THE NORTHWEST QUADRANT

Investor Returns vs. Investment Returns: Did You Do as Well as Your Fund?

Larry Solomon, MBA, CFP®

It's common practice to look at a manager's total return number for a snapshot of what performance to expect, but that won't give you the full picture. Numerous studies have shown that investors' actual gains frequently pale in comparison to reported total return numbers. This phenomenon frequently plays out among funds that attract assets after streaks of hot performance, only to see some investors get skittish at the first signs of underperformance.

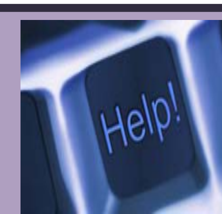
To get a sense of how investors in a strategy fund have really fared, we need to look at something called investor returns. Investor returns factor in the timing of investors' purchases and sales to depict the returns earned by the typical shareholder. A fund's investor return takes into account the fact that not all of its investors bought shares at the beginning of a period and held them until the end. Christine Benz at Morningstar provides a simple example: Assume a fund generated a 50% total return in a calendar year, with most of those gains coming in the year's first quarter. If investors added substantial sums of money to the fund after its first-quarter run-up, the fund's investor returns for that year would be lower than the fund's 50% total return.

Morningstar has found that volatile funds (often focused on one sector) tend to have the greatest discrepancies between total returns and investor returns. This relationship makes sense: volatile funds may entice investors on the upswing, but spook them into withdrawing during rough patches. So, investors in volatile funds can unwittingly end up buying high and selling low.

But it's not just volatile sector funds that suffer from this problem; many diversified strategies also tend to attract assets at the worst possible time, after periods of strong performance. One extreme example is CGM Focus, run by famous stock picker, Ken Heebner, which has achieved a solid annual total return of 8.83% for the 5 year period ending 7/31/2009, over 9% better on average per year than the S&P 500 during the same time frame. Actual investors in this strategy, however, fared much worse, losing -18.34% per year on average over the same trailing 5 years. How is this discrepancy possible? Most investors in CGM Focus arrived after the strong performance of 2006 and 2007 only to get whipsawed by this funds -48.18% decline in 2008. Now that's bad timing!

Of course, all this isn't to say you should never invest in a fund with an excellent track record or after a period of good performance. Rather, it again reinforces the point that chasing performance in a vacuum is a fool's errand. In the absence of other quantitative and qualitative selection criteria, such as returns vs. benchmarks and peer groups, risk measures, continuity of management, and organizational strength, investing in last year's leaders won't achieve a desirable result in the future and won't get you to the territory of less risk and higher return known as the Northwest Quadrant. ❖

TRUSTEE SERVICES: TAKING THE BURDEN OFF YOUR LOVED ONE



I. Mark Cohen, JD, LLM & CFP®

There is an old saying that money does not create behavioral problems, it accelerates them. Being a trustee is a big job in and of itself. When it is complicated by a sibling's rivalry or distrust, little errors can be blown out of proportion and become nightmares. Those are the cases that end up in an attorney's office and typically go to litigation. Are there really that many bad trustees out there?

I do not think so. I can say from our experience at Cohen & Burnett that in nearly every case the trustee is not a bad person. Rather, he/she is either unaware of his/her duties (and liabilities) or are so emotionally involved that he/she is unable to make appropriate choices.

One such case we concluded a little while ago involved three sisters who were equal beneficiaries of their mother's trust and appointed co-trustees, acting by the majority. Two of the sisters never liked the third (our client). They ganged up on her, took more for themselves, and refused to give her any information. What followed was lengthy and expensive litigation where the third sister ultimately got her fair share and was reimbursed by the other two for her costs. When Mom was doing her estate planning and set things up this way, she must have had some inkling that there might be bad blood among the sisters. But she probably thought that if she forced them to work together they would get past their issues and learn to work together.

After seeing a number of these cases over the years, we started offering our services as either as Administrative Trustee, (handling reporting and taxes), or as Trustee, handling all matters related to the trust. When you hire us as trustee you solve two problems: (1) you have an independent, knowledgeable trustee who will not get mad or get even with the beneficiaries, and (2) you have relieved a great burden from someone you love.

