

True North

Compass Financial Consulting, LLC

Providing Financial Direction

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Love (And Good Financial Stewardship) Means Never Having To Say You Are Underdiversified

Over the years, we have seen many clients and prospective clients who have accumulated a substantial portion of their wealth in only a few stocks. The idea of diversifying from these concentrated positions has become a much discussed and implemented part of our clients investment plan, as they have taken to heart, and have acted on the premise, that the prudent course for long-term financial success, in regards to their investment portfolio, is to diversify their assets. So, we have a message for some of our past and future prospects regarding that situation known as “concentrated” wealth. We know that it is often hard to think about, much less act on, selling those beloved positions that have grown to be a substantial portion of your net worth. But, we caution you not to become emotionally attached to these stocks for you see these investments cannot love you back. At some point, they will invariably turn their back on you much like that 3rd grade girl who checked the “no” box when passed the note asking, “Do you like me?” Ouch, that memory still hurts. So, the best way to avoid the pain of a stock that jilts you is to consider actively spreading the love or, in investment terms, “diversify”. Feel free to use the line, “its not you, its me,” but at least consider “breaking up” with a few shares at a time.

With the permission of Nick Murray, a terrific and often quoted financial writer, we wanted to reprint portions of his recent article found in [Financial Advisor](#) magazine. We think the article will act to reaffirm the strategy of diversification from concentrated positions.

“The global pharmaceutical giant Merck is simply one of the greatest companies which has ever existed. Its scientists have developed breakthrough after breakthrough, with drugs that saved or improved millions of lives. And, for decades, its stock was an unquestioned core holding in institutional and individual portfolios everywhere in the world.

Not only did the stock price make Merck a perennial top performer, but - even with its staggering need to invest capital in the development of new drugs- the company compounded its cash dividend at double digit rates. Indeed, there came a moment in the 1990s when, for the first time, Merck’s cash dividend (adjusted for splits) was higher than the stock price had been 30 years earlier. There was not, anywhere in the world, a bluer chip than Merck.

But on September 30, 2004, Merck announced that it was withdrawing its blockbuster anti-inflammatory drug Vioxx from the market, citing evidence that the drug was responsible for significantly increased risk of death from heart attacks.

Merck’s stock opened 27% lower than it had been before the announcement—and then continued to decline. Every tort lawyer in the country crawled out from under his or her rock, and filed a class action lawsuit. The financial press began carrying serious articles to the effect that Merck would have to declare bankruptcy in order to save anything of itself from the claims of Vioxx litigants.

From its bull market high in late 2000 (when investors were still flying into it as a port in the storm), Merck stock declined about 70% to its post-Vioxx trough. Today, as Vioxx suits are deservedly failing all over the country, the stock price has just reached half of where it was seven years ago.

*But this isn’t an essay about Merck. It’s any essay, not to put too fine a point on it, about owning too much Merck. And about the illusory iconic status that springs up around the stock of genuinely great companies. And about how trees do not grow all the way to the sky. And about how even the bluest of blue chips can-and regularly does-blow up. This essay is, finally, a cry from the heart. Its core message is one of the eternal truths (and iron laws) of investing: **You can get rich by underdiversifying but you cannot stay rich by underdiversifying.***

The only economic constant is change- “creative destruction”, Schumpeter called it. Three thousand years before that, the author of the book of Ecclesiastes said, “To everything there is a season, and a time to every purpose under heaven.” Finally, my favorite President, Harry S. Truman, said, “The only new thing in the world is the history you do not know.” To which I might have the temerity to add-just in the narrow context of this essay-“...or the history you have chosen to ignore because you’ve decided that you’re exempt from it- that your particular blue chip is the exception to the iron law.”

(Continued on page 2)

Diversification...(continued)

Maybe you inherited a big slug of stock. Maybe you picked a great stock, and rode it to wealth. And maybe you worked for a great company for 30 years, bought every share you could through their very generous employee stock purchase plan (like Merck's), and you ended up with more money than your mom and dad knew was in the world when you were a kid.

I say two things: (1) God bless you; you're the American dream. (2) Sell every share you have to until that stock is no more than 20% of your net worth ...

Overconcentrated stock positions- regardless of how shrewdly, patiently and even nobly they were accumulated-are a form of Russian roulette...The hammer may come down on an empty chamber for you today. But somewhere else, the hammer is striking a bullet, be it an astonishing fraud like Enron, or a straight up corporate disaster like Merck's Vioxx, or the obsolescence of a core technology like Eastman Kodak's, or just the terminal exhaustion of a no-longer-great-or-even-good institution like Sears- which was destroyed by Kmart, which was destroyed by Wal-Mart...whose stock is worth no more than it was seven years ago. Which is itself an accomplishment of sorts: after all, classic blue chip Coca-Cola is trading at half its price from ten years ago, and Cisco- the greatest technology blue chip since IBM went from icon to implosion- is still two-thirds below its peak price in 2000.

