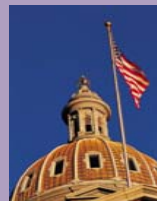


THE
NORTHWEST
QUADRANT
"REAL RETURN" INVESTING

Larry Solomon, MBA, CFP®

ESTATE PLANNING AND FEDERAL
TAX DEVELOPMENTS:
NEWS FROM THE FRONT LINES



Andrew Vanderhoof, JD, LLM

At present, inflationary pressures are scarce. The brutal global financial and economic crisis that began in the fall of 2008 provoked a massive decline in asset and commodity prices. Changes in consumer prices in most countries have flattened or turned negative in recent months, making deflation—falling prices—a bigger near-term threat than inflation. Recognizing the potential for deflationary forces to gain self-perpetuating momentum, policymakers around the world have implemented a series of unprecedented actions. Central banks in most countries have aggressively slashed interest rates, while the Federal Reserve and others have pursued extraordinary quantitative easing measures. Furthermore, many governments have enacted large economic stimulus programs and offered massive guarantees to financial institutions.

There is justifiable concern, however, that the lingering effects of these government policies will lead to an outbreak of higher inflation once they succeed in stabilizing the global economy and financial system. While these factors do not necessarily preordain an outbreak of 1970s-style double-digit inflation rates, they do present the potential risk that inflation may become a bigger factor in the foreseeable future.

The principal effect of inflation is obvious: it reduces purchasing power! Periods of high or rising inflation also have negative implications for stock and bond markets. In particular, stocks perform poorly because rising inflation is often accompanied by rising interest rates, which increase borrowing costs for corporations, reduce profits, and even cause stock valuations to decline as investors discount expected future earnings. Meanwhile, bonds suffer during inflationary periods: when interest rates (yields) rise, bond prices fall.

Understanding the concept of "real return" investing—striving for returns that outpace inflation—is critical to increasing your wealth faster than inflation is shrinking it. There are two broad categories of assets that historically have tended to hold up during inflationary climates: real assets and inflation-adjusted securities.

Real assets are tangible materials or property that can be expected to maintain (or increase) value even if the value of financial assets depreciates as a result of inflation [i.e. crude oil, timber, gold, or commercial real estate: apartment buildings, offices, shopping malls, typically owned through Real Estate Investment Trusts (REITs)].* Because REITs and commodities are hard assets with intrinsic economic worth, they tend to be less influenced by rising prices than paper-based monetary assets.

During inflationary periods, securities structured to provide built-in adjustments for rising price levels are also compelling. U.S. Treasury Inflation-Protected Securities (TIPS) are Treasury bonds whose principal value is adjusted semi-annually based on the movement in the CPI. The coupon rate for TIPS is constant, but generates a higher amount of interest when the inflation-adjusted principal rises. While increasing prices will erode the "purchasing power" of the yield on a nominal bond, an investor in TIPS will receive a return that adjusts to the rate of inflation automatically.

A diversified approach using one or more of the options described above can mitigate a portfolio's exposure to the corrosive effects of inflation and potentially improve overall results. ❖

From April 24, 2009, to April 26, 2009, Cohen & Burnett, P.C. attended the Douglas W. Conner Advanced Estate Planning and Administration Seminar at the Homestead in Hot Springs, Virginia. This intense three-day seminar is the preeminent estate planning seminar for attorneys in Virginia and attracts estate planning experts from around the country.

At this legal seminar, the latest estate planning techniques and recent developments in the law are discussed. Topics included recent federal tax developments, use of general powers of appointment, recent developments in Virginia law, post mortem planning for IRA distributions, split-dollar life insurance arrangements, conservation easements, the Uniform Trust Code, and use of grantor trusts.

By attending this seminar, Cohen & Burnett, P.C., insures that its clients are receiving the latest and best estate planning and estate administration services. After the seminar concluded, Mark Cohen met with the legislative committee that is rewriting the Virginia Small Estate Act. By actively participating in the drafting of this new legislation for the Virginia General Assembly, Cohen & Burnett, P.C., will be intimately familiar with the new law, and thus, will be able to provide top level advice to its clients.