If you have any questions or to learn more about our trustee services, please give us a call. ❖

Navigating the Bay: Mark and Wes captained a 46' Jeanneau sail boat on the Chesapeake for a spectacular company outing on October 1. The wind hit 18 knots at one point, but otherwise, it was all smooth sailing. *Top Row (L-R)*: Wes Burnett, Elizabeth Clark, Larry Solomon; *Bottom Row (L-R)*: Mark Cohen, Sue Greco, Warren Ellsworth, Jan Ellsworth, and Nicci Yang.

MANAGING PARTNER

Weston D. Burnett, JD, LLM & CFP®

We had a busy summer at the firms. We managed the move of roughly 200 accounts away from Dunham as well as the move of hundreds of direct placements to NFS (a division of Fidelity). I estimate it took over 2000 work hours to prepare forms, have them signed by each client and then manage and monitor the movements. There will be many months of continued work to ensure that all of the direct placements are correctly reporting and distributing. The sole purpose of this major undertaking was to improve service and performance for our clients. The client meetings we had over the last quarter have been wonderful experiences for us as the entire staff looks forward to your visits.

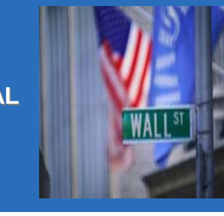
I recently had an interesting conversation with one of our valued, long-standing clients. He asked whether there would be quality, one-on-one advisory time lost with me as our firms grow and expand. I assured him that the advisory time with me (or Mark) will always be there for our clients no matter what. We now have an outstanding team of specialists to help me and Mark prepare clients' forms, monitor investments, and ensure accuracy and timeliness of our reporting. Thanks to our team of professionals that each have at least 20 years work experience each on average, we have been able to bring our record keeping and investment tracking to state-of-the art, including instantaneous electronic downloads of investment information, etc. Mark and I will always know what is happening with each of our clients and want you to rest assured that we are here for you…no matter how large we will hopefully get.

On the family side, Barb and I spent some quality time with our three children at our cottages on Lake Winnepesaukee in New Hampshire this August. Their fiancés and friends were there in large numbers: 8 JD's, 3 MD's and 3PhD's. It's nice to know the next generation is even smarter! We also saw twenty or more other friends and relatives there for the Burnett Association Clan meeting. Our daughter, Jennifer, got word that she had passed her PhD comps. Barb traveled over six of ten summer school-break weeks including a couple visit to her parents in Pensacola, FL. My mother is moving to assisted living this fall.

For myself, my summer highlight was a Mediterranean cruise with Barb from Istanbul to Barcelona, complete with a trek up the volcano of Mt. Aetna in Sicily. Upon our return, I got to take three mountain climbs in New Hampshire, the last up Mt. Washington. In August, I had the rare opportunity to take a private tour of the Smithsonian Postal Museum collection where I saw one-of-a-kind, never exhibited items – a philatelist's dream. My two sons, Mark and I are again doing the 100-mile Seagull Century Ride in early October. Once again, I'm fairly confident that David and Edward leave me and Mark in their dust.

We wish you and your family warm wishes for the holiday season ahead. ❖

THE FUTURE OF THE WEALTH MANAGEMENT INDUSTRY: THROUGH THE EYES OF A FINANCIAL PLANNING STUDENT



Rick Mountjoy, Jr., CFP® Candidate

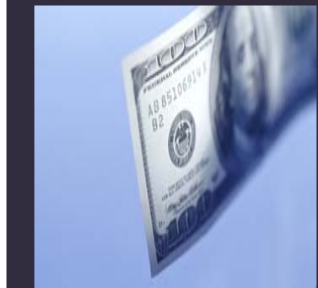
Rick is an undergraduate student at Virginia Polytechnic Institute and State University studying to be a Financial Planner in the Department of Agricultural and Applied Economics. He interned with Navigator Wealth Management this summer and continues to work with us remotely from school on a part-time basis.

As you may well know, the wealth management industry is on the verge of a vast transformation. Highly publicized cases of impropriety on the behalf of certain wealth managers have caused many U.S. clients to become hesitant in trusting financial professionals with their hard-earned money. It has come to be increasingly difficult to find a manager who is a tried and true fiduciary. Having said this, one reoccurring theme in deeming a manager an honest fiduciary is fee structure and transparency. The way(s) a manager is compensated for their services rendered is a topic that is heavily stressed in my financial planning curriculum at Virginia Tech, and on a grander scale, in Congress.

