



Take Control of Your Wealth: The 250 Best Financial Advisers

By Melissa Phipps July/August 2002, Worth Magazine

The brightest in the business are mitigating risk and managing uncertainty. Here are their best ideas.

The headlines of the past year have read like a modern-day Shakespearean tragedy. Against the disquieting backdrop of domestic terror, war, corporate deceit, rising unemployment, and recession, trillions of dollars of stock market wealth have been erased from our collective account statement. The new reality has been painful.

In these unpredictable times, Worth's list of the nation's most elite financial advisers serves as a guidepost for superior financial wisdom. The advisers on our list are selected for their creativity, depth of knowledge, and dedication to their clients. Most important, they also know how to minimize uncertainty by successfully managing the elements of their clients' financial lives that can be controlled—from fees and taxes to diversification and debt management—so their clients can worry a little less about the things that seem out of control, such as the direction of the stock market. These strategies may not result in the outsize portfolio gains that many investors came to expect during the late 1990s, but they can help wring out extra returns and protect against losses. They are essential for staying in control of one's wealth.

The success of any financial strategy begins with the choice of an adviser. It's time to get choosy. A dizzying array of brokers, bankers, insurance agents, and accountants are aggressively recasting themselves as comprehensive financial advisers. Our list of the 250 brightest minds in the business includes only those who can deliver a truly integrated offering. "You can't make good investment decisions in isolation," says Don Phillips, managing director of mutual fund tracker Morningstar. "The real value is in having someone quarterbacking all of your financial activities."

Anything less can be costly. Adviser David Polstra, chairman of Polstra & Dardaman in Atlanta, recounts the story of a new client whose broker had recommended an investment in tax-exempt municipal bonds. Trouble was, the client fell prey that year to the dreaded alternative minimum tax, which wiped out the after-tax yield advantage over corporate bonds. "A comprehensive planner looks for things such as AMT status," Polstra says, "but the average investment manager may not know to ask." Polstra, like roughly 80 percent of the advisers on our list, is a certified financial planner, or CFP. Although no designation can guarantee superior advice, clients who work with CFPs can take comfort in knowing that their advisers have passed a comprehensive exam covering everything from simple cash-flow management to sophisticated trust strategies. Most of the other advisers on our list hold designations that suggest similar broad-based competencies. The best among them are adept at asking the right questions. One simple rule of thumb: If advisers don't get personal, they're not doing their jobs.

Investors often feel least in control when it comes to managing their investment portfolios. To a large degree, the mercurial stock market

is to blame, but the approach is too. A typical equity allocation includes between nine and 12 mutual funds or separate accounts spread across four domestic and two foreign investment styles, half of which are actively managed. Well diversified? Yes, but consider the drawbacks. First, one manager may be selling a stock while another is buying it. Second, active managers are apt to chase returns, subjecting investors to short- and long-term capital gains as they move in and out of stock positions. Even the most tax-aware investors can expect taxes to lop off roughly 2 percent in annual returns. Fees too are costly. According to Chicago investment consultants Ennis Knupp and Associates, the average institutional multimanager equity portfolio costs investors 1.2 percent. Individuals often pay more. If the pundits' forecasts for single-digit returns in this decade prove correct, taxes and fees will be serious dead weight.

Some forward-looking advisers are reshaping the traditional asset allocation model to minimize this drag. Their approach, dubbed the core-and-satellite equity portfolio, calls for fewer working parts and far fewer managers. In recent years, the approach has gained ground in the exclusive world of private family offices that manage money for the superwealthy. Now advisers are finding that they can also apply the approach to client portfolios worth a minimum of \$1.5 million. "This may become the investment model for the future," says Harold Evensky, chairman of the Evensky Group in Coral Gables, Florida.

Here's how it works. The core portfolio, which constitutes up to 60 percent of the equity allocation, is modeled on a broad market index such as the Standard & Poor's 500, the Russell 3000, or the Wilshire Total Market. It is either passively or actively managed for style but actively managed for tax efficiency—meaning capital losses are used to offset capital gains. Around the core are up to four actively managed satellite positions selected solely for their ability to boost returns. Funds are chosen to provide exposure not found in the core—to micro-cap stocks, emerging markets, real estate investment trusts, or market-neutral hedge funds, for instance.

