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April 22, 2005

Mr. William Horton
Horton, Maddox & Anderson, LLC
One Central Plaza
835 Georgia Ave
Chattanooga, Tenn 37402

RE: Glen Smith vs. Samoan Financial Advisors and David Johnson

Dear Mr. Horton,

Pursuant to your request, I have completed a review of the above case. This examination has included the deposition of Glenn Smith of June 18, 2004, David Johnson of June 18, 2004 and the Exhibits to the deposition of Glenn Smith, June 18, 2004.

I have found extensive inconsistencies in the plan, process and products offered by Johnson , et al. Specifically I noted the written statement of Johnson on September 7, 1997 at the initiation of the relationship wherein he states that "over the next 12 months we will Dollar Cost Average into your new portfolio using no load funds." First, as expressed below, DCA does not work, has not worked and universally will not work in the future. It reduces returns two thirds of the time versus lump sum investing. Secondly, Samoan Express and Johnson and his supervisors were fully aware that a fraud was taking place. Samoan Express does not have No Load Funds. To signify that to a naive investor is just plain wrong, illegal and fraudulent.

Next is the letter to Smith referencing a meeting between the two on June 9, 1998. **"We reviewed your goals. The retirement was to have approximately $23,000 in income annually. At this goal your monies would last until age 88. If you were to retire a year earlier, you will have money, but would run out before age 88." Smith did not have sufficient funds to last to age 88- or anywhere close. Per the data below, in order to have a 95% chance of reaching age 88, he would have needed $285,000. He was already $160,000 underfunded at the time of that letter.** Samoan Express and Johnson either knew or should have known that the statement was false- certainly giving Smith a completely false sense of security that his retirement was in order and that his trusted advisers could provide the income he needed. That they failed is evidenced by the huge losses he sustained.

The Samoan Express financial plan utilizes a flat rate of return over the 20+ years of retirement. That is not valid. The problem is that the volatility and inconsistencies of the market over individual time frames makes it effectively impossible to utilize a singular return for retirement purposes. In some periods of statistical historical returns, the yields might have been very favorable. In other time frames, the retiree would never have had sufficient funds over his lifetime. Numerous studies (WSJ, Bernstein, etc.) have shown that in order for a retirees portfolio allocation to work over time, the retiree cannot take out more than about 4% annually in order to have a 95% chance of retaining the portfolio for the actuarial lifetime.

In Mr. Smith's (Smith) situation, he wanted an additional $1,000 before taxes to add to his Social Security. (The $21,000 in the deposition is incorrect- per extended conversations with Smith. It's supposed to represent a $2,100 per MONTH income- roughly $1,000 net after tax more than his Social Security provided at that time). While I would have preferred an actual budget to validate specific costs- particularly someone with limited assets- and believe it mandatory in order to do competent retirement planning, the conversations with Smith regarding his requirements seem satisfactory for this report. I chose a free web site- Fireseeker.com- to determine the feasibility rate for the extra $12,000 from Smith's account- actually any account set up for retirement with a fixed allocation (save for rebalancing.). It uses 108, 23 year periods to account for the various payment periods and simply shows what was possible. Of course, one can use different start dates, time frames, periods of payments, but this simple and easily observable analysis clearly displays what happens. Obviously there are numerous other software programs- but they are using the using the same historical numbers. There are variations to the input- how much is invested in stocks versus bonds and so on, but Fireseeker is simple and direct and competent.

I note from the Samoan Express's website on March 30, 2005, "regardless of the asset allocation strategy you choose and the investments you select, keep in mind that a well-crafted plan of action over the long term can help you weather all sorts of changing market conditions as you aim to meet your investment goal(s)." Possibly acceptable- except a retiree would need a lot of funds in order to be able to withstand volatility in returns over time. The question before us is whether Smith had the adequate funds in order to "weather all sorts of changing market conditions". Simply stated, he never came close. He could not retire and withdraw $12,000 from his asset base and even come close to statistically covering his income for his actuarial lifetime. Samoan Express knew this then and knows this now. Unless a retiree has a large portfolio, the funds will not be adequate. Johnson 's comments about the ability to retire and Samoan Express's plan are not valid and both knew- or should have known- that. I submit that they both were clearly aware of the inability of Smith's account to provide retirement income as stated.

By simply analyzing a "basic" request of a retiree who needs $12,000 gross income annually beyond Social Security, requires a (mandatory) offset for inflation, estimating a lifetime of 23 years (as identified in the Johnson plan though longer than Smith's statistical actuarial lifetime), has a mutual fund expense ratio of 1.7%, utilizes an allocation of 50% stocks and 50% bonds results in an initial account value of $285,000 that would produce a success rate of 94.7%. (A 5% "failure" rate is considered acceptable in planning. 100% is not "realistic" since it must account for the very worst of times.) In other words, in about 5% of the time, a portfolio would have been depleted before 23 years.

