

# THE SHERIDAN ROAD MAP

## The Best Route to Financial Success



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## LOOK BEFORE YOU LAY OFF

### If you're looking to reduce your payroll, make sure you do it legally

In these tough economic times, many employers need to significantly cut costs and overhead to continue to survive. Some are considering layoffs, while others are increasingly seeking alternatives to layoffs. This month we will explore three of the most common options available to employers—layoffs, reductions in workweeks or salary, and furloughs—and address some of the legal pitfalls that can be associated with each.

To assist me with the discussion, I have called upon the expertise of my colleague, Amy Beth Dambeck, who has assisted investment advisory firms throughout the country with various employment-related issues for several years.

#### Issue #1: Layoffs

Layoffs are often necessary and certainly a reality in a bad economy. Decreased morale and productivity, and unintended, further loss of personnel (as remaining employees often begin to search for and accept other employment believing that their own positions are not secure) may result. Employers could also potentially incur legal costs as a result of layoffs, as the selection of employees for layoffs may give rise to a variety of wrongful termination claims. The current state of the economy makes such lawsuits more prevalent, as job prospects are often bleak.

As Dambeck's experience has shown, it is not uncommon for terminated employees to assert claims of discrimination alleging that they were selected for a layoff due to their race, gender, age, disability, or some other protected status, while

others may claim that they were laid off in retaliation for complaining about wrongful conduct. Regardless of the resolution of such allegations, the costs in defending or settling a charge of discrimination can be significant.

This does not mean that layoffs should be avoided, but they should be carefully planned and executed to minimize costs and exposure to legal liability. In selecting employees for a layoff, several items warrant examination and consideration. The obvious first step is determining whether positions are essential, may be consolidated, or should be eliminated. You should also take a careful look at your company policies, handbooks, manuals, and any employment agreements to determine what post-employment obligations may be owed to employees being considered for layoff (i.e., notice, payment of accrued paid time off ("PTO"), severance pay, or benefits).

As with any other decision that has legal or financial consequences, be sure to accurately and carefully document the basis of any layoff, the objective reasons for the selection of each employee, and be aware of special circumstances as to any employee selected for layoff, e.g., the employee just returned from a maternity or disability leave, has previously complained about harassment or improper conduct, has requested an accommodation for a disability, etc. When such circumstances exist, it is all the more important to carefully document the decision to lay off and, of course, base the selection for layoff on lawful criteria. It is prudent to consult with legal counsel on such issues, as well.



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# LOOK BEFORE YOU LAY OFF *(continued from page 1)*



## **Issue #2: Use of Separation/Severance Agreements, or Releases**

If facing layoffs, the utilization of severance/separation agreements and releases can serve to reduce or eliminate exposure to

wrongful termination and other claims.

While it may seem a bit counter-intuitive to offer severance benefits—i.e., payment of salary continuation or a lump sum amount, benefits continuation, or a combination of both—it truly is not. Laid-off employees will face financial hardship and uncertainty. They are often hurt that they were selected for termination over others and worried about their financial future and the costs of continued healthcare benefits. Such circumstances understandably increase their propensity to assert legal claims against their former employers. Accordingly, it is often prudent to offer a reasonable severance package that, in exchange of a full release of claims against the company, will confer continued salary or benefits for a defined period of time. Please note that strict compliance with legal requirements is critical to the effectiveness of any release and, often, specific language and notice requirements must be present to effectuate a valid release of certain legal claims. Through the use of well-drafted separation/severance agreements, employers can insulate themselves against most claims. Accordingly, Amy Beth highly recommends the use of severance/separation agreements in conjunction with any layoffs.

## **Issue #3: Reduced Workweeks and Wage and Hour Laws**

More employers are contemplating the reduction of hours, reductions in salary and the use of furloughs to avoid the necessity of having to lay off employees. However, even well-intended decisions can be fraught with legal consequences if not properly executed.

Employers may want to reduce the workweek and corresponding pay across the board for all employees, including exempt employees. The term “exempt employees,” refers to employees who are exempt from certain wage and hour laws, and usually applies to administrative, executive, or professional employees who receive a regular, annual salary. While not all salaried employees are exempt, in practice, hourly employees are never deemed “exempt.”

For example, an employer who wishes to reduce the workweek and salaries by 20%. Such a pay reduction will threaten exempt status if the 20% cut brings an employee’s salary below the required, statutory minimum amount—currently set at \$455 per week under federal law (and higher in many states).

To reduce the risk of running afoul of federal and state laws, it is recommended that employers reduce the salary of exempt employees without dictating the hours they work. Any such cuts or reductions must be made only after the provision of appropriate, advance written notice and never during a current pay period.

