
First Trust
CLIENT RESOURCE KIT
DIRECT INDEXING
First Trust Advisors L.P. | 1-866-848-9727 | www.ftsma.com

Direct Indexing Goes Mainstream, and Financial Advisor Insights

First Trust

Direct Indexing AUM

$1.35 Trillion

as of 6/30/2026

Based on a recent survey:

41% of financial advisors report using direct indexing

42% of non-users plan to adopt the concept over the next 12 months

Source of AUM: Money Management Institute (MMI), MMI-Cerulli Advisory Solutions Quarterly, September 2026. Direct indexing AUM represents assets in manager-traded separately managed accounts (SMAs) offered through U.S. fee-based advisory programs.Source for survey data: Investment Executive, Perspective, September 18, 2026. Based on the 2026 FTSE Russell Direct Indexing Survey, an online quantitative survey of 400 U.S. financial advisors from a mix of channels (wirehouse/traditional, independent broker-dealer and RIA) who have some familiarity with direct indexing. The survey responses were collected between May 19th to June 9th, 2026. Past trends may not continue and future projections may not be realized.

Below are the key potential benefits financial advisors cited when implementing direct indexing strategies.

64%
tax-loss harvesting

56%
tax-efficient transitions

40%
reducing concentration risk

Source: InvestmentNews, May 2024. Among the 34% of respondents that describe themselves as "very familiar" or "extremely familiar" with direct indexing from a survey of 631 financial professionals conducted by RIA Channel.
Potential benefits are not guaranteed and will vary based on an investor's individual circumstances and market conditions. Direct indexing strategies also involve risks and limitations, including the potential for tracking error, tax consequences, transaction costs and other expenses. Tax-loss harvesting may not be available or beneficial in all circumstances. Please see the next page for additional information regarding the risks and limitations of direct indexing.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

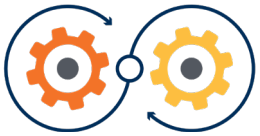
Not FDIC Insured | Not Bank Guaranteed | May Lose Value

What is Direct Indexing?

First Trust

Direct indexing seeks to closely track the performance of a market index while creating tax savings to increase after-tax returns. Investors own individual securities in a portfolio via a separately managed account ("SMA"). Holding individual securities rather than a single fund allows investors to customize their exposure to the initial index according to their needs while allowing for greater tax efficiency.