Yet Smith's account was not greater than roughly $125,000- over a 56% reduction from the statistical 95% probability that he would have enough money for his lifetime. There is no way that Johnson /Samoan Express could remotely indicate that there were sufficient sums for retirement- but that is exactly what they did. They actually should have told Smith that he had to work longer to build up his retirement kitty and/or complete a formal budget to determine if his retirement costs could be cut. At that point, another analysis would have been required to validate the 95% success rate. Pursuant to such fundamentals, **Smith's account was effectively $160,000 less than required in order to safely provide for retirement.**

Reference is made to the investment plan for Smith made up by Samoan Express or Johnson on September 6, 1997. Under the proposed allocation, it shows that Smith would have $210,197 at age 68. It is based upon a static return that has little reference to reality. While it does state it is a hypothetical illustration based on assumptions made, it does not state that the assumptions do not reflect the statistical history of the market with its extreme volatilities. Further that if the market declines precipitously at any point- similar to the past dips of 1973 and 1974- and certainly at the initiation of the plan- that the allocations and returns projected would be meaningless. The use of a flat and stable return does not makes sense without the clear statements of uselessness given such volatility. **Per Peter Berstein, “"Understanding that we do not know the future is such a simple statement, but it's so important............anything can happen. There really is such a thing as a "paradigm shift," when people's view of the future can change very dramatically and very suddenly. That means that there's never a time when you can be sure that today's market is going to be a replay of a familiar past."**

Absent leaving the portfolio intact (save for rebalancing), Johnson /Samoan Express needed to monitor the economy for the statistical occurrence of another 1973/74 where losses over 45% were evidenced. Further, periods of substantial performance are usually followed by far lower returns. Such an event would have devastated a portfolio in the extreme since significant losses for a retirees portfolio cannot be made up. Again, from Fireseeker, “Taking money out of the portfolio when the market is down depletes the future earning power of the portfolio, potentially to the point where it cannot recover.” The economic and financial debacle of 2000-2003 was not a statistical aberration- it certainly had happened previously. Samoan Express and Johnson were therefore responsible for any adjustments to a portfolio to reflect an economy that would significantly devastate a retirees portfolio particularly since they obviously had not identified adequate funds for Smith’s retirement in the first place. (See Exhibit attached)

However, neither Samoan Express nor Johnson undertook a formal endeavor to adjust the portfolio even as the economy was dropping into recession. After the tech market meltdown in March 2000, any viable adviser was well in tune with the economy- certainly addressing the inverted yield curve, FED policy on interest rates, productivity, manufacturing statistics- the entire gamut of leading, coincident and lagging indicators. That they apparently deferred the effort over to a totally unsophisticated client who recognized that his portfolio was declining precipitously and wanted/needed professional assistance that was not competent is not acceptable. Samoan Express has innumerable analysts who follow the economy and were cognizant of the past failures of the market and the implications on a retiree. They (obviously) failed to adjust Smith’s portfolio for the debacle. This is not to say that some losses would not be sustained. But at some point in 2000, the portfolio had to be adjusted to reflect the economy’s weakness. And the market’s.

Additionally, it should have been obvious to Samoan Express and Johnson that if a portfolio’s returns are negatively impacted at the beginning of a problem, the retirees income would almost never recover. Of course, with the inadequate assets to begin with, Smith had lost his retirement availability almost in total.

Samoan Express was clearly aware of this implication since, on the “Proposed Investment Plan”, Risk Tolerance wherein it states that there is a 98% chance of realizing a return which is greater than the worst case return and a 2% chance of exceeding the best case (see illustration). It states that “the range of returns illustrated by the left bar in the graph represents the statistically calculated worst case to best case range of returns for your proposed portfolio. Further, “over time, the combination of annual returns should move your average return ever closer to the portfolio’s expected return.” That’s all very nice and an inducement to enter the market place with equity investments even with the caveats. Smith and literally all other Samoan Express clients would essentially feel the same since the “computer program” said so and they were buying the plan from an adviser they “trusted”.

But what the plan failed to indicate is the flip side of the bell shaped curve. If a 2% “problem” (I see it more as

4%) should impact a portfolio at the initial stages, the losses could not be made up from a retiree's portfolio. I refer to the real life time frame of 1973/74 that was clear reference to losses in real life. That the 90's were supporting unreasonable and unsustainable returns is no rationalization that such extreme losses could not occur again. That Samoan Express and Johnson were caught in the same euphoria as consumers is no defense of their fiduciary responsibility for not recognizing the extreme volatility of the stock market. That there was a psychological block to the reality of stock market volatility is a reflection of behavorial finance that has been known for decades in the industry and certainly known to the professional entities at Samoan Express. But such professional advisers do not have the luxury of mistaking inaction for responsible activity. That they made be "afraid" of making a mistake is no defense for not attempting a rational and competent adjustment. Of course, they would be liable no matter what the occurrence if the errors were based on totally nonexistent study and research.

Per Ken Fisher regarding standard deviations and volatility, "if you take your average advisor, he or she knows that the long-term history of stocks has averaged about 10%, which is true. In his bones, he will believe a return in any given year of 0% percent to 20% is more likely than a return above or below those levels. The history of Western markets, however, is exactly contrary to that. Returns are higher or negative 70% of years in America. They are between 0% and 20% only in the remaining 30% of the calendar years since 1926. In overseas Western developed markets, returns of zero to 20% happen in only 25% to 40% of years. Returns greater than that or negative happen 60% to 75% of years. Overwhelmingly, markets are more volatile than people think." Those are not esoteric comments- they are pure facts. Facts that were always known to Samoan Express. Facts that demanded activity.

Dollar Cost Averaging (DCA)

Dollar cost averaging was identified in the material as a supposedly valid way of investing. "Supposedly" since there was no identification of what was being accomplished. While DCA is bandied about the industry as a standard method of investing, it has not worked in the past, does not work today and, almost assuredly, will not work in the future. (Two researchers (Williams and Bacon) have discounted dollar cost averaging by statistically showing that putting all the funds in at one time outproduces dollar cost averaging by two to one. They invested a theoretical sum in 90 day T-bills and moved into the S&P 500 over a year's period. They compared these results with investing all the funds at once- starting with different periods from 1926 to 1991.