Some of the topics presented at the seminar that were applicable to most Cohen & Burnett, P.C., clients included new statutory provisions concerning medical powers of attorney (revised definitions of healthcare and capacity, and modified provisions concerning medical research and an agent's authority), the Uniform Power of Attorney Act (financial powers of attorney and various default provisions), the Uniform Principal and Income Act (including provisions for Unitrusts), and anatomical gifts.

One presentation at the seminar focused on post mortem planning for IRA distributions and included (i) options available to a surviving spouse, (ii) options available to beneficiaries other than the surviving spouse, (iii) options available where a trust is the beneficiary, (iv) what happens when an estate is the beneficiary, and (v) the mechanics of a charity as a beneficiary. All of the foregoing scenarios can affect Cohen & Burnett, P.C. clients, and the seminar also laid out exactly what options would be for clients.

The presentation on federal tax developments contained a discussion of the federal estate tax and the exemption amount. For 2009, the first \$3.5 million of an estate is exempt from federal estate tax. For 2010, the exemption amount is slated to be unlimited (and thus, no federal estate tax). There are several bills pending in Congress to modify the law as it is currently written. Future issues of this newsletter will keep Cohen & Burnett, P.C., clients informed as to what Congress decides to do in this important area of estate planning. ❖



MANAGING PARTNER

Weston D. Burnett, JD, LLM & CFP®

This quarter Rick Mountjoy joined us as our summer intern. He is a Virginia Tech student who is studying to be a Certified Financial Planner and plans on attending law school. Greg Armstrong will be leaving us by July. He recently announced his engagement and is excited and challenged by a Certified Financial Planner course that he enrolled in at Georgetown University. We wish him the very best in his future pursuits.

We continue to send out our monthly Navigator Wealth e-News. Anyone reading this newsletter in June or July who has not received our e-News and wants to be added to the mailing list, simply send an email to reception@cohenandburnett.com with the subject "Subscribe to e-News" and you'll get it from now on. Or if you know a friend who might benefit from the e-News alerts, feel free to subscribe them as well.

On the family side, all is well. Our daughter Jennifer became engaged to an attorney, J.D. Beard in Charlottesville, and they plan to wed there next May 30. They announced their engagement at an ideally named restaurant called "Just in Thyme." They have carried on a long distance courtship as she worked on her Ph.D. in Louisville, KY, and he worked as a public defender in Charlottesville. I was invited along to see her try on wedding dresses in a bridal shop, one place I never expected to visit. I marvel at any woman who can wear those heavy dresses and high heels and even think to bend over or stoop down. David is knee deep in securities litigation with his NY firm. Edward loves Booz Allen and has found someone special in his life. Barb's highlight was a trip to Pensacola over spring break while visiting her mother who had eye surgery, and then attending National Math-Counts in Orlando where the Virginia team finished tenth. Her last day of school will be punctuated by us boarding a flight for a Mediterranean cruise. I was proud of my brother's son Christian who graduated from the Naval Academy in May. The ceremony was marked by President Obama's speech, the Blue Angels flying over head, and a rousing cheer when John McCain, IV, graduated. My mother's apartment was home-base for the after-party for the 30 or so Burnetts that attended the ceremony.

On a personal note, I was delighted to wrap up the sale of three houses this quarter. I also exhibited my stamp collection of soldiers' letters from the Philippines during the Spanish-American War (starting with letters from my great-grandfather to my great-grandmother) at a national stamp show in Northern Virginia that resulted in a gold medal. I continue to train for two upcoming 100-mile bike races, and in June started training again for summer mountain climbs. ❖

FINANCIAL PLANNING:
DISTRESSED SELLERS SHOWER
OPPORTUNITIES ON BRAVE BUYERS



I. Mark Cohen, JD, LLM & CFP®

We all know that banks are in considerable distress and have seriously curtailed lending. One reason banks are not lending is that Wall Street has lost its appetite for things like mortgage backed securities, so banks have no place to remarket their loans. Where they are selling, banks are getting about 50 cents to the dollar. This also devalues the banks' holdings, forcing them to sell performing loans at huge discounts, creating extraordinary opportunities for prospective buyers. Here is an example that illustrates why buying in this economic crisis may potentially yield long-term benefits.