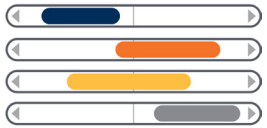
Select Index



Choose a Benchmark

- ☑ U.S.
- ○ Global
- ○ All Cap

Customize



Personalize

- Align personal values
- Account-specific needs
- ESG

Sample & Optimize

Example

S&P 500® Index — Full Index

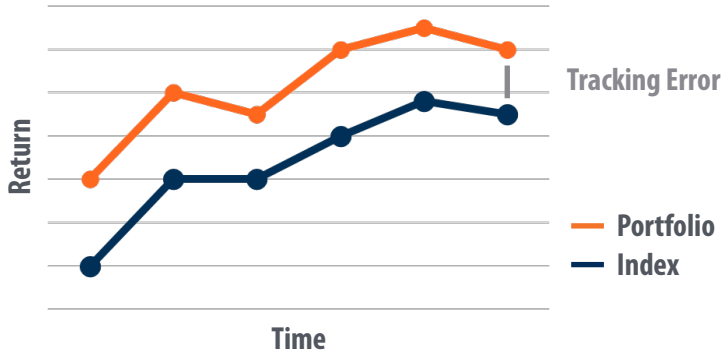
HCA Exxon BP Pepsi Coke J&J



Direct Indexing — "Sample" of Full Index

HCA BP Pepsi

Portfolio



Tax Alpha

Example Starting Portfolio

HCA BP Pepsi

Sell Pepsi → Buy Coke

Example Rebalanced Portfolio

HCA BP Coke

Creates Realized Tax Loss to Offset Gains

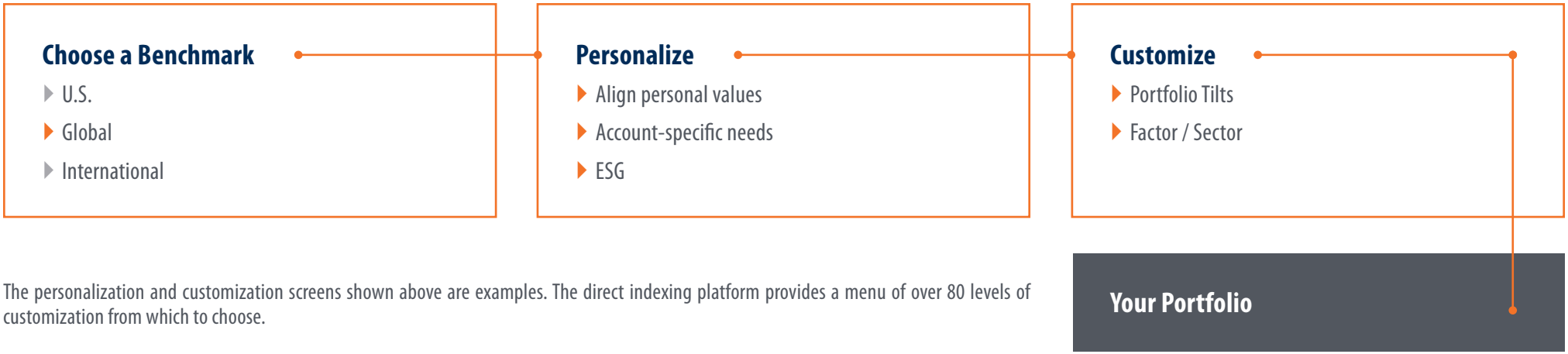
This example is for illustrative purposes only and not indicative of any direct index account. References to specific securities should not be construed as a recommendation to buy or sell and should not be assumed profitable.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Personalization

First Trust

Whether prioritizing traditional factors, risk management strategies, thematic positioning, or values-based investing, advisors can completely customize their clients' exposure to selected benchmarks based on their investment goals and personal values.



The personalization and customization screens shown above are examples. The direct indexing platform provides a menu of over 80 levels of customization from which to choose.

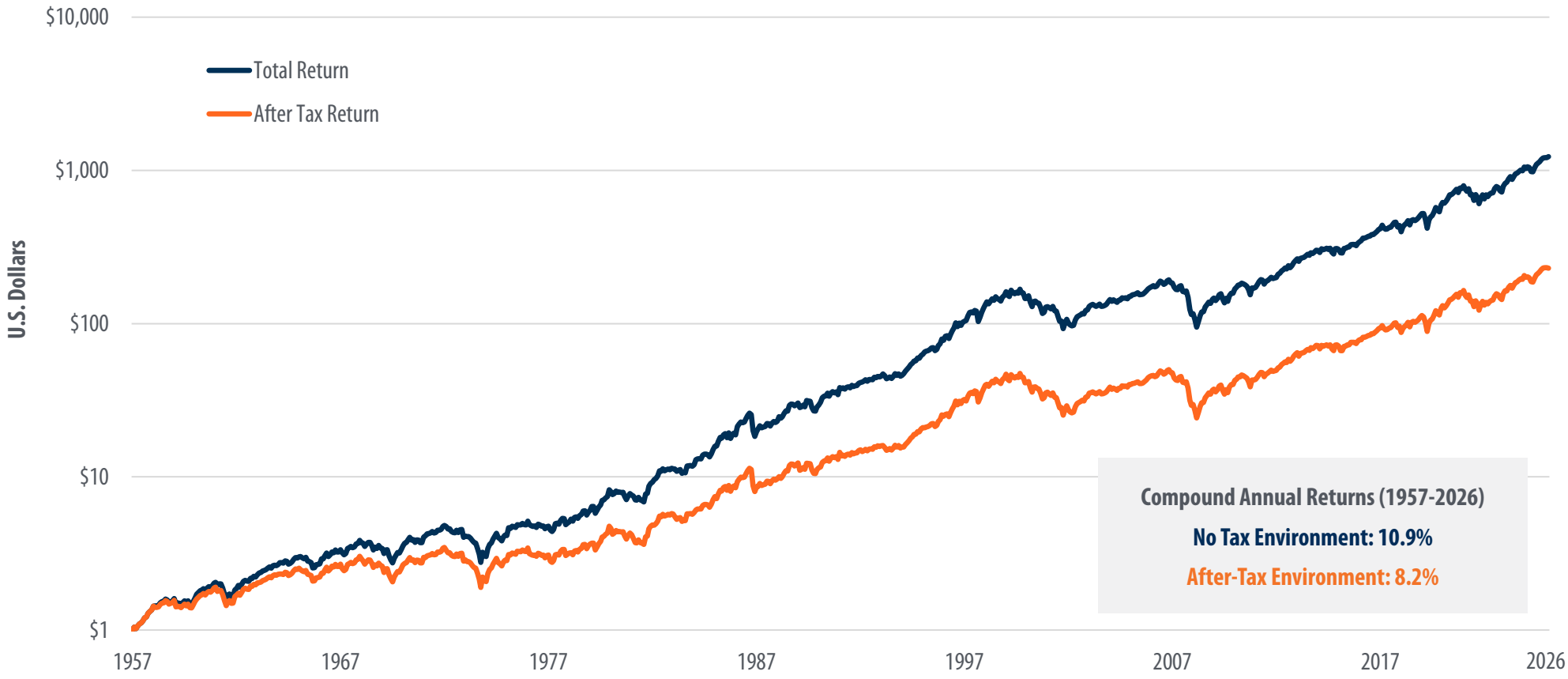
The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Tax Drag

