THE NORTHWEST QUADRANT

The Financial Advisor's Alpha – Part 2

Larry Solomon, MBA, CFP
Director of Investments and Financial Planning

In my last column, I discussed the ways that financial advisors can add value for their clients, also called the Advisor's Alpha. This quarter, I want to cover specifics on several of those techniques, the estimated value they add, and how they're actually implemented in client portfolios.

Cost-Effective Implementation

Costs matter, and although other professions may claim that "you get what you pay for," in the world of investments, the opposite is true; you keep what you don't pay for. Cost-effective implementation is a critical component of every advisor's tool kit and is based on this simple math. The average mutual fund has expenses of 1.27% according to Morningstar. If low costs are associated with better investment performance, as research has repeatedly shown, then costs should play a primary role in investment selection. Index fund and exchange-traded -fund (ETF) costs are among the lowest in the industry. By focusing on the lowest cost funds, which Vanguard defined as those with expenses in the bottom 10% of their peers, they estimated that advisors could save clients 0.35%to 0.46% annually. Similarly, combining active and passive strategies, a technique that OptiFour uses to drive down costs, results in average expenses of 0.62% vs. 1.06% in an all actively- managed portfolio for a typical moderate investor,
a savings of 0.44%. Note that this value added persists regardless of market conditions and can add thousands of dollars to a client's net worth over time.

Behavioral Coaching

A Vanguard study of actual client behavior in retirement plans found that investors who deviated from their initial allocations trailed an equivalent target-date fund by an average of 1.50% per year. More frequent switching resulted in larger underperformance. This suggests that the guidance that an advisor provides to help clients maintain a long-term perspective and discipline during market turmoil is a huge benefit. Most investors are aware of these time-tested principles, but have difficulty sticking to them, and that is where the advisor, as behavioral coach, really earns his fees. Abandoning an investment strategy can be costly, and research shows that some of the biggest detractors are market-timing and performance chasing, often called the "big mistakes."

Strong relationships need to be established before the volatile markets that challenge investors' confidence in their plan, allowing advisors to act as emotional circuit breakers, circumventing investor's tendencies to chase returns or time the market and protecting them from significant wealth destruction. Saving clients from the "big mistakes" could more than offset years of advisory fees.

Together, effective implementation and behavior coaching can add more than 2% per year to the client's bottom line. Next quarter, I will elaborate on a few more of the tools in the Advisor's Alpha toolkit. ■

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COHEN & BURNETT, P.C.
OPTIFOUR INTEGRATED WEALTH MANAGEMENT, L.L.C.
7601 Lewinsville Road, Suite 205 | McLean, VA 22102
Tel: (703) 847-8900 | Fax: (703) 847-8902
www.cohenandburnett.com | www.optifour.com
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A compass rose is a figure displaying the orientation of the cardinal directions, north, south, east and west on a map or nautical chart. We found it fitting to name our newsletter after this recognizable symbol of navigation and direction. If you prefer not to receive our quarterly newsletter or if you have any feedback or ideas for topics, please email Wes Burnett: wes@optifour.com.

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The Compass Rose

COHEN & BURNETT, P.C. OPTIFOUR INTEGRATED WEALTH MANAGEMENT, LLC

Spring 2015 Volume 26 ESTATE AND FINANCIAL PLANNING UPDATE

FOUNDING PARTNER

I. Mark Cohen, J.D., LL.M., CFP®

Ever since my daughter, Rachel, was a teenager we have had a tradition of visiting New York City during Spring Break and watching a Broadway show. This tradition continued all the way through college, until she moved to San Antonio, Texas, and began her teaching career. I am pleased to report that we will be resuming this tradition this Spring Break. Additionally, my son, Michael, will be flying in from Arizona to join us as well. We plan to see the Book of Mormon and eat a deli sandwich from Katz's.

Rachel is now finishing her third year with Teach for America and is planning to obtain her graduate degree in educational policy. She has been admitted into a number of great programs, but is keeping her options open. Michael will be ending his tour with the Army in the fall and has also been admitted into a number of great graduate programs but is holding out until he can consider all of his options.

My youngest daughter, Holly, has been continuing her work with the Capitol Area Food Bank but has begun taking online courses towards a graduate degree in community development from Penn State.

