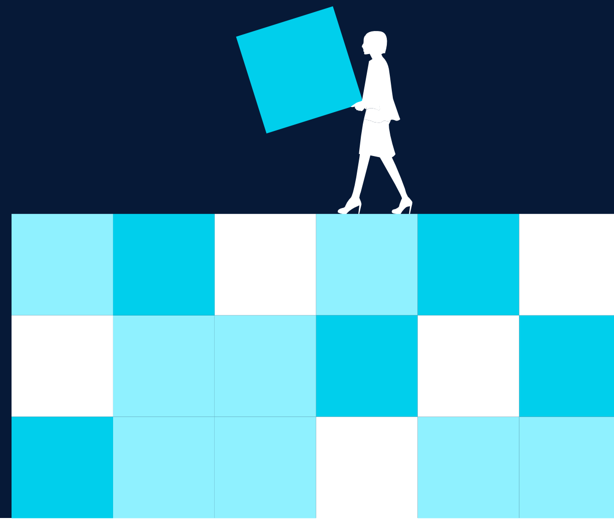
T. Rowe Price



Active ETFs and tax loss harvesting: What you need to know

From the Field
August 2024

Key Insights

- Exchange-traded funds generally have a more favorable structure for tax efficiency than some other investments, such as mutual funds.
- The dispersion and focus on Magnificent 7[1] (MAG7) stocks present an opportunity for skilled managers in the small- and mid-cap space to add alpha.
- Tax loss harvesting opportunities are limited in 2024, but there are some categories that have been under pressure and in the red over longer time frames.

Kevin Signorelli
Head of ETF Specialists

Chris Murphy
CIMA®, Senior ETF Specialist

With year-end approaching, the time to evaluate capital gains consequences and "tax smart" strategies in nonqualified accounts is here. Opportunistically trading positions can have a meaningful impact on capital gains liability and after-tax performance. Whether an investor has losses to harvest or seeks to realize a gain on a position to avoid a meaningful capital gain distribution, moving those assets into an exchange-traded fund (ETF) may have the potential to produce a tax-efficient portfolio moving forward. Active ETFs may be a good tool for investors to consider during this year's tax loss harvesting season. The active ETF market now offers investors access to well-known active asset managers, such as T. Rowe Price, along with the major ETF benefits of convenience, cost-effectiveness, and capital gains tax efficiency.

Why consider using an active ETF as we approach year-end?

1. ETFs have been more tax-efficient

In terms of capital gains tax, ETFs have historically been a more tax-efficient vehicle than some other investment structures, such as mutual funds. The main

[1] "The "Magnificent 7" comprise Alphabet (Google), Amazon, Apple, Meta, Microsoft, NVIDIA, and Tesla. The specific securities identified and described are for informational purposes only and do not represent recommendations.

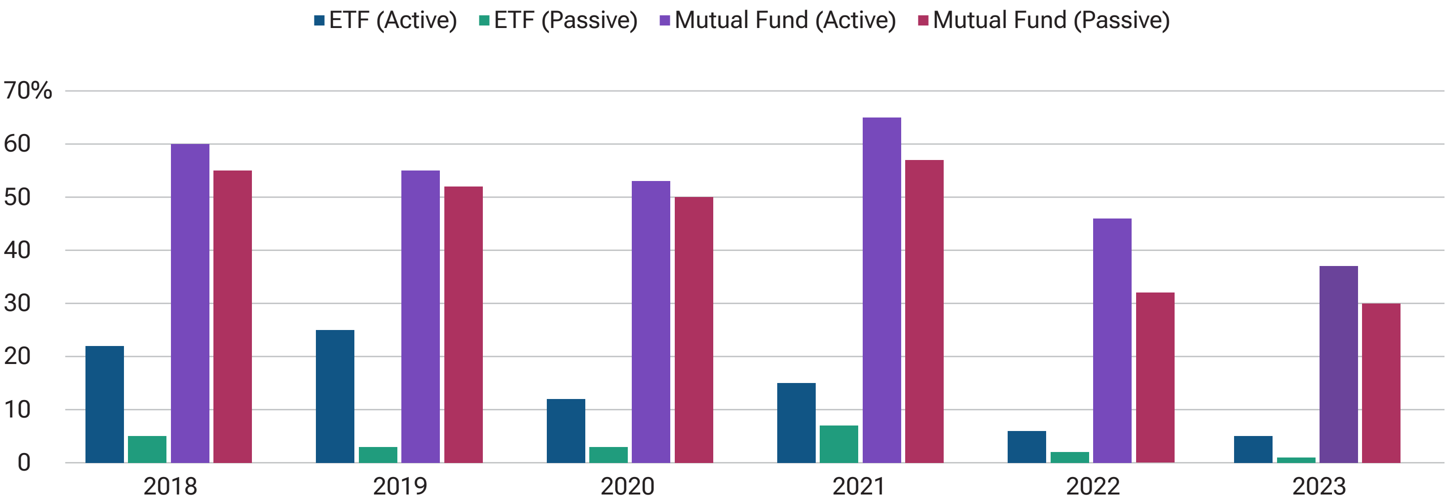
reason ETFs have been more tax-efficient is due to the ETFs' unique create/redeem mechanism and the ability for ETFs to facilitate outflows in kind. Even though ETFs may still generate a capital gain distribution, the impact of shareholders buying and selling doesn't play a role the way it does with mutual funds.