To assist me in answering the question of where fee structures in the wealth management industry are heading, I requested Dr. Alex White, an instructor at Virginia Tech to answer a few related questions. Dr. White earned his Ph.D. from Virginia Tech where he centered his research on retirement planning strategies for agricultural producers and small business owners. The initial question I asked was: "Where do you see fee structure heading in the future?" Dr. White responded by saying, "The fee structure used to be primarily "revenue based"…A lot of the fees were based on a percentage of assets under management. This is great in an expanding or steady economy, but a lot of planners had their revenues decreased dramatically when the stock market fell - asset values decreased, therefore revenues (fees) for the planners decreased. When the economy started to look pretty bleak, a lot of planners tried to move (or started to move) towards a more "risk based" fee structure rather than going entirely on a percentage of assets under management, they moved towards a combination of "annual fee" and a smaller percentage of assets". The major trouble with managers changing the way(s) they are compensated during a market downturn or correction is it naturally causes confusion and discomfort with clients. In order to establish an honest relationship between manager and client, it is imperative the manager be 100% transparent in their fee structure.

The next topic I asked Dr. White's opinion on is whether or not there is going to be any subsequent legislation passed to correct the lack of fee transparency in the industry. His view is, "If the current trend of foundering financial institutions and expanding government policy continues, I would not be surprised to see more legislation concerning transparency of the fee structures. Just to restore confidence in the US public, a minimal level of legislation may be worthwhile".

Although the wealth management industry is currently experiencing substantial regulatory issues, the bright side is these issues are actively being handled. Although the most beneficial action for the industry may be a complete overhaul in the rules and regulations financial managers must follow, many professionals, and academics alike, believe the industry will come through these dynamic times with widespread success. ❖



A Brave New Economy

Last in a Three-Part Series About the Economic Stimulus Plan and Its Potential Impact on You

Weston D. Burnett, JD, LLM & CFP®

We hope this series of articles has broken the stimulus package into digestible pieces for you to think and learn about. Please join us at our November 10 Town Hall meeting where a distinguished panel of economic and investment experts from around the US will be on our panel to discuss the State of the Economy and Possible Future of Your Investments (see ad below).

Environment

The package includes $9.2 billion for environmental projects at the Interior Department and the Environmental Protection Agency. The money would be used to shutter abandoned mines on public lands, to help local governments protect drinking water supplies, and to erect energy-efficient visitor centers at wildlife refuges and national parks. The Interior Department estimates that its portion of the work would generate about 100,000 jobs over the next two years. Yet the plan will only make a dent in the backlog of cleanups facing the EPA and the long list of chores at the country's national parks, refuges and other public lands. It would be more like a down payment.

When it comes to national parks, the plan sets aside $735 million for road repairs and maintenance. But that's a fraction of the $9 billion worth of work waiting for funding.

At EPA, the payout is $7.2 billion. The bulk of the money will help local communities and states repair and protect bays, rivers and other waterways used as sources of drinking water. The rest of EPA's cut — $800 million — will be used to clean up leaky gasoline storage tanks and the nation's hazardous waste sites.

Law Enforcement

The stimulus bill includes plenty of green for those wearing blue. The compromise bill doles out more than $3.7 billion for police programs, much of which is set aside for hiring new officers. The law allocates $2 billion for the Byrne Justice Assistance Grant, a program that has funded drug task forces and things such as prisoner rehabilitation and after-school programs.

An additional $1 billion is set aside to hire local police under the Community Oriented Policing Services program. The program, known as COPS grants, paid the salaries of many local police officers and was a "modest contributor" to the decline in crime in the 1990s, according to a 2005 government oversight report. Both programs had all been eliminated during the Bush administration.

The bill also includes $225 million for general criminal justice grants for things such as youth mentoring programs, $225 million for Indian tribe law enforcement, $125 million for police in rural areas, $100 million for victims of crimes, $50 million to fight internet crimes against children, and $40 million in grants for law enforcement along the Mexican border.❖

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COHEN & BURNETT, P.C.
NAVIGATOR 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.navigatorwealth.com

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.

