THE NORTHWEST QUADRANT

The Active/Passive/Alternative Approach

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

Last quarter, this column covered how OptiFour selects and monitors investments and the six P's of our due diligence process. This quarter, we thought it would be helpful to explain our investment strategy and the portfolio construction process.

We call our strategy the **Active/Passive/Alternative** approach, and as the name implies, it consists of three sleeves, each of which plays a distinct and complementary role in our client portfolios.

For the active segment, we prefer using a limited number of broad and flexible active managers, often called **Global All Cap** or **Global All Asset** strategies. This contrasts with most other financial advisors, who construct portfolios with 12 or more different managers each covering a narrow style box, market capitalization range or asset category. Rather than hire many active managers operating independently, we take a more integrated approach, using 1-4 managers with broad flexibility to add value where they can find opportunities, and to move among stocks and bonds and US and international and small, mid and large cap stocks regardless of style, or size, or geographic region. In short, we want to hire managers that can go where the money is, avoiding risks and capitalizing on opportunities on a global basis. Fewer active managers also provides better transparency, risk control, and accountability for results and improves the likelihood of outperforming a benchmark at the portfolio level.

For the passive segment of our strategy, we use a blend of low-cost index funds or **Exchange-Traded-Funds (ETFs)** in a mix that mirrors the client's strategic allocation in the active sleeve. Index funds simply deliver market returns with tax-efficiency and very low fees. They also tend to complement our active managers, improving diversification, smoothing returns, and driving down overall costs.

The third sleeve of Optifour's portfolios consists of **Alternative Investments (Alts)**, which are not correlated with traditional stock and bond strategies. Our **Alts** historically included mostly illiquid investments such as **Non-Traded REITs**, **Equipment Leasing**, **Oil & Gas Programs**, etc., but have evolved to focus primarily on liquid **Alternative Investments** which have daily pricing and trading with lower costs. Because **Alts** don't behave like stocks and bonds, adding a 10%-20% weighting in them helps further boost diversification, reducing risk and improving portfolio returns. The categories of alternatives we currently use include **Managed Futures**, **Master Limited Partnership (MLPs)**, **Real Estate Investment Trusts (REITs)**, **Long/Short Equity**, **Commodities**, and **Global Infrastructure**, but we are continually evaluating new strategies in this space.

Our typical portfolio will consist of 40%-45% **Active**, 40%-45% **Passive** and 10%-20% **Alternative** strategies, but these proportions vary depending on the client's specific needs and objectives. Together, these three segments help us enhance diversification, reduce costs, increase performance consistency, and improve the probability of success in achieving client goals. ■

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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

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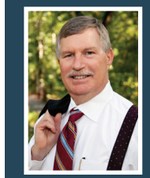

FOUNDING PARTNER

I. Mark Cohen, J.D., LL.M., CFP®

Summer has finally arrived and the fully foliated trees outside my window cast a verdant glow on my office.

I am pleased to announce that Leigh and I were married in St. Michaels, Maryland at the end of June. We sailed over from Annapolis together with most of the wedding party, spent the weekend there, returned the guests to Annapolis and then honeymooned sailing on the Chesapeake for the next week. It was a small wedding with just immediate family and a few friends. Wes officiated. Leigh has two delightful daughters, Dana and Holly who are about the same ages as my kids. Both live nearby. Dana is married to Joe and all the kids are fully employed and making their way in the world.

Of course, I was glad to see Michael and Rachel and the rest of the family that came to the wedding. Rachel is going to teach Kindergarten for another year in San Antonio and has moved to a new apartment in the South Town part of the city, near the Riverwalk. It is a happening part of town and she is pleased to be able to have a place for herself. She was excited to land a summer internship with the city of San Antonio working on planning for the future of early childhood development.

Michael is settled in Sierra Vista, Arizona, living in a nice apartment off base. His first "home" as well. He is also close to a lot of our family that lives in Tucson and Phoenix. He notes that the "Op Tempo" at his current job is very different from Korea. He should have plenty of time and access to have a decent social life. Important to a young man of his age.

Mark ■

Executive Leaders Radio

Starting this year, I have been co-hosting a weekly radio show called Executive Leaders Radio. It is the number 1 business radio show from New Jersey to Virginia in terms of potential listening audience, hours of programming, geography covered and quality of shows. It is broadcast nationally in over 11 additional states and over 14 additional radio stations. The shows are also archived on iTunes, Podcast Alley and their own website, below. The CEO guests typically run businesses that are $10 Million to $16 Billion in revenue. The 12 minute interviews are able to provide a clear sense of who they are, what influences shaped them, and how they got where they are now. Listeners of all ages can relate to and learn from their stories.

We tape the show on Thursdays and typically broadcast on WFED 1500 AM and WWFD 820 AM on Sundays from 9:00am to 10:00am. You can also catch all the past shows on www.ExecutiveLeadersRadio.com. ■

MANAGING PARTNER

Weston D. Burnett, J.D., LL.M., CFP®

We hope you had an interesting spring and summer. For Cohen & Burnett, we have been extraordinarily busy and happy at that. Our tax season staff has moved on. Sarah Mugmon, here on a Fellowship that ended June 30, is studying for the Virginia Bar exam at the end of July and recently started work at a legal and tax publishing house, Bureau of National Affairs. Rasheda Nipu, our spring semester intern, graduated from Syracuse Law School and is studying for the Virginia Bar and looking for a job. Ted Elkins is back working on his documentary.

Trustee work at George Washington University continues to fill my nights and weekends. Highlights were hiring of a new Dean of the Law School. His name is Blake Morant, a charismatic African American male, who has been the highly successful Dean of Wake Forest Law School for the last seven years. He is also the incoming President of the American Association of Law Schools. My wife and I endowed at GWU Law School the Burnett Family Professorial Lecturer in International and Comparative Law and Policy as we have five family members with degrees in international law or international affairs.