Keep in mind, there are many factors that will impact the tax efficiency of an ETF and should always be taken into consideration (trading activity, issuer procedures, time in market, etc.). For investors seeking a tax-efficient vehicle with the benefits of active management, active ETFs have the potential to add value to an investor's portfolio.

The graph below (Fig. 1) illustrates the percentage of all active and passive U.S.-listed mutual funds and ETFs that made capital gain distributions in each of the past five calendar years. It's a myth to say that an ETF will never generate a capital gain. But structurally speaking, ETFs have done so at a much lower rate than mutual funds—even actively managed strategies. Some of T. Rowe Price's Active Equity ETFs, for example, have distributed little (or in some cases, even zero) year-end capital gains over the past three years.

Percentage of mutual funds and ETFs that distributed capital gains

(Fig. 1) Over the past five years, fewer ETFs than mutual funds paid capital gains



From December 31, 2018, to December 31, 2023.
Past performance is not an indication of future results.
Source: Morningstar Direct, calendar year data as of 12/31/2023. Percentage of the total number of products that distributed long-term and/or short-term capital gains across all U.S.-listed mutual funds and ETFs. Percentages were calculated on a per-year basis at year-end, based on the Morningstar Direct database, and vary by year. See Additional Disclosure.

2. Active ETF strategies have added alpha in the small- and mid-cap U.S. equity markets

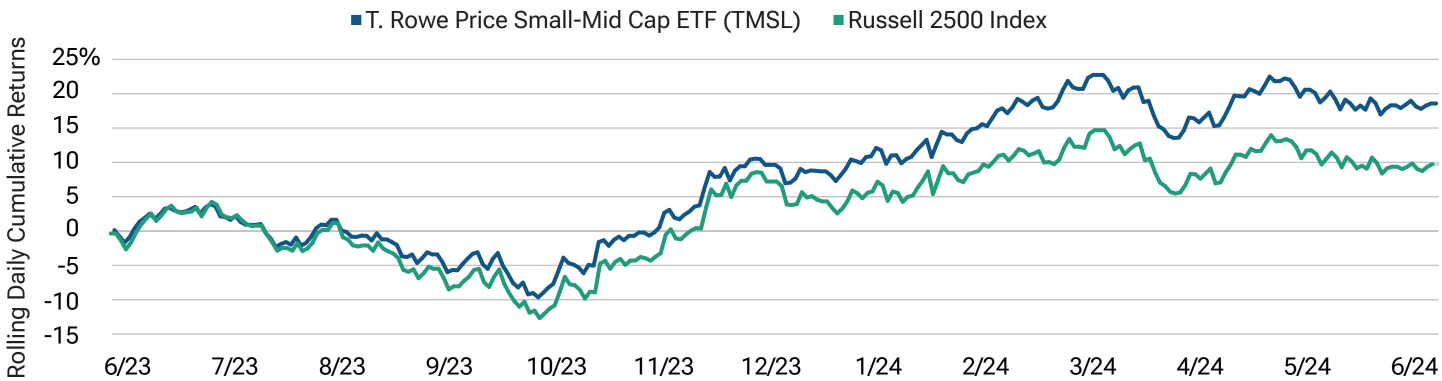
With outsized market leadership and investor interest in MAG7 stocks, many quality businesses are being overlooked by investors, including some of the most attractive stocks in the small- and mid-cap space. Historically, intra-stock dispersion tended to lead to an increase in active manager outperformance of the index. Even in 2023, a year in which large-cap indices were dominated by just a handful of mega-cap technology stocks, small-caps still had the widest dispersion of returns. In this environment, skilled active managers with depth of resources should be able to find ways to generate alpha. And they did—with 65.7% of small- and mid-cap core managers beating the Russell 2500 Index year-to-date, and 49% outperforming over the last 12 months.[2] The T. Rowe Price Small-Mid Cap ETF (TMSL) has exceeded the returns of the Russell 2500 Index by 8%[3] over the last year.

