THE NORTHWEST QUADRANT

The Financial Advisor's Alpha

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

This quarter's column is about a concept that's hard to define: Quantifying how a financial advisor adds value, which a recent Vanguard study termed "The Advisor's Alpha." For any managed investment, alpha is defined as the value that the portfolio manager adds (or subtracts) vs. a relevant benchmark. Similarly, Vanguard described the advisor's alpha as the total value the advisor generates through investment-oriented services as well as relationship-based services and advice.

Traditionally, financial advisors have tried to measure their value and justify their fees through their investment performance, i.e. by selecting investment strategies for clients that outperform a market index or benchmark. But market beating returns are rare. Most studies show that on average, 60% to 80% of active managers underperform their benchmarks over any calendar year, and the chance of a manager outperforming the benchmark over consecutive years or longer time periods is even lower.

Vanguard's Advisor's Alpha	Value Added to Client's Portfolio (in additional annual return %)
Suitable asset allocation	>0.00%
Cost-effective implementation	0.45%
Rebalancing	0.35%
Behavioral coaching	1.50%
Asset location	0.00% to 0.75%
Spending strategy (withdrawal strategies)	0.00% to 0.70%
Total-return versus income investing	>0.00%
Total potential value added	Approx. 3.00%

Source: "Putting a value on your value: Quantifying Vanguard Advisor's Alpha," Vanguard Research, March 2014.

A more comprehensive framework should take into account all the ways that the financial advisor adds value using the accepted best practices and tools of wealth managers, such as financial planning, risk management, asset allocation, implementation, tax planning, behavioral coaching, and asset location. The Vanguard study sought to quantify all the benefits that advisors can add relative to others who are not using them.

For many clients, entrusting their future to an advisor is not only a financial commitment but also an emotional one. Investors are looking for someone they can trust. For those without the time, willingness, or ability to confidently handle their financial matters, working with an advisor may also be a matter of peace of mind. The value of trust and peace of mind are virtually impossible to quantify, but their significance is real and should not be deminished by difficulty in measuring them.

Clients only get to keep and spend net returns after taxes and fees, and the focus of wealth management should always be to maximize the client's net results. For those aspects of the advisor's value that lend themselves to measurement, Vanguard estimates that advisors can add an average of 3.00% annually in net returns through careful use of the tools in the advisor's alpha framework which are listed here. Next quarter, I will explain these techniques and how they add value for clients in greater detail. ■

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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.

THE COMPASS ROSE

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

Winter 2015 Volume 25 ESTATE AND FINANCIAL PLANNING UPDATE

FOUNDING PARTNER

I. Mark Cohen, J.D., LL.M., CFP®

Winter has finally arrived and Leigh and I did something that was a first for both of us. While we are happy sailing small sailboats, this time we went on a very big boat. Specifically, we took a Western Caribbean cruise with Holland America out of Ft. Lauderdale. We visited many interesting ports and participated in fun activities included riding horses to the top of a mountain and back, and then riding them while they were swimming in the ocean (we switched horses – apparently they are specialists). I also got a chance to sail on an older America's Cup yacht, a special treat for me.

We had the pleasure of hosting our oldest daughter and son-in-law, Dana and Joe, on this trip as well and really enjoyed the week getting to know them better. Dana and Joe live in Ashburn, VA. Dana works as a veterinary tech in Great Falls. Joe works as a software engineer for AOL where he creates apps for Android based phones. They are both great fun to travel with.

Holly, our youngest daughter lives in Alexandria, VA, and works at the Capital Area Food Bank. I had not realized, until she started working there a couple years ago, that amidst our high concentration of wealth in this region, there are so many hungry people who do not know where their next meal will come from. We are very proud of Holly for her dedication to feeding the hungry.

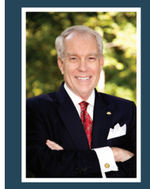
Michael is still in the Army in Sierra Vista, AZ, but he has been seeing a delightful young lady from Tucson for several months by now.

Happy Holidays

As 2014 comes to a close, we hope you all have had just as exciting a year as we have. In September, we celebrated Dan Frix's fifth year with the firm by closing early and taking a group trip to Top Golf in Alexandria. It was a great opportunity to commend Dan for all of his hard work throughout the years.

In October, the Client Advisory Board informed us a Q&A section would be a beneficial addition to our newsletter. Following up with this suggestion, if you have any questions or concerns you would like us to address, please email them to rasheda@cohenandburnett.com and we will do our best to answer them. We hope to take everything we have learned this past year and make this upcoming one the greatest ever, for our clients and our firm. We thank you all for your support and look forward to a great 2015. Happy Holidays!

Rachel is still in San Antonio but was reassigned from Kindergarten to 5th grade eight weeks into the school year. She had wanted something different from Kinder but switching in the middle of the year has its challenges. Overall, however, she is doing fine. ■



MANAGING PARTNER

Weston D. Burnett, J.D., LL.M., CFP®

We hope you had a great fall. We have been in our Suite 205 offices for eight years and in this building for 17 years. We decided a little facelift was needed for our office. So we replaced the 27-year-old ceiling tiles with brighter ones and now have LED lights, for a much brighter office. Next is a fresh coat of paint.

My Trustee work at George Washington University continues. As the Chair of the Law School Campaign, I kicked off the Campaign at a grand dinner in the Corcoran Gallery on October 24 while also introducing the new Dean. Good news is that both the University and Law School campaigns are over 60% towards their goals. I also am chairing the Universitywide Trustee-Faculty- Administrator Committee on identifying best practices for selecting and reviewing college deans' performance. Our entire family dined over Christmas with the Associate Dean for International Comparative Law and Policy, Susan Kamaranian, for whom Barb and I funded an endowment.

