TAX ADVANTAGED SOLUTIONS · SMAS · OPPORTUNITY ZONES

Your Clients Don’t Need the Best Loss Engine. They Need Enough Time.

John “JB” Menefee, CFA Director of Investor Relations, Pinnacle Partners

June 2026

I began my career at Parametric and played a small part in the meteoric growth of AUM behind their pioneering long-only Direct Indexing strategy. Then I watched from afar as quant investing stalwarts like AQR and Quantinno developed more dynamic loss harvesting engines in the form of long/short SMAs. With the addition of a short book, these vehicles expanded the loss accumulation net to be effective across market cycles.

It’s an intuitive concept. When longs fall, you harvest. When shorts rise against you, you harvest. The result is a loss engine that runs in varying market conditions, not just down ones. Academic research from BlackRock’s Aperio team quantified that advantage: a 130/30 long/short portfolio generates **2.7 times more capital losses** than a long-only portfolio over its first ten years. For clients sitting on a large capital gain — a business sale, a concentrated stock position, a crypto exit — that loss engine was compelling on its own.

The result has been yet another boon to tax-advantaged investment management, to the tune of $150B in AUM.[1] This innovation, however, still has two meaningful limitations — time and supply — and that’s what I’d like to expand on here.

The Loss Engine Is Getting Constrained

The two largest custodians in the RIA space just pumped the brakes on long/short SMAs.

Fidelity paused new account openings for tax-aware long/short strategies in December 2025. The pause extended through January, then February, and as of mid-February 2026 it became indefinite. The internal rationale, per multiple advisor sources, boiled down to governance: the short book creates governance and risk management complexity that Fidelity wasn’t yet scaled to handle.

Schwab, the largest RIA custodian in the country with over $5 trillion in advisor assets, followed on April 23rd with its own restrictions. New enrollments are capped at 200%/100% leverage, cutting off access to the more aggressive strategies pitched at 300%/200%. RIAs can no longer allocate more than **30% of their total Schwab assets** to long/short SMAs. Account minimums also jumped: $1M for standard Reg T accounts and $3M for portfolio margin.

These aren’t minor tweaks. They represent a structural constraint on the very strategies that advisors have been building their loss-harvesting workflows around.

How Do I Outsmart the Clock?

Time can be an advisor’s chief opponent. Barring a massively telegraphed wealth creation event like a certain rocket company’s IPO, most advisors don’t have the luxury of thorough pre-planning. Add in the fact that well-laid plans don’t always survive contact with the enemy — volatility, in this case — and the reality is clear: from the moment a gain is realized, advisors are working against a shot clock.

This is where long/short could usually step in to significantly cut down on that tax bill. But what if, as we just discussed, your access has been capped? Worse yet, God forbid a client sells late in the year. Neither long/short nor long-only, on their own, fully solve for this constraint. The shot clock is still running regardless of which SMA you choose.

A constrained loss engine doesn’t mean a broken tax strategy. It means you need a structure that gives it more time to work. This is exactly where Opportunity Zone investing becomes not just complementary but essential.

OZ Breathes New Life into Loss Harvesting

High net worth clients demand tax-advantaged solutions, and advisors need every tool at their disposal to deliver them. One of those tools — the long/short SMA — just got significantly harder to access. So the question becomes: what fills that gap? The answer, increasingly, is pairing OZ with whatever loss harvesting strategy your client can access. OZ doesn’t replace the SMA. It gives you, the advisor, time to compound fresh tax-alpha into their portfolio through the power of deferral.

Before we get to the math, it’s worth grounding what an OZ investment actually is, because the tax benefits tend to dominate the conversation at the expense of the investment case. A Qualified Opportunity Fund deploys capital into designated low-income census tracts, typically through institutional-quality real estate development. The gain is deferred, but the underlying asset is working during that period, creating distributions — in the case of real estate, through rental payments. Under OBBBA’s permanent framework, the invested gain is deferred for five years from the date of investment. At that point, investors receive a 10% basis step-up,[2] reducing the taxable gain, and all appreciation above the original investment exits completely tax-free at the ten-year mark. That’s a powerful standalone outcome that doesn’t require a single harvested loss to justify.

The pairing is where it gets exceptional. A $1M capital gain invested into a QOF, alongside $1M in cost-basis deployed into a 130/30 SMA, generates approximately **$185,000 per year in harvested losses** on the SMA, equivalent to $44,100 in annual tax savings. Over five years, those accumulated losses (~$926K) exceed the $900K taxable gain after the OBBBA step-up.

> **Tax bill: $0.** Three mechanisms stack at year five — the deferred gain, the 10% OBBBA step-up, and five years of accumulated SMA losses — to fully eliminate the liability.

Now re-read that in the context of a constrained long/short environment. The OZ investment gives the loss engine a five-year runway. You don’t need to generate $1M in losses in year one. You have five years to accumulate them systematically, within whatever leverage and allocation limits the custodian allows.

For clients working against a ticking clock, OZ doesn’t just extend the runway. It resets it.

“Enhanced” Long-Only

Long-only direct indexing is still very much a legitimate strategy. It’s designed to generate after-tax alpha while tracking a benchmark. The result is a well-constructed Beta portfolio with meaningful potential for loss accumulation in its early years. But its well-documented limitation is that loss-generating capacity decays as the portfolio matures and embedded gains accumulate. Recently, advisors compensated by reaching for long/short — more aggressive offset against a deferred gain and a more durable loss generating engine.

Long/short, however, comes with real friction. The short book introduces operational complexity that, as we’ve just seen, custodians themselves are struggling to manage at scale. Short locate and borrow costs are fragmented and unpredictable. Margin requirements are meaningful. And the fee drag on long/short strategies runs materially higher than long-only — costs that directly erode the tax alpha you’re trying to capture. For many clients, the juice was worth the squeeze. Now, with access constrained and execution less certain, it’s worth revisiting the drawing board.