S&P 500® Index Pre-Tax and After-Tax Returns

First Trust

Investing in the capital markets is one of the best ways to build wealth over time, but paying taxes on investment gains can significantly reduce overall portfolio return. To understand the impact of taxes, investors should focus on after-tax returns, the returns that are based on how much money they ultimately keep after paying taxes.



Data from 12/1957-1/2026.

Source: S&P and Bloomberg. The S&P 500® Index monthly dataset uses data beginning in 1957 and represents yearly total returns and yields of large-cap stocks, small-cap stocks, corporate bonds, government bonds of several maturities, and inflation. Hypothetical value of $1 invested since 1957, with taxes paid monthly. Annual income tax and capital gains tax rates assume a Consumer Price Index (CPI) equivalent income increase every year to the max social security tax income ($160,200 in 2023). Historical tax rates calculated using historical income tax, capital gains tax rates and qualified dividend income tax rate since 2003. For illustrative purposes only and not indicative of any direct index account. An investment cannot be made directly in an index. This should not be construed as a representation that any account will, or is likely to, achieve profits, losses or tax savings similar to those reflected in this example. **Past performance is not a guarantee of future results.**

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Not FDIC Insured | Not Bank Guaranteed | May Lose Value

How Tax-Loss Harvesting Works

First Trust

Offsetting Gains with Losses

Tax-loss harvesting can be used in taxable accounts to minimize tax liabilities by strategically selling capital assets that have experienced a capital loss. By realizing these losses, investors can offset capital gains and potentially reduce their overall taxable income.



For example, assume an investor sold **Investment A** and incurred a $100,000 long-term capital gain. At the 20% capital gain tax rate, the tax liability would be $20,000.

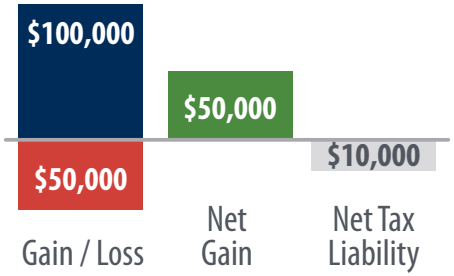
Now assume the same investor implements a tax-loss harvesting strategy and sold **Investment B**, realizing a loss of $50,000. The result would be a net capital gain of $50,000 and the net tax liability would be reduced to $10,000.