On the family side, our oldest son, David, the top flight litigation attorney in Manhattan got engaged to Maureen Nash on October 13. The wedding is planned for May 16, 2014. We are ecstatic as his fiancé is all we could ever dream of in a spouse for our son. She is Associate Director for Development for the Frick Museum in New York City. She is from Chicago so over Thanksgiving we went to meet her family, who are an absolute delight. At Christmas, our family got together and then Barb and I slipped away for a cruise in the Caribbean over the holiday school break. ■

Inflation Adjustments for 2015

Dan Frix, CPA/PFS, CFP®

In 2014, the Consumer Price Index increased enough to trigger many adjustments to tax brackets and other items affecting tax returns in 2015. While not an exhaustive list, this article summarizes many of the changes that will affect individuals. If you want to know more about any tax changes which may affect your personal situation, please do not hesitate to call us.

Next year, the federal marginal income tax brackets will be about 1.6% higher than the tax brackets during 2014. For example, a married couple filing jointly (MFJ) will need Taxable Income of over $151,200 before their income is taxed at the 28% marginal tax rate. This is 1.6% higher than the $148,850 threshold in 2014. Additionally, next year, the Adjusted Gross Income (AGI) threshold to start the phaseout of personal exemptions and itemized deductions will be 1.6% higher than in 2014. Thus, for MFJ taxpayers, the AGI threshold will be $309,900 which is $4,850 higher.

For those who contribute to their employer's 401(k) or other retirement plans, the annual contribution limit will be $18,000 which is $500 higher than in 2014. Similarly, the "catch-up" contribution limit for anyone over age 49 will be $6,000 which is $500 higher. For those who contribute to an IRA, the maximum amount which can be contributed to either a Traditional IRA or a Roth IRA of $5,500 has not changed. The "catch-up" contribution for those over age 49 of $1,000 is also unchanged.

The maximum earnings subject to the 6.2% employer and employee Social Security taxes will be $118,500 next year which is 1.3% higher than the $117,000 limit in 2014. Self-employed individuals will pay the 12.4% self-employment tax on this limit (with a deduction for one-half of the self-employment taxes paid).

The annual exclusion for gifts not subject to gift tax reporting remains at $14,000 per person per recipient in 2015. The estate and gift tax exclusion increases to $5.43 million next year – which is up from the $5.34 million limit this year. ■

2014 Elder Law Updates to the Virginia Code

Rasheda Nipu

The year 2014 brought about many changes for the world of Elder Law. For example, the Virginia Code recently reduced the age requirement for personal appearance and visual exams for issuance or renewal of licenses to operate motor vehicles from 80 to 75 years. A number of these changes also have estate planning consequences.

Section 17.1-227 of the Code, for instance, now grants immunity to clerks from claims of negligent recordation, except when grossly negligent or engaged in willful misconduct. Consequently, counsel will now bear the increased measure of responsibility to ward against innocent mis-recordation of documents. Another beneficial change affects the estate rights of married persons. Particularly, the Code provides a family lump sum allowance of $24,000, increased from $18,000. Married persons may now also enjoy an increased homestead allowance of $20,000, in comparison to last year's $15,000 amount.

Further, a trust instrument that expressly incorporates Section 64.270(E) of the Code will operate as limited exculpation for acts and omissions on the part of the trust director. Fortunately, any exculpatory terms in the trust instrument relieving the trust director of liability will be unenforceable to the extent the trust director's act or omission constitutes a breach of trust committed in bad faith or with reckless indifference to the purposes of the trust. These terms will also be unenforceable where it is found that the terms were inserted as a result of an abuse by the trust director of a fiduciary relationship to the settlor (creator of the trust). It makes sense, then, that exculpatory terms drafted by the trust director will be deemed invalid unless the trust director can prove that the terms were adequately communicated to the settlor.

Though not all of these updates will be drastically impactful for estate planners, it is notable to point out that many of these changes attempt to target accountability towards the individuals drawing up the instruments. This, as many will note, is quite a relief to those leaving their estate planning needs in the hands of their attorneys. ■

What Happens To My IRA When I Die

Part II In A Series

Ryan R. Berges

Beneficiary selection errors are one of the biggest problems we see with IRAs. Generally speaking, a married person should name their spouse as their primary beneficiary. This is because a spouse is the only beneficiary that can claim an inherited IRA as their own. This right does not extend to children or trusts. In some circumstances, such as a second marriage, there may be good reason to name a beneficiary other than your spouse. Each IRA participant has their own family situation and needs.

Frequently, we see people try to name their trust as the primary beneficiary after they sign all their legal documents as part of an estate plan because of confusion and misunderstanding. If you are married, before naming a trust or another person as an IRA beneficiary, it is critically important that you discuss with your legal counsel the need for, and ramifications of, such a selection. It is also important that the type of trust you designate is a "qualified beneficiary" under IRS guidelines.

There are other family circumstances that you need to consider when making beneficiary selections. Do you have a special needs child? If so you should name their special needs trust (or create one if you haven't already) as the beneficiary of their portion instead of naming the child directly. Do you have a child that is a spendthrift or who has legal issues such as a pending divorce? Then you should seek qualified legal counsel as to how to handle that situation. And finally, do not give your entire IRA to one person in the family hoping that they will divide it according to your wishes, things just cannot and do not happen that way.

One of the major advantages of working with multi-disciplinary firms, 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 how to choose a custodian to hold your IRA. ■