We’ve already established that no single strategy fully solves the time constraint on its own. With OZ in the picture, you can spare your clients the operational complexity and fee load of highly leveraged long/short accounts. It no longer needs to do the heavy lifting. The five-year deferral window gives a long-only SMA the time it needs to accumulate sufficient losses to offset the invested gain, steadily and systematically, without the operational baggage.

And the structure gets even more compelling around years three and four. Well-structured OZ real estate projects typically refinance their underlying assets as construction stabilizes and properties reach stabilized occupancy. Those refi proceeds are distributed back to investors as debt proceeds, not income, which means no recognition event.[3] Redeployed into the long-only SMA, they arrive as fresh capital with new cost basis, resetting the harvesting clock before the long-only portfolio begins to ossify.

The pairing isn’t a fallback for advisors who can’t access long/short. It’s a complete solution in its own right.

The Pairing Does More Than Manage Taxes — It Builds a Better Portfolio

There’s a version of this conversation that never gets had because advisors frame the OZ + SMA pairing purely as a tax exercise. The fuller picture is worth examining.

An advisor recommending a long/short or long-only SMA is, by definition, adding equity exposure. The SMA is an equity portfolio, diversified across names, yes, but correlated to the same market forces driving the client’s existing holdings. When the gain event happens — a business sale, a liquidity event, a concentrated position — the instinct to redeploy into an SMA keeps the client squarely in the asset class they just partially exited.

This is especially worth considering in today’s market, where index-heavy equity portfolios are increasingly concentrated in a handful of mega-cap tech names. A long-only SMA tracking a broad index isn’t as diversified as it appears — and a client who just sold a concentrated tech position may find themselves right back in similar exposure. The SMA manages the gain. It doesn’t solve the concentration problem.

OZ changes that. A well-structured OZ investment is institutional-quality real estate, an asset class with low correlation to public equities, driven by different supply and demand dynamics, and producing returns through a fundamentally different mechanism.

This isn’t just tax-efficient portfolio construction. It’s genuine diversification. The SMA manages the gain. The OZ investment puts that gain to work in an asset class that earns its place in the portfolio independent of the tax wrapper. For clients who’ve spent decades accumulating equity exposure, that’s not a minor footnote. It’s a meaningful allocation shift.

The counterfactual of going SMA-only doesn’t fully solve the problem. Long-only ossifies. Long/short is increasingly hard to access. And both require either careful pre-planning or a favorable calendar — a gain that hits late in the year leaves little runway to harvest meaningful losses before the tax year closes. OZ sidesteps all of it. However you think about the pairing, the simplest way to frame what OZ does is this: it buys you time. Time to harvest, time to plan, time to build a better portfolio.

Fair Questions Worth Asking

Not every OZ investment is created equal, and any advisor worth their fee should push back on that point before anything else. The tax benefits are real, but they don’t rescue a bad real estate deal. Underwrite the investment first. Look at the market fundamentals, the sponsor’s track record, the asset class demand, and the business plan as if the tax wrapper didn’t exist. If the deal stands on its own merit, the OZ benefits are the bonus — not the thesis. Don’t let the tax tail wag the dog.

The second question is one of client suitability. OZ investments require patient capital. A ten-year hold is the structure, not a worst case scenario, and advisors have to know whether their client can genuinely support that before the conversation goes any further. The gain event itself is a useful filter — a client reinvesting proceeds from a business sale is in a fundamentally different position than one who may need that capital working for them in the near term. Getting this wrong doesn’t just hurt the client. It poisons the well for a strategy that, in the right hands, delivers exceptional outcomes.

Finally, the complexity is real. Coordinating across investment, tax, and financial planning requires active participation from the advisor, the client’s CPA, and the fund manager. For advisors who lean into that coordination, it becomes a point of differentiation — the kind of multi-disciplinary work that separates a sophisticated practice from a transactional one. For those who don’t, it’s a friction point worth acknowledging honestly before you start.

Use them as a filter, not a reason to walk away.

PINNACLE PARTNERS

The Bottom Line

The restrictions at Fidelity and Schwab are a signal, not an anomaly. Long/short SMAs are phenomenally powerful tools, and the industry is still building the infrastructure to support them at scale. For advisors who have been recommending these strategies independently, this is the moment to revisit the structure.

Whether you're pairing OZ with a long/short SMA or a long-only strategy refreshed by a refi distribution, the architecture is the same: OZ as the gain deferral anchor, the SMA as the loss harvesting engine.

If you're working with a client sitting on a gain and wondering how to structure a long-term tax picture, this is worth a conversation.

Want to go deeper?

Pinnacle Partners has developed detailed analysis on the OZ + TLH SMA pairing, including projected growth models, year-by-year tax timelines, and refi distribution mechanics. We're happy to share that literature directly.

JB Menefee john@pinnacleoz.com · 541.610.5671

Blake Backer blake@pinnacleoz.com · 425.736.7084

[1] Sullivan, Brent. "Tax-aware long/short grows to $150+ billion AUM." Tax Alpha Insider, April 30, 2026. https://www.taxalphainsider.com/p/tax-aware-longshort-grows-to-150

[2] The 10% basis step-up applies to investments in urban Qualified Opportunity Zone Funds. Investments in rural-designated Opportunity Zones are eligible for a 30% basis step-up under OBBBA.

[3] Refinancing proceeds are debt, not income, and do not trigger a recognition event under current QOF rules. However, distributions in excess of the investor's basis in the QOF interest may be treated as a partial inclusion event. Confirm treatment with qualified tax counsel prior to refinancing.