## **Issue #4: Furloughs**

Some employers may want to reduce overhead by discontinuing part of the firm’s operations during slow times, such as for a few days or one or two weeks around holidays. For many employers, mandatory furloughs may be a viable alternative to layoffs. So make sure you consider these issues that surround furloughs:

**Risk of Loss of Exempt Employee Status.** Exempt employees must be paid the same minimum salary for each pay period. If an exempt employee performs any work during a workweek, that exempt employee must receive his or her entire salary for that week. Failure to compensate an exempt employee for a week where any work is performed will jeopardize that employee’s exempt status. However, if an employer furloughs an exempt employee for an entire week, then no salary is owed for that full week and the employee’s exempt status will not be affected.

When employees are furloughed, employers should insist that they not work. With so many remote access devices that we all have these days, it is likely that some exempt employees will be inclined to check e-mail, return phone messages, or otherwise “work” while on furlough. However, as exempt employees are entitled to pay for any week in which work is performed, employers should clearly advise that work is not authorized during any furlough without advance written approval.

**Use of Vacation/PTO During Furloughs.** While ideally an employer would want to mandate the use of PTO/vacation time during furloughs to save resources by having employees deplete paid time off, this may run afoul of applicable state laws. Mandatory vacation use also raises issues when some employees do not have sufficient vacation accrued to cover the entire furlough. Further, if an exempt employee does not use vacation/PTO days for an entire week and does some work during that week, the employer could end up having to pay the employee for the entire workweek to avoid the loss of his or her exempt status.

**Required Notice to Employees of Furloughs or Reduced Workweeks.** Employees must be provided with advance, written notice of any mandatory furlough or implementation of a reduced workweek. Unless state law requires greater notice, best practices suggest providing at least 30 days’ written notice. Also be sure to review your firm’s employment handbooks, policies, or agreements that may mandate notice requirements for any change in salary or terms of employment.

### **Put It in Writing**

With a minimal amount of advance review and consideration of available options, employers can minimize their risk of exposure to liability while optimizing the benefits provided by these employment decisions.

These troubled economic times have brought considerable change to the employment landscape. It is wise to seek the advice of legal counsel prior to making decisions to layoff employees or implementing alternative work policies to ensure compliance with relevant—and often changing—laws.

# HE'S GOT THE MOMENTUM

## Cliff Asness brings his hedge fund skills and momentum investing beliefs to the mutual fund world.

Cliff Asness is known as a hedge fund manager who caters to institutions, is a true believer in momentum investing, and despite his University of Chicago credentials, a heretic who rejected Fama-French dogma on the efficient markets to build his own investing doctrine using the often-criticized concept called momentum investing. But these days, the shop he helped found in August 1988, AQR (for Applied Quantitative Investing) Capital Management, based in hedge fund's downtown, Greenwich, Connecticut, has entered the mutual fund world. Three funds were launched in July, all with \$5,000 minimums: AQR Momentum (AMOMX) in large caps; AQR Small Cap Momentum (ASMOX) in small caps, and AQR International Momentum (AIMOX) in international, all of which use his momentum strategy and are available on the Schwab and Fidelity platforms. Earlier this year the firm launched the AQR Diversified Arbitrage fund (ADANX), which uses multiple arbitrage strategies. Asness and his partners are now quite interested in reaching the ears and pocketbooks of advisors and their high-net-worth clients.

He spoke to Editor Jamie Green during the Schwab Impact 2009 conference in San Diego in mid-September, just before he presented his case to the assembled advisors in a conference session. Ebullient but also self-effacing, Asness nevertheless remains a true believer in his shop's unique approach to investing, despite the naysayers.

**How much does AQR manage now, and what's the mix of clients and vehicles?** We manage about \$22 billion, with about two-thirds in traditional investments, trying to beat the benchmarks, and a third in hedge fund assets. Most of the money is from institutions, very little from the high net worth; our clients tend to be endowments, pension funds, and state plans.

**Is it easier to invest on behalf of institutions, which have a much longer time horizon, than it is for individual clients, who may be more swayed by emotion and a shorter time horizon?** Institutions can be as bad as individuals. And retail investors have one advantage: they're masters of their own fates. The only way to not do well for your clients is to pay too much for Wall Street.

**Why have you gotten into the mutual fund world now?** We've defied easy labels for a long time. We started building this [mutual fund] effort three to four years ago, though I admit the timing now is fortuitous. We're trying to diversify using the same set of models and beliefs that we've used [in the institutional business].

As for the mutual funds we've introduced so far, we first asked, what do we do that we think—this is our opinion—is missing from the mutual fund world? Pretty quickly we came

up with three different momentum funds and a diversified arbitrage fund. We have three momentum funds: large cap, small cap, and international. They're different in that they are different securities, but not in spirit.