"Nearly two thirds of the time, a lump sum strategy significantly outperformed dollar cost averaging".) DCA only works with lump sums. It means the spreading out of the monies over a period of time- generally referenced as 12 months- though some have even suggested years. It can reduce the risk of loss since it can avoid purchases at the very extreme prices. But so does leaving assets in all cash. The point is that DCA underperforms the market approximately 2/3rds of the time. It is almost always better to put all the funds in at one time. And this makes sense if you are going to get higher returns in 66% of the historical patterns. That said, lump sum investing into a bad economy tanks is a fallacy in itself.

While DCA is only thought of as a "conservative" process, it can nonetheless be an extremely risky proposition when the market has an extended downtrend. For example, the use of DCA from 2000- 2002 would have meant putting in monthly payments into a declining market. Effectively every purchase was at the highest price for that period. The next month's prices was even lower- hence the previous purchase would have lost and the new purchase was going to go down as well. No valid reasoning exists either for leaving risky securities to more exposure nor to adding significantly to the risk with more monies that were almost guaranteed to lose in value. I submit that Samoan Express was well aware of the articles addressing the fallacy of DCA and should have recognized the failure to keep doing it in a completely dropping market.

A professional article by Moshe Milevsky notes, **"because of the higher standard deviation with dollar cost averaging, you would have higher odds of ending up with less money overall."** And "amongst the general public, DCA appears to be an axiom of prudent investing....... In contrast to this widespread practice, financial economists have shunned this strategy and repeatedly demonstrated its irrationality. .... and mean variance inefficiency. "

Firms and individuals have a fiduciary duty to inform clients of these facts prior to its use. Samoan Express and Johnson may be attempting a psychological "benefit" in suggesting a novice/unsophisticated client go slowly into the marketplace. But it is categorically wrong to pursue lower returns at the same time- certainly without informing the client.

Risk

Samoan Express and Johnson violated their fiduciary duty by implying that risk goes down over time. (See deposition exhibits). The issue is that standard deviation is not risk ipso facto. It is a type of risk- but is not all risks that a portfolio return will encounter. There is business risk, economic risk, dollar risk, interest rate risk and a host of others. That said, it does give a decent view of the volatility of a security at a singular point in time based, however, on historical data only. It cannot reflect what is happening now nor what will happen in the future. However, one of the main marketing positions of literally all brokerage firms is the statistical computation that standard deviation goes down over time. That is a true statement but note what was stated. Standard deviation goes down, but not risk. Risk of loss goes up the longer a security is held.

First, to review standard deviation over time. If you potentially held the security for five years and the annual volatility measured by one standard deviation was a high 30%, the standard deviation is reduced to "only" 13.42% because you simply divide the annual deviation by the square root of the years held- in this case 5 years. That number is 2.236. And if you held it for 10 years, you divide by 3.16 for a volatility of just 9.48%. If you had started with just 20% volatility, then a 5 year deviation would result in a 8.94% volatility and a 10 year deviation of only 6.32%.

(Since the historical annual standard deviation for the market is about 20%, I have a significant concern for the standard deviation as stated on the plan; Asset mix comparison- Non Qualified Assets. I cannot confirm that an annual standard deviation of a portfolio consisting of 44.29% large capital stocks; 16.47% small capital stocks; 20.59% international stocks and just 17.64% intermediate bonds would yield an annual standard deviation of 12.19%. Without the corresponding correlations it is impossible to know what internal calculations were being made, what historical dates were used, etc. I believe that the correlations are not that offsetting and that the combinations would not offer a singular starting year of 12.19%. (The correlations used, weightings, and the overall calculations represented by Samoan Express software will need to be established before trial. This is critical to validate the standard deviations used in their presentations.)

However, a great fallacy to the Smith plan is the continuing reference to how risk (standard deviation) goes down over time and simply leaving it at that. Professional analysts have always known that risk goes up.

The book on Investments by Bodie, Kane and Marcus, 1989, page 222, Appendix C, called "The Fallacy of Time Diversification". The comments addressed the 30% deviation identified above and that a investor would be "emotionally relieved" that over a 5 year period, the volatility would be reduce to an "acceptable" 13.42%.

But it notes that the impact of a one time standard deviation over the entire portfolio could reduce the amount anticipated by almost 50%. (Probably earlier Investment books also identify the statistical fallacy, but that is the book I have used.)

"A standard deviation in the average return over the five year period will effect final wealth by a factor of (1-.1342) to the fifth power = .487. (That's the formula. One minus the standard deviation for the time period selected and the resulting number multiplied to the "X" power where x represents the number of years in question.) That means that final wealth will be less than one half its expected value."

"Time diversification does NOT reduce risk. It is true that the per year average rate of return has a smaller standard deviation for a longer time horizon. It is also true that the uncertainty compounds over a greater number of years. Unfortunately, this latter effect dominates in the sense that the total return becomes more uncertain the longer the investment horizon."

"The lesson is that one should NOT use the rate of return analysis to compare portfolios of different size. Investing for more than one holding period means that the amount at risk is GROWING. This is analogous to an insurer taking on more insurance policies. The fact that these policies are independent of each other does not offset the effect of placing more funds at risk. Focus on the standard deviation of the rate of return should NEVER obscure the more proper emphasis on the possible dollar values of a portfolio strategy".

As additional commentary, one must also analyze a situation where there are more than one year's problems where returns suffered (1973/74; 2000- 2002). While it is not known when such a situation might happen again (referencing 1973/74), it is clear that it could happen. There was a fiduciary duty to inform the client Smith of the eventuality of such a situation and the devastating impact on a portfolio. Further, that such a situation, if not dealt with at its inception, could completely decimate his retirement prospects. Unfortunately, Smith was never informed of such a calamity nor what was necessary to protect him from such an exposure. It is clear that leaving assets alone would not accomplish his retirement objectives. Simply stating that the "market will always come back" not only provides nil relief but has little real life application to a retiree of limited means who can never recover from such a loss. Or the equally myopic view of "tightening one's belt"- certainly if the adviser has not even demanded a formal budget to know what the bottom line actually was.

