS

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Hedging

- Protective Puts
- Cost-efficient Collars

Monetization

- Outright Liquation
- Staggered Exit

Diversification

- Margin
- Securities Lending

Income Augmentation

- Covered Call Writing

Gifting

- CRUT
- Gifting to Family

WHY SHOULD YOU CARE?

Diversifying an excessively large position can help reduce your risk significantly.

Once you have accumulated all your hard earned wealth, protecting it should be one of your priorities. You may have made your wealth as an entrepreneur and so therefore might have vast sums of wealth concentrated all within a single company. Too many eggs in one basket is never a good idea and could set your retirement and financial goals back by years if not managed correctly. Highly concentrated positions are often due to the following:

- Sale of a closely held private business that has gone public.
- Stock and option incentive programmes from your employer.
- A large inheritance encompassing a significant position in a handful of stocks.

Managing a concentrated equity position can seem complicated especially when we take into consideration taxes, sentiments & emotions and the fear of missing out. These issues are often at the forefront of investment decision making which often leads to poor decision making and excessive risk taking in certain situations.

At Dunhill Financial, our specialists are committed to providing the best solution that's specifically tailored to your needs. Each strategy has a number of highlights and not every one of those strategies is necessarily the answer to your needs. Our specialist will help determine the right bespoke strategy that's relevant to your objectives.

This document provides a high-level overview of the various strategies that can allow you to effectively manage these concentrated positions whilst mitigating excessive risks. As with all investments please consult a qualified financial and tax advisor to help you figure out if this is the right course of action for you.

HEDGING

Hedging is often the most common reason why an individual may seek professional advice on how to best manage their wealth.

After all, you've made it here because of the hard work and success you have achieved, it's only natural that you would like to capitalise on that and mitigate your future risks accordingly.

Hedging strategies encompass a subset of other strategies within the wider universe, with many involving the use of derivatives such as options. This allows you to protect against the tail risk of the position going against you, whilst controlling the degree of risk that you are comfortable with.

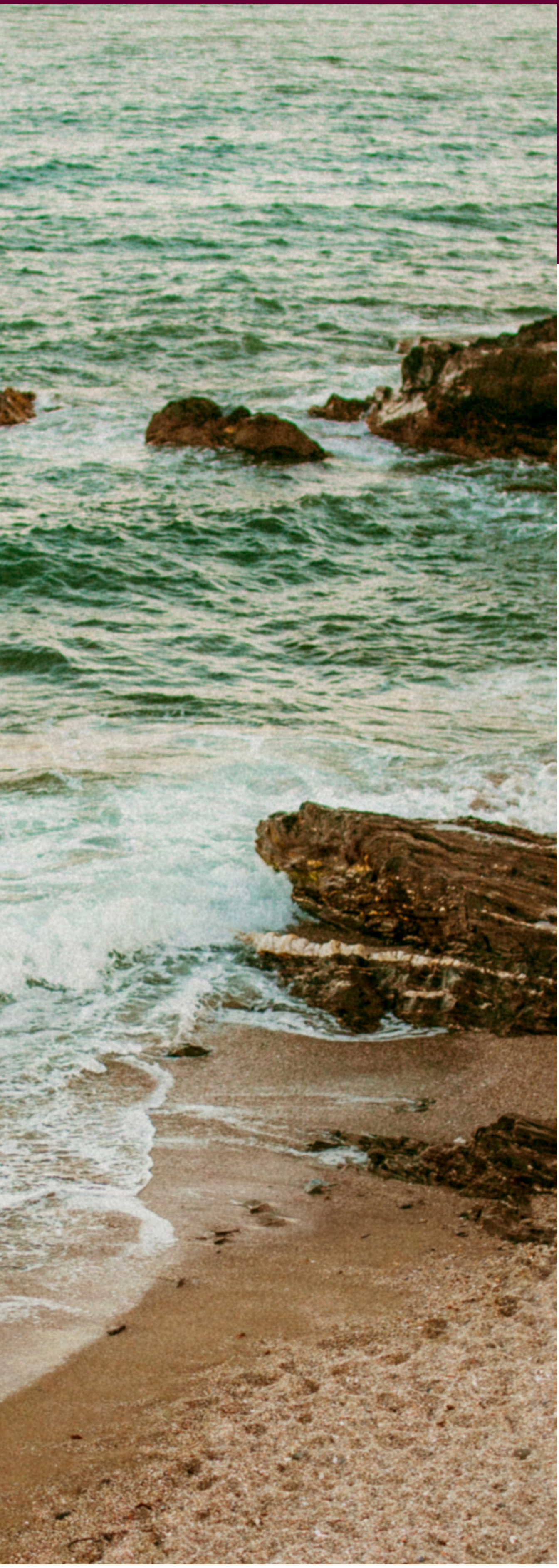
PROTECTIVE PUTS

A tool that is frequently used by financial professionals in helping clients deal with hedging their downside risk of sizable positions is through the use of buying “put” options. A put option is a contract giving the owner the right, but not the obligation, to sell or sell short–a specified amount of an underlying security at a predetermined price within a specified time frame. This predetermined price that the buyer of the put option can sell at is called the strike price.

