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Seperately Managed Accounts: A Customized Approach to Investing

Separately managed accounts are custom portfolios that investment professionals manage for high-net-worth investors. In return for maintaining a minimum balance that can range from a low of approximately $100,000 to a high of several million dollars, the investor receives personalized service, customized asset allocation, and long-term planning.

Investors typically approve the selection of the portfolio manager and help set certain investment parameters — a preference for socially responsible stocks, for example. The portfolio manager oversees the account with the objective of helping the investor pursue financial goals and, potentially, reducing or delaying capital gains. Investors who face special situations — such as holding a substantial position in a single company's stock — may find separately managed accounts helpful in managing risk.

Separately managed accounts differ from traditional brokerage accounts in that investors pay a percentage of assets for a combination of services instead of paying on a per-transaction basis. Unlike a mutual fund, a separately managed account does not pool assets. The investor owns the securities held within the account and maintains voting rights and other privileges typically afforded to shareholders.

As your income and net worth increases, your financial planning may also become more complex. Tasks such as diversifying a portfolio that includes concentrated holdings and improving tax efficiency can perplex even a sophisticated investor.

Some investors have found a solution to these and other issues in separately managed accounts. Here's how they typically work: Together with your financial advisor, you select an experienced portfolio manager who analyzes your investment goals and preferences, as well as your current holdings. The manager constructs a custom portfolio and, in some cases, issues a written investment policy statement that is based on your needs and will guide future buy and sell decisions. Unlike with a mutual fund, you alone own the securities in the portfolio -- not just a share of them -- and you have ongoing input concerning their management.

Because a separately managed account entails a high level of service, investors typically are required to maintain a minimum balance that can range from a high of several million dollars to a low of approximately $100,000, depending on the firm.

Customized Allocations

The primary appeal of separately managed accounts lies in the portfolio manager's ability to tailor the asset allocation and diversification to your needs. For example, if a business or a single company's stock represents a large portion of your net worth, the portfolio manager can help you enhance your level of diversification and hedge the risk associated with concentrated positions. Or if you prefer to maintain a socially responsible portfolio, you might instruct the manager to avoid stocks of companies that conduct alcohol- or tobacco-related businesses or to favor the stocks of companies with enlightened environmental or social policies.

If it's important to you to maintain a given investment style -- such as growth or value investing -- the portfolio manager is required to adhere to your preferences. In other words, you can avoid style drift sometimes associated with mutual funds. Also, if you want to remain fully invested, the portfolio manager is not required to maintain a cash position in order to accommodate the redemptions of other shareholders, as would be the case with a mutual fund.

	Separately Managed Account	Mutual Fund
Minimum Balance	From $100,000 to several million, depending on firm	Depending on firm, can open an account with as little as $50
Security Selection and Asset Allocation	Manager makes decisions based on your objectives	Depends on the fund's investment objectives
Timing of Trades	Manager makes decisions based on your objectives	At discretion of portfolio manager
Capital Gains	Based on your objectives, can be reduced or delayed	Capital gains distributions are out of shareholder's control
Account Management	Financial advisor helps you select portfolio manager	Portfolio manager is selected by the mutual fund firm
Support	Professionals undertake investment planning, portfolio management, performance measurement, and trading according to parameters you establish	You can use telephone support, Web sites, and branch offices, depending on the firm. A personal representative may be available

Tax Strategies

Another compelling advantage of a separately managed account is the potential for tax efficiency. A mutual fund may pass along to an investor built-in taxable capital gains that accumulated prior to the investor's purchase of the shares. Because the portfolio in a separately managed account is assembled from scratch, the investor doesn't inherit anyone else's tax consequences.

In addition, the manager of a separately managed account can pursue a low turnover ratio (a measure of how frequently assets are bought and sold) in order to minimize tax consequences. The manager can also work with your tax advisor to employ loss-harvesting techniques, if appropriate, offsetting gains with losses, for example. Another technique that might be used is "doubling up," which involves recognizing a loss on a particular stock for tax purposes while still holding a position in that stock.

Finally, separately managed accounts may enable investors to more easily carry out certain gifting strategies for estate planning and tax purposes.

Getting Started

When exploring the world of separately managed accounts, you'll start the same way you would with any other type of investment vehicle -- by identifying your goals, assessing your time horizon, and determining your risk tolerance. In most cases, you'll meet with the portfolio manager prior to initiating the relationship.

The portfolio manager typically is someone who has undergone a rigorous screening process and has extensive experience in wealth management for high-net-worth investors. Before the selection is confirmed, you'll often have an opportunity to review the individual's track record managing the types of investments that you desire. If personal meetings with the portfolio manager are important to you, you may be able to request someone within a given geographic proximity.

After the portfolio manager begins investing on your behalf, he or she typically will be monitored on two levels. First, the investment firm will monitor the portfolio manager's performance. Second, you'll receive periodic performance updates and you may have an opportunity to meet with your portfolio manager occasionally to review your investments. If you or the investment firm are unhappy with the portfolio manager's results, you may be allowed to select another manager.

Fees and Other Considerations

You should be aware of the fees that you'll pay for your account, which may run as high as approximately 1% to 3% of assets per year. This percentage generally includes investment planning, portfolio management, performance measurement, and trading commissions, but it may or may not include the asset management fees associated with the underlying subportfolios. Because account fees normally involve a package of services, you may be able to save on custodial and other services that might otherwise entail additional charges.

While separately managed accounts have many benefits, they aren't for everyone. You may not be able to liquidate portions of your account as quickly as you could shares in a mutual fund. You will receive periodic performance updates, but you may not be able to track the value of your account as frequently as you could with a mutual fund. And while the fees encompass a range of services, they may be higher than the expense ratios of some mutual funds.

During the past few years, the financial services industry has reduced minimum balances on separately managed accounts. These lower minimums mean that personalized service, customized asset allocation, and long-term planning are available to a greater number of investors who have accumulated wealth. If this sounds like you, and you need help managing a complex portfolio, you may want to explore separately managed accounts.