

Pinnacle Capital Management

A Financial Advisor's Guide to Separately Managed Accounts

What is a SMA?

A separately managed account (SMA) is a single investment account comprised of individual stocks, bonds, cash or other securities, tailored to achieve a specific investment objective by adhering to a particular investment strategy. SMAs are under the management of a professional investment firm, such as Pinnacle Capital Management (PCM). In the United States, the vast majority of such firms are called registered investment advisors (RIAs). PCM is an RIA.

Is a SMA a "pooled investment"?

No. The investor who establishes a SMA directly owns the investment securities held in the SMA. That ownership is not shared with any person or entity that has not established the SMA. This is different, for example, from a mutual fund, in which each investor in the fund owns none of the investment securities held in the fund but instead owns an interest in the pool of investment securities that comprises the fund.

Who actually manages the investments in a SMA?

SMAs are directly managed by an individual portfolio manager (PM) or sometimes by a team of portfolio managers. The PM is responsible for researching, purchasing and selling the investments held in the SMA. The PM is also responsible for maintain the allocation of the investments n the SMA in accordance with the SMA's particular investment strategy.

What other names are used to refer to SMAs?

SMAs are also known as: actively managed accounts, discretionary managed accounts, individually managed accounts, managed accounts, privately managed accounts, separate accounts and wrap accounts.

What is a RIA?

RIAs, such as PCM, operate under the regulatory auspices of a federal law known as the Investment Advisors Act of 1940 (1940 Act) and the purview of the U.S. Securities and Exchange Commission (SEC). Under the 1940 Act, all RIAs are in a fiduciary relationship with their investment clients.

Who is the appropriate investor for a SMA?

The investment community is made up of institutional investors, ultra-wealthy individuals & family investors, high net worth individual investors and middle-income individual investors. SMAs can be appropriate for just about all members of the investment community.

What amount of assets is required to establish a SMA?

At PCM, the minimum amount of assets required to establish a SMA varies. Most of PCM's SMAs require a minimum of \$100,000. However, for certain SMAs the minimum is \$60,000 and for others the minimum is \$250,000.

Does PCM impose a maximum on the amount of assets held in a single SMA?

No, there is no maximum. PCM has managed a single SMA with over \$250 million.

Who actually has custody of the investments held in a SMA?

RIAs typically have a primary custodian they work with for direct business placed with the RIA. For PCM, the primary custodian is Wells Fargo Clearing Services (formerly First Clearing Corporation). There are other third party custodians that offer platforms for SMAs, such as; Charles Schwab, Fidelity and TD Ameritrade to name a few. Advisors might utilize a third party platform for a client to offer a SMA.

How does an investor in a SMA know how the investments held in the SMA have performed?

Performance of each SMA is typically provided by the RIA to clients doing direct business with the RIA, usually on a quarterly basis – but can be provided on an as needed basis. Those clients that are utilizing a financial advisor would most likely be provided performance by means of reporting software utilized by the advisor.

What do SMAs offer the investor?

SMAs provide the comfort of professional investment guidance and a heightened level of personal service. They also offer investors the opportunity to take an active role in their financial life through contact with the PM. SMAs also offer the flexibility to invest in different investment strategies, while providing the liquidity and potential tax benefits that come from owning individual securities as opposed to owning an interest in a pooled investment.

What are the benefits of owning a SMA?

The following are benefits to owning a SMA: the opportunity for portfolio customization and communication with PMs, proxy voting rights for individual companies, transparency of portfolio holdings and transactions, portability of underlying securities, strategic capital gain or loss realization and pass-through to investor for high tax efficiency and charitable gifting of low-cost-basis shares of companies owned.

What are the key differences between a SMA and a mutual fund?

There are many differences between a SMA and a pooled vehicle like a mutual fund. With SMAs each portfolio is unique to a single account owner, so that would be the main difference with a mutual fund, where each investor owns shares of an account. In other words, if you set up a separate account with Money Manager X, then Manager X has the discretion to make decisions for this account that may be different from decisions made for other accounts. With a mutual fund all decisions by a manager affect each investor equally based on the shares they own. So for example, let's say a manager launches a mutual fund and an SMA with the same strategy, at the same time, and they both include the same 20 stocks weighted exactly the same. The beneficial interests in either vehicle are identical at the outset, but the statements will look different. For the mutual fund client, the position will show up as a single-line entry bearing the mutual fund ticker symbol. The value will be the net asset value from the close of business on the statement's effective date. The SMA investor's statement, however, will list each of the positions held in the account and their values separately, and the total value of the account will simply be the aggregate value of each of the positions. From this beginning point, things will begin to diverge. Decisions the PM makes for the mutual fund – including the timing of purchases and sale of shares, dividend reinvestment and distributions – will affect all fund investors in the same way. For SMAs, the decisions are at the account level and will therefore vary from one investor to another based on their particular situation.

How much do SMAs cost? And how do the fees differ from mutual funds?

Mutual fund fees are fairly straightforward. The key number is the net expense ratio, including the management fee, miscellaneous ancillary expenses and a distribution charge called a 12(b)1 fee for certain eligible funds. Many funds also have different types of sales charges all laid out in a prospectus. SMAs do not come with prospectuses. RIAs list their basic fee structures in a regulatory filing called a Form ADV Part 2. An investor can obtain this document by contacting the RIA. However, the published fee schedule in the ADV Part 2 is not necessarily firm – it is subject to negotiation between the investor (or financial advisor for an investor) and the RIA. Often, it is not a single fee but a scale in which the fee (expressed as a percentage of assets under management) decreases as the asset volume (the amount invested) increases.

How is the financial advisor compensated for clients invested in SMAs?

Financial advisors charge a fee based on assets under management (AUM) for each SMA. The fee is typically a percentage of the AUM, or in some cases a fixed minimum dollar amount, which is normally charged quarterly.

What is the relationship between the financial advisor and PCM?

Financial advisors contract with PCM to manage assets, on a discretionary basis, for their clients when utilizing PCM's SMAs.

How does a financial advisor establish a SMA with PCM?

If an advisor is using the First Clearing platform the following is needed to do business with PCM: a First Clearing brokerage account, managed account paperwork and the PCM SMA sheet. If an advisor is establishing a SMA with PCM through an outside platform an account would need to be established on that platform and any other required paperwork, by the platform, to utilize a SMA – nothing additional is currently needed with any outside platforms from PCM.



100 Limestone Plaza • Fayetteville, NY 13066 • (315)234-9716

244 North Main Street • Mansfield, MA 02048 • (774)719-2759