

**THE
NORTHWEST
QUADRANT**

The Case for Commodities Revisited

Larry Solomon, MBA, CFP®

Diversification is one of the most important rules of investing. If you invest in a range of different asset classes, losses in one may be offset by gains in another. Investing in commodities—whether oil, gold, or soybeans—is yet another way to achieve broader diversification.

Generally speaking, commodities are raw materials derived from the earth that people consume directly (food), or are used to create products that people either buy, use, or consume on a daily basis. Investors allocate a percentage of their assets to commodities for the following reasons:

Diversification — Historically, there has been an imperfect correlation between the returns of both commodities and commodity stocks and other asset classes like U.S. stocks and bonds.

Potential return — Individual commodity prices fluctuate according to such factors as supply and demand, currency fluctuations, and inflationary pressures. At times in history, commodity prices have experienced multi-year bull and bear market cycles. In recent years, increased demand due to massive global infrastructure projects has greatly influenced commodity prices. In general, as demand rises, so may commodity prices.

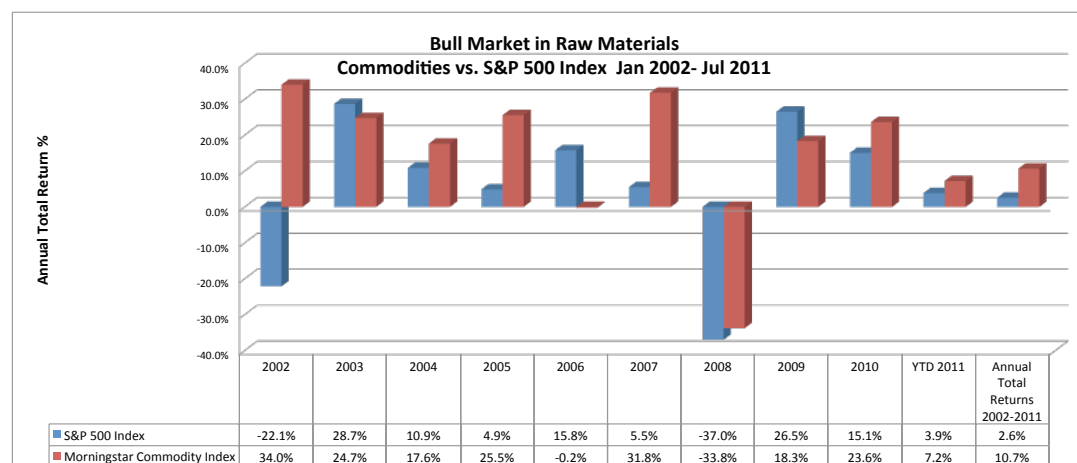
Potential hedge against inflation — Since the supply of many commodities is constrained in the short term, higher inflation often means higher commodity prices. While commodities have shown strong performance in periods of high inflation, investors should note the volatility associated with the asset class.

There is a fourth, more far reaching argument in favor of commodities, best articulated by Jeremy Grantham, famous market strategist and co-founder of GMO Asset Management. The supply-demand dynamic for commodities has been altered over the last decade as consumption by emerging-market economies, like China and India, has mushroomed and supplies of many materials have dwindled. From 1900 until 2002, prices of key commodities declined, interrupted by periodic but relatively short-lived spikes (during the two world wars, for example).

Although global demand rose in the period, supplies of many materials more than kept pace. In agriculture, for example, the “green revolution” beginning in the 1940s led to dramatic gains in crop production. Grantham argues that the surge in raw materials prices since 2002, though interrupted by the 2008 plunge, indicates a paradigm shift, and that going forward, skyrocketing developing market demand, price pressure and global shortages of natural resources will be the norm.

For investors who believe that raw materials are in a long-term bull market, the question then is how best to participate. Other than trading commodity futures or buying physical commodities outright, there are three main choices: funds that track broad commodity-price indexes; funds that own a diversified mix of stocks of commodity-producing companies; and exchange-traded funds that target commodity niches, such as agriculture or metals, by owning either the materials themselves or stocks of companies involved with them.

To avoid the volatility of a single sector, we favor the broad commodity indexes that typically combine niches such as energy, agriculture and precious metals to provide one-stop raw materials exposure and create a composite of world consumption. Two broadly diversified, low cost ETF options are iShares S&P GSCI Commodity-Indexed Trust (GSG) or PowerShares DB Commodity Index Tracking (DBC). ■



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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 Michael Cohen: michael@cohenandburnett.com.

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THE COMPASS ROSE

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ESTATE AND FINANCIAL PLANNING UPDATE

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FOUNDING PARTNER

I. Mark Cohen, J.D., LL.M., CFP®

Fall is approaching and after some really sweltering days in July and August, a hurricane, and an earthquake, I am ready for a cooler, drier, and more stable fall. Fall is that exciting time of year when we are charged up from our summer and ready to tackle new projects.

The family continues to do well. Michael was accepted to Army Officer Candidate School and will report to Fort Benning Georgia in May. Until then he will be working here at the office helping out with client services and operations. Rachel has now begun her senior year at William and Mary and expects to graduate with a bachelor's degree in anthropology next May. She is still trying to decide what her next steps will be.