Let me mention diversified arbitrage. In the hedge fund world, we've done each of the so-called arbitrage strategies: merger arbitrage, convertible arbitrage, closed-end arbitrage. For maybe 10 years now, we do them in a similar geek-like fashion: we don't do much in the way of individual meetings with management, but we build very diversified risk-controlled portfolios: we give up looking for the one right merger, but

we also give up the cost of putting all your eggs in one basket and choosing the wrong merger. We try to pick up the general premium—and this has been a huge premium for 30 years—that mergers close more often than they don't. Even when they don't close, it's like an insurance company: when somebody dies early, you pay off a lot more than the policy, but you're betting on net that the policies cover it. We try to do it a little better, and if I call it an index approach the guys back home

will yell at me, but it's largely a much more diversified, focusing-on-costs and getting-exposure approach.

We looked and found there are a few people who do various aspects of arbitrage in the mutual fund world, but no one does a diversified set of many of the strategies. Mergers is the cleanest, easiest example that everybody knows of. Convertible arbitrage is now a bigger part of the portfolio: you buy the convertible bond and try to hedge away as much of the risk as you can, and they tend to trade fairly cheaply; it looks like a piece of equity and a piece of credit exposure.

If you try to hedge them away, you tend to make money for a long time; you lost a lot of money in 2008 and you made a ton of it back in 2009. We wrote a paper, called *The Limits of Convertible Arbitrage*, about the ride in convertible arbitrage [see [InvestmentAdvisor.com](http://InvestmentAdvisor.com) to access the paper].

What we noticed was that no one was doing the full set of arbitrage strategies; even in the first quarter of this year, even last year, it was a fairly low-volatility portfolio.

These are famous last words, but the good news is that it's hard to lose all your money doing a very diversified set of these strategies; the bad news is that you're never going to post an up 50% in a year either. We're up about 10% for this year in the arb fund. The stock market is up more than that now, but we were up in the first quarter as well.

The point is that we've had a very low correlation to the equities market and very low volatility. I said this in the Barron's interview recently (August 31), but if we're ever up

*“The scariest thing about leverage is that you have to borrow it from someone else, and that someone will want it back.”*

## HE'S GOT THE MOMENTUM *(continued from page 3)*

50% in a year with this fund, you should do an expose of that. We look at this fund as having bond-like volatility but not very correlated to equities or bonds.

By the way, we think the word arbitrage is misused: if you're long and short the same thing, it's not riskless.

### **Tell me about the origins of your beliefs in momentum investing, and how you use it in building portfolios.**

[Narasim] Jegadeesh and [Sheridan] Titman wrote first about momentum research in the late 1980s. We don't think the markets are totally efficient, and that in addition to the Fama-French three-factor model, there's a fourth factor [to explain stock market performance]: price momentum.

In a way, the formula is simple: we buy what's going up, and we sell what's going down. I did my dissertation on momentum investing at the University of Chicago [*Variables That Explain Stock Returns, 1994*, available at [AQR.com](http://AQR.com)]. Eugene Fama is one of my heroes, but I was nervous when I told him I wanted to write on momentum investing. But he told me, "If it's in the data, write it."

Fama-French is all about size and value. If there's any magic to adding value and momentum, it's that they hedge each other over time. Momentum is a good substitute for growth. [For more on momentum, see AQR's research paper, *The Case for Momentum Investing*, by Adam Berger, Ronen Israel, and Tobias Moskowitz, at [AQR.com](http://AQR.com)].

**What part of an ideal portfolio would be momentum?** If I were building my own portfolio, it would be roughly half value, half momentum.

**Since you are a quant shop, do you worry about the macro economic and political environment?** In momentum, we're doing a relative value bet, not a market direction trade, but I do think the economic recovery will be slow. These new tariffs on China worry me [the Administration announced on September 11 that it was slapping steep tariffs on Chinese-made tires that were causing "market disruption"]. It's textbook: if you want to turn a recession into a depression, become protectionist.

I'm also still University of Chicago through and through: when you print a lot of money, it's going to have an effect on the economy. If you invest your fears, it's a bad idea. But all of these worries, hopefully [they won't] affect our investing.

**What are your feelings on leverage these days?** We've always preferred strategies with lower leverage—our diversified arbitrage fund, for example, is levered 1.3 to 1. But last year was not a fun year, and the scariest thing about leverage is that you have to borrow it from someone else, and that someone will want it back: the cost of leverage is always higher than you think.

I think 2008 was an acid test: who survived and who didn't; who managed leverage well, and who didn't.