Capital Assets may include the following: Investment securities (stocks, bonds, ETFs, mutual funds, etc.), real estate, collectibles (coins, stamps, art), jewelry, precious metals (gold, silver, etc.), businesses, intangible assets such as patents, copyrights and trademarks.[1]

Without Tax Loss Harvesting



With Tax Loss Harvesting



[1]Source: IRS.gov.

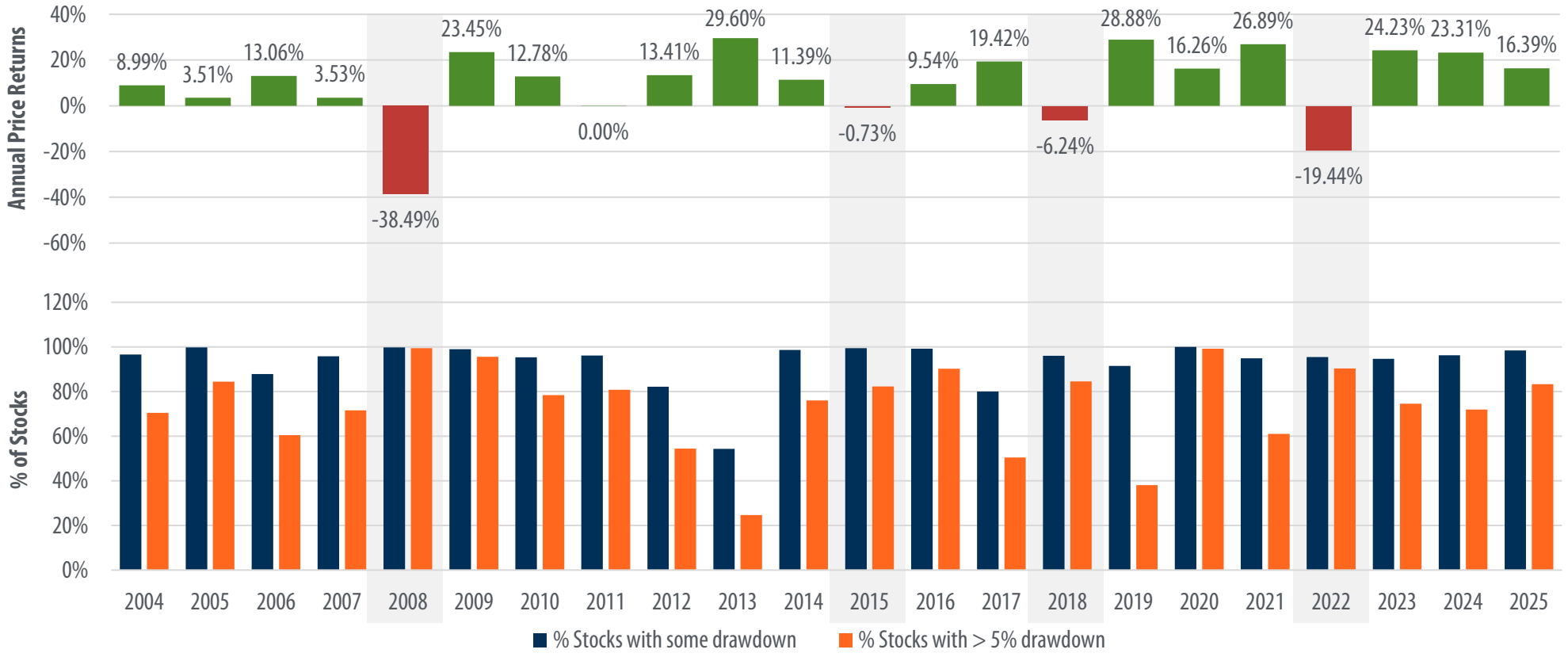
The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Not FDIC Insured | Not Bank Guaranteed | May Lose Value

Tax Loss Harvesting Opportunities Exist in All Markets

First Trust

S&P 500® Index Price Returns and % of Stocks with Drawdowns Throughout the Year



Over 20 Years (Annualized):