This allocation model provides broad tax-managed exposure in the core. As a result, investors can afford to take more risk in the satellites. And because satellite investments are selected to produce excess returns, there is no need for regular portfolio rebalancing—the inherently tax-inefficient process of selling what outperformed to buy what underperformed. Mark Balasa, co-president of Balasa Dinverno Foltz & Hoffman in Schaumburg, Illinois, figures his core-and-satellite portfolios have boosted his clients' after-tax returns by an average of 2 percent a year since he began employing them in early 2000.

There are no guarantees when it comes to investing, but there are such things as guaranteed returns. Annuities are insurance contracts that typically promise a tax-deferred fixed or variable stream of payments in the future in exchange for giving up a lump-sum payment up front. Many annuity products are oversold by commission-hungry brokers and

insurance agents. Most are too expensive. In a market in which nothing comes easy, however, advisers point to two exceptions that are ideal for wealthy investors: TIAA-CREF Personal Annuity Select, a no-load fixed annuity, and USAllianz Alterity, a variable annuity.

TIAA-CREF Personal Annuity Select is a sensible place to park cash for five years or less. It currently offers a guaranteed 4.85 percent minimum annual return, after fees, through March 2003, when the rate will be adjusted to reflect changes in the aggregate yield of the bonds held in the portfolio (chances are the rate will move higher). The key is flexibility. Unlike most fixed annuities, TIAA-CREF Personal Annuity Select permits assets to be withdrawn every six months. Since it's a tax-deferred vehicle, a 10 percent penalty is assessed against the yield for withdrawing funds before age 59 1/2. Even so, the reduced yield is still a healthy 4.36 percent, compared with money market yields that currently average below 2 percent.

Because of its guaranteed return, USAllianz Alterity can help moderate the dangers of investing in high-risk, high-return asset classes. "We have a client who invested \$100,000 on the day the market opened following the terrorist attacks—all in emerging markets," says Mark Cortazzo, senior partner of Macro Consulting Group in Parsippany, New Jersey. "His account is up more than 28 percent." What makes this annuity attractive, Cortazzo says, is the living benefit provision, which guarantees that the investment will accumulate by 5 percent a year regardless of the performance of the underlying assets. It offers a payout after seven years based on the highest anniversary value of the assets in the annuity, which are disbursed with interest over 10 years (the contract can be surrendered in five years without penalty). Investors can hold a wide range of mutual funds in the annuity, including offerings from JW Seligman, Oppenheimer, and PIMCO. Although the total fee, including the cost of the underlying funds, can run as high as 2.5 percent, it doesn't affect the guarantee. Since it takes a minimum of seven years to realize the benefits of the investment, Cortazzo uses USAllianz Alterity for long-term money.

When it comes to asserting control over one's wealth, the mantra that advisers find themselves repeating most often is "Diversify out of large single-stock positions." In this post-Enron era, investors shouldn't need much coaxing. But the message still tends to fall on deaf ears—even in Enron's home turf of Houston. "Clients buy into all of it," says adviser Clark Blackman of Houston's Post Oak Capital Advisors, "except when I bring up the subject of selling their company stock."

Although there are no hard and fast rules, advisers typically argue that a single stock position should represent no more than 5 to 20 percent of an individual's total net worth. If it's possible to sell enough of your single stock position at today's prices to meet your long-term financial needs, do it. If you must adopt a more gradual approach, build as diversified a portfolio as possible around the concentrated position and develop a plan to sell it progressively.

Diversification is most tricky for executives and other corporate insiders. In 2000, the Securities and Exchange Commission gave insiders the right to set up prearranged selling plans so shares could

be sold without raising eyebrows as long as the terms are outlined in advance and are adopted without the use of inside information.

Sell plans can be structured flexibly so that insiders can optimize sales in varying market conditions, says Tim Kochis, co-founder of Kochis Fitz in San Francisco. Kochis often drafts plans so that his clients can sell more shares as the stock price rises and sell fewer as it falls. Other factors, as long as they are objective, can also be built into the plans, including such lifestyle issues as selling a specific number of shares between certain dates to cover the purchase of a new home. The key is to establish the formula carefully. "Trying to change a plan once it is in place can have a negative effect on the market," Kochis says. "It's worse than not having a plan to begin with."