We had a really nice family vacation in San Diego, escaping some of the worst heat here. The highlight for me was a day sailing on the Californian, a replica of the brig-rigged tall ship revenue cutter, C. W. Lawrence, that patrolled the coast of California from 1848 until 1851.

One of our basic missions at Navigator Wealth Management is to demonstrate that our multidisciplinary model is not only the best way for clients to receive coordinated, objective advice on their legal, tax and financial matters, but also a successful business model for the advisor. As for the latter, I am pleased to announce that we have had our most successful 1st and 2nd quarters ever. We are on track for our most successful year. As for the first part of our mission, I have been asked by Virginia Continuing Legal Education to speak at the 20th Annual Elder Law Seminar in Richmond this Fall. The topic is “What do you say to clients who ask you for advice on financial products or ideas?” I am particularly excited to be presenting this topic to Elder Law attorneys. It reflects a growing recognition by these attorneys that financial and legal matters are linked and should be coordinated by the attorney. Much of our focus as estate planning and elder law attorneys is on the preservation of our client's resources. We know more about our client's resources, legal structure and family dynamics than any of their other advisors. And, unlike many of their other advisors, we are required to serve our client's best interest by providing objective advice and avoiding any conflicts of interest.

We will have a white paper on this topic shortly on our website and can mail a hardcopy upon request. Wishing you a happy and productive fall season. ■

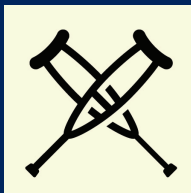
Cohen and Burnett Hosts First Annual Summer Picnic for Staff and Clients

On Friday July 15th, Cohen and Burnett held its first annual summer picnic at Olney Park in McLean, VA. All staff members and over 40 clients and their families attended, enjoying the balmy weather with food to match the summer season. We have Wes and his grilling skills to thank for some delicious burgers and hot-dogs, and for his brightly-striped, monogrammed cooking apron. Several families brought their children, who played on the swing-set and jungle gym next to the tables. However the heart of the picnic was the opportunity it presented for clients and staff to socialize in a pleasant outdoor setting just before a weekend. Navigator prides itself on serving clients professionally and on enjoying interactions with them in a more relaxed environment.

For members of the Navigator team, the picnic was something of a capstone for the 2nd quarter and a pleasant way to end a dynamic billing season. The picnic was also an opportunity for Mark and Wes to officially bid a fond farewell to Nicci Yang, who is moving to Wisconsin with her family. The picnic was a great success and the first of many - we hope to see you there next year. ■



Staff and clients give a warm send-off to Nicci Yang and her family.



Your Long-Term Care Insurance Premiums

Dan Frix, C.P.A.

We were certainly pleased that many of our clients and friends were able to join us in June for a seminar on the advantages of long-term care (LTC) insurance. Some individuals in our seminar audience were not aware of the tax implications of LTC insurance premiums on their federal and state tax returns. While we covered this briefly during the seminar, we'd also like to share this information with you. So here is a brief recap of the rules.

Federal Returns — LTC insurance premiums are includable, up to certain limits, with other medical expenses on Schedule A as an "Itemized Deduction." The includable LTC insurance premiums are limited, depending upon the age of the covered individual, which ranged (2010 tax returns) from a low of \$330 for someone under age 41 to a high of \$4,110 for someone over age 70 as of the end of 2010.

These LTC insurance premiums, together with all other allowable medical expenses, are aggregated and are deductible to the extent that the aggregate costs exceed 7.5% of the taxpayer's Adjusted Gross Income (AGI). Because of this threshold, most people are not able to take advantage of these deductions.

Virginia Returns — For residents of Virginia, LTC insurance premiums receive a much more favorable tax treatment. Amounts paid for LTC insurance are deductible in Virginia as a subtraction from federal AGI. There is no limitation on the dollar amount of these premiums. The only limitations are (i) the LTC premiums cannot have been "actually included" as a deduction on the federal return and (ii) the deductible LTC premiums cannot also be used in the calculation of the LTC premium credit as further described below.

Virginia also permits a credit against the state income tax for the first 12 months of an individual's LTC insurance coverage. The credit is equal to 15% of the premiums paid for this coverage and is claimed in the year(s) in which these premiums were actually paid.

Maryland Returns — Residents of Maryland do not receive a deduction for LTC insurance premiums. Instead, residents can receive a credit against their state income tax of up to \$500 per individual for the LTC insurance premiums paid. For someone under the age of 41 at the end of the taxable year in which the credit is claimed, the maximum credit is limited to \$330 rather than the aforementioned \$500 per individual.

100% Disabled Veterans Are Entitled to Property Tax Exemption

Andrew Vanderhoof, J.D., LL.M.



Effective January 1, 2011, the Virginia Code, "exempts from taxation the real property, including the joint real property of husband and wife, of any veteran who has been rated ... pursuant to federal law to have a 100 percent service-connected, permanent, and total disability, and who occupies the real property as his principal place of residence."

