

CONCENTRATED EQUITY STRATEGIES



---

**COMMON INVESTOR OBJECTIVES:**

**MANAGE YOUR ASSETS.  
PROTECT YOUR WEALTH.  
BUILD YOUR LEGACY.**

A concentrated holding of stock in a single company is one component of wealth management that affects many successful individuals and their families.

Strategies for management of these concentrated holdings involve complex and time-consuming issues that can be challenging for even the most sophisticated investor.

Because your Raymond James financial advisor understands your unique personal situation, he or she can help you determine how the following information may apply to you. Your advisor can then assist you in the development and implementation of strategies that are customized to your needs.

---

Often, the very asset that has led to the creation of significant wealth is the one that poses the biggest risk to future financial security. Stock and option incentives from your employer allow for participation in a company's growth. A large inheritance may come in the form of a significant position in a single security. A sale of a closely held business for shares of a publicly traded company is increasingly common.

While each of these scenarios can create wealth within a family, they can also lead to the accumulation of a disproportionately large concentration of net worth in one security. This sort of concentrated equity position can add significant risk and volatility to your portfolio, since price changes in the security can have a major affect on the overall wealth and future financial security of you and your family.

Tax issues created by the sale of the stock, emotional attachment to the company, bullish sentiments on the stock's future or concerns about insider status at the company may paralyze otherwise rational investors to the point of inaction. Here we present several strategies that may be appropriate for those who wish to mitigate the risk of over-concentration. Of course, as with all investment decisions, determining the right course of action is dependent on your individual circumstances. You should consult with your financial and tax advisors before employing any of the strategies described below.

The concentrated equity techniques discussed in the following pages can be summarized in four general categories:

- Hedging,
- Monetization,
- Tax-Efficient Diversification and
- Tax-Efficient Gifting.

Options trading involves risk and is not suitable for all investors.

Supporting documentation for any claims (including any claims made on behalf of our options programs or our options expertise), comparisons, recommendations, statistics or other technical data will be supplied upon request.

There is a pronounced skew in single-stock returns. While the additional return potential for holding the right stock is substantial, significant underperformance has been four times as likely.

Source: Bernstein Wealth Management Research, 2004.

Options may be executed in the listed or over-the-counter (OTC) markets. Often, investors with larger positions (greater than \$1 million) can benefit from the customization of the OTC market. OTC options will, however, expose the investor to the credit risk of the counterparty on the trade.

The fees charged in an OTC collar vary by transaction and are generally 3% or less. Factors such as the size, duration, and structure of the collar impact the fee, which is built into the structure and may affect the calculated floor and/or ceiling values of the OTC collar.

## Hedging

Options and other types of derivative securities can allow retention of the stock position and any ownership rights. This approach can help protect against downside risk, too, by allowing you to specify the amount of risk you are willing to accept – and then controlling that risk for a fixed premium. While one or more hedging alternatives may be appropriate as methods for decreasing the risk associated with concentrated positions, it is important to remember that options involve risk and are not suitable for all investors. You should obtain a copy of a current Options Disclosure Document from your financial advisor or from the address on the back cover of this brochure before choosing these types of strategies, which are described below.

### Protective Puts

A common way to hedge potentially poor performance of a large holding is to buy put options. Put contracts give you the right to sell the underlying shares of stock at a predetermined strike price at or before a specified future date.

This places a definitive limit on any potential losses while preserving upside potential. However, this benefit comes at a price: the premiums associated with options can be expensive, contracts must be continually renewed and you can lose the full cost of purchasing the protective put in a short period of time. This strategy raises the breakeven price on the underlying security by the amount of the put premium.

### Covered Calls

The selling of covered calls is a common strategy for increasing the income from a large stock position. A call option seller receives an upfront cash premium, thereby becoming obligated to sell the stock at a predetermined price (the strike price). If the stock appreciates above the strike price, it may be sold, thus limiting your potential upside in the stock and triggering capital gains taxes. It is important to note that the income earned from covered call option writing does provide limited downside protection, but only up to the value of the income. This strategy does not usually provide protection from significant downward price movements.

