THE NORTHWEST QUADRANT

The Six P's of OptiFour's Due Diligence

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

Due diligence, the process of selecting and monitoring investments, is one of the most critical functions of any wealth manager. OptiFour follows a rigorous and structured process, articulated in our firm-wide Investment Policy and documented at our quarterly Investment Committee meetings, where we decide to add, retain, or replace investment strategies. Whether we are looking at active traditional managers, index funds, or alternative investments, the same basic qualitative and quantitative criteria apply. We call these metrics the Six P's of due diligence. I had the opportunity to make a presentation on this subject at our last Client Advisory Board meeting, and several Board members thought it would be useful topic for my quarterly column. These six criteria, often formulated as questions, are listed below.

1. Performance: The first criteria we evaluate existing and prospective strategies on is past performance, net of fees. If it's an active strategy, it needs to outperform its stated benchmark and rank in the top half of a group of similarly managed funds, called a peer group. Also, the strategy must have at least a three-year track record of actual results. There is very little evidence that past good performance persists; however, past poor performance often does. Managers that historically fail to add value are likely to underperform in the future. To us, performance is most useful as a negative screen, to help narrow the universe of choices and exclude strategies from further consideration.

2. Philosophy: The second criteria we look at is the investment philosophy or thesis. In active managers, we prefer flexible "go-anywhere" strategies, often called global-all-cap, where the manager has the flexibility to invest in securities of varying sizes, styles, asset classes and locations (within limits), and go where the money is.

3. Process: Next we look at the investment process, how the manager selects securities and constructs portfolios. For example, is it a top-down strategy capitalizing on macro trends or a bottom-up fund screening for stocks based on fundamentals? What limitations are there on position or sector weights? The investment process should also be clearly defined and repeatable.

4. People: This metric addresses who is running the strategy and what they bring to the table. Is it a single manager or a team? What is their average tenure on the fund? For better continuity, we prefer team-managed funds with long -tenured managers and deep talent pools.

5. Parent: This standard focuses on the parent company. We evaluate their ownership structure, resources, corporate culture and reputation, especially looking for legal/regulatory issues. We prefer independent firms owned by their employees or shareholders, whose goals are aligned with our client's.

6. Price: Lastly, we emphasize the strategy's expenses, comparing them to the peer group averages. Fees are the only facet of investing that we can predict and control and we prefer strategies with total fees that are below the peer group average. Performance may come and go, but expenses last forever, and the lower we can drive investment fees, the more returns our clients keep. ■

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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
www.lessonstomychildren.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. 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

Spring 2014 Volume 22 ESTATE AND FINANCIAL PLANNING UPDATE

FOUNDING PARTNER

I. Mark Cohen, J.D., LL.M., CFP®

We are contemplating yet another snow as I write this in early Spring. This will be a winter for the records and we are sure ready for some warmer temperatures. This February, Leigh and I were able to spend a warm week in St. Petersburg, FL, where we both took a 7-day learn to sail course, followed by a two-day course on what to look for in a used sailboat. We both passed with flying colors and hope to do a lot of sailing in the Chesapeake this season (as soon as it warms up).

Recently, we flew to San Antonio for the weekend of Rachel's birthday to spend some time with her and meet her boyfriend. She is doing very well as a kindergarten teacher and is thinking of staying there another year. Her boyfriend, Remi, is a delightful young man currently studying philosophy.

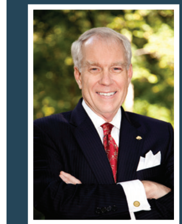
Michael is now a First Lieutenant, United States Army, leaving Korea and heading to Ft. Huachuca, AZ for his next duty station. He will be spending a couple of weeks here in Virginia along the way and we are thrilled to see him. His new duty station puts him much closer to his mother, his grandparents, and a lot of other family that live in Tucson and Phoenix.

In the second half of April, Leigh, Wes and I will be spending 9 days rafting down the Colorado River in the Grand Canyon, starting at Phantom Ranch. As some of you long-time readers may recall, I did the first half of this trip, from Lee's Ferry to Phantom Ranch a year and a half ago and had the experience of a lifetime. We are with the same company and looking forward to another great trip. Wishing all of you a wonderful spring and summer.