Meanwhile, when Leigh moved in with me she brought with her one dog (Cricket) and three cats (Ted, Ben, & Kyle). Since then we have adopted another dog, Bandit. He, like the other pets, is a rescue. Unfortunately, we had to say goodbye to Cricket, who was suffering from cancer. Virtually a perfect dog, Cricket had served as a wonderful role model for Bandit. In order to fill the gap left by Cricket, we recently adopted Penny, a sweet Australian Shepard/German Shepard mix.

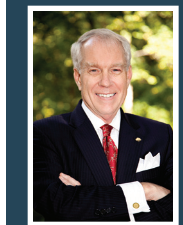
Leigh and I are doing fantastic. I am happy to announce that we have signed up for the "One Day Hike" which is a 50km (31 miles) walk on the C&O canal towpath from White's Ferry to Harper's Ferry. Most weekends we will be training for this event by spending 6-8 hours walking on the towpath with our dogs Bandit and Penny. This will be an exciting adventure for the both of us. ■

Welcome New Members of the Family

Cohen & Burnett welcomes two new members to its dedicated team, Rasheda Nipu and Tanya Blakely. Rasheda joined the team this past fall as the firm's newest Associate Attorney. Rasheda graduated from the University of Virginia with a Bachelor's Degree in Psychology. In May, she earned her law degree from Syracuse University and was admitted into the VA Bar in December of 2014.

In January, Tanya M. Blakely, joined OptiFour Integrated Wealth Management as Director of Client Relations. As such, she is responsible for overseeing all OptiFour client services. Tanya lived in Germany from the time she was 7 months old until age 7. She graduated from the University of Wuerzburg in 2004, with a Bachelor's Degree in International Business.

Tanya started her career working for large brokerage firms including Bank of America, Merrill Lynch, and Morgan Stanley. After 10+ years of working for Corporate America, she began her career at a Registered Investment Advisory firm in Maryland, where she specialized in Investment Operations. ■



MANAGING PARTNER

Weston D. Burnett, J.D., LL.M., CFP®

As I write this in late February, the temperature is close to zero and snow is falling, but by the time you read this, spring will have arrived with blossoming trees. We have started work on a total revamp of our websites, www.optifour.com and www.cohenandburnett.com, with a view towards launching the updated versions later this year. Around the same time, we also expect to become active through social media.

Cybersecurity is in the news daily with hackers finding their way into all kinds of large corporations and government organizations. Accordingly, as a proactive measure, we commissioned our own cybersecurity study this past winter which has led to numerous changes made by our IT provider, various additional upgrades in software, as well as internal changes in our own policies and procedures. You should now notice many changes in how we serve you.

On the family side, our daughter-in-law, Alka Pradhan was in the news and on TV a lot. Her work as a human rights attorney has garnered national and even international attention. We always find it interesting to see her on some news broadcast. In February, our family gathered several times to celebrate five birthdays. On March 20, Barb and our granddaughter, Sitara, celebrated their joint birthday. On April 5, we all rushed around outside our house on a mad Easter Egg Hunt, a fine family tradition made up of crazy people laughing and running with a little competitive juice flowing. Our granddaughter, of course, gets the head start. Additionally, in May, Barb's mother will celebrate her 90th birthday at our house and our granddaughter gets baptized by the same Navy chaplain who baptized her father (our son) and her aunt (our daughter).

In the meantime, I have three articles pending publication in a philatelic magazine. I will join my son in late April in Spartanburg, SC for a BMW performance driving school. Further, this spring, my spare time will be spent prepping for hiking 14000ft peaks in Colorado this summer and prepping for a 100 mile bike race in Salisbury, MD in September. ■

Affordable Care Act changes Your 2014 Tax Returns

Dan Frix, CPA/PFS, CFP®

When filing your 2014 federal income tax return, you will notice several changes related to the provisions of the Affordable Care Act (ACA). The ACA's "individual shared responsibility provision" requires the taxpayer, and each dependent, to have qualifying health care coverage for each month of the year. Taxpayers for whom this applies, provided they did not acquire this insurance through the "Marketplace" (described below), will simply check a box on their tax return and will not need to do anything else when they file.