### Low Cost Collars

This strategy is basically a combination of the previous two. It is used for hedging downside risk in the stock without incurring the full cost associated with a protective put. By selling a covered call option and buying a protective put option at the same time, you have the potential to offset some or all of the put premium's cost. Be aware that the call option component of this strategy limits the potential upside in the performance of the stock. Effectively, a collar allows you to lock in a minimum and maximum value of the holding until expiration. Collars executed in the listed options market may include significant transaction costs since they involve multi-leg option strategies.

#### SAMPLE OTC COLLAR TRANSACTION

Number of shares	100,000
Current price	\$50
Total value	\$5,000,000
Put (floor) price	90% (\$45)
Call (ceiling) price	120% (\$60)
Net premium	0% (\$0)
Term	24 months

Closing Price	Client's Value	Client's Total Value	Value Protected	Profit Participation
\$25	\$45	\$4,500,000	\$2,000,000	\$0
\$35	\$45	\$4,500,000	\$1,000,000	\$0
\$40	\$45	\$4,500,000	\$500,000	\$0
\$50	\$50	\$5,000,000	\$0	\$0
\$55	\$55	\$5,500,000	\$0	\$500,000
\$60	\$60	\$6,000,000	\$0	\$1,000,000
\$75	\$60	\$6,000,000	\$0	\$1,000,000

This example is for illustrative purposes only and does not reflect the performance of any specific investment.

## Monetization

“Monetization” is another term for generating cash from a stock position. While an immediate sale solves the concentration issue, there are other techniques that may be more appropriate from a tax-planning perspective.

### Outright Sale

The most obvious method for reducing the risk of a concentrated position is to simply liquidate a portion of the stock and use the proceeds to invest in a more diverse range of securities. Many investors resist this strategy because selling outright may result in significant capital gains taxes related to the low cost-basis of the stock. Investors should avoid basing the decision to sell exclusively on the tax impact. Depending on the situation, selling the shares and paying the taxes may be the most acceptable and immediate solution for your lack of portfolio diversity.

### Affiliate Transaction Plans (10b5-1 Plans)

Executives at a company must deal with additional issues when selling employer stock. Your Raymond James financial advisor can assist in a variety of executive solutions. Senior executives wishing to sell some of their shares can employ a 10b5-1 Sales Plan. This solution allows the executive to set up a tailored sales plan while in an open trading window that can be executed over time, even during trading black-outs. This can be an effective sales strategy for executives who have specific liquidity needs or desired price targets.

#### SAMPLE VPF TRANSACTION

Number of shares	100,000
Current price	\$50
Total value	\$5,000,000
Put (floor) price	100% (\$50)
Call (ceiling) price	120% (\$60)
Upfront payment	85% (\$4,250,000)
Term	24 months

### Variable Prepaid Forward

A variable prepaid forward (VPF), another common technique for monetizing a large stock position, can address some of the concerns associated with an immediate sale. A VPF provides similar protection to a collar, but with the added benefit of providing you with an immediate cash payment. A VPF is an agreement to sell a variable number of shares at a specified future date (typically one to five years) in exchange for an upfront cash payment. This cash advance is normally between 70% and 90% of the stock’s current market value and is determined based on factors such as the stock, size, duration and structure being executed.

It is important to note that VPFs protect against losses related to downside movement in the stock price (at an amount equal to the initial cash payment), but may also limit potential upside in the stock. At the contract’s expiration, you are responsible for delivering a number of shares (or the cash equivalent) as determined by the stock price at that time. Tax on the sale of the shares is generally deferred until the contract expiration date. Seek counsel from your tax advisor about your specific situation, since tax consequences may impact this strategy.

The initial proceeds from a variable prepaid forward can be used to invest in a diversified portfolio. Meanwhile, you still maintain a limited upside in the performance of the stock, continue to receive the current dividend and potentially defer the capital gains taxes associated with the eventual sale.

The fees charged in a VPF vary by transaction and are generally 3% or less. Factors such as the size, duration, and structure of the VPF impact this fee, which is built into the discount on the upfront payment.

