Mariner
WEALTH ADVISORS

Strategies for Managing Concentrated Stock in a Diversified Portfolio

A concentrated stock position that might help create wealth could eventually present risks to your portfolio and financial peace of mind.

When you have a concentrated stock position, consider consulting with your advisor about how it fits into a diversified wealth plan.

What is a concentrated stock position?

A concentrated stock position is a single stock holding that is more than 10% of a clients total investable assets. There are many ways you could have a concentrated stock position including through equity-based compensation, inheritance of a sizeable single stock position and from receiving stock in a publicly traded company as part of the sale of a closely held business.

> *“Concentrated stock positions can represent a fortunate outcome for some investors but do come with significant potential risks.”*

Vesting to Receive Stock Shares

One form of concentrated stock is a restricted stock unit (RSU). Companies typically offer employees RSUs held in a brokerage account. Once vested, employees can do what they want with the shares. If you leave the company before you’re vested, you forfeit your shares. RSUs are typically assigned a fair market value and considered income, therefore part of the shares are withheld to cover income taxes.

It’s important to consult with a wealth advisor and tax professional who can help you decide when to sell your stock while being aware of the capital gains tax it will trigger.

Understanding the Risks

Outsized or concentrated positions in a single stock might expose an investor to excessive (and potentially uncompensated) risks. As one example, a blue-chip stock could lose its allure abruptly, resulting in a steep price decline. Alternately, for example, a company could experience cyclical swings in profitability, which might cause its stock price to materially deviate from the broader market. And the broad equity market historically has had its own ups and downs.

For these reasons it is recommended that you evaluate stock concentration before circumstances demand it and consider diversifying your position.

5 Ways You Can Diversify a Concentrated Stock Position

1. Incrementally Selling Shares
2. Net Unrealized Appreciation (NUA)
3. Using Options to Hedge the Position
4. Gifts of Stock
5. Donate Shares to a Trust

Incrementally Selling Shares

A sale of stock is might be the most appropriate and simplest means of reducing a concentrated stock position. Tax considerations, potential market impact, reinvestment of proceeds and timing of sales, however, are all elements for you to consider within the context of a coordinated personal wealth management plan.

If your shares are subject to Rule 144 (or are otherwise subject to restrictions) additional considerations might be appropriate. For example, filing for a 10b5-1 plan to demonstrate your selling decisions in advance, while specifying a formula to control the trading of the shares over a specific period of time, might be appropriate.

Alternatively, you and your advisor may want to discuss the use of a blind trust. A blind trust may be managed by a discretionary trustee who can determine how much will be sold, at what price and when. A trustee can also consider incorporating various hedging strategies.

Net Unrealized Appreciation (NUA)

An NUA strategy allows investors to pull low basis, highly appreciated stock out of the corporate retirement account and pay ordinary income tax on the basis only. Because the stock is removed from the qualified account, the net unrealized appreciation, or the difference between the basis and the current price, is taxed when it is sold at a long-term capital gain.

Using Options to Hedge the Position

You also might consider using singular or multiple combinations of options to help guard against a significant drop in stock value. For example, purchasing a put option is similar to buying insurance against the risk of loss (below a certain level) in your stock. A protective put option provides an investor the right (but not the obligation) to sell all or a portion of his or her shares at a predetermined price. Similar to insurance, if the price of the stock goes up, the value of the option could expire worthless. For this reason, purchasing puts should only be considered as part of a comprehensive plan.

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In addition to purchasing puts, selling call options (attached to the underlying stock position) can provide income (and some level of price protection) against a decline in share value. Selling call options limits participation in future price appreciation, so it should be considered as part of a larger, systematic strategy.

You may also want to consider option combinations. For example, a cashless collar combines the two previous strategies of buying protective puts while also selling calls. Based on market pricing and parameters, premiums received from selling the call options may partially or fully offset the cost of buying the put option (and thus the “cashless” reference).

The components of a cashless collar:

- Purchasing a put gives the investor the right (but not the obligation) to sell stock at a predetermined price.
- Simultaneously, the investor may sell a call, providing another investor the right to purchase the stock at a predetermined price.
- The premium earned on the call may be used to offset the cost of the put.
- The taxability of this option contribution differs, based on the underlying components and their tenure, and must be analyzed as part of the larger strategy in advance.
- Hedging incentive stock options before or shortly after exercise creates a separate and special set of considerations, since hedging during the first year after exercise might be a disqualifying disposition and trigger ordinary income taxes.
- In addition to general taxability, special tax rules might apply, as some transactions could be considered a "constructive sale." Consider seeking the advice of a tax professional before beginning an options-based disposition strategy.

Gifts of Stock

Outright gifts of concentrated stock might be a part of a larger plan but should be considered within the context of an investor's estate and estate taxes.

Gifts are subject to annual limitations (as to taxability). Work with your wealth advisor, estate and tax professionals to help analyze your estate or estate tax considerations in advance.

Donate Shares to a Trust

By donating highly appreciated stock to a charitable remainder trust (CRT), you might be eligible to receive a tax deduction at the time of the contribution. The trust's future payout rate may be managed in a manner conducive to income objectives or tax planning, as appropriate.

Gifts to the trust would be treated as irrevocable donations that could subsequently be sold to diversify or to create income. In most circumstances these sales would not trigger immediate capital gains tax at the time of sale.

In addition to these more common tools, there are several methods to manage concentrated positions, although they often involve additional risks, costs and complexity.

Summary

Concentrated stock positions can represent a fortunate outcome for some investors but do come with significant potential risks. And, to help minimize risk, they should be part of an overall, diversified portfolio.

Mariner Wealth Advisors offers professional resources to analyze your situation. We will work to develop a strategy that considers your objectives and time horizon, how your securities are titled and any restrictions that apply, while simultaneously considering your investment objectives, including charitable aspirations, as well as applicable fees, costs, complexity and potential tax impact.

For more information visit: marinerwealthadvisors.com

Sources:

"Restricted Stock Unit"

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