Mark ■

Moonlight on the Potomac

In March, we had our annual client appreciation gala. Our OptiFour clients were treated to a "Moonlight on the Potomac" dinner cruise on the Nina's Dandy. As they did last year, guests had the privilege of listening to a presentation by keynote speaker, Jeff Coons, the CEO of Manning and Napier. In addition, we all were able to enjoy beautiful sunset and evening views of Arlington, Alexandria and Washington, DC. The sunset and evening views of the Kennedy Center were absolutely stunning. Despite the uncharacteristically frigid and windy March weather, we had great turnout and were very happy to get a chance to see so many of our wonderful friends and clients that evening. This was by far our most popular client appreciation Gala, and we have gotten more positive feedback from guests than for any of our previous events. We are very pleased to show our amazing clients how much we appreciate your giving us the privilege of working with you in building your futures. ■



MANAGING PARTNER

Weston D. Burnett, J.D., LL.M., CFP®

We hope you had an interesting winter and spring. For Cohen & Burnett, we are in the middle of another busy tax season. The IRS was still issuing forms and related paperwork at the end of February, making March and April thoroughly exciting. We have three special people helping us: GWU Law graduate and recent Maryland bar admittee, Sarah Mugmon, third-year law student, Rasheda Nipu, and UVA graduate, Ted Elkins.

Trustee work at George Washington University continues to fill my nights and weekends. Highlights were settling on the final candidates to interview with the President of the University for Dean of the Law School. My wife and I attended two different events at which five Justices of the US Supreme Court were present. Barb and I are pictured below with Justice Sonia Sotomayor. The GWU Board of Trustees accepted two large gifts for public health policy totaling $80M and is conducting due diligence on a cy pres gift to the University of the Corcoran Gallery building, its endowment and the Corcoran Gallery of Art and Design.

On the fun side, I commuted to work oftentimes on foot in January through March because driving in the snow was not as appealing as taking a walk for 2.5 miles over hill and dale. Quite a delight when the snow is coming down and there is no one out except an occasional snow plow. My wife was surprised one week when she emailed our children to volunteer to babysit grandchild, Sitara, on Saturday night. The response came back that they were in Sofia, Bulgaria courtesy of the Bulgarian Government. Barb had to wait a whole week. My personal goals of late are to prepare for the rafting and hiking trip in the Grand Canyon in April, hiking in Glacier National Park in August and the 100 mile Seagull Century Bike Race in September. ■

Tax Benefits of 529 Plans

Sarah Mugmon, J.D.

It is vitally important to save for the future, and qualified tuition plans (also known as "529 plans") provide a way to save for a prospective college student's education expenses. A 529 plan is an investment instrument created to fund a designated beneficiary's higher education costs. Federal tax law encourages taxpayers to contribute to 529 plans by deeming any increase in the plan's value as a non-taxable event for both account holders (i.e., those who make contributions) and beneficiaries. Furthermore, any amount distributed to beneficiaries for qualified education expenses is also non-taxable.

States also encourage such saving through tax benefits for contributors of 529 plans. The following is a brief summary of tax benefits available in Virginia, Maryland and the District of Columbia.

VIRGINIA

Virginia tax law allows an account holder of a 529 plan, if under age 70 on December 31 of the taxable year, to deduct on his or her Virginia tax return up to $4,000 of contributions per plan. If more than $4,000 was contributed to an account in one year, the account holder can carry forward the excess amount every year until the contribution amount is fully deducted. For account holders 70 years of age or older, the entire amount contributed to the 529 plan is deductible in the taxable year it was made.

MARYLAND

Account holders under Maryland law can deduct up to $2,500 of contributions per 529 plan. Similarly to Virginia, this means that if an account holder has three children, sets up a plan for each child, and contributes $2,500 to each plan in a taxable year, the account holder may deduct $7,500 on the Maryland tax return for that year. Any contribution amount exceeding $2,500 may be carried forward for up to 10 years.