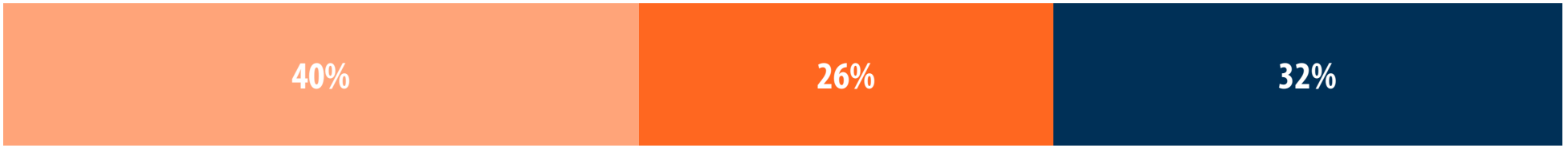
- On average, 98% of stocks in the S&P 500® Index experienced a drawdown at some point during the year.
- 83% of stocks were down 5% or more from their annual starting price.
- In years with large drawdowns almost all stocks experienced some negative returns.

Data from 12/31/2003-12/31/2024. Source: S&P, Capital IQ. **Past performance is not a guarantee of future results.** Index data is for illustrative purposes only and not indicative of any actual investment. Index returns do not reflect any fees, expenses, or sales charges.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Historical Return Breakdown of the S&P 500® Index Constituents

First Trust



Underperformed the Index | **Underperformed and Lost Money** | **Outperformed the Index**

66% of the S&P 500® Index constituents underperformed the Index.

Since 1990, approximately **25% of the stocks** in the S&P 500® Index went down by at least 50% and remain below that level.

Since 2015, individual stocks in the S&P 500® Index have averaged **28.24%** volatility, compared to **18.11%** for the Index itself.

Data from 1/31/1990 to 12/31/2025 unless otherwise noted. Sources: Capital IQ and Bloomberg. Returns are measured from the date added to the index (or start of the study period) to the date removed (or end of the study period) for all companies included in the index during the study period, using month-end prices. Index data shown is for illustrative purposes only and not indicative of any actual investment. Indexes do not charge management fees or brokerage expenses and no such fees or expenses were deducted from the performance shown. Indexes are unmanaged and investor cannot invest directly in an index. **Past performance is no guarantee of future results.**

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Not FDIC Insured | Not Bank Guaranteed | May Lose Value

Direct Indexing Scenarios

First Trust

Scenario 1

Index Fund Investor Seeking To Increase After-Tax Returns

Scenario: Client is invested in and adding to beta indexed funds in a taxable account.

Goal: Maintain return profile of a beta index while adding tax alpha.

- The direct index SMA can be funded with a mixture of cash, stocks, and ETFs and new money is diverted from beta positions.
- The client maintains beta index exposure with the tax loss harvesting engine of Direct Indexing running underneath, providing the potential for tax loss alpha and after-tax outperformance.

Scenario 2

Exiting Appreciated Positions

Scenario: Client has a concentrated position in securities that have appreciated in value and client is averse to selling given the tax costs.

Goal: Track a risk appropriate benchmark and minimize the securities overweight while minimizing taxes.

- The client can use an in-kind transfer of stock positions to fund the direct index SMA. Also funding with cash may be helpful but is not required.
- The direct index algorithm uses any cash and higher basis securities to reposition around the concentrated securities and more closely track the benchmark.
- Tax losses can be generated through intraday tax loss harvesting while staying fully invested. Offset losses with the sale of appreciated securities and reinvest proceeds to improve tracking of the benchmark.

Scenario 3

Complementary Tax Loss Engine

Scenario: Advisor has models or active strategies that generate consistent taxable gains while seeking investment alpha.

Goal: Offset gains from active strategy with losses generated by Direct Indexing.

- Run a separate direct index SMA account with the goal of index returns and generation of tax losses to offset the active strategies.

Scenario 4

Future Taxable Liquidation Event

Scenario: Client is anticipating a sizeable taxable gain in future years – for example, from the sale of property or a business.

Goal: Accumulate losses while benchmark indexing to mitigate a future concentrated cap gain event.

