Allspring

Direct Indexing FAQ

The Allspring direct indexing FAQ below addresses the most common questions to help you understand whether direct indexing may be the right fit for your portfolio.

Date	Topic
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Direct indexing frequently asked questions

Direct indexing is one of the fastest-growing strategies in the world of personalized and tax-efficient investing. Investors are increasingly asking how it compares with traditional index funds and exchange-traded funds (ETFs), whether it can improve after-tax returns, how it can address taxes and diversification considerations around concentrated or highly appreciated holdings, and what risks or trade-offs exist. The FAQ below addresses the most common questions to help you understand whether direct indexing may be the right fit for your portfolio.

1. What is direct indexing, and how does it compare with index funds and ETFs?

Direct indexing is an investment strategy that allows you to replicate an index by directly owning a subset of individual index securities within a separately managed account (SMA). Unlike index funds or ETFs, which are pooled vehicles, direct indexing—sometimes called personalized or custom index investing—provides greater tax efficiency, transparency, flexibility, and customization. Investors can gain more control over their holdings while still closely tracking the performance and risk characteristics of an index.

2. How does direct indexing improve after-tax returns?

Direct indexing can enhance after-tax outcomes through several strategies:

- Tax-loss harvesting: Capture losses to offset gains elsewhere across your portfolio
- Personalized transition planning: Control the timing of capital gains from legacy holdings
- Tax-aware trading: Manage withdrawals with minimal tax impact
- Charitable donations: Donate appreciated securities in a tax-efficient way

Together, these techniques can improve long-term, after-tax returns while keeping your portfolio aligned with its tracking index.

3. What is tax-loss harvesting in direct indexing, and how does Allspring approach it?

Tax-loss harvesting is a tax-efficient investment strategy that involves selling securities at a loss to offset capital gains and reduce taxable income. Proceeds from the sale are reinvested in similar securities to maintain market exposure while avoiding wash-sale rules. Harvested losses that are not used to offset gains in the current year can be carried forward to offset gain liabilities in future years.

At Allspring, we employ a daily, proprietary, data-driven process—overseen by experienced portfolio managers—to identify tax-loss-harvesting opportunities while considering overall portfolio risk. While other strategies may focus strictly on tax-loss harvesting, without consideration to tracking error, our approach carefully balances the potential tax benefits with the need to minimize tracking error—helping portfolios stay closely aligned with their tracking indexes.

4. What is tracking error, and why does it matter in direct indexing?

Tracking error measures how much a portfolio's performance deviates from its benchmark. In direct indexing, managing tracking error is critical: too much deviation may expose investors to unintended risks or outcomes. Allspring manages tracking error carefully, seeking to strike the right balance between capturing tax benefits and maintaining close alignment with the index. We believe this approach offers a more holistic and familiar experience for the investor.

5. Will I see more activity or trading in my account with direct indexing?

Yes. Because direct indexing aims to track a benchmark and incorporates tax-loss harvesting, investors usually see more frequent trading activity than with a traditional equity SMA. While this may seem unusual, the higher level of activity is necessary to maintain both tax efficiency and benchmark alignment.

6. Can I customize my portfolio with direct indexing?

Yes. One of the advantages of direct indexing is portfolio customization. You can:

- Exclude specific companies and industry groups
- Align your portfolio with value-based or faith-based preferences
- Personalize exposure while still aiming to track an index
- Specify a capital gains budget to limit tax liability in any given year
- Fund with legacy securities by selecting a transition option that best meets your needs

This flexibility allows investors to pursue financial goals and personal values at the same time.

7. How can direct indexing help me diversify out of a concentrated stock position?

Direct indexing provides a tax-aware framework for reducing concentrated stock exposure gradually. Positions can be sold over time to mitigate the tax impact in any given year, with proceeds reinvested into a diversified, tax-managed portfolio. The customization capabilities of direct indexing enable a gradual transition, aligning the portfolio with the investor's desired end exposure as an objective.

