Investing That Reflects *What Matters to You*

An introduction to direct indexing and the benefits of VADIS



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First Affirmative Financial Network, LLC, doing business as Formative · Registered Investment Advisor
SEC File #801-56587 · Colorado Springs, CO · Certified B Corporation

The Evolution *of Investing*

From active management to index funds to something more personal.

One of the most important findings in modern finance is that it is extremely difficult to consistently beat the stock market. S&P Dow Jones Indices found that over the 20 years ending in 2025, about 95% of actively managed U.S. stock funds underperformed their benchmark index.[1]

This insight led to one of the most significant shifts in investing history: the growth of index funds with a goal of matching, not beating, the market. These funds hold a broad basket of stocks designed to mirror the performance of a market index, like the S&P 500 or the total global stock market. As of August 2026, index funds held about 54% of U.S. long-term mutual fund and ETF assets, up from 19% in 2010.[2]

But index funds come with limitations. Because a fund pools your money together with other investors, you can't customize the portfolio to reflect your personal values. And you potentially miss out on powerful tax-saving strategies that are only possible when you own stocks individually.

Direct Indexing represents the next step in this evolution. As its name implies, it is another form of index investing with a goal of matching the financial performance of the market, but you own individual stocks directly instead of through a fund. This direct ownership provides potentially meaningful advantages in tax management and values alignment. That's the foundation of VADIS.

Active Management	Index Funds & ETFs	Direct Indexing
A manager picks stocks, trying to beat the market.	Goal to match the market at low cost, but no personalization.	Goal to match the market, with added values alignment and potential tax benefits through direct ownership.

1. S&P Dow Jones Indices, SPIVA U.S. Scorecard, Year-End 2025 (https://www.spglobal.com/spdji/en/documents/spiva/spiva-us-year-end-2025.pdf).

2. Investment Company Institute, Active and Index Combined Long-Term Mutual Funds and ETFs, August 2026 (https://www.ici.org/research/stats/combined_active_index); 2010 figure from the ICI 2025 Investment Company Fact Book.

What Exactly Is *Direct Indexing?*

In a traditional index fund, you buy a single product that holds stocks on your behalf. Every investor in that fund owns the same stocks. Direct indexing takes a different approach. Your portfolio holds a selection of individual stocks from the benchmark, selected to closely match the benchmark's performance while reflecting your personal values and tax needs. The goal is returns similar to the benchmark's, delivered through a customized portfolio.

Step 1: Choose a Benchmark

The process begins by selecting a benchmark that matches your risk tolerance and investment goals. For example, an investor might choose a global stock benchmark. Your portfolio will aim to mirror the financial performance of this selected benchmark.

Step 2: Express Your Values and Tax Needs

You can choose to remove companies or industries that conflict with your values, and tilt toward companies leading on issues you care about. Tax considerations can also shape portfolio decisions. For example, if you already hold stocks that would generate a large tax bill if sold, a direct indexing strategy can keep those holdings and build the rest of the portfolio around them.

Step 3: Optimize to Match Benchmark Performance

Once values and tax needs are expressed, a direct indexing strategy optimizes your portfolio with an objective to minimize **tracking error** — a measure of how much your portfolio's returns are expected to vary from your benchmark's (see Glossary for more details) — while reflecting your tax and values objectives.

> **EXAMPLE: HOW DOES THE PORTFOLIO MIRROR THE BENCHMARK IF I REMOVE COMPANIES?**
>
> If you choose to remove a company from your portfolio, the portfolio doesn't simply leave a gap. Direct indexing strategies identify other stocks with similar market characteristics — such as sector, size, and price behavior — and adjust their weights so the portfolio continues to perform similarly to the benchmark, even without the excluded company.

Step 4: Ongoing Management

Once the portfolio is built, it is actively maintained. Ongoing management includes periodic rebalancing to stay aligned with the benchmark, tax-loss harvesting to capture savings opportunities as they arise (when applicable), and adjustments as your values preferences or financial circumstances evolve.

Tax Benefits of *Direct Indexing*

Owning individual stocks enables a range of tax strategies, including:

- Building around stocks you already own instead of selling them and paying tax
- Holding each investment in the account where it's taxed most favorably
- Donating shares with large gains to charity

One significant strategy to highlight is **Tax-Loss Harvesting**.

What Is Tax-Loss Harvesting?

