Concentrated Stock Risks: How to Protect Your Wealth and Achieve Long-Term Goals

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Many investors find themselves with a substantial portion of their wealth tied up in a single company. This might come from executive compensation, an inheritance, or just savvy stock picking. What starts as a well-balanced portfolio can easily become dominated by one stock, especially in regions with booming tech sectors.

When a single stock makes up more than 10% of your portfolio, you're taking on more risk than you might realize. It's easy to overlook this risk if you're confident about the stock's future or trying to avoid taxes. However, excessive concentration can lead to significant losses and threaten your long-term financial goals.

So, how should you handle a concentrated position in your portfolio? It really comes down to your financial plan and long-term objectives. Some may need to sell part of their holdings to invest in income-generating assets, while others might wish to pass their wealth to heirs. To navigate this, consider these questions:

- Do you need immediate cash flow?
- How much risk are you willing and able to take?
- How much tax are you prepared to handle?
- What's your and the analysts' outlook on the stock?

There are various strategies to reduce risk and manage taxes, each with its pros and cons. Often, a combination of approaches works best. It's a good idea to discuss these with your wealth consultant and tax professional to find the right strategy for you. If you're curious about how Evergreen can assist you, click here to take our client compatibility survey.

Selling Shares

The most straightforward approach is to sell some or all of your shares. While this may not be the most tax-efficient short-term solution, it can be managed through a well-thought-out plan. By selling shares gradually and considering your tax situation, you can reduce the tax impact and avoid selling at an inopportune time.

Hedging Strategies

If you can't sell your stock or want to avoid immediate taxes, you might consider hedging strategies. One option is using equity collars, which involve selling call options (allowing someone to buy your stock at a set price) and buying put options (allowing you to sell your stock at a set price). These strategies can be complex and have significant tax implications, so working with a tax advisor is crucial.

Exchange Funds

Exchange funds let you swap your concentrated stock for a diversified mix of stocks, offering immediate diversification without a taxable event. However, these funds often require a commitment of several years and may come with higher fees and minimum investments. While they help manage company-specific risk, they don't eliminate capital gains, as your original cost basis remains.

Qualified Opportunity Zones

Qualified Opportunity Zones offer a way to defer gains from sales, though they don't eliminate them. Created to provide preferential tax treatment for investments in economically distressed areas, these zones allow for deferral of the gain until a future date, with potential tax-free gains on the invested amount if held long-term. These funds have high minimums and varying returns, but they might suit those looking to defer significant capital gains.

Gifts to Loved Ones

If the stock isn't needed for your retirement or cash flow, consider gifting it to loved ones. This can remove the stock from your estate and potentially shift the tax burden to beneficiaries in lower tax brackets. You can also make gifts to trusts to restrict access to the funds. Remember, the recipient inherits the original cost basis, so discuss tax implications with them beforehand.

Charitable Giving

For those with philanthropic goals, donating appreciated stock to charity can be a great way to reduce exposure. Charitable Remainder Trusts (CRTs) offer an immediate tax deduction while providing income to you. The assets are diversified, and after the trust ends, they go to a chosen charity. Donor Advised Funds (DAFs) allow you to make larger contributions in one year to maximize tax deductions, then distribute to charities over time. These options are valuable for those committed to giving back.

When Not to Sell

Sometimes, keeping a concentrated position makes sense, especially if you plan to pass it on to heirs. This way, they receive a stepped-up cost basis and can diversify without triggering capital gains taxes. Always review this decision in the context of your overall financial and estate plan to find the best strategy for your situation.

1. IRS Opportunity Zones FAQ

2. IRS Estate and Gift Tax Updates

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