The expertise of the planner and company become paramount in not just earning monies but retaining them. They completely failed to do so by either refusing to investigate current economics or were incompetent to do so. The statement from Samoan Express- "regardless of the asset allocation strategy you choose and the investments you select, keep in mind that a well-crafted plan of action over the long term can help you weather all sorts of changing market conditions as you aim to meet your investment goal(s)"- is false.

Samoan Express and Johnson are responsible for Smith's losses due to a breach of duty in the offering of professional advisory work.

Rebalancing

The Samoan Express Plan identifies rebalancing as a method of correcting imbalances in allocations as time goes forward. I note, under the section, Rebalancing and Reoptimization, "At times, investor's instincts lead them to invest when the market has been good and to pull their money out when the market has declined. While that investment method may feel right, it is a virtual guarantee of trouble. The "gut level" technique may lead you to buy high and sell low. The strategic asset allocation plan provided here can serve to guide you to a disciplined long term investment approach."

The problem is that the "guarantee of trouble" was what can actually happen if one rebalances during a period of particularly bad economics. Note the term, ***economics***. Market gyrations happen all the time. Market corrections of 10% or so are commonplace and reflect, in part, an inefficient market that is trying to become efficient. However, there are greater periods of uncertainty that are not directly evidenced by the market. They may be represented by periods of economic flux that bear greater impact on the movement of all areas- unemployment, interest rates, capacity, productivity rates, manufacturing and so on. These significant downturns are not market movements per se but severe economic developments that will invariably impact the market since the companies universally mirror economic trends. If the trends continue for an extended period, so will the market. Such trends were identified in literally every statistical element and were amply presented in the press, FED documents, economic statistics and more. That the March 2000 drop was an aberration could have been true- but in going months forward, a softening of all the economic indicators was evident. Caution was advised. That Samoan Express and Johnson were indicating that buy and hold was a strategy and "confusing" the commentary with marketing. Buy and hold might work for those with an unlimited investment period. But a retiree does not have that luxury. The retiree has a finite time frame since they not only must recoup any losses in a short period of time but are also taking funds out from a depleting asset. Samoan Express and Johnson were completely aware of the fallacy of buy and hold in this situation but excused the issue by attempting to state that Smith was the "pilot" while the Johnson was the "navigator". Samoan Express and Johnson are the sole entities with the (supposed) ability to know the statistical history of the market and economy and in receipt of extensive data covering same.

Here is the analysis of the problem with rebalancing in a down economy. Say you started with 100,000 in the S&P 500 at the beginning of 2000. You lost 9% (round numbers) in 2000. Now you are at $91,000. Next year, you lose 12% and are down to $80,000. And you are still told to stay in the market *because it will come back* . In fact, if you were doing rebalancing you would be putting MORE money into a market and an economy that was experiencing a downturn. But we'll just leave it at $80,000 at the beginning of 2002. However now you are down ***another*** 22% at the end of 2002 to $62,500. So in three years, you are down about 40% overall in your equities. But do you know what percentage you have to earn to get back to break even? 61.6%.The odds of high returns similar to the 90's just to get back to where you started with is almost complete folly in a reasonable time frame. We are in a new period where growth will be much lower. There is a probability that another economic debacle will happen again. It's just pure numbers. It is a statistical fact. That an adviser was not taught past history, the ability to interpret the data or the understanding why it was so important does not release the adviser from the fiduciary duty of addressing such obstacles and applying activity to reduce exposure to the portfolio.

But the losses are even worse with rebalancing. It's not just the fact that money was left to continually lose. It is the fact that, if one rebalanced a portfolio to maintain a specific risk profile, then more money was introduced into the market while the world fell apart.

Let's review another portfolio of 70% stocks and 30% bonds starting in 2000. The 70% of equities might have half of that in large cap funds, 20% in small cap, 15% in whatever. The same with the bond section. But I will just use the S&P 500 for the equities.

Let's assume there was $100,000 total in the portfolio at the beginning of 2000 with $70,000 in equities. At the end of 2000, stocks were down 9.1%. So the equity side dropped $6,370. I'll assume the bond side stayed stable. The essence was that the equity side was now too LOW and you would have to BUY another $6,370 of stocks/funds to get back up to the 70/30 split. So now what happens in 2001? The S&P loses another 12%- and as should be obvious, so does the inclusion of the new $6,370. Now the equity side is now down by $8,400. Since you are using the standard rebalancing format, you have to buy $8,400 more stock/funds to build yourself up again. Now go through 2002. The S&P dropped another 22% and your $70,000 is now down another $15,400. You go out and buy another $15,400 of stock/funds to get back to the position of equity and risk that your adviser had indicated was necessary or appropriate for your financial situation. Does this make any rational sense? Why would anyone put more money into an inherently bad economy? Simple. They had been led to believe that the best allocation was one that stayed the course (no change) or to rebalance (normally) at the end of one year. But it should be perfectly clear- if you do so in an economy that is tanking- your risk of loss gets

greater since your are committing funds at the worst possible time.

Now pundits will say that it is impossible to know when the economy is bad. I'll admit that it is not easy, that it takes a lot of reading, that it requires a background greater than some simplistic designation- certainly far more than the nil insight by brokers, that you have to read material from the FED and so on. So be it- some things are simply hard to do. But the economic mess starting in March 2000 was obvious. The additional loss in November and December 2000 made the economic conditions more pronounced. One could not dismiss the calamity.