When a stock in your portfolio drops below the price you paid for it, you have an **unrealized loss**. Tax-loss harvesting means selling that stock to realize the loss, which can then offset **capital gains** from your other investments and, in limited amounts, ordinary income.

What about "Buy low, sell high"?

At first glance, tax-loss harvesting seems to break the oldest rule in investing: buy low, sell high. But when a direct index portfolio sells a stock for tax purposes, it immediately buys a similar one,[3] such as selling one bank stock and buying another. You stay invested, ready to benefit if prices recover, and you capture a loss you can use at tax time.

> One academic study estimated that tax-loss harvesting added about 0.8% a year in after-tax value.[4] It generally defers taxes rather than eliminating them, since replacement shares have a lower cost basis; the benefit comes from keeping more invested in the meantime.

Why Individual Stocks Create More Opportunities

Even when the overall market rises, individual stocks behave very differently: some may gain 50% or more while others fall 20% or 30%. A fund averages these into a single return. When you own the stocks individually, you can act on each one:

Stocks That Appreciate

Hold for long-term growth or donate the most appreciated shares to charity for a deduction at full market value with no capital gains tax.

Stocks That Decline

Sell to harvest the loss, offsetting gains on your tax return.

3. Tax rules don't let you claim a loss if you or your spouse buy the same or a nearly identical investment within 30 days of the sale, in any account (the "wash sale" rule). That's why a similar stock is bought instead. VADIS monitors for wash sales across the accounts it manages. Wash-sale monitoring reduces risk but cannot guarantee avoidance in all circumstances.

4. Chaudhuri, Burnham, and Lo, "An Empirical Evaluation of Tax-Loss-Harvesting Alpha," Financial Analysts Journal, 2020. Hypothetical; reflects wash sale rules, excludes transaction costs. Results will vary.

What Is *VADIS?*

VADIS (Values-Aligned Direct Index Solution) is a direct indexing solution tailor-made for people who want to align their investments with their values. Combining advanced data and technology with experienced investment management, VADIS helps you identify and reflect your values through your portfolio. VADIS is built by two leaders in values-based investing:

YourStake
THE DATA

More than 150 data points on what companies actually do, from carbon emissions to labor practices, so you can see exactly why each one is in or out of your portfolio.

Formative
THE INVESTMENT TEAM

A pioneer in values-based investing since 1988. Formative manages your portfolio as a fiduciary, with a legal and ethical duty to act in your best financial interest.

You choose what matters

Human Rights · Environment · Weapons · Healthy Communities · Responsible Technology · Equality & Justice · Animal Welfare · Faith-Based Values

These are just a starting point. You can be as broad or as specific as you like, from avoiding an entire industry to supporting companies that lead on a single issue.

WHAT YOU CAN COUNT ON

Know what you own
Your portfolio holds individual stocks in your own account, so you can see what you own.

Designed to track
It aims to closely follow a broad market benchmark you choose with your advisor.

Personalized to you
Your values, risk, and tax needs reflected in your portfolio

Where VADIS *Stands Apart*

VADIS includes all of the benefits of direct indexing described earlier. What sets it apart is how deeply it's built around your values.

BUILT AROUND YOUR VALUES

In-Depth Values Personalization

Choose from 150+ values-based metrics. Leave out what you don't want to own, and invest more in companies leading on what you care about.

Guided Values Discovery

A values questionnaire and your advisor help turn what you care about into clear portfolio choices.

Clear Impact Reporting

See how your portfolio compares to the market on the issues you chose, with concrete measures like quantity of pollution or dollars of labor violations.

A Voice in Your Companies

VADIS engages directly with company management to push for change on your behalf and votes your shares in line with your values.

PLUS, RIGOROUS FINANCIAL MANAGEMENT

Tax-Aware Management

In taxable accounts, VADIS works with your advisor to limit the taxes you pay while transitioning, then looks for losses to harvest along the way.

Household Optimization

If you have several accounts, VADIS can coordinate across them, holding each investment where it's taxed least while keeping your overall portfolio aligned.

Your Journey *With VADIS*

From your first conversation to seeing the impact of your investments.