8. Can direct indexing help manage taxes when selling a business or large asset?

Yes. Direct indexing can play an important role when preparing for a liquidity event such as selling a business or large asset. By funding the account ahead of time with existing investments, investors can build a "bank" of capital losses to offset future gains. This strategy helps soften the tax impact of a large sale. Allspring coordinates with clients and their advisors to help maximize effectiveness.

9. How often will my direct indexing account be reviewed?

At Allspring, we review accounts daily using our proprietary optimization process. Many providers only review monthly or quarterly, which can miss opportunities during market volatility. Our daily reviews allow for more opportunities to capture tax alpha while balancing savings with benchmark alignment.

10. Can direct indexing integrate with my existing investments?

Yes. Direct indexing can work seamlessly alongside mutual funds, ETFs, and other holdings. It can serve as a customizable, tax-managed sleeve within your broader investment portfolio. Accounts can be funded with cash or existing securities.

11. Who may benefit most from direct indexing?

Direct indexing is particularly well suited for:

- Investors in higher tax brackets seeking tax-efficient investing strategies
- Individuals with concentrated stock positions
- Investors desiring customization for values-based investing
- Investors preparing for large taxable asset transitions
- Holders of appreciated positions in underperforming or tax-inefficient active strategies
- Investors using fund models that suffer from capital gains due to required fund distributions or model rebalancing

12. What are the potential risks or trade-offs of direct indexing?

As with any equity-based strategy, investments can lose value. Key considerations include:

- Performance may diverge from the benchmark, especially with customizations
- Tax benefits, while central to the strategy, aren't guaranteed
- More frequent trading may lead to higher transaction costs
- More account activity and oversight add some operational complexity

Conclusion

Direct indexing offers investors a powerful way to combine the benefits of index investing with the flexibility of customization and robust tax management. Whether you are looking to manage taxes more effectively, transition out of a concentrated stock position, or align your portfolio with personal values, direct indexing can provide tailored solutions. As with any investment, it's important to understand the risks and work with an advisor to determine if direct indexing fits your overall strategy.

To learn more about direct indexing and Allspring's capabilities, please visit [Direct Indexing With Allspring].

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The wash sale rule is an IRS regulation that prevents investors from claiming a tax deduction on losses from a security if they buy the "substantially identical" security within 30 days before or after the sale. This 61-day window (including the sale date) is designed to prevent people from "manufacturing" tax losses to lower their tax bill while effectively maintaining their investment position.

Tax alpha refers to the additional value or returns generated in an investment portfolio by incorporating strategies that minimize tax liabilities, such as tax-loss harvesting. Tax alpha is based on historical performance and does not represent future results.

Tax-loss harvesting is the selling of investments at a loss so that losses can be used to offset gains on the sale of other investments—thereby reducing capital gains tax owed. Proceeds from the sale may be used to purchase similar securities to maintain the general composition of the investment portfolio.

There are several investment-related risks associated with tax loss harvesting. There is potential that the tax loss harvesting may:(i) negatively affect the overall performance of an investor's portfolio; and (ii) result in a temporary overweight and/or underweight of certain sectors, securities, and/or cash in an investor's portfolio that influences performance, and Allspring will not consider any other account that the investor may have. Tax-loss harvesting involves the risks that the new investment could perform worse than the original investment and that transaction costs could offset the tax benefit. Allspring may repurchase securities for an account after the end of the tax loss wash sale period at a price higher or lower than that for which they were sold. Allspring will not attempt to harvest every tax loss that occurs in an account. Securities sold for the purpose of tax loss may or may not be repurchased by Allspring for the selling account following the 30-day wash sale period. Allspring cannot prevent wash sales that may occur in other accounts besides the account to which the tax loss harvesting was applied. Furthermore, Allspring cannot prevent wash sales that may occur due to investor or financial advisor requests that impact trading in the account. Investment strategies that seek to enhance after-tax performance may be unable to fully realize strategic gains or harvest losses.

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