And where are the Nifty Fifty of yesterday-the handful of "one-decision" stocks which, when I came into the business 40 years ago, you bought whenever you had the money, and never sold, because they would only be higher tomorrow? Where are Polaroid and Xerox, not to mention Burroughs, Control Data and Wang Laboratories? Where for that matter, are the car companies, Ford, GM and Chrysler? Where is the company whose invention turned the prairies of the American West into the breadbasket of the world: International Harvester- a blue chip for nearly a century, until it disappeared? Where is the Penn Central railroad? Where is Johns-Manville, whose products

insulated every home and office building in America- right up until we discovered that asbestos kills? I could go on like this for hours, and not even get to Pan American World Airways, whose stock actually went to zero twice.

The holder of an overconcentrated stock position isn't even an investor anymore. He's a bettor, and he's betting on a very long shot: the thesis that the iron law of creative destruction does not apply to him, because his chip is so blue that it is exempt. Worse, he's betting the preponderance- if not all- of his fortune on this wildly improbable thesis.

His philosophy...is summed up in the motto that Joseph Hazelwood, the captain of the Exxon Valdez, chose to have printed under his picture in the Merchant Marine Academy yearbook: "It can't happen to me." Hazelwood bet his career on that thesis- and lost everything. The holder- against all reason, logic and probability- of an overconcentrated stock position is doing the same thing- and risking his fortune in the process."

For those with concentrated positions in their active portfolios, we hope this article helps you understand why we encourage a plan of diversification. Of course, that diversification does not have to, and sometimes cannot, be done overnight. But, know that we will continue to suggest and challenge you on the topic of diversification. For our former and future prospects, if you are curious to discuss your concentrated positions further, please feel free to contact us.



He's [got] a FICO, she's [got] a FICO, wouldn't you like to know your FICO too?

(The above title should be read in the style of the old Dr. Pepper commercial)

With the recent credit freeze, there has been much more emphasis placed on an individual's credit rating. Many who were able to receive credit in the past are finding they are now denied access to mortgages, credit cards, etc. They are finding that their credit scores matter! Credit scores can range from 300 (low end) to a perfect 850. Here are the scores and the categories into which they fit:

760 and above- Excellent- 40% of scores
700-759- Good- 18% of scores
620-699- Good- 27% of scores
500-619- Poor- 13% of scores
Below 500- What credit?- 2% of scores

Recently many of you have called with questions about your score or wanting to figure out how you can obtain it. So, our entire firm went through the exercise of obtaining their credit score to understand the process. Turns out, it was very easy with most folks utilizing a site called www.myfico.com. Indeed, the reports even give you hints how to improve your FICO score. Take a look below and see how your planners stack up, then we challenge you to beat our scores with our contest detailed on page 4.

Kevin—767, "Excellent." Kevin was dragged down by playing the frequent flyer game with way too many cards.

John—797, "Excellent." Just short of 800. John blames it on the idea that the credit bureaus know he has three daughters, so he is already getting dinged for the potential wedding expenses.

Jennifer—805, "Excellent." Surprising, given her need for open lines of credit with dog food companies.

Tana—815, "Excellent." Beat that she exclaims!! We think she was seriously upset for not having a perfect score.

A Medicare Primer



We continue our general articles on topics for which clients have requested information. This is a scaled down version of a longer write-up that can be found at our website. At the site, www.financialdirection.com, you will also find papers on long-term care insurance, social security and college education.

What is Medicare?

Medicare is health insurance for people 65 years and older, under age 65 with certain disabilities, and anyone with End-Stage Renal disease. The Social Security Office recommends enrolling 3 months prior to your 65th birthday. There are two types of Medicare plans: The Original Medicare Plan and the Medicare Advantage Plan. The Original Medicare Plan has two parts: Part A (Hospital) and Part B (Medical).

What is Part A (Hospital)?

Part A covers inpatient care including hospitals, hospice care, skilled nursing facilities (not, repeat, not long-term care), and home health services. Part A generally does not charge a premium because the recipient paid Medicare taxes when he or she was employed.

What is Part B (Medical)?

Part B (Medical) is optional and charges a monthly premium. Part B covers costs for such things as doctor services, outpatient care, and other medically needed services not covered by Part A. For most Part B services, you will pay a deductible plus pay a portion of the costs in coinsurance.

What is Part C (The Medicare Advantage Plan)?

The Medicare Advantage Plan, or Part C, combines Part A (Hospital) and Part B (Medical). The coverage is provided by Medicare-approved, private insurance companies. Your overall costs may be lower than the Original Plan and you may receive extra benefits, but your

choice of doctors may be limited by a network.

