CAPITAL GROUP® | AMERICAN FUNDS®

Introducing Capital Group ETFs to our Tax-Aware portfolios: ETFs can help improve tax efficiency

Capital Group exchange-traded funds (ETFs) are now included in the following tax-aware solutions*:

American Funds Model Portfolios

- American Funds Tax-Aware Moderate Growth Model Portfolio
- American Funds Tax-Aware Growth and Income Model Portfolio
- American Funds Tax-Aware Moderate Growth and Income Model Portfolio
- American Funds Tax-Aware Conservative Growth and Income Model Portfolio
- American Funds Tax-Aware Moderate Income Model Portfolio
- American Funds Tax-Aware Conservative Income Model Portfolio

American Funds Portfolio Series

- American Funds Tax-Aware Conservative Growth and Income Portfolio (Class F-2: TXIFX)

Legend:
- Growth
- Growth and Income
- Preservation and Income

Why add ETFs to our tax-aware portfolios?

One of the benefits of ETFs is that they offer investors tax efficiency, which stems from the unique way that they're structured. This allows for two main sources of tax efficiency: trading in the secondary market (aka: externalization)[1] and in-kind redemptions.[2]

The key is the creation/redemption process, which allows for in-kind redemptions. In-kind redemptions typically result in distancing ETF shareholders from redemption activity by individual investors.

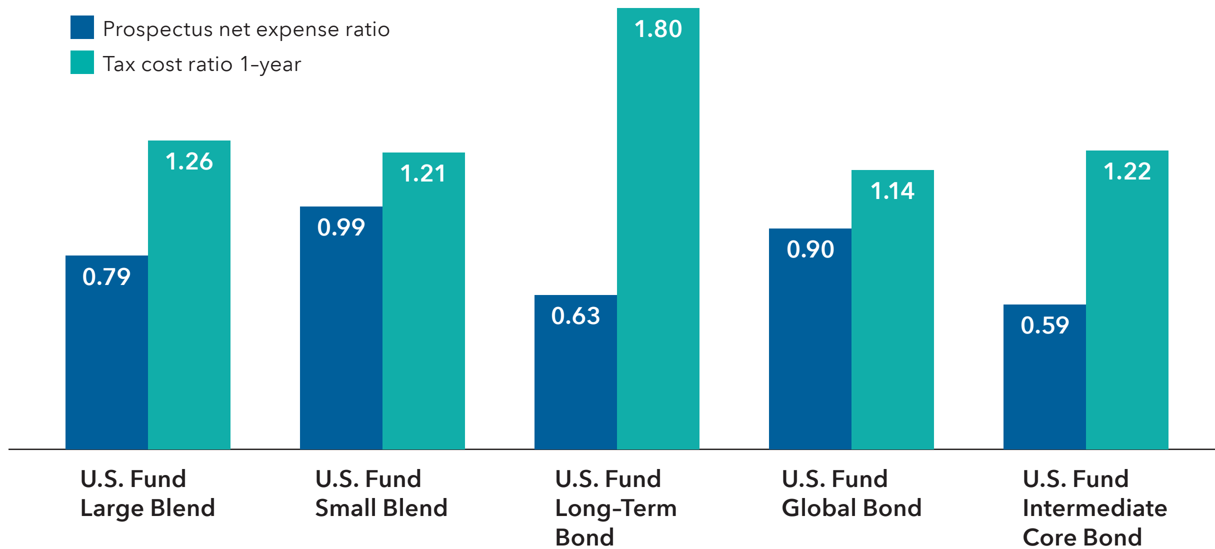
Why is tax efficiency important?

Taxes are usually a bigger drag on investment results compared to fees. While expense ratios are important, taxes can be even more of a drag on returns. If you compare the average net expense ratios from Morningstar's universe of investment products, including mutual funds and ETFs, to their tax cost ratios, (which Morningstar uses to measure how much the annualized return is reduced by taxes)[3] you'll notice that the drag on results is much greater from taxes than expenses.

*We added the following Capital Group ETFs to our tax aware solutions in September 2023: Capital Group Global Growth Equity ETF (CGGO), Capital Group Growth ETF (CGGR), Capital Group Core Equity ETF (CGUS), Capital Group Dividend Value ETF (CGDV).

Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so they may lose value.

Tax drag impact on results compared to expense ratio



Source: Morningstar fund categories; data as of 8/31/23

Tax drag is important because 45% of mutual funds still paid capital gain distributions in 2022,[4] despite poor market returns. In comparison, only 4% of ETFs paid capital gain distributions, while 6% of actively managed ETFs and 2% of passively managed ETFs distributed capital gains in 2022. When we compare the rates at which mutual funds and ETFs[5] paid capital gains distributions, we can see that the structure of the ETF is the reason for the tax efficiency, not the investment approach.

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[1]Externalization: ETFs trade in the secondary market, like a stock exchange, which largely insulates the fund from individual investors' trading activity. In other words, if an ETF investor decides to sell shares of an ETF, a majority of the time, the transaction will occur in the secondary market, which does not involve any interaction with (or impact to) the fund.

[2]In-kind redemptions: When selling activity on an exchange does result in a redemption from the fund, it is usually tax-free to remaining investors. ETFs generally satisfy redemption requests in the primary market through an in-kind delivery of securities to an intermediary (rather than cash), which means client redemptions from the fund do not generally create taxable events for remaining shareholders.

[3]Per the SEC's guidance, after-tax returns are calculated with the highest tax rates prevailing at the time of the distribution, as if the investor were in the highest tax bracket (37% maximum federal tax rate on capital gains and ordinary income). Because Morningstar uses after-tax returns to calculate the tax cost ratio, those assumptions also apply to the tax cost ratio. Therefore, the tax cost ratio is an estimate of what investors experienced. Investors in lower tax brackets will not experience the full tax costs implied by the tax cost ratio.

[4]Source: Morningstar based on data for the year ending December 31, 2022 and accessed on January 20, 2023.

[5]Source data includes all mutual funds and ETFs issued in the U.S. and excludes obsolete funds and target-date funds.

Investors should carefully consider investment objectives, risks, charges and expenses. This and other important information is contained in the fund prospectuses and summary prospectuses, which can be obtained from a financial professional and should be read carefully before investing.

Model portfolios are provided to financial intermediaries who may or may not recommend them to clients. The portfolios consist of an allocation of funds for investors to consider and are not intended to be investment recommendations. The portfolios are asset allocations designed for individuals with different time horizons, investment objectives and risk profiles. Allocations may change and may not achieve investment objectives. If a cash allocation is not reflected in a model, the intermediary may choose to add one. Capital Group does not have investment discretion or authority over investment allocations in client accounts. Rebalancing approaches may differ depending on where the account is held. Investors should talk to their financial professional for information on other investment alternatives that may be available. In making investment decisions, investors should consider their other assets, income and investments. Visit capitalgroup.com for current allocations.

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TXIFX: The return of principal for bond funds and for funds with significant underlying bond holdings is not guaranteed. Fund shares are subject to the same interest rate, inflation and credit risks associated with the underlying bond holdings. Higher yielding, higher risk bonds can fluctuate in price more than investment-grade bonds, so investors should maintain a long-term perspective. Investing outside the United States involves risks, such as currency fluctuations, periods of illiquidity and price volatility, as more fully described in the prospectus. These risks may be heightened in connection with investments in developing countries.

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