Proposed Investment Plan

This section of the plan notes, "Asset allocation provides a strategic plan that builds the foundation for your portfolio's return. Studies on the performance of professionally managed pension funds have found that 91% of a portfolio's **performance** results from the asset mix of the portfolio." This is wrong because it is NOT performance but **variability**- an entirely different focus. ("The problem with BHB is that an analysis of variation of quarterly returns tells us nothing about how return accumulates over time." Bill Jahnke) While corrected on Samoan Express's site now, it still reflects serious errors on the part of Samoan Express and Johnson in providing accurate material to Smith. While it is true that Smith would not grasp the significance of the correction and Samoan Express could state that it is a mistake that did not impact the overall complaint, I submit it is a serious lapse that impacts the entire emphasis that Samoan Express and Johnson have on providing accurate and properly researched information. The implication in its use is severe. Erroneously quoting a major study in order to solicit business for asset allocation cannot be rationalized out as a simple mistake.

As additional commentary: "The Brinson report did have value- though the allocations might more realistically reflect a 15%, 30%, 70% (or their) 93.6% position of the overall return. Nonetheless, financial planners have almost steadfastly focused on a set allocation of funds defined primarily through the use of computerized offerings by an innumerable number of companies each promising the best allocation. And each effectively suggesting you stay the course since that is what is easiest (Samoan Express in their 1999 commentary on diversification- "Get clear on your personal goals, then buy and hold a diverse portfolio of investments through thick and thin"). I offer this in contrast to staying the course- and I have repeated and taught the issue for years. Statistics show that maintaining a portfolio of securities through the 1973/74 debacle would have eventually returned an adequate return- and over time the stock orientation out classed other allocations of bonds or cash. But they forget one crucial element- the investor holding the portfolio as they watched their net worth decrease over 45%+ in that short two year period. Sure the market came back- but investors did not break even for about 10+ years. The untold emotional turbulence and family and financial strife could, in no way, offset some advisor's statement-"let's stay the course". Literally every one of those investor's would have preferred being OUT of the market and being able to sleep at night. I submit such commentary- "stay the course"- misses the human element and is inherently flawed from the outset. Maybe institutional investors could have been led to maintain a severely declining portfolio- but I think not. I think the advisor would have been fired for being not only negligent but woefully irresponsible."

And from Frank Schmid, FED Reserve of St Louis, "Although we have a fairly good understanding of stock market risk, assessing stock market uncertainty is incomparably harder. The observable past only tells us so much, though, because we cannot tell whether the future will follow the patterns of yore. Uncertainty rises from imperfect knowledge about the way the world behaves."

An additional quote on the subject from the WSJ and Barron's 2002, "The buy-and-hold mantra that was drilled into investors' psyches by the bull market of the '80s and '90s no longer leads to nirvana." And "the buy-and-hold philosophy also argues that stocks go up over time. According to data from Chicago-based Ibbotson Associates, from 1926 to 1999, 90% of five-year periods were positive for stocks. But those figures don't reveal long periods of pain in the stock market. After the 1929 crash, the Dow Jones Industrial Average took 25 years to regain its pre-crash levels. The Dow traded above 1000 in 1968, but failed to close above that level again until 1984." Why were those statistics not identified to investors. Why were those problems not adjusted in the portfolio for Smith in 2000- 2002. The problems were clearly identified and, though they had happened many years prior, they can not be excluded from statistical patterns that would, almost assuredly, happen again.

The commentary is extensive and it is not the intent to write a complete treatise from every analyst who has reviewed the subject. Suffice to say, the "buy and hold philosophy" is a marketing pitch that did not hold water in the past and could never be assumed to exist in the future. That Samoan Express and Johnson wished to use this as a statistical fact for the future was a violation of a basic fiduciary duty. Repeated from Samoan Expresses's plan "At times, investor's instincts lead them to invest when the market has been good and to pull their money out when the market has declined. While that investment method may feel right, it is a *virtual guarantee of trouble*............" The virtual guarantee of trouble was the lack of analysis by Samoan Express and Johnson leading to a completely violated retirement plan. Further, Samoan Express and Johnson were completely aware that Smith had to take money out of his portfolio in order to have living expenses. The odds of getting back to where he was before is effectively negated in total since there is less and less money each month of which the market (supposedly) increases.

From a plan I presented to a widow in 2001, "I will make this note however- and an issue that I always teach in all classes. The market is volatile- clearly evidenced by 2000 and 2001. But beyond that is the problem of 1973/74 where the market dropped over 45% in a little under 2 years. The plan I am submitting will cover most contingencies of returns but nothing can prepare anyone for a loss that large. Regardless of the investments I select- and they are for long term positions- it is absolutely mandatory that a continual review of the market- specifically economics- be conducted at all times to assure that you do not fall into the scenario of losses that large. That would almost assuredly negate any viable planning at almost any point in your life."

From a plan I presented in 2004 for a couple in their 40's. "Unfortunately, a lot of the theory may not work well in practice. The world does not provide consistent returns of 5%, 10% or whatever. The 2000- 2002 market clearly identifies what can go wrong. If the portfolio is decimated in the early years, any attempt to take out the projected constant return will lead to insufficient funds. Statistically, if you take out no more than about 4% annually during retirement you have about a 95% of having adequate funds (it's called a Monte Carlo analysis- a statistical run of numbers covering "all" market contingencies that are based on past performance). However, also unfortunately, the amount of money you would need for a 4% distribution well exceeds $10,000,000. Well, that is just not feasible. The offset to this is to adjust the portfolio to analyze economics to avoid major downturns. Easier said than done since few advisers bother to read the mandatory economics (Fed reports for example) and even fewer have the ability to analyze the facts therein. But there is your key to success. If you plan for an even, stabilized return over time, it just won't happen. It is true that you can end up very wealthy if the market responds favorably and at the right time. But just as frequently, the uneven returns can devastate your retirement. This is not intended to be an alarm per se. You have many years of earning and investing. If you do it diligently and the market responds as it has in the past, you should have more than adequate funds. But just sticking in money and hoping for the best probably won't cut it."