65.7%

of small- and mid-cap core managers beat the Russell 2500 Index year-to-date.

Opportunity exists in the small- and mid-cap space for active ETF managers

(Fig. 2) The T. Rowe Price Small-Mid Cap ETF (TMSL) outperformed the Russell 2500 Index over a trailing 12-month period



Performance data quoted represents past performance and does not guarantee future results; current performance may be higher or lower than performance quoted. Investment returns and principal value will fluctuate and shares, when sold, may be worth more or less than their original cost. To obtain the most recent month-end performance, visit troweprice.com. Market returns are based on the midpoint of the bid/ask spread as of 4 p.m. ET and do not represent returns an investor would receive if shares were traded at other times.
Please also see Additional Disclosures for standardized performance information.

From June 30, 2023, to June 30, 2024.
Source: T. Rowe Price.

[2]Source: As of June 30, 2024; Jefferies.
[3]As of June 30, 2024. Average annual one year return.

3. Lower fees for an active approach

When considering a move from mutual funds to ETFs, actively managed ETFs may also offer investors a way to reduce overall portfolio expenses in the process. Reduced expenses can help with the overall long-term outcome. ETF operational costs are often streamlined relative to active mutual funds with fewer shareholder services, client statement reporting, and other expenses. Well-established firms may have additional pricing advantages. By leveraging the global scope and scale of our firmwide resources, T. Rowe Price active ETFs are competitively priced relative to their peer groups. For example, illustrated below (Fig. 3) are some examples of where T. Rowe Price active ETFs offer competitive fees relative to category averages.

Are there tax loss harvesting opportunities this year?

Only a few investment categories may be worth considering for tax loss harvesting opportunities in 2024, and, ultimately, it will depend on an investor's holding period and individual portfolio allocations. Investors should always consult their financial professional and tax advisors accordingly.

1. Static thematics

After taking the ETF world by storm in 2021, thematic investing continues to impact ETFs in 2024 and beyond. Over 155 thematic equity ETFs are available to investors with a collective AUM exceeding USD 122 billion.[4]

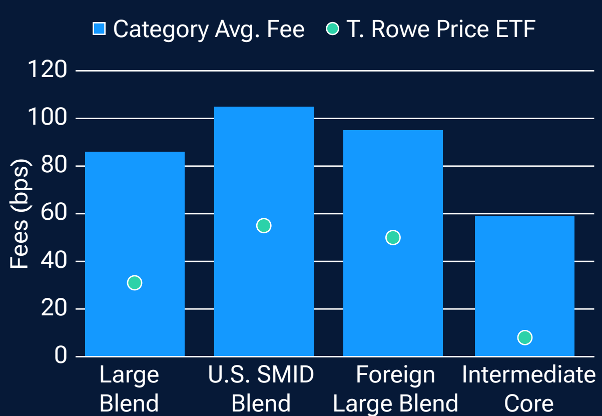
The thematic ETF category is quite diverse, offering both wide-ranging and singularly focused options. Today's investors have opportunities to pursue broader, multi-themed "Innovation" ETFs that cast a wide net across traditional industries and sectors or take a more granular approach with ETFs that focus on clean energy, advanced infrastructure, life sciences, electric vehicles (EVs), or robotics.

With some of the largest thematic ETFs down substantially over the last three

[4] As of May 31, 2024, ETF Action.

Fee comparison of T. Rowe Price active ETFs

(Fig. 3) ETF total expense ratios versus category averages of mutual funds



Mutual Fund Category	Category Avg. Fee	T. Rowe Price Active ETF Solution	Expense Ratio	Difference
Large Blend Equity	0.86%	TCAF	0.31%	**0.55%**
U.S. SMID Blend Equity	1.05%	TMSL	0.55%	**0.50%**
Foreign Large Blend Equity	0.95%	TOUS	0.50%	**0.45%**
Intermediate Core Bond	0.59%	TAGG	0.08%	**0.51%**

Past performance is not an indication of future results.
Source: Morningstar Active/Passive Barometer study as of 6/30/2024. Percentage of the total number of actively managed U.S.-listed mutual funds and ETFs that outperformed their benchmark across all Morningstar categories, intermediate core bonds, and small-cap equities. All data calculated and reported by Morningstar, illustrated by T. Rowe Price. See Additional Disclosure.

years, however, we see an opportunity for investors sitting on losses to swap with active ETFs that can still provide access to companies at the forefront of emerging trends but in a diversified approach.