% Change	Stock Price	SHARE DELIVERY		Net Value Retained by Client
		Shares Delivered	Shares Retained	
-50%	\$25	100,000	0	\$0
-25%	\$37.50	100,000	0	\$0
-15%	\$42.50	100,000	0	\$0
-10%	\$45	100,000	0	\$0
-5%	\$47	100,000	0	\$0
0%	\$50	100,000	0	\$0
5%	\$52.50	95,238	4,762	\$250,000
10%	\$55	90,909	9,091	\$500,000
15%	\$57.50	86,957	13,043	\$750,000
20%	\$60	83,333	16,667	\$1,000,000
30%	\$65	84,615	15,385	\$1,000,000
50%	\$75	86,667	13,333	\$1,000,000

This example is for illustrative purposes only and does not reflect the performance of any specific investment. The “Net Value Retained by Client” column equals the product of the shares retained and the assumed stock price at maturity.

Exchange funds are offered as private placements and are not registered under the Investment Company Act of 1940. Therefore, they have strict net-worth requirements that must be met. Your financial advisor must be aware of your investable net worth and other important information before this strategy can be evaluated or recommended.

## Tax-Efficient Diversification

### Equity Exchange Funds

Using an exchange fund can be a viable alternative for those who wish to achieve diversification without selling shares outright. Exchange funds essentially allow for shares of the stock to be contributed to a diversified fund in exchange for a pro rata share of ownership in the resultant portfolio. A major benefit here – besides the increased diversification – is that because the stock isn't actually sold, capital gains taxes are not incurred. However, you still face the risk of loss if the other stocks in the pool decline in value, so be aware that diversification does not ensure a profit or protect against a loss. There are other considerations regarding this technique that should be discussed with your financial advisor, including, but not limited to your time horizon, liquidity of exchange fund shares, objectives and actual holdings within a particular fund, eligibility of particular stocks, and net-worth requirements.

### Managed Account Solutions

Another technique for diversifying a position is to use a professional portfolio manager to execute an agreed-upon, customized strategy. There are many strategies that can be implemented to help manage your concentrated position. Your Raymond James financial advisor can assist in reviewing the alternatives to find a solution that aligns with your objectives.

### Borrowing Using Margin

A leveraging strategy addresses the risk related to concentrated positions by using the large stock position as collateral to purchase other investments. This strategy – often referred to as margining securities – may be appropriate in some cases, but it involves an incremental degree of risk that should be evaluated with your advisor.

Margin may be an appropriate method for addressing concerns of a concentrated position if these risks are well understood; however, it may be used more effectively in combination with other techniques described in this brochure.\*

### Net Unrealized Appreciation

Because of the growth of employer savings plans to meet retirement goals, it is not uncommon for employees to have a significant amount of employer stock in their qualified retirement plans. When it comes time for employees to leave the nest, most are willing to directly roll over all qualified plan assets into a traditional IRA. However, there may be another option that should be considered – one that offers significant tax advantages.

By not including the employer stock in the traditional IRA rollover when you retire, you're exposed to income taxes immediately as a taxable distribution. However, the taxes due will be applied only to the cost basis of the stock.

\*Borrowing on margin and using securities as collateral may involve a high degree of risk and may not be appropriate for all investors. Market conditions can magnify any potential for loss. If the market turns against the investor, he or she may be required to deposit additional securities and/or cash in the account. The securities in the account may be sold to meet the margin call, and the firm can sell the investor's securities without contacting them. The interest rates charged are determined by the amount borrowed.

The remaining untaxed value, called net unrealized appreciation, is deferred until later sale – and then only at favored capital gain rates. If the cost basis of the employer stock is much lower than the current market value, exposing the stock to taxes now may be more advantageous in the long run than eventual distributions taxed at ordinary income tax rates. While this strategy does not result in immediate diversification, it can be used effectively in combination with other techniques to help you diversify your holdings.

## Tax-Efficient Gifting

Some methods for reducing concentrated equity risk can also help you leave a long-standing and meaningful legacy. Consider these ways to achieve philanthropic or generational transfer goals while lessening your tax obligation.

### Charitable Remainder Trusts

Charitable remainder trusts (CRTs) allow for the donation of an asset – in this case a portion of a concentrated stock position – to a donor-controlled trust. The owner can then sell the stock and reinvest in a diversified portfolio – and you will continue to receive a stream of income over a set number of years or for the duration of your lifetime. When this period expires, the remaining assets in the trust become the property of the chosen charity.