Imagine that you are looking to buy a residential rental property for \$500,000 (its appraised value). As it happens, the property is encumbered by a loan also for exactly \$500,000. It is a standard 30-year-fixed loan at 6 percent interest. The house is rented to a good quality tenant with a perfect track record for paying on time. The rent pays for the entire cost of the property, the debt service, insurance, taxes and repairs. (I know this is fantasy land, but stay with me on this.) You would like to make a 5-8 percent return from appreciation in real estate and start negotiating with the seller to see if you can improve the return. But then the bank makes you an offer you find hard to believe. The bank is so desperate to raise cash that they offer to sell you the loan for \$250,000. You snap it up before they have the opportunity to change their mind.

You now have a performing six percent note that you bought at half-price, so its yield to maturity is 12 percent. That is a better return than you were expecting from the purchase of the property with a whole lot less work, and it is secured by a property you wanted to buy anyway. If the owner defaults on the loan, you own the property at half price. Either way, you win. I know this is too good to be true in the residential space, but there is potential for this type of scenario in the commercial world.

Navigator Wealth Management works with a number of investment programs that are actively seeking out and taking advantage of such opportunities. If this appeals to you and you want to learn more, please contact us. These opportunities are here now, but will likely be gone once the economy recovers and banks start lending again. ❖



A Brave New Economy

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

Weston D. Burnett, JD, LLM & CFP®

The \$787 billion dollar American Recovery and Reinvestment Act of 2009 represents an unprecedented attempt to change the direction of our economy. This is the second part of a three-part series where we will summarize parts of the economic stimulus plan and the potential impact on all of us.

Infrastructure

Highways will be repaved for the first time in decades. Century-old waterlines will be dug up and replaced with new pipes. Aging bridges, stressed under the weight of today's SUVs, will be reinforced with fresh steel and concrete. The \$90 billion is a mere down payment on what's needed to repair and improve the country's physical backbone, but it's a start.

Energy

There's a 30 percent tax credit of up to \$1,500 for the purchase of highly efficient residential air conditioners, heat pumps or furnaces. The credit also can be used by homeowners to replace leaky windows or put more insulation into the attic. About \$300 million can go for rebates for energy-efficient appliances. The package includes \$20 billion aimed at "green" jobs to make wind turbines, solar panels and improve energy efficiency in schools and federal buildings. It includes \$6 billion in loan guarantees for renewable energy projects as well as tax breaks or direct grants covering 30 percent of wind and solar energy investments.

Another \$5 billion is marked to help low-income homeowners make energy improvements. About \$11 billion goes to modernize and expand the nation's electric power grid and \$2 billion to spur research into batteries for future electric cars.

Schools

A main goal of education spending in the stimulus bill is to help keep teachers on the job. Nearly 600,000 jobs in elementary and secondary schools could be eliminated by state budget cuts over the next three years, according to a study released this past week by the University of Washington. Fewer teachers mean higher class sizes, something that districts are scrambling to prevent. The stimulus sets up a \$54 billion fund to help prevent or restore state budget cuts, of which \$39 billion must go toward kindergarten through 12th grade and higher education. In addition, about \$8 billion of the fund could be used for other priorities, including modernization and renovation of schools and colleges, though how much is unclear, because Congress decided not to specify a dollar figure. The Department of Education will distribute the money as quickly as it can over the next couple of years. And it adds \$25 billion extra to *No Child Left Behind* and special education programs, which help pay teachers' salaries, among other things. The stimulus bill also includes more than \$4 billion for the Head Start and Early Head Start early education programs and for child care programs. ❖

ESTATE PLANNING QUIZ



1. Were your estate plan documents drawn up less than five years ago?
2. Were they written in the same state in which you currently reside?
3. Do you have a living will (advanced medical directive)?
4. Have you made time to have an estate plan written especially if you have children, a small business, and/or other significant assets (i.e. valuable collectibles)?