2. Fixed income funds still under water

Most fixed income funds have remained in the red over the last three years. Investors may want to consider both taxable and tax-exempt active bond strategies that can shift across multiple segments of the risk and maturity spectrum while exploiting structural index inefficiencies. More recently, a sharp pullback in below investment grade markets—in particular, bank loans—has provided a tactical opportunity for investors to harvest losses in that asset class.

As we move into the end of 2024, active ETFs can be a useful tool for investors looking to reposition their portfolios. ETFs offer multiple benefits, including tax efficiency, lower costs, and the potential to outperform the benchmark. There are many factors and considerations that can impact the tax efficiency of any investment. Remember, individual investor circumstances will vary.

Tax loss harvesting opportunities

(Fig. 4) Only a few investment categories are worth considering this year

2024 Opportunities	Strategies to Consider
Static Thematics	TGRT: T. Rowe Price Growth ETF TMSL: T. Rowe Price Small-Mid Cap ETF
Fixed Income Funds Still Under Water	TOTR: T. Rowe Price Total Return ETF TFLR: T. Rowe Price Floating Rate ETF TAGG: T. Rowe Price QM U.S. Bond ETF TAXE: T. Rowe Price Intermediate Municipal Income ETF

ETFs offer multiple benefits, including tax efficiency, lower costs, and the potential to outperform the benchmark.

INVEST WITH CONFIDENCE™

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

Additional Disclosure

The Russell 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, also referred to as "smid" cap. The Russell 2500 Index is a subset of the Russell 3000® Index and includes approximately 2500 of the smallest securities, based on a combination if their market cap and current index membership.
For more information on Third Party Market Data, please visit troweprice.com/marketdata.

T. Rowe Price Small-Mid Cap ETF (TMSL)
Average Annual Returns

	1 Year	3 Years	5 Years	Since Inception
Market Price	18.36%	N/A	N/A	20.32%
NAV	18.58%	N/A	N/A	20.40%
Benchmark	10.47%	-0.29%	8.31%	11.70%
Value*	8.11%	N/A	N/A	8.70%

Data as of June 30, 2024
Benchmark: Russell 2500 Index
Inception Date: June 14, 2023
*Value is the performance difference between the NAV and benchmark total returns.

T. Rowe Price Small-Mid Cap ETF (TMSL) gross expense ratio: 0.55%. The gross expense ratio reflects the fund expenses as stated in the fee table of the fund's prospectus prior to the deduction of any waiver or reimbursement.

Performance data quoted represents past performance and does not guarantee future results; current performance may be higher or lower than performance quoted. Investment returns and principal value will fluctuate and shares, when sold, may be worth more or less than their original cost. To obtain the most recent month-end performance, visit troweprice.com. Market returns are based on the midpoint of the bid/ask spread as 4 p.m. ET and do not represent returns an investor would receive if shares were traded at other times.

Important Information

Call 1-800-225-5132 to request a prospectus or summary prospectus; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

The information contained herein is not intended as tax advice. This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. This information is not intended to reflect a current or past recommendation concerning investments, investment strategies, or account types; advice of any kind; or a solicitation of an offer to buy or sell any securities or investment services. The opinions and commentary provided do not take into account the investment objectives or financial situation of any particular investor or class of investor. Please consider your own circumstances before making an investment decision.

The views expressed are those of the author as of July 2024 and are subject to change without notice; these views may differ from those of other T. Rowe Price associates. Information contained herein is based upon sources we consider to be reliable; we do not, however, guarantee its accuracy. All data are subject to change or revision.

ETFs are bought and sold at market prices, not net asset value (NAV). Investors generally incur the cost of the spread between the prices at which shares are bought and sold. Buying and selling shares may result in brokerage commissions, which will reduce returns.

Risk Considerations: Past performance is not a reliable indicator of future performance. All investments are subject to market risk, including the possible loss of principal. Active investing may have higher costs than passive investing and may underperform the broad market or passive peers with similar objectives. As with all equity investments, the share price can fall because of weakness in the broad market, a particular industry, or specific holdings. Fixed income investing involves risks, including, but not limited to, interest rate risk and credit risk. Diversification does not guarantee protection against losses.

T. Rowe Price Investment Services, Inc. distributor, and T. Rowe Price Associates, Inc., investment adviser.

202407-3707512
CCON0193383