Because this charitable trust is itself a tax-exempt entity, donating shares to a CRT helps you defer capital gains taxes upon the sale of the shares. Plus, the transaction may result in a charitable income and estate tax deduction.

### Pooled Income Funds/Charitable Gift Annuities

These programs provide the benefits of establishing a CRT without the establishment cost, ongoing management responsibilities or owner control. You deposit the stock into a charitable fund, receive an income tax deduction and get a fixed or variable stream of income over your lifetime. The principal is left to the qualifying charity of your choice.

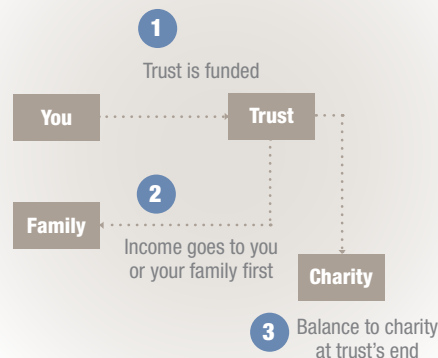
### Gifting to Family Members

Another way to manage a concentrated personal investment in a single security is to give some of the stock to family members or trusts. The annual gift exclusion rule allows a person to give up to a predefined maximum value per beneficiary – free of any gift or generation-skipping transfer taxes. This value can change over time, so it is important to review current gifting limits with your financial and tax advisors.

Furthermore, the lifetime gift exclusion allows for even larger gifts to be made. Although the cost basis in the stock carries over to the beneficiary, all existing and future income and appreciation occurs in his or her hands. This could allow for savings in income, estate and state death taxes.

For many investors, multiple techniques may be employed in combination. For example, using the NUA strategy to remove a large position from a qualified plan can be followed by the use of an exchange fund – this immediately diversifies the position and continues to defer the capital gains.

#### HOW A CHARITABLE REMAINDER TRUST WORKS



## The Value of Professional Advice

While a concentration in a large, low cost-basis stock position is one of those “good problems to have,” over-concentration must be addressed if you wish to avoid significant risk to the future financial security of your family. A professional financial advisor understands this risk and can assist you in making decisions regarding what is likely your family’s largest asset. A professional financial advisor can also provide you with access to ongoing research that examines individual companies; this research can then be evaluated when making decisions.

If reducing the risk exposure of a single stock is so important, why do people not take action? There may be financial and non-financial factors that are behind the aversion to reducing concentration risk.

**Taxes** | The outright sale of a low cost-basis position can lead to a large tax liability. However, taxes are only one consideration when making a financial decision, and should be weighed alongside the risk of volatility and significant losses in the stock. Investors should not “let the tax tail wag the investment dog.” You should consult with your tax advisor when considering changes in strategy.

**Dividend income** | When the dividends from a large stock position provide a significant source of income for a family, it can be difficult to look past that fact and consider selling the stock. The dividend yield on a stock, however, is only one component of its total return and risk profile; a few days

of negative performance in the stock price can lose much more value for the holder than an entire year’s worth of dividend payments. The dividend is also not guaranteed and can be cut with no advance notice. Your portfolio may be repositioned to provide the same level of income for your family, without taking on the significant risk associated with the volatility of a single stock.

**Behavioral finance biases** | Individual investors often make investment decisions that are driven by emotional biases and misconceptions. These issues typically lead to economically irrational behavior. If clients can better understand these biases, they can increase the chance for long-term investment success through a realignment of their risk-return balance. Some of the more common biases include:

*Overconfidence:* Investors need to take the time to understand the full spectrum of risks associated with each investment they own and then assess how they fit into their personal risk tolerance levels. Using tools like Monte Carlo simulations can help illustrate this issue.

*Anchoring:* Occasionally, investors target a price above where the stock is currently trading as the point at which they will reduce their concentration risk. Many times, the limit price represents a recent high for the stock. There may be no fundamental reason for the stock to trade back up to that high price. And if the stock trades down further, the investor will continue to participate in downside price movements.