If you answered "NO" to even one of the questions above, you may need to consider updating (or starting) your estate planning documents. We can help. Call our office today for a complimentary 10-minute telephone evaluation to help you determine if your documents are current, and if not, to schedule an appointment to update them. ❖

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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.

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THE COMPASS ROSE

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

ESTATE AND FINANCIAL PLANNING UPDATE

Summer 2009

Volume 5



FOUNDING PARTNER

I. Mark Cohen, JD, LLM & CFP®

Our entire family just spent five days in Tucson helping my mother celebrate her 75th birthday (and my father's 76th). We came back from the desert and were reminded how verdant and lush summer is in Virginia. The roses are in full bloom and the hostas are in their glory—until the deer get to them. If anyone knows a sure-fire way to keep the deer from eating them, please let me know.

Michael and Rachel both had successful years at William and Mary. Rachel is now a rising sophomore, and is working most of the summer as a camp counselor. Michael is a rising junior, and is spending the summer in Arizona. In addition to visiting family and hiking in the desert mountains (a love he inherited from me), he will also take a couple of classes in his field at U of A that are not offered at W&M. Kathy and I are looking forward to some short sailing trips, a Danube river cruise in July, and a week with Wes and Barb at their New Hampshire lake house in August.

As investors, we are living through extraordinary times. For example, as I write this, the markets are up about 30 percent from their lows to just breaking even for the year. If I had suggested this extreme volatility even two years ago, you all would have thought that my vision was impaired. What is clear, however, is that asset allocation and diversification works. Most of our financial planning clients have a part of their portfolios allocated to direct placement programs (DPPs). In the early fall, we increased this allocation for most clients and reduced their stock holdings. As the name implies, DPPs are direct investments in a business venture and they are not traded on any major exchange. Their value changes based upon the experience of the particular business but unlike stocks, they are not affected by investor sentiment.

In these days when the "rational investor" appears to be an endangered species and panicked selling is contributing to vastly undervalued stocks, (see *Distressed Sellers...Brave Buyers* on p. 3 for how we take advantage of this situation), although there are unique risks associated with DPPs, their illiquid nature makes them less vulnerable to "panic" selling. If you would like to learn more about how proper diversification and asset allocation can improve your portfolio, give me a call and let's chat. ❖

Expert Panel Addresses Tough Questions about Economic Future at NWM Town Hall Meeting



Left: Expert panel fields interesting questions about the future of the economy: (L-R): Matt Jameson, KBS; Derek Schwartz, ICON; Patrick Cunningham, Manning & Napier; and Mark Cohen.



Above: Wes Burnett, NWM, moderates panel. Left: An audience of fifty poses challenging questions about the impact the market will have on their investments and overall health of the economy, as well as when the market volatility might slow down.

Recession...economic stimulus package... stock market roller coaster...Wall Street implosion...car industry debacle...what's next and how will it affect the economy? This and other tough questions were asked at the May 20 Town Hall-style meeting at the offices of Navigator Wealth Management.

The panel of experts who flew in for this gathering of over 50 people included Patrick Cunningham, Managing Director of Manning & Napier Advisors, LLC; Derek Schwartz, Regional Vice President of ICON Securities, Corp.; and Matt Jameson, Regional Vice President of KBS Capital Markets Group, Inc. Mark Cohen sat on the panel and Wes Burnett moderated.

The audience posed a variety of questions about the health of the panelists' respective industries and of the economy overall. The panelists agreed that, although this has been one of the worst economic downturns in recent history, recovery is on the horizon. It will be a gradual process, requiring patience by experts and investors alike.

When asked about what key factors these companies maintain in keeping their health in the market downturn, Matt Jameson of KBS attributed their success to capitalizing on opportunities in the market (i.e. ability to purchase high quality debt at tremendous discounts), while Patrick Cunningham commented on Manning & Napier's expertise and ability to quickly shift fund portfolio investments into other sectors when the stock market was faltering.

Due to the great interest in the May meeting, NWM will host another Town Hall-style meeting in the late fall. Please contact the office for details. ❖