Despite the depressed equity market, concentrated stock positions often have a low cost basis, so taxes can wipe out around 35 percent of the value when the shares are sold. Investment banks offer a variety of expensive derivatives strategies that provide diversification but postpone the tax bite. (We wrote about this in "Security Blanket," July/August 2001, available to Worth subscribers on www.worth.com.) Fortunately, investors can employ a cheaper, more benevolent diversification strategy by using a charitable remainder trust, or CRT.

One key advantage of a CRT, says Norman Boone, founder of Boone Financial Advisors in San Francisco, is that the single stock position is first put in the trust, then sold off and invested in a diversified portfolio. In effect, diversification has no tax consequences, so the assets will grow more quickly. At the same time, grantors get a current-year gift-tax deduction. Beneficiaries and their spouses receive an annual income stream for life—typically between 5 and 10 percent of the assets (younger beneficiaries usually start at the lower end). The instrument is structured so that at least 10 percent of the assets will be donated to a charity at the conclusion of the trust. The designated charity can be changed at any time, but the trust itself is irrevocable. For this reason, Boone recommends placing no more than a third of one's net worth in a CRT.

To have debt or not to have debt? That is the age-old question. With interest rates still at 40-year lows, treating tax-deductible debt as a cheap source of liquidity can make sense for wealthy investors. "The less you need a mortgage, the more you should have one," says Kochis, who encourages high-tax-bracket clients who can comfortably service their debt to take full advantage of the \$1.1 million maximum mortgage deduction when buying new homes. The cash, Kochis says, can instead be invested in equities. The key is to be confident that your expectations for after-tax equity returns exceed the after-tax cost of the mortgage. To maximize the tax deduction, Kochis adds, homeowners should favor an interest-only mortgage that defers payment of principal.

Interest rates should inevitably climb as the economy recovers—bad news for fixed-income investors. Ross Levin, president of Accredited Investors in Edina, Minnesota, says that investors who rely on their portfolios for income should consider paying down their mortgage as an alternative to holding bonds. Lower debt costs can reduce the amount that must be drawn from the portfolio. This strategy is especially suited for investors in low- or no-income tax states such as Florida or Nevada, where the mortgage interest deduction has less of an impact.

Some advice for small-business owners who are refinancing their home mortgages: Consider borrowing extra funds to pay off a higher-interest commercial real estate loan. Adviser Louis Stanasolovich, president of Legend Financial Advisors in Pittsburgh, has worked with many clients holding commercial loans with rates of 8 to 9 percent, compared with home mortgages that are now available at 6.5 percent or less. To profit from the spread, Stanasolovich advises

his clients to pay off the excess funds borrowed via the lower-rate residential mortgage in as many or fewer years as were remaining on the commercial loan.

Debt, diversification, fees, and taxes-topics such as these may not make for interesting cocktail chat. But if the consequence of being boring is stability, then for rational investors, boring is just fine.

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How This List Was Created

Selecting the best advisers from among the many standouts who counsel America's wealthy is no easy task. We start by accepting nominations from readers, industry associations, investment firms, and the advisers we know. Candidates are asked to complete an extensive survey detailing their backgrounds, professional designations, client-retention rates, and average portfolio returns. We also ask candidates for their best ideas about wealth management and study them carefully. Advisers in the running must submit a sample financial plan and two letters of recommendation. Registered investment advisers must also supply their Form ADVs, which describe their services, fee structures, and disciplinary histories (this is a document that any prospective client should review). We verify designations with industry associations and check backgrounds using the Lexis legal database to search court records.

Most advisers on our list carry the certified financial planner, or CFP, designation (see story for details), but it's by no means a requirement. A certified public accountant, or CPA, who is also a personal financial specialist, or PFS, should also be equipped to provide broad-based advice on investments, taxes, and other wealth management issues. Prospective clients, depending on their needs, may want to shop for more specialized designations. The designations of chartered financial analyst, or CFA, and certified investment management analyst, or CIMA, both suggest expertise in investing and portfolio management.

All the advisers on our list are taking new clients. Before you sign up, study the fee structures. About 80 percent are fee-only advisers who earn a fixed fee or a percentage of assets under management. The rest accept fees and commissions. If the fit isn't just right, the advisers on our list can provide referrals to other specialists.

We're proud of our list, but we know that many great advisers haven't yet come to our attention. Do you know of one we missed? We welcome your input. —M.P.