Put options are traded on various underlying assets, including stocks, currencies, bonds, commodities, futures, and indexes.

This allows your downside to become capped in the event that your position experiences weakness and begins to pullback below a predetermined price known as the strike price. This strategy also allows you to capture any potential upside whilst overseeing the risk.

This strategy can be expensive depending on the underlying security and it’s volatility in addition to the prevailing market conditions at the time. Contracts typically have to be renewed on a perpetual basis in order to keep the protection and you could potentially lose any premiums within these timeframes.



COST-EFFICIENT COLLARS

A collar, also known as a hedge wrapper or risk-reversal, is an options strategy implemented to protect against large losses, but it also limits large gains. An investor who is already long the underlying creates a collar by buying an out of the-money (OTM) put option while simultaneously writing an out-of-the-money call option. The put protects the trader in case the price of the stock drops. Writing the call produces income (which ideally should offset the cost of buying the put) and allows the trader to profit on the stock up to the strike price of the call, but not higher.

OPTIONS CONSIDERATIONS

While one or more hedging alternatives may be appropriate to help decrease the risk associated with a concentrated position, it is important to remember that options themselves incur risk and are not suitable for all investors as they are derivative instruments.

MONETIZATION

Annuitizing the position is a way of generating cash flow from a concentrated position.

This is often used if the continued exposure to the underlying security is desirable and/or beneficial. This approach of monetization may be achieved via the underlying security providing dividends or a blend of derivative strategies such as options and selling contracts to collect premiums.

This allows for a staggered exit and/or reduction of the concentration in the position allowing a far greater fidelity to the taxable obligations.

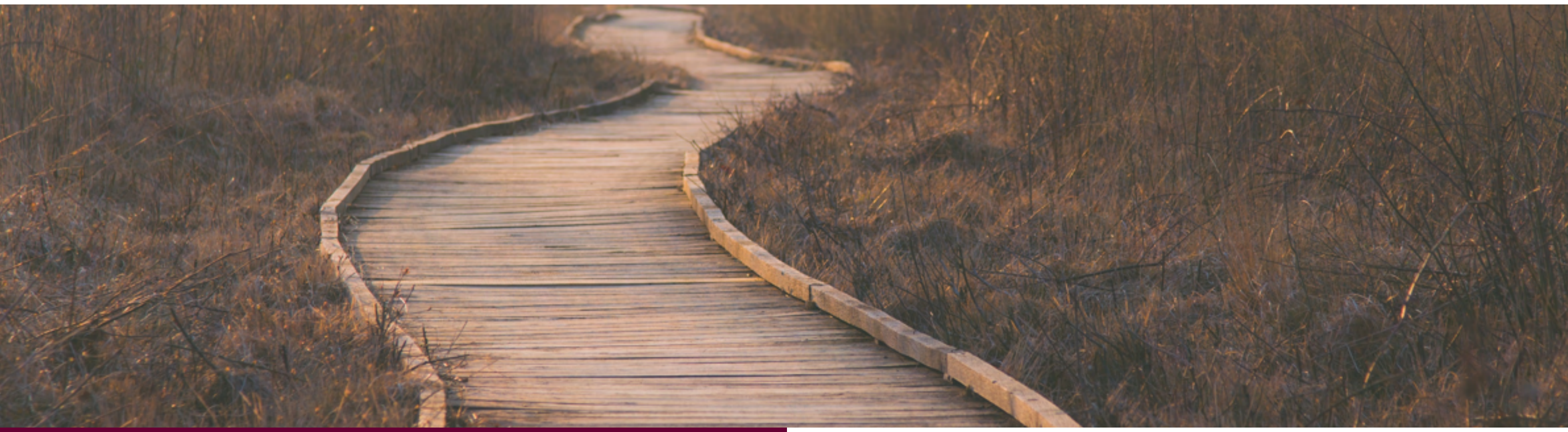
STAGED EXIT

A simple yet effective strategy of reducing hazard imposed due to top heavy positions is to simply wind down a portion of the stock whilst using the proceeds to reinvest into a diversified portfolio.