More significantly is this statement from page 97 of my ***1995*** course titled "Practical Investment Theory and Application" approved for Continuing Legal Education by the California State Bar, "The stock market has returned 10% annually on average the last 50 years. My primary concern however is NOT trying to be in the market when there is a major bear market- for example the early and mid 70's. The market lost about 45% in a relatively short time. And true that time did erase the drop, but it took about 13 years. If you had retired during that time, you would have less money than when you started. That is unacceptable." On page 99, "Author Frank Jones also notes that the tendency of the performance of all funds toward regression to the mean limits the value of too much reliance on long term performance as the only measure in selecting mutual funds." I concur wholeheartedly. Asset allocation identification of risk, and, most importantly, a review of current and forecasted regional, national and worldwide economics are the keys to intelligent investing."

In short, all major brokerage firms have numerous economic and statistical analysts who are completely informed about these risks. It is the duty of the firm to advise and educate clients to the problems that will arise and what they intend to reduce a overly risky exposure. Buy and hold in a rapidly an continually declining economy increases risk- most times far beyond an elderly client to absorb in their lifetime.

Glenn Smith deposition:

Page 6- Smith has a high school education. No investment courses, no ability to use a financial calculator. No identification in the material to even remotely indicate sophistication whatsoever.

Page 27: Smith indicates he had 13 to 14 funds. That is at least twice as many as any advisors suggest. Once you get beyond about 6 funds, you might as well index and be done with it.

Page 46: Smith noted that he "trusted Mr. Johnson implicity..............." Smith selected Johnson through a referral and had done no research on Johnson in order to validate competency or trust. Merely being licensed with a broker/dealer is no indication of competency.

Page 61: Smith notes that Johnson had indicated that Smith was ready to retire. As indicated above, there was no validity to Johnson 's statement.

Page 64: Johnson says that "you have to be patient, the market will come back." Perhaps- but the issue is when. Smith further notes that "I am needing some of this money now". The issue of stock losses, a limited time frame of retirement and the fact of taking continuing income streams from a declining asset value has been addressed above.

Page 65: The statements indicate that the actuarial lifetime of a 61 year old is up to age 88. That is incorrect. Per the Department of Health and Human Resources, 1996, a male age 61 had a life expectancy of 18.2 years.

Page 66: Johnson 's letter indicates that they will DCA over 12 months into **no load funds**. I have addressed DCA previously. However, it is obvious that Smith does not know what a no load fund is. He is merely parroting the letter by Johnson of September 9, 1997 wherein he states "over the next 12 months, we will Dollar Cost Average into your new Portfolio using the no-load funds." The funds were all back end loaded with significant redemption fees. Further, Samoan Express, Johnson and all supervisors know full well that these were not no load funds and could never be expressed as such. **Only pure no load funds and/or those with 12b-1 fees of .25% or less could be called no load.** Back end loaded Class B shares have large 12b-1 fees. That is what they are noted for. Not only could they not be called this, but all securities parties knew that the written statement attesting to same was categorically wrong.

Additionally, because of these extensive 12b-1 fees, Samoan Express and Johnson knew that back end loaded funds invariably cost investors far more than Class A shares over time. And since a retirement period over 15 years was contemplated, the wrong class of funds were sold.

Page 74: Smith indicates he talked with Pippenger- Johnson 's supervisor on June 12, 2001 and Pippinger indicated Smith was "in the right place". I disagree as evidenced above.

Page 79/80: Smith indicates that Johnson would do DCA in a Federal income bond fund. But even under the (misguided) assumption that DCA works, the only commentary has always only been on equity positions. I have never heard of any value of utilizing DCA on bond funds since the volatility is so low. If there are no ups and downs, what is the point? The adviser has to have a clue to the movement of interest rates. If they are going down, then you take advantage of the possible gain in value and put all the funds in. If interest rates are going up, the use of most bond funds will produce a loss. DCA will not stop either one of these from happening. As to the movement of rates, the FED's open policy of indicating the possible direction of the economy has been transparent. No research papers I have ever seen even considered the value of DCA in bond funds.

Page 107: Smith said Johnson "explained my stocks were like heads of cattle and it would go back up and so forth. And he said we could take your money that you got left and put it in a retirement fund similar to Dupont might have and let you draw a couple hundred or whatever it might be per month." Once again, I may not dismiss the issue about the stocks going back up but once the losses are so severe, there is so little left that it might not make any difference. I am assuming Johnson meant Dupont and an annuity- but it is not perfectly clear.

Page 110: Smith notes "so while you have to focus on the longer, here I am 67 or so years old at that time or 65, ...; anyway, I don't have a long time. I don't have another year sometimes is what I was trying to get across. I needed to start drawing that money in 1999 or early 2000............... I couldn't live on Social Security alone." The statements in deposition is exactly what Samoan Express and Johnson either knew or should have known were the critical points of this case. Smith did not have adequate funds for retirement nor, after the losses sustained, did he have enough time to have them grow again.

Page 112: ".......and he said your stocks and bonds are worth whatever and the market will come back. Even thought he price is down now, they'll come back up history tells us. That is what he was saying."