Many Medicare Advantage Plans offer prescription drug coverage. If your Part C Plan does, then you cannot enroll in a stand-alone Part D Plan (Prescription Drug Plan). Doing so will automatically switch you to the Original Medicare Plan. Part C Plans that do not cover prescription drugs (such as Private Fee-for-Service-Plans and Medicare Medical Savings Account Plan) allow you to enroll in a Part D Plan.

Costs include monthly premiums, service deductibles, and co-payments. Out-of-pocket costs are usually lower than the Original Medicare Plan, but it can vary from person to person depending upon the types of benefits that are needed. Under a Medicare Advantage Plan, the familiar "Medigap" coverage is not needed.

What is Part D (Prescription Drug Coverage)?

Part D is the prescription drug coverage provided by Medicare. This coverage is usually facilitated by private insurance companies. Part D plans vary widely. They all involve a monthly premium, and you may be required to make co-payments and reach an annual deductible for prescription drugs. There is also a possible coverage gap where you may have to pay all drug costs up to a certain amount.

Plans have a list of covered drugs and contract with various pharmacies and sometimes mail-order programs. Participants want to make sure their current drugs are on the list and that a suitable drug provider is available on any Part D plan they are considering. Most Part C Plans (Medicare Advantage Plans) cover prescription drugs. However, Part D (Prescription Drug Coverage) may be chosen if Part C does not cover prescriptions. Part D Plans should be reviewed each year during the fall. Plans may be switched November 15th – December 31st.

Medicare Prescription Drug Coverage plans are complicated, and it is difficult to assess future benefits. Calculating your

costs with your current drug list is about the only way to determine whether you should obtain Medicare Prescription Drug Coverage, and if so, which plan you should choose. You may enroll in a Part D plan 3 months before you turn 65 to 3 months after you turn 65. You will be subject to a late penalty each year if there was a continuous 63 day period in which you did not have prescription drug coverage.

What is Medigap Insurance?

Medigap insurance is Medicare supplement insurance. It is provided by private insurance companies to fill in the gaps of the Original Medicare coverage. Generally, you must have Part A (Hospital) and Part B (Medical) to purchase a Medigap policy. It may pay deductibles, coinsurance, and other costs not covered by the Original Medicare Plan. Spouses are not covered, as each person has to purchase a separate policy. You should secure this coverage at the same time you enroll in Medicare or you face the possibility that you would need to go through an underwriting process which could lead to your being denied coverage.

How to choose the right Medicare plan?

Each year you can review your health-care needs and switch to a more suitable plan. Consider the cost, the benefits you may or may not need, doctor and hospital choices, access to care while traveling, convenience, cost of prescription drugs, and pharmacy choices. Unfortunately, the numerous options make the selection process difficult, so we all need to hope that Parts E through Z never make an appearance. For those looking for guidance with the selection process, resources include your current health insurance company (who can help you assess Medigap coverage and Medicare Advantage Plans), as well as the Social Security Administration (www.ssa.gov) or the American Association of Retired Persons (www.aarp.com).

A BIG Congratulations Goes To...



A big congratulations to Tana Gildea for passing the Certified Financial Planner™ exam. She is now officially a CFP® candidate, and once she completes her hours of service she will receive the formal CFP® designation. If we might brag for a moment, only 51% of the candidates for the exam passed the test, and it makes our firm a perfect four for four in terms of employees passing the test on their first sitting. However, no one else can claim as having passed it while also balancing a job, four kids and their endless activities, and, oh yeah, a husband—sorry for the final billing there Tom. Please join us in congratulating Tana in this terrific accomplishment!



IN PURSUIT OF THE TRIVIAL

We are going to step out of our normal monthly trivia question, and, instead, we are going to challenge each of you to go and discover your FICO score. As mentioned in our earlier article, knowing your score helps you understand your credit profile, which, like it or not, drives many lender's decisions to extend credit, determines the interest rates you get on loans, and so on.

You can determine your FICO score by utilizing the service of any of the three credit bureaus or through www.myfico.com. For about \$16, you will learn your score as well as get tips for improving it. For those willing to share their score with us, we plan to award the person with the highest FICO score a Canon digital camera.

We will take all FICO submissions through 5pm Eastern Time on October 31st. You must respond to kraus@financialdirection.com or johnb@financialdirection.com with the information. If you do not have email, you may call us. In the event of a tie, we will include those names in a drawing to determine the winner. Staff from the accounting firm of Bridges & Dunn-Rankin will conduct the drawing and certify the results.

Answer for Spring 2007. Social security is a benefit paid because of the mandate in the government program commonly abbreviated as OASDI. What does OASDI stand for?" Answer: Old-Age Survivors and Disability Insurance. The winner of the contest, as drawn by the staff of Bridges & Dunn-Rankin from all correct answers, was Grace Sadiq.



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