Selling your position in its entirety can result in consequential capital gains taxes due to the low cost basis of the underlying securities. This strategy is often combined with others in order to manage the risks associated with a concentrated position whilst ensuring that taxes do not become burdensome.

As always we recommend consulting with a tax specialist before any strategy is implemented. Jurisdictions can have a large impact on the overall tax liabilities especially as an expat, so it’s worth paying close attention to.

TAX-EFFICIENT DIVERSIFICATION



Diversifying a condensed equity position can help control your risk. Some methods of diversification may invoke immediate tax obligations; however, there are a number of strategies that can be used to achieve an overall diversified net worth in a tax efficient manner.

ETFs

An ETF can be a suitable avenue to explore in your journey to diversify your wealth without having to sell any shares outright. An ETF allows you to contribute your underlying shares in kind and receive a number of shares in return within a wider basket. A great benefit of such a strategy is that this swap is not considered a taxable event due to no sale taking place. This strategy although viable and tax efficient is not generally recommended due to the large minimums and excess upfront capital required to effectively implement. Furthermore this strategy may not be available for all underlying securities.

MARGIN STRATEGIES & STOCK LENDING

Margin and stock lending strategies allow you to leverage your underlying stock position to unlock equity that would be otherwise unavailable and tied down to the existing position all without having to completely sell out of your holdings.

This typically involves borrowing cash from our custodian/broker/private bank whilst holding your underlying stock in the account as collateral. This allows you to effectively borrow a percentage of the overall value, which can then be reinvested in a diversified mix.

It is often a recommended strategy in combination with a blend of other strategies mentioned herein for individuals and high net worth families, especially as the current interest rates on the loan are very competitive as outlined in the fees section below.

INCOME AUGMENTATION

Sometimes generating an income is the best course of action especially if the underlying stock is likely to be held for longer periods of time and/or preferable to keep exposure in the name due to the rapidly growing industry and disruptive innovation.

This allows clients with large positions in certain stocks to obtain a regular stream of income either via regular dividends or generating artificial income via the use of derivatives such as options for growth oriented stock that do not pay any dividends.

COVERED CALLS

Covered calls allow you to supplement the existing income from a concentrated position or generate cash flows where none existed prior. Selling covered calls allow you to receive a lump sum of cash upfront, often referred to as the "premium" however this then means you are obligated to sell the underlying stock at the determined price commonly known as the "strike price" if the stock were to trade above the range close to expiry. This strategy can limit your potential upside and can invoke capital gains if the underlying security is forcibly sold due to exercise/assignment.

TAX-EFFICIENT GIFTING

Leaving a legacy is sometimes more meaningful than anything else.

Various gifting strategies can also be used in combination with the aforementioned to help leave a lasting impact and achieve philanthropic objectives all the while managing your taxable obligations.

CHARITABLE REMAINDER TRUSTS (CRUT)

Further assets can be structured into a donor advised fund (DAF), such as a Charitable Remainder Unitrust (CRUT) in order to minimize the estate tax obligations.

This allows the donor to have a reliable stream of income, whilst minimizing if not eliminating the tax obligations for capital gains.

This also allows you to donate money to a cause that you feel passionate about and also benefiting from the trust not having to pay capital gains tax when it sells an asset within the confines of the trust due to the tax exempt nature of the charitable trust.

GIFTING TO FAMILY MEMBERS

Gifting to family members can be a tax efficient way of passing wealth onto the next generation. The annual gift tax exclusions allow you to gift up to a certain threshold for each beneficiary without having to worry about any generation skipping or gift taxes. These gifting limits are subject to change due to the shifting political landscape, so these should be discussed with our specialists and tax advisors to determine the suitability.

FEES

Fees for each strategy can vary dramatically depending on the underlying security and the prevailing market rates as well as the interest rates.

Option strategies are typically the most expensive, however these can be mitigated and or enhanced in your favour depending on the type of strategy selected. They are not always immediately available especially for newer issues of stock that have just gone public.

Margin & Line of credit strategies allow you to unlock a percentage of equity that is tied up in a position in order to diversify your overall portfolio and net worth without having to necessarily sell any position right away. This is extremely cost effective and allows your advisor to build a bespoke portfolio solution around your existing concentrated position.

Fees vary again depending on the overall size of the concentrated position, however rates for margin and lending strategies are very competitive.