*Mental accounting:* Investors often categorize various parts of their personal wealth into different buckets. Single-stock concentrations are reviewed separately from their other investments, which are also segregated from their retirement plans, bank accounts, insurance policies, etc. Investors should actually incorporate all of these factors into a comprehensive review of their risk/return profiles across all of their assets. This is especially true for clients who are employed by the company in which they own a concentration.

Issues like these are difficult for people to overcome. That's why the perspective of a professional financial advisor is so valuable. Informed, objective counsel can help clarify potential choices and propose more suitable solutions.

## Customized Solutions

Due to the complexities involved in the strategies covered in this brochure, it is important that you work with your financial advisor and tax professional to determine that the technique you employ is suited for your long-term objectives and risk tolerance.

Keep in mind that these strategies are not "all-or-nothing" decisions. In other words, either a single technique or a combination of strategies may be used for some or all of your concentrated holding. Your financial advisor and a team of support specialists at Raymond James stand ready to assist you in evaluating your choices and creating a customized solution. Turn the page for some questions to review with your financial advisor to get the process started.



## SELECTED U.S. COMPANIES DECLARING BANKRUPTCY: 1987–PRESENT

Adelphia Communication  
Bank of New England  
Bethlehem Steel  
Boston Chicken  
Burlington Industries  
Charter Medical  
Circuit City Stores  
Columbia Gas Systems  
Conseco  
Delphi Corporation  
Delta Airlines  
Drexel Burnham Lambert  
Eastern Airlines  
Enron  
Federated Dept. Stores  
Financial Corp. of America  
Fruit of the Loom  
General Motors  
Global Crossing  
IndyMac Bancorp, Inc.  
Kmart  
Lehman Brothers Holdings, Inc.  
Magellan Health Services  
Montgomery Ward  
Nortel Networks  
Pacific Gas & Electric  
Polaroid  
Refco Inc.  
Rockefeller Center Properties  
Spiegel  
Sunbeam  
Texaco  
Texas American Bancshares  
Tribune Company  
Tropicana Entertainment, LLC  
UAL (United Airlines)  
Washington Mutual, Inc.  
Winn-Dixie Stores  
WorldCom

Source: [bankruptcydata.com](http://bankruptcydata.com)

## Next Steps

Here are some questions to explore with your financial advisor to help determine which solutions may be most appropriate for your situation. These questions are a general guide and do not represent all the factors that should be considered before making a decision to use the strategies described in this brochure. Your advisor can help you consider the individual risk factors of each strategy in the context of your specific financial situation.

- 1 What is the objective for this stock position in the context of your long-term wealth management plan?
- 2 In what stock(s) do you own a concentrated position? Is the stock held individually, jointly with your spouse, in a retirement plan, in a trust or in some other entity? How many shares do you own and what is the cost basis?
- 3 Based on the size of your position, the company's market capitalization, any restrictions on the shares and your net worth, which strategies in this document would be available to you?
- 4 What is your outlook on the stock's future performance? What does available research indicate?
- 5 Do you have immediate liquidity needs for the value in the stock position?
- 6 Are you willing to pay upfront costs to provide for downside protection against price declines?
- 7 To what extent do you rely upon dividend income from the position for current cash flow?
- 8 Are you charitably inclined? If so, how can you use the stock position to achieve charitable objectives while managing your risks of concentration?

---

RAYMOND JAMES FINANCIAL (NYSE-RJF) is a Florida-based diversified holding company providing financial services to individuals, corporations and municipalities through its subsidiary companies. Its three principal wholly owned broker/dealers, Raymond James & Associates, Raymond James Financial Services and Raymond James Ltd. have more than 5,300 financial advisors serving 1.8 million accounts in 2,300 locations throughout the United States, Canada and overseas. In addition, total client assets are approximately \$196 billion, of which approximately \$29 billion are managed by the firm's asset management subsidiaries.

---

[raymondjames.com/wealthmanagement](http://raymondjames.com/wealthmanagement)

# RAYMOND JAMES®

Individual solutions from independent advisors

International Headquarters: The Raymond James Financial Center  
880 Carillon Parkway | St. Petersburg, FL 33716  
727-567-1000 | Toll-Free: 800-248-8863 | [raymondjames.com/wealthmanagement](http://raymondjames.com/wealthmanagement)