DISTRICT OF COLUMBIA

Account holders under the District of Columbia's law can deduct up to $4,000 per year, or up to $8,000 per year in the case of account holders filing a joint return. The carry-forward period extends for 5 years after a contribution exceeded the allowable deduction in the year it was made. The rules may vary based on state of residence or type of plan, so please contact us with any questions you may have regarding creating and contributing to a 529 plan. ■

What Happens If You Die Without A Will?

Rasheda Nipu

When a person dies intestate (without a will), how his or her assets get disposed of varies depending on the intestate succession laws of the state. In Virginia, Maryland, and DC, who gets what depends on whether the decedent was married, had living children or parents when they died. In all three states, if the decedent died with surviving children but no surviving spouse, the children inherit everything. The state laws diverge past this point.

For instance, in Maryland and DC, if the decedent died leaving a spouse, that spouse's share depends on whether the decedent had surviving parents or descendants (children, grandchildren, or great grandchildren); whereas in Virginia, the surviving spouse's share depends solely on whether the decedent had surviving descendants. This rule makes things easy for Virginia; if the decedent died leaving a spouse but no descendants, the spouse inherits everything. In Maryland, however, if the decedent died leaving a spouse, no descendants yet had surviving parents; the spouse inherits $15,000 worth of the decedent's estate plus ½ of the balance, leaving the other half to the parents. The same scenario in DC would leave the spouse with ¾ of the estate and the remaining quarter to the surviving parents.

If the decedent died with both a surviving spouse and descendants, the outcome varies even greater. For example, if the decedent died leaving a spouse and 3 children, all of whom are also children of that spouse who has no other children from previous relationships; the intestate distribution in all three states is different. In DC, the spouse inherits 2/3rds of the estate and the children inherit the remaining 1/3rd. Meanwhile, in Virginia, the spouse inherits everything. Interestingly, the outcome in Maryland would depend on the age of the surviving children. In the case of minor children, the spouse inherits half the estate, while the children inherit the other half. If none of the children are minors, the spouse inherits $15,000 plus half the remaining estate, while the children share the other half.

Clearly, complexities within today's family dynamics create even greater varieties in the outcome of intestate distributions, for which reason appropriate estate planning is beneficial. ■

Introducing OptiFour's Client Advisory Board

Kammie Bingham

In the third quarter of 2013 OptiFour began internal discussions around the idea of forming a Client Advisory Board (CAB). We reached out to and engaged Stephen Wershing, President of 'The Client Driven Practice' which specializes in running client advisory boards and coaching advisors on customizing their businesses to their clients' needs, to serve as a moderator for our board.

The first CAB meeting was held on November 5, 2013, and the initial dialog focused on the topic of OptiFour's Annual Review Process. The then-current process was outlined to the board and members were given the opportunity to openly comment on and provide suggestions as to what they like, would change, and areas where OptiFour could improve the process. After the meeting, OptiFour reviewed all the recommendations and implemented some of the proposals. Going forward, the Annual Review agendas will be more individually tailored. Specifically, we replaced the broad-based questions found at the beginning of the old agenda with a 'Previous Annual Review Meeting Summary.' The summary will be sent out by Mark or Wes following an Annual Review meeting and that same summary will be inserted at the top of the agenda for the next year's meeting. The goal is to send these agendas out prior to the meeting, thereby giving our clients more time to review the topics that will be discussed and get back to us regarding any additional items they wish to add for review.

The second CAB meeting was held on February 4, 2014. The meeting kicked off with a summary of the changes OptiFour intended to make to the Annual Review Process as a direct result of the expressed suggestions from the Client Advisory Board. Following the prior meeting summary, the CAB tackled new topics of OptiFour's Quarterly Market Commentary and Investment Management Presentation. We are currently in the process of reviewing the notes and transcript from the meeting and working on finding ways to incorporate some of the recommendations.

The CAB has already proved to be invaluable. We look forward to hearing much more and integrating additional client-driven propositions into OptiFour's practices to help us improve the overall experience for our clients. ■