- The direct index SMA can be funded with a mixture of cash, stocks, and ETFs that would otherwise have been invested for equity exposure.
- The client maintains the desired equity index exposure while harvesting losses and building a bank of capital losses that can be carried forward to future tax years.
- Upon the sale of the appreciated asset, the client can offset a capital gain with any capital losses carried forward.

Scenario 5

Offset Taxable Payouts of Illiquid Alternatives

Scenario: Client has exposure to illiquid alternatives that produce taxable payouts prior to full liquidation.

Goal: Offset periodic tax liabilities with losses generated by a direct index SMA and build up reservoir for full liquidation event.

- Run a direct index SMA in parallel with private investments to generate capital losses that can be used to offset future capital gains.

Scenario 6

Values Based Client

Scenario: Client wants to invest with their specific personal values and not the general values of an ETF or fund.

Goal: Precisely reflect the client's values while tracking the client's chosen benchmark as closely as possible.

- The client along with the advisor chooses an index to seek to track its performance. The client also chooses their personal values screens and tilts. The direct indexing algorithm optimizes stock selection to seek returns as close as possible to the index while reflecting the client's personal values.

Hypothetical scenarios are presented for educational and illustrative purposes only. They are not representative of any actual client experience.
Beta is a measure of price variability relative to the market.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

Not FDIC Insured | Not Bank Guaranteed | May Lose Value

Risks & Disclosures

First Trust

There can be no assurance that a strategy will achieve its investment objectives. For additional information, please refer to First Trust Advisor L.P. Form ADV Part 2A.

This is not an offer to buy or sell any security and does not include a complete list of all securities purchased or sold in the period or for all clients. Actual holdings will vary and there is no guarantee that any client will hold any mentioned positions. Investing in securities involves the risk of loss, and there is no assurance that any investment strategy or discipline will be profitable.

There is no assurance that a separately managed account ("SMA") will achieve its investment objective. Accordingly, you can lose money investing in an SMA. SMAs are subject to market risk, which is the possibility that the market values of the securities in an account will decline and that the value of the securities may therefore be less than what you paid for them. The value of investments held by the strategy may increase or decrease in response to economic, financial, and political events whether real, targeted, or perceived in the U.S. and global markets. It is difficult to predict the timing, duration, and potential adverse effects (e.g., portfolio liquidity) of events.

Direct Indexing involves actively trading in and out of positions. An SMA strategy with high portfolio turnover may result in higher levels of transaction costs and may generate greater tax liabilities for shareholders.

While SMAs can be customized, accounts with smaller balances may struggle to achieve optimal diversification across multiple asset classes due to the higher cost of individual securities.

Fees associated with SMAs can be higher than mutual funds and ETFs that include manger, service, and advisory fees. Being able to withdraw cash from an SMA may be delayed due to the amount and type of positions to be sold. Withdraws may negatively impact the SMA's performance.

