

# Diversifying Concentrated Stock Positions Using Exchange Funds

## A TAX-EFFICIENT DIVERSIFICATION STRATEGY FOR PG RETIREES

### EXECUTIVE SUMMARY

Most Procter & Gamble retirees accumulate a significant concentration in PG stock over the course of their careers. While this concentration can be a source of pride and financial success, it also introduces substantial portfolio risk.

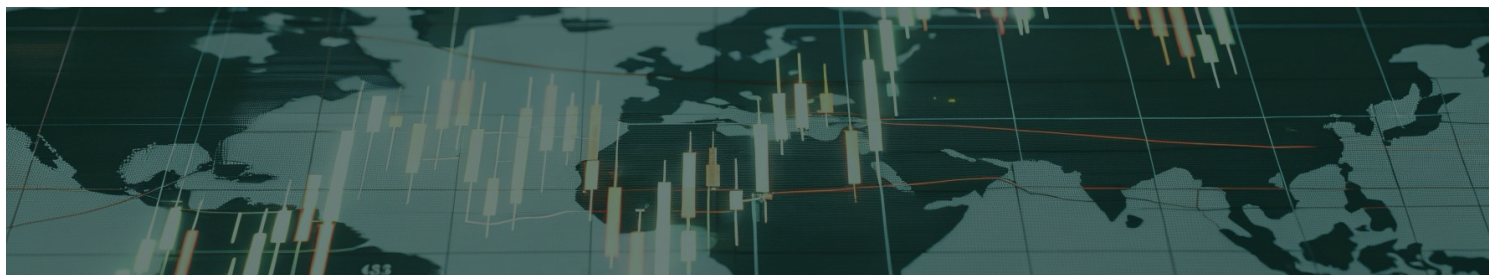
Exchange funds offer a powerful, tax-efficient solution for diversifying concentrated stock positions without triggering immediate capital gains taxes. This whitepaper explains how exchange funds work, their benefits, limitations, and how they can be used strategically within a broader wealth management plan.

## Risks of Concentration in a Single Stock

PG'ers accumulate large positions in PG stock through decades of PST contributions, and sometimes via LTIP and employee stock purchase plans. While concentration in PG stock can sometimes accelerate wealth accumulation, there are risks that must be considered:

### KEY RISKS INCLUDE:

- Volatile Return Profile
- Lack of diversification
- Tax constraints, especially if holding low basis preferred stock



## What Are Exchange Funds?

An exchange fund is a pooled investment vehicle that allows investors to contribute highly appreciated stock, such as preferred shares of PG once distributed from the PST Plan via NUA, in exchange for a diversified portfolio without triggering an immediate taxable event.

## HOW EXCHANGE FUNDS WORK

- Stock Contribution to Exchange Fund Provider
- Pooling of Assets from multiple contributors, with differing concentrations, pooled together to mimic an index
- Diversification Benefits via pooling of contributed stock holdings
- Holding Period (typically 7 years)
- Redemption into a basket of diversified securities

## TAX TREATMENT

- No capital gains at contribution
- Cost basis carries over post-share redemption
- Continued tax deferral until securities are sold after redemption

## IMPORTANT CONSIDERATIONS & RISKS TO EXCHANGE FUNDS

- Illiquidity (7-year lockup)
- Accredited investor requirement
- Less control over holdings
- Fees
- Potential Tracking error

## ALTERNATIVE STRATEGIES

- Gradual selling
- Direct indexing pre-retirement to accumulate capital losses
- Options strategies, such as Covered Calls
- Charitable giving, and the utilization of Donor Advised Funds or Charitable Trusts
- Potential Tracking error

## CONCLUSION

Exchange funds provide an solution for diversifying a concentrated PG position in a tax-efficient manner while implementing a sustainable long term investment position.

## WHY EXCHANGE FUNDS ARE EFFECTIVE FOR PG RETIREES

- Maintain tax deferral
- Achieve immediate diversification without incurring capital gains
- Maintain equity market exposure
- Reduce emotional barriers to portfolio construction

## TIMES WHEN EXCHANGE FUNDS MAKE SENSE

- \$1M+ concentrated position, or excess exposure to PG stock via other holdings on balance sheet, such as LTIP rosters
- Significant unrealized gains
- High tax bracket
- Long-term horizon for liquidity need from contributed stock