On the fun side, I, together with Mark and Leigh, rafted and hiked for ten days in the Grand Canyon in April. I loved hiking the side canyons to Thunder River, Surprise Valley or many waterfalls and grottoes. The picture below shows me in the Havasupi that empties into the Grand Canyon. I continue to train with a heavy back pack for hiking in Glacier National Park in August. I also try each weekend to log a 60-80 mile, bike ride to ready myself for the 100 mile Seagull Century Bike Race in September. ■

Leaving Burial Instructions for a Designated Agent

Sarah Mugmon, J.D.

Death of a loved one is often overwhelming, and the many decisions family members must make add to the overall distress. One of the beginning steps in administering an estate is arranging the funeral and disposition of remains. Although sometimes overlooked in the estate planning process, people often feel strongly about how their remains are to be treated upon death. A person may want assurance of his or her wish to be buried, cremated, entombed, memorialized, or some combination thereof upon death. A person may also want to mitigate uncertainty as much as possible for loved ones left behind. A signed document designating a particular individual to make arrangements for the funeral and disposition of remains provides an avenue to ensure your wishes are carried out properly.

Virginia law provides that a person may designate an individual as the agent responsible for making any desired funeral arrangements. The designation is made through a signed and notarized writing that details the desired disposition method. The designated agent must also sign the writing, showing his or her agreement to carry out the individual's wishes. Requiring the designated agent's signature also puts the agent on notice that the person wants a specific disposition of his or her remains. The designated agent has priority over all other persons otherwise entitled to make such arrangements, provided that the agent presents a copy of the signed and notarized writing to the funeral service establishment (and to the cemetery, if any) within 48 hours of the funeral service establishment receiving the remains.

Nothing precludes the next of kin from paying costs associated with the funeral or disposition of the remains, provided that such payment is made with the consent of the person designated to make the arrangements. Expenses incurred by the designated agent will usually be charged against the decedent's estate and reimbursed by the decedent's Executor or Trustee pursuant to the terms of the decedent's Will and/or Trust.

It is important that you tell your family members what funeral and burial arrangements you want. One way of doing that is to formally name an agent to oversee that process. ■

E-Filing Tax Fraud On the Rise!

Dan Frix and Rasheda Nipu

Since 2008, tax identity theft has exploded, seeing an increase from 51,700 cases to more than 1.1 million in 2011. This rise is due largely to the dramatic increase in the number of Americans filing their income tax returns electronically. The option to e-file is appealing as it provides for avoidance of the hassle and cost to mail the return, via certified mail, at the post office; an immediate electronic postmark confirmation of a timely filing; and the potential arrival of a refund in as little as seven days.

However, there is an increased risk that someone can file a fraudulent return to obtain a bogus refund. The only information someone needs to electronically file a fraudulent return is the person's name and social security number. Once obtained, it would be easy for anyone to simply make up income by creating a phony W-2 Form. The thieving individual can then have the refund posted to an anonymous "Green Dot" prepaid Visa or Master Card, available in any drug store. These cards have routing and account numbers that work the same way as other direct deposit accounts but are virtually untraceable.

Unfortunately, evidence of fraud in these cases is difficult to find – no signatures, no fingerprints, and generally not identified until after it's happened. The IRS will generally replace a stolen refund, but if the refund was stolen through the use of a made up bank routing number, it will not replace the refund until after the bank returns the funds to the IRS. Otherwise, the only recourse for the victim is to file suit against the (often untraceable) perpetrator.

To improve protections for taxpayers, the IRS has proposed limiting direct deposits of refunds to only bank accounts which are in the name of the taxpayer and/or requiring taxpayers to change the bank account number every three years. While this may help, it may not totally solve the problem. With today's budget constraints, the IRS mandate to electronically file tax returns is not going away. Accordingly, an individual's best option is to be very diligent with the protection of their identity and especially their social security number. ■

New Limits on IRA Rollovers

I. Mark Cohen, J.D., LL.M, CFP®

In most cases when you take money out of your IRA and put it in your own pocket, you will have to report the amount as ordinary income and pay tax on the amounts withdrawn. There is one big exception – if you roll that money over to another IRA you own within 60 days (a "rollover") the transaction will not be taxed. But you cannot do that more than once per year for each IRA account. For example, if you have three IRA accounts, you could do three 60-day rollovers in the same 12 month period, one for each IRA account. The Tax Court, however, ruled recently in a case called "Bobrow" that an IRA owner who makes a tax-free rollover cannot do so again within 12 months in any IRA account. So, you now can do only one 60-day rollover per year, regardless of the number of IRA accounts you own.

The IRS announced a few weeks after that ruling that they would follow this new interpretation. However, since their regulations and Pub 590 still have the old rules, they will adopt this new rule effective January 1, 2015. In the meantime, the current regulations and Pub 590 are out of date and should not be relied upon for the correct interpretation of the once-per-year limitation.

Note that there are two ways to move funds from one IRA to another: the 60-day rollover discussed above; and a Trustee-to-Trustee transfer where the funds are paid from one IRA directly to another and never come into your possession. The new limit only applies to 60-day rollovers where funds are paid from your IRA to you and you have 60 days to pay them into another IRA. Bottom line: when it comes to moving IRA funds, go with the direct, trustee-to-trustee transfers. These will not trigger the once-per-year rule.

Also, remember that required minimum distributions for IRA holders who are 70 ½ or older will not qualify for rollover or Trustee-to-Trustee transfers. Those must be reported as income. ■