THE COMPASS ROSE

COHEN & BURNETT, P.C. NAVIGATOR WEALTH MANAGEMENT, LLC

ESTATE AND FINANCIAL PLANNING UPDATE

Fall 2009 Volume 6

FOUNDING PARTNER

I. Mark Cohen, JD, LLM & CFP®

Kathy and I joined my parents on a wonderful Danube River cruise in July on Uniworld's River Beatrice, the queen of their line. It was like having a 5-star restaurant and 5-star hotel floating down the river at night, spending each day at the heart of another amazing city. All told, we stopped at eight destinations starting in Passau, Germany. In Austria we stopped at Linz, (side trip to Salzburg), Melk, Durenstein, and Vienna. In Slovakia we visited Bratislava and in Hungary we spent several days in Budapest on a post-tour extension. My parents also did a pre-tour extension in Prague. The weather was excellent for the entire tour and there were no travel glitches. I can think of no better way to visit this part of Europe.

Michael and Rachel are back in school. Michael spent the summer in Arizona visiting family and taking a class at U of A. He is now taking 18 units in his double major of Middle East studies and government, is president of Hillel, and treasurer of AEPi. Rachel spent the summer at home working as a camp counselor, and took off the last two weeks of summer to visit her boy friend (also a sophomore at William and Mary) and his family who are State Department, currently stationed in Guatemala.

Kathy is hard at work putting a tutoring company together with our friend Janet Frank. Startups are always exciting and challenging and I wish them the best of success.

As of this writing, the markets seem to have stabilized with the Dow at around 9,500, PE ratios averaging around 16, and the good news about the economy appears to be outweighing the bad news. My own view is that the markets are now fairly valued and will move up slowly in pace with the economy's recovery. I wish all of you a happy autumn. ❖

Client Members Appointed to NWM Investment Policy Committee

In July, Lt. Gen, Bill Ginn of Alexandria, VA and Dr. Ken Jordan, Jr. of Annapolis, MD accepted appointments to sit as client members on Navigator Wealth Management (NWM)'s Investment Policy Committee. The Investment Policy Committee (IPC) is responsible for the "prudent administration" of investment platform selection, establishment of investment policy objectives and guidelines, selection of investment managers and ongoing monitoring of such investment platforms.

General Ginn and Dr. Jordan join NWM principals, Mark Cohen and Wes Burnett, along with Wealth Navigation Manager, Larry Solomon, as the first client members to sit on the IPC.

In his career General Ginn served in the US Air Force; graduated with distinction from Harvard Business School; was a CPA; was a contractor/consultant to the Department of Defense and the State Department; taught Financial Accounting at Northeastern University; and founded and sold three small businesses. In his retirement, he and his wife, Anita enjoy traveling, skiing, sailing, and spending time with their family.

Dr. Jordan supported the Office of Naval Research (ONR) in developing research priorities in Net-Centric Warfare, and the Defense Information Systems Agency (DISA) in the systems engineering for the Global Information Grid (GIG) as a consultant up until his retirement. From 1979 until 2005, Dr. Jordan was with SAIC, from 1992 as a Corporate Vice President. In the 1970s, he held several positions in the Department of Defense including Director, Strategic and Space Systems in the Office of the Secretary of Defense, and Principal Deputy Assistant Secretary for R&D, U.S. Air Force. In addition to receiving his doctorate in science from MIT, he was a Fulbright Scholar at the Sorbonne in France. He currently enjoys his retirement sailing in Annapolis and visiting with his grandchildren.

According to Larry Solomon, "As a Registered Investment Advisor (RIA), NWM is answerable to the highest standards of fiduciary care in the management of its clients' assets. In order to carry out that responsibility with the utmost degree of good faith, honesty, integrity, loyalty, and undivided service to the client's best interest, NWM designed their Investment Policy in order to provide a clear "roadmap" for NWM as a fiduciary to provide direction and procedural guidelines that will allow for the selection and ongoing monitoring of investment options, service providers, as well as to comply with the fiduciary standards imposed by law, and help NWM invest client assets to achieve and potentially exceed their financial goals/expectations." ❖

NWM Recognized for Excellence by Pacific West Securities

Mark Cohen, Wes Burnett and Larry Solomon attended the Pacific West Securities annual Leadership Summit in Seattle, Washington September 16– 18. During the closing ceremonies, they were surprised to learn the results of an informal survey of the Pacific West staff where Navigator Wealth Management was recognized for their commitment to integrity and excellence.

"Although this was not a formal award, it was still an honor that we were acknowledged by our broker dealer on something we hold near and dear as a firm: truth and transparency," said Wes Burnett, President and CEO of NWM. "Although we won other awards as a firm at the Leadership Conference this year and in years past, this public recognition meant the world to us since it got at the heart and soul of our business," said Mr. Burnett. ❖