Later on the page, Smith was questioned, "That's pretty much consistently what Mr. Johnson told you when you raised those concerns about he value of your account day to day, he just said you need to be patient and sit tight and things will work out; is that generally what he told you?

Answer, "that's pretty much what it was. But I couldn't sit. I must go on the record and say that I couldn't sit and live on $1,282 a month and live on that money" Once again the point was always obvious- Smith had insufficient assets to begin with. But whatever existed had to be retained as much as possible. Samoan Express did not provide adequate or competent advisory services.

Page 114: Johnson 's attorney as if Johnson told Smith "this year hold tight on your expenses. Hold off on asking for monthly income and give the market time to recapture itself before we begin a stream of income?"

Answer, "he says here hold off on asking for any more money from Samoan Express until the market can recapture itself before asking for a stream of income............." Where is the formal budget? Since a formal plan was done and paid for, minimum facts were needed to be established. And annual expenses is the key to a plan.

Page 130: Question- "But what concerns you about the funds was the fact that they had gone down, not so much that they were Samoan Express funds. If the Samoan Express funds had gone up, you wouldn't have had a concern of being with Samoan Express funds?" I have a question with the validity of the question to begin with. If people were that sophisticated to begin with, they would not have to use a planner. Less sophisticated might use a planner but would have immediately recognized the extensive expense ratios of Samoan Express and opted out. Totally unsophisticated people get absorbed by the marketing and perception of trust. Smith was clueless to the elements of planning and put his entire retirement in the hands of Samoan Express. He was unaware of risk and reward. Like most people, he hoped for a gain. When there was a loss, it is generally only then they might do additional homework. That said, most implicitly trust their adviser.

Johnson Deposition

Page 6: "At that time I do not think I had an option, no. It was all proprietary product mutual fund".Almost every recognized authority on planning has identified the problem with being a "captive agent". The use of only one family of products has invariably led to abuses of fees and commissions as well as a limited or non existent selection of funds

Additional commentary notes that Johnson has a series 7 license. That is equivalent to one college course. He also notes the CFP designation. It is equivalent to one college semester. The designation and the payment of a financial plan- no matter how sophomoric- establishes a clear fiduciary duty by Johnson and Samoan Express to know what they are doing. They had to get a formal budget. They had to know about the historical past and its predilection to the future. I focus on 1973/74. They had to know that the presentation of standard deviation was wrong. They had to know that risk of loss went up. They had to know about the (invalid) use of a flat rate return. They had to know that the Brinson material was incorrect. They had to recognize the problems of the inverted yield curve. They had to note the FEDs moves. They cannot defer such knowledge, research, competence and more over to a totally unsophisticated consumer who didn't even know what a Class B fund was.

Page 8: References a fee for the plan. I am assuming that Johnson was/is a Registered Investment Adviser.

Page 13: Johnson states that "I think when you look at the S&P 500........... during the recession that first year it was down 26%; the second year it was down 34% or something like that; and then going to 2002 the S&P 500 was down another 18% before March." Obviously these numbers are flawed since it indicated that the S&P 500 was down 60% in the first two years alone. But that is not the focus of my comment. Any adviser who experienced a 26% loss in one year with effectively no economic viability to the future would certainly not entertain more equities. Looking to the second year of Staub's numbers- at some point you would halt the continued losses of another 34%.

Page 21: Johnson notes that Smith's "monies were not going to last him until his life expectancy.............. which is 87, 88 of life expectancy." Those figures are incorrect. The actuarial lifetime of Smith at age 65 was approximately another 18 years. That said, given certain planning elements, it is good to add a few years for safety and that is why a planner might use a lifetime to the late 80's. But it was not Smith's actuarial lifetime."

Page 23: Reference is again made to DCA into an income type fund. As stated, I have never heard or seen any research advocating DCA into bonds. Actually, there is nothing that validates DCA into equities. Milvesky did indicate that the most volatile of equities might profit from DCA- but no standard consumer would be in those funds anyway.

Horton asks, "did he indicate any change in his investment goals at this time period in 1999. Johnson indicates, "yes,. Wanted to do what he originally wanted, to be in the moderate aggressive risk tolerance. once in the retirement, wanted to participate in the market in the moderate to aggressive risk tolerance".

I take strong exception both to the question and the answer in that Smith paid for a plan that was to determine what he was supposed to do and why. To suggest that a totally naive and unsophisticated investor is the entity to decide what to do and when is ludicrous in the extreme. Samoan Express and Johnson , by payment for a plan and through commissions from products, took upon themselves the fiduciary responsibility to guide Smith to the retirement ***they*** designed- not Smith. Be it conservative, aggressive, whatever, Samoan Express and Johnson were responsible for "doing the numbers" to determine if Smith was headed in the right direction. But, as previously stated, the numbers by both entities were invalid from inception.

Page 30: Johnson 's reply to DCA- "that's when an investor takes a lump sum in a conservative position and wants to move to a more aggressive position and they don't want to do it on a lump sum basis. The market could drop today six points. If you are thinking the market's going to have volatility, then doing some on a monthly basis mathematically has shown to take the volatility out of the market when you are buying more shares lower than higher. The market has come down during that month that you are putting the thousand dollars over."

The problem is that, mathematically, the investor loses money as they utilize DCA. Are both Samoan Express and Johnson saying Smith wants to do this? Further, Johnson indicates that this is done when moving to a more aggressive position. I repeat, I have never heard of even a remote suggestion of DCA into a bond fund. Further, I submit that once investors knew how DCA actually worked, they would take a much different position on its use.