However, the Attorney General has issued an opinion that provides that real estate held in the revocable trust of the 100% disabled veteran does not qualify for this exemption. The Attorney General, citing the Virginia Supreme Court, noted that the Commonwealth has an announced policy "to distribute the tax burden uniformly and upon all property," and thus, statutes granting tax exemptions are construed strictly against the taxpayer.

The Attorney General explained that under the Virginia Code, a "person" and a "trust" are two different entities, and because the tax exemption provisions do not include "trusts," they will not be construed as eligible for the exemption.

The legislative committee that Mark sits on is considering a statutory fix, but unless and until this happens, veterans that are 100% service-connected disabled will have to remove their real estate from their trusts in order to take advantage of this tax exemption. ■

This credit is a "one time" credit for each individual and, therefore, once claimed cannot be claimed again for the same individual. To qualify for the credit, the individual's LTC insurance coverage must have commenced on or after July 1, 2000.

Summary — This is a brief overview of the tax implications of LTC insurance premiums affecting most of our clients and friends. If you would like to know more about the tax treatment of LTC insurance in other states, or if you'd like to discuss how this information applies to your personal situation, please do not hesitate to give us a call. ■



MANAGING PARTNER

Weston D. Burnett, J.D., LL.M., CFP®

Nicci Yang, her husband, Chad and two young sons moved back to Wisconsin this summer to be closer to family. Michael Cohen, Mark's son and a William and Mary 2011 graduate, joined us in August for nine months before he reports next spring for Army OCS. We also hired Sean Hobaugh, a senior at George Mason University majoring in economics, as our school year intern. We completed our upgrade in early June to the Small Business Server 2011.

On the family side, Barb and I spent ten days in late June-early July in Peru visiting the world heritage site of Machu Picchu, a magical place built by the Incas and discovered 100 year ago by a Yale professor, and Lake Titicaca, the highest navigable lake in the world. Our daughter, Jennifer, completed her PhD in Psychology this summer and started working for the University of Virginia Medical Center in August. Edward, David and Alka and many friends joined us in late August at our summer cottage in New Hampshire for fun and outdoor activity. We have two family weddings this fall first in New Hampshire in September for my brother's son, Christian Burnett, a young navy pilot and his fiancé Alle. Then, a month later, we gather again in North Carolina for Barb's sister's son, Matthew Brewer wedding to his fiancé, Julie. My mother is doing as well as can be expected and was able to watch the NH wedding via skype at her place in Annapolis, MD.

On the personal side, I remain very active with George Washington University on the executive committee of the Alumni Association and am now in charge of the quarterly wine dinners for the Cosmos Club for the next three years, an interesting new challenge for me. I continue to spend my spare time on long bike rides and 20 mile runs along the Potomac and on long hikes along the Appalachian Trail in Virginia, Maryland or Pennsylvania with the Wanderbirds, a 75-year-old hiking organization. I like the beer cooler on the bus at the end of the hike. ■



Giftting House to Children



Kathryn Duffy, J.D.

Many clients ask whether they are better off if they gift their house to their children while they are still living instead of leaving it to them after they die, because they believe the transfer will avoid probate and avoid estate taxes. While this does avoid the hassle of probate for the children, it does not avoid estate taxes. Any gifts made to children with a fair market value in excess of \$13,000 are subject to the gift tax, and would require a gift tax return to be filed. This gift will also count against your estate tax exemption (currently \$5 million) as the gift tax and estate tax are unified.

Giftting the property outright to your children during your lifetime can also leave them with some harsh income tax consequences. When you inherit property after someone's death, you take the property with a step-up in basis to the fair market value at the date of the transferor's death. However, when you gift property to someone, they get a carryover basis, so if you purchased the home thirty years ago for \$100,000 and the home is now worth \$500,000, your child would take it with your original \$100,000 basis, leaving them with \$400,000 in capital gains, which translates to about \$60,000 owed in income taxes. In order to qualify for the income tax credit on the sale of a home (currently \$250,000 for individuals and \$500,000 for married couples), they would have to live in the house as their primary residence for at least two years before they can qualify for the credit. However, if you had left it to them as a bequest through a will or a trust, then they would take it with a basis of \$500,000 and have no capital gains if they were to sell it.

As far as giftting the house in order to avoid probate, deeding the property into a revocable living trust and distributing it through the trust is a much better alternative, as it avoids probate, and ensures a step-up in basis for your children at your death. It also leaves control of the property in the hands of the homeowner, and protects it from any potential creditors of the children. Your home will pass to your children after your death, and there are none of the adverse consequences associated with making the transfer during your life.

Under the new Medicaid rules, your principal residence is no longer counted as an asset for determining Medicaid eligibility, so there is no longer the need to transfer the property to qualify for Medicaid. Under prior rules, many people gifted their homes to their children in order to avoid having their home count as an asset, which would often disqualify them from Medicaid eligibility, but the new rules exempt homes from counting against eligibility, so that is no longer a reason to gift a home to your children. ■