If anyone named on the return did not have health care coverage for the entire year, Form 8965 (new) must also be completed if such individual(s) have an exemption from coverage for the period during which they did not have insurance coverage. If the they do not qualify for an exemption, the Taxpayer must calculate the shared responsibility payment. This payment, which is calculated on Form 8965, will be added to the income tax liability and will be paid, or reduce the refund, when you file your tax return.

If the taxpayer or dependent(s) were insured through the Marketplace and the estimated household income was below certain thresholds, then they were eligible to receive advance payments of the "premium tax credit" to reduce their health insurance payments during 2014. Those who received these advance payments will receive Form 1095-A (new) from the Marketplace documenting the advance payments.

These taxpayers will also complete Form 8962 (new), which calculates the taxpayers' household income and the allowable premium credit they can claim. The difference between the calculated credit and the advance payments will be added to the tax bill (if the advance payments exceed the credit) or reduce the tax liability / increase the refund (if the credit exceeds the advance payments received).

These are very complex provisions which can demand much detail about your health insurance for successful preparation of your return.

Legal: UPAA – Legislative Agenda Regarding Power of Appointment

I. Mark Cohen, J.D., LL.M., CFP®

I have the privilege of leading a committee of the Virginia State Bar seeking to enact the Uniform Power of Appointment Act (UPAA) into law in our Commonwealth next year. A power of appointment is created when you give another person (other than the Trustee) the power to direct where some or all of your assets go. Unlike the Trustee, this powerholder is not acting in a fiduciary capacity and has no duty to actually exercise the power. Most of the trusts I write contain powers of appointment. Accordingly, if I wrote your trust and it included a bypass trust, you will likely find a limited testamentary power of appointment in the second paragraph of the bypass trust. This allows the surviving spouse to redirect where the funds in the bypass trusts go upon his/her death. Most of the time the surviving spouse keeps things the way they were written, but it is, nonetheless, a source of comfort to know that you have the ability to change things in the bypass trust should the need arise.

Currently, there is a very small amount of legal guidance or precedent in Virginia regarding powers of appointment. This bears emphasis because such little law in such a practical aspect of estate planning leaves too many questions unanswered. For example, what happens to ineffectively appointed property? Should it be disposed of according to the trust? Does it go to the taker(s)-in-default of an appointment? Or does it go to the power holder's estate?

Further, another consideration is when a residuary can exercise a power of appointment held by the testator. That is, must the residuary clause expressly mention the power of appointment? What if it simply says "I hereby exercise any power of appointment I hold?" The documents I draft always include language to address these questions and several others that can come up, but many documents are not so artfully and thoughtfully written. Passage of this Act would be an important addition to the law of the Commonwealth and hopefully lead to less litigation over vaguely drafted documents. ■

What Happens To My IRA When I Die

Part III In A Series

Ryan R. Berges

This quarter we continue the series "What Happens To My IRA When I Die" and look at an angle most investors probably do not pay much attention to—does it matter where my IRA is held? The US Treasury regulations require that a qualified custodian hold your IRA. Even so-called "self-directed" IRAs must have a custodian. The custodian's job is to hold all of the IRA assets and to make sure you comply with all IRS rules on IRAs. They also report to the IRS when you put money into an IRA or take money out of an IRA. Generally speaking, banks, credit unions, trust companies, and brokerage firms qualify to be IRA custodians.

At first glance it may seem like all IRA custodians are the same; after all they must all play by the same rules. But there are nuances and differences that you should be aware of before opening an IRA. For instance, we would question a client's desire to open a bank IRA for two major reasons—first, why put a long-term IRA in a bank account that only provides savings or CD rates of return; and second, our experience has taught us that banks frequently do not have the knowledge to properly handle your IRA at death. When looking at investment firms for IRAs, do you want to go with a single firm that only offers proprietary mutual funds or do you want to go with a brokerage firm that offers a wide array of investment choices? For more advanced investors perhaps they want to have an IRA with a Trust company that specializes in untraded investments such as real estate. Think about where you want your IRA to take you before you make a choice of your IRA custodian.

One of the major advantages of working with a multi-discipline firm such as Cohen & Burnett and OptiFour is that you get professional advice based on a holistic approach under one roof. These three disciplines must work together to help use, grow, and pass on your IRAs effectively. Next quarter we will talk about the operational steps that actually take place in your IRA after your passing. ■