1	**Share what matters to you**	Complete risk and values questionnaires, then work with your advisor to choose a benchmark and refine your preferences. Together, you'll also discuss any tax needs you'd like reflected in your portfolio.
2	**Review your proposal**	VADIS builds a proposed portfolio that avoids the companies you want to leave out and favors those you want to support. See how it compares to your benchmark (or current holdings) on values, risk, and taxes.
3	**Approve and get invested**	Once you approve your proposal with your advisor, Formative invests your account. If applicable, the move from what you own today in a taxable account can be managed to limit taxes.
4	**Watch it adapt with you**	Your portfolio is rebalanced over time to stay on track. When your values or circumstances change, tell your advisor and your portfolio changes with you.
5	**See your impact**	Your reports show how your portfolio is doing, both financially and on your values. Review them with your advisor along the way.
6	**Make your voice heard**	As a shareholder, you have a say in how companies are run. VADIS votes and engages on your behalf, with no extra work for you.

Is VADIS *Right for You?*

There are many reasons VADIS might be the right fit for your investment needs.

THE CORE FIT

You want your investments to reflect your values *and returns that track the market*

That's exactly what VADIS was built for. Your portfolio reflects the issues you care about while being designed to closely follow a broad market benchmark.

AND/OR

You're in a situation where direct indexing makes sense on its own.

While VADIS is a great solution for anyone prioritizing values-alignment, it also helps with problems traditionally solved by direct indexing.

You're in a higher tax bracket

The higher your tax rate, the more tax management can save you.

You hold a lot of one stock

Diversify around it without being forced into a big taxable sale.

You give to charity

Donate your most appreciated shares for a larger tax benefit.

You have large gains to offset

From selling a business, exercising stock options, or other investments.

You invest new money regularly

New money in a taxable account creates fresh chances to harvest losses.

You have more than one account

Place each investment in the account where it's taxed least, across your household.

Glossary of *Direct Indexing Terms*

Benchmark
The market index your portfolio is designed to track, such as the S&P 500, the MSCI All Country World Index (ACWI), or a blend of stock and bond indexes.

Capital Gain / Loss
The difference between what you paid for an investment and what you sell it for. A gain may be taxed; a loss can offset gains. Before you sell, it's "unrealized."

Capital Gains Budget
A limit you and your advisor set on the gains your portfolio may realize during a transition, to manage your tax bill while aligning existing holdings with your values.

Direct Indexing
Owning a selection of individual stocks from an index in your own account, instead of a fund. It tracks the index while allowing personalization and tax management.

Exclusions and Tilts
An exclusion removes a company or industry from your portfolio. A tilt gives more weight to companies leading on issues you care about.

Household Optimization (Asset Location)
Holding each investment in the account where it's taxed most favorably, like growth stocks in a Roth IRA and bonds in a traditional IRA.

Index Fund / ETF
A fund that holds a basket of securities designed to match a market index. An ETF (exchange-traded fund) trades like a stock. Every investor owns the same holdings.

Proxy Voting & Engagement
Shareholders can vote on company matters and engage with management. With VADIS, you keep these rights, and the VADIS team votes and engages on your behalf, in line with your values.

Rebalancing
Periodically adjusting your holdings so your portfolio stays close to its benchmark as market movements cause some positions to grow or shrink.

Tax-Advantaged Account
An account with special tax treatment, such as a traditional IRA, Roth IRA, or 401(k). Taxes on growth are deferred, or in Roth accounts may be avoided entirely.

Tax-Loss Harvesting
Selling an investment that has dropped below its purchase price to realize a loss that offsets gains, then buying a similar investment so your portfolio stays invested.

Tracking Error
How much your portfolio's returns vary from its benchmark's, measured as the standard deviation of the difference between them. With 1% tracking error, you'd expect your annual return to land within about 1 percentage point of the benchmark's in roughly two out of three years.

Ready to *Get Started?*

VADIS represents the next step in the evolution of index investing. It combines the market-tracking foundation that has served investors well for decades with meaningful personalization, tax-aware management, and a real voice as a shareholder.

Talk to your financial advisor to:

1. Discuss your values and financial goals
2. Review a personalized VADIS proposal
3. See how your current portfolio compares

IMPORTANT INFORMATION

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This material is for informational purposes only and is not investment advice. Direct indexing and tax-loss harvesting involve risk, including tracking error relative to a benchmark. Values screens may cause a portfolio to perform differently than a broad market index. Tax-loss harvesting applies only to taxable accounts and generally defers, rather than eliminates, taxes. Ongoing tax-loss harvesting is available for taxable accounts of $250,000 or more; smaller taxable accounts receive tax-aware management at their annual rebalance. Tax information reflects federal tax treatment; state treatment of capital losses varies. Research findings and hypothetical examples are not a projection or guarantee of future results. Formative does not provide tax or legal advice; please consult your own tax professional regarding your circumstances.

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