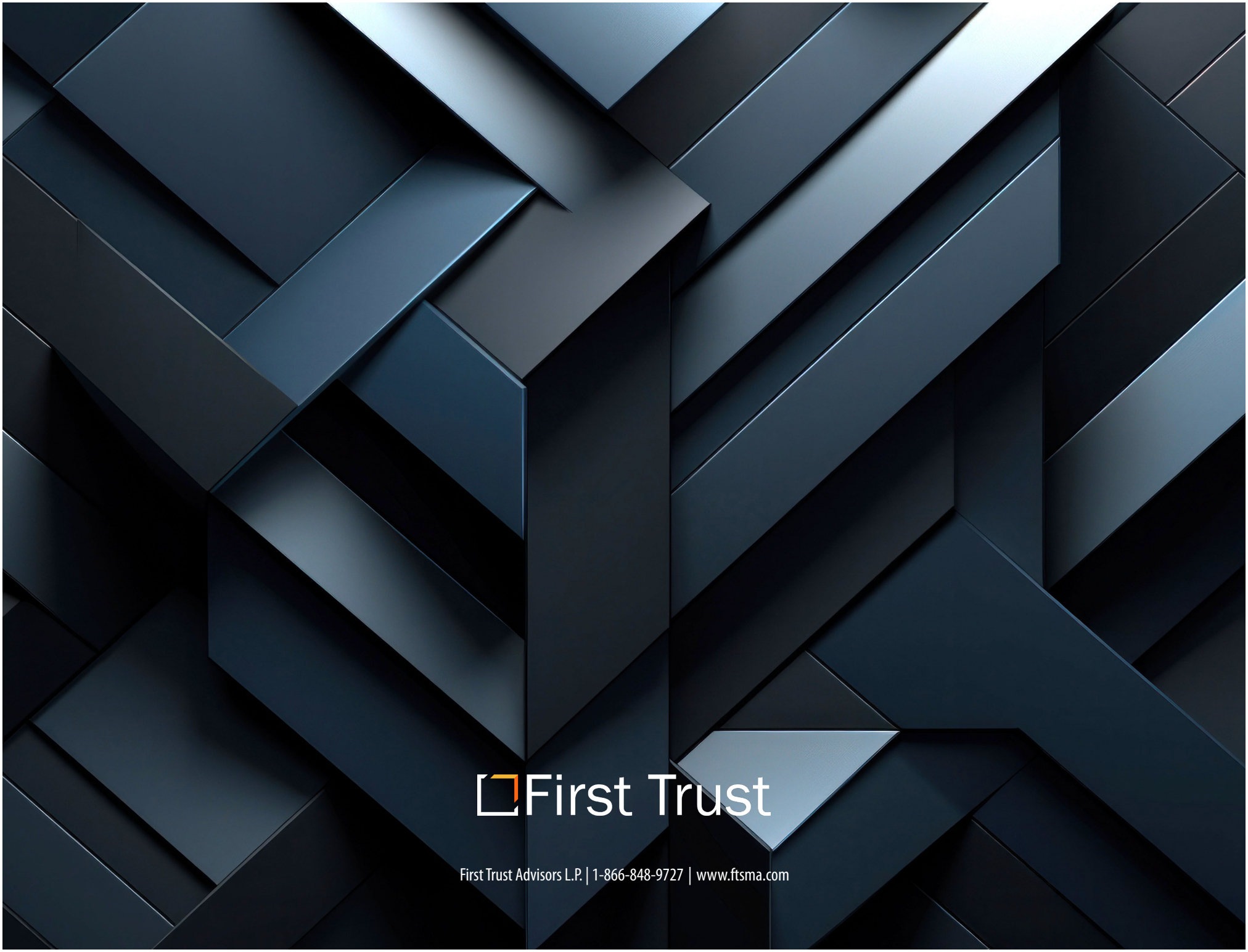
Investment Strategies that seek to enhance after-tax performance may be unable to fully realize strategic gains or harvest losses due to various factors. Market conditions may limit the ability to generate tax losses. Tax-loss harvesting involves the risks that the new investment could perform worse than the original investment and that transaction costs could offset the tax benefit. Also, a tax-managed strategy may cause a client portfolio to hold a security in order to achieve more favorable tax treatment or to sell a security in order to create tax losses.

This summary is not intended to be tax or legal advice. This summary cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. This summary is being used to support the promotion or marketing of the transactions herein. The taxpayer should consult an independent tax advisor.

Investors or financial professionals should consult with a tax professional regarding the potential application of loss deferral regimes, such as wash sales and straddles, to the securities and potential transactions in this strategy, along with all the other securities and transactions in the investor's broader portfolio.

The information presented is not intended to constitute an investment recommendation for, or advice to, any specific person. By providing this information, First Trust is not undertaking to give advice in any fiduciary capacity within the meaning of ERISA, the Internal Revenue Code or any other regulatory framework. Financial professionals are responsible for evaluating investment risks independently and for exercising independent judgment in determining whether investments are appropriate for their clients.

The **S&P 500® Index** is an unmanaged index of 500 companies used to measure large-cap U.S. stock market performance.



First Trust Advisors L.P. | 1-866-848-9727 | www.ftsma.com