Page 35: Johnson notes "that the second reason I put him in B was with Samoan Express, different than almost any other company, you don't pay anything coming in for a class B and you have no expenses............" Certainly there are expenses for running the fund so I am at a loss why anyone would say there are "no expenses".

Page 38: Johnson notes, "I think on the form itself and looking at it..with sitting down with Glenn and talking about, first, how he wanted his portfolio structured, I would have gone through the..from the left hand side of the ultra conservative to the right hand side of the aggressive. Glenn is the driver always, and I am the navigator So he's going through those choices, then he would have chosen the moderate aggressive" Once again I point to the (inadequate) plan. Smith went to Samoan Express and a Certified Financial Planner for the assistance in his retirement. He had no idea what the implications were to his income or retirement since he was unaware that Samoan Express and Johnson were incompetent in planning his retirement. Smith is NOT the pilot- he is flying blind into an area he knows effectively nothing about. He cannot use a financial calculator, he has no background in the securities market; has not developed a budget and had no idea of statistics. All this was the purview and responsibility of Samoan Express and Johnson .

Page 45. Johnson notes, "my advice was twofold. One, go into cash if you can't stand the heat of this...what's happening in the market. Let's go to cash or let's stick with the plan. You've dollar cashed over into these funds, let's tick with the plan. And, you know, looking into the mirror, I sure didn't know the recession was going to last three years. But, no, he always, always, always had the choice given to him of moving to cash. I repeat- Smith is being led down a garden path to devastation. Any true adviser looking at the economy had to be aware that it was going down at a precipitous rate. Further, and most importantly, Samoan Express and Johnson knew or should have known of the severe repercussions to Brunlow's portfolio. They should have known he never had enough money statistically to stay in the market over a long period of time. As such, they had to clearly monitor the market and, fundamentally, the economy to be sure that pervious encounters with major declines were not going to decimate his portfolio, his income and hence, his retirement.

Page 47: Johnson notes that "Glenn called and said I cannot live with what the money market is yielding, it will not provide me with the retirement funds, you have to be more aggressive" Well, the funds that Glenn had were already known or should have been known by Samoan Express and Johnson would never provide the income Glenn needed from inception. Glenn did not need to be more aggressive- he had to be told to be less aggressive while the economy was in a tailspin and then, only then, embark on a different strategy. But to engage in more equities in a losing environment is complete folly. To be clear, I do not expect perfection with any investment strategy. But what was provided to Smith was complete incompetence.

Page 51: The commentary for most of the page shows the complete folly of Smith picking the various investment strategies for his retirement. There is comment on emerging markets, utility funds, high yield tax exempt and so on. The statement that the high yield tax exempt was to be utilized for his long term care payments makes no sense whatsoever. By definition, high yield means lower quality. High yields are also directly impacted by interest rates. And as stated, Smith's tax bracket was minimal. Illogical use.

Page 57: Johnson notes he showed the Smith portfolio to his supervisor and "he reviewed the portfolio and felt like the portfolio with Glenn's long term retirement goals at his age was appropriate. Unacceptable since the initial plan did not show the sums necessary for a long term retirement in the first place. It was about $160,000 underfunded at inception. The goals could never be reached under a buy and hold notion. And unless the portfolio was carefully monitored for the impact of a 1973/74, Smith's opportunity for a dependable retirement was about nil.

Page 63: Johnson notes that "I made no moves during the recession. I have made some since we've come out of the recession anticipating going forward." This is a major fault of Samoan Express and Johnson in recognizing their fiduciary duty to all clients. It is not sufficient to state that you have competency to make adjustments during "good times" but are completely incapable of addressing what to do in a major downturn that could completely decimate a clients portfolio and retirement.

Morningstar reports

I have already addressed the use of so many funds in a singular portfolio. The consensus of the industry is that you rarely need more than 6 funds- some suggest less. When you use more than that, might as well just index. This commentary refers to the comparison of literally all the funds selected to basic category funds. The AXP funds almost universally underperform their comparable funds. In other words, they are terrible selections. It's simply hard to pick any that reflect a fiduciary duty. Certainly, anyone viewing the bond funds would clearly recognize that the high fees are going to decimate the returns- and the economy was in a scenario of historically low rates to begin with. One can suggest that the use of a bond funds reduces risk overall- but the returns of a bond fund with these types of fees reduce their *use*. You can then look at Mutual B, Diversified Bond B, Small Company, Partners Small Cap and so on. Even assuming that Smith had adequate monies in order to retire to begin with, it is also obvious that he would need more than normal since the returns of these funds were so much less than their peers- even the S&P 500. More importantly, the returns on bonds was absolutely dismal and that made the overall risk all the higher once interest rates were to change- and they have. The lawsuits generated against Samoan Express seem justified by retirees, at least, since the ability to meet their retirement goals was severely impeded. All in all, these funds should not have been used. The forced use- even though the plan said the investors could go elsewhere- is a breach of duty. Samoan Express knows full well- and has historical validation- that almost everyone who buys a plan will use their agents and products.

Summary

Smith is a completely unsophisticated retiree who knew nothing of the statistics of investing. He was induced to pay for and follow a financial plan that was flawed from the outset. The funds needed for retirement were never available for Smith- they were around $160,000 light based on historical returns allowing a 95% probability of success. Additionally, under such underfunding, it was imperative for Samoan Express and Johnson to insure that the initial balance was maintained (save for the regular drawdown). They knew that a scenario such as 1973/74 had decimated portfolios before and could be realistically anticipated to happen again. The edict about buying and holding was not valid and it was clearly obvious thereafter in 2000- 2002. They breached their fiduciary duty in dealing with Smith's monies, his retirement and his future.

Very Truly,

Errold F. Moody Jr.