**Do you invest in your own funds?** We invest in all our funds, but most of my wealth is in the business.

An investor should consider the investment objectives, risks, charges and expenses of the Fund carefully before investing. To obtain a prospectus containing this and other information, please call 1-866-290-2688 or download the file from [www.aqrfunds.com](http://www.aqrfunds.com). Read the prospectus carefully before you invest. There is no assurance the stated objective(s) will be met.

*By James J. Green • Investment Advisor, October, 2009*

### **Retirement Plan Limits for 2010**

Description	2010	2009	2008	2007	2006
401(k)/403(b) Elective Salary Deferral Limit	\$16,500	\$16,500	\$15,500	\$15,500	\$15,000
457(b) Annual Deferral Limit	\$16,500	\$16,500	\$15,500	\$15,500	\$15,000
SIMPLE Elective Deferral Limit	\$11,500	\$11,500	\$10,500	\$10,500	\$10,000
401(k)/403(b)/457 Catch-Up Contribution Limit	\$5,500	\$5,500	\$5,000	\$5,000	\$5,000
SIMPLE Catch-Up Contribution Limit	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500
Annual Dollar Limit - DB Plans	\$195,000	\$195,000	\$185,000	\$180,000	\$175,000
Annual Addition Limit - DC Plans	\$49,000	\$49,000	\$46,000	\$45,000	\$44,000
Annual Compensation Limit	\$245,000	\$245,000	\$230,000	\$225,000	\$220,000
Highly Compensated Employee Limit	\$110,000	\$110,000	\$105,000	\$100,000	\$100,000
Key Employee Compensation	\$160,000	\$160,000	\$150,000	\$145,000	\$140,000
Social Security Wage Base	\$106,800	\$106,800	\$102,000	\$97,500	\$94,200

This summary is designed to provide an overview of selected Retirement Plan Limits for 2010 and is not intended to be comprehensive. This data is provided for informational purposes only and should not be construed as ERISA, legal or tax advice. Although care has been taken in preparing this material, NRP Financial, Inc. does not guarantee its accuracy. Source: IRS IR 2009-94

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# MOST AMERICANS WILL BE TOO POOR TO RETIRE AT 65

## Popular index finds that 51% are ill-prepared

More households are at risk of being unable to maintain their standard of living during retirement, according to the Center for Retirement Research at Boston College.

The center last week updated its National Retirement Risk Index, a measurement of retirement readiness that evaluates American households' financial assets, housing and changes in Social Security benefits. Nationwide Mutual Insurance Co. underwrites the index.

The latest index shows that 51% of Americans aren't prepared to retire at 65, up from 44% in 2007, when the index was last updated.

This estimate doesn't consider the cost of health care or long-term care. If those were included, 70% of the population wouldn't be prepared to retire, according to Paul Ballew, Nationwide Mutual's senior vice president of customer insights and analytics.

Results also show that younger people have felt the brunt of the economic decline.

Fully 56% of households led by Generation Xers are at risk of failing to meet retirement needs, compared with 49% in 2007.

The disappearance of pension plans, as well as troubles with the Social Security system, place younger Americans at a higher risk of being unable to hold on to their standards of living during retirement, Mr. Ballew said in an interview.

"The cradle-to-the-grave relationship with the employer is severed," he said. "Younger people have to be responsible for their own retirement."

In the aftermath of the financial crisis, a combination of distrust of advisers and increased interest in "simple assets" and savings vehicles to deal with immediate money shortages may have distracted some households from saving for retirement, Mr. Ballew said. "There's a hunker-down mentality," he said. "Crisis management — dealing with a deficit on the household balance sheet — takes precedence over retirement planning."

By Darla Mercado • Investment News, November 2009

## HISTORY REPEATING ITSELF?

### The current market looks similar to the Great Depression in more ways than one.

In a September report, Daniel Alpert, founder of New York-based investment bank, Westwood Capital, says the current "hope" rally is strikingly reminiscent of market moves in 1930, following the 1929 crash. He isn't forecasting another Great Depression, but it sure makes for an interesting (and scary) read.

In his paper, titled "Haven't We Been to this Show Before?" Alpert describes the mood of the market at the peak of six month rally in 1930: "Speculation that another bull market was in the offing brought anxious capital back in from previously frightened

traders. Unemployment threatened to define the economic picture in a way that hadn't been seen in decades. The Federal Reserve and banks were lowering the cost of money to borrowers still able to borrow."

Indeed, unemployment reached 15.9 percent in 1930, "nearly identical" to today's BLS' 16.3 percent U-6 figure, a more accurate measure that includes part-time workers looking for jobs, and unemployed people who have stopped looking but still want jobs, he says.

### Mirror, Mirror - Comparison of Two Crashes and the Aftermath on the Dow Jones Industrial Average

	<u>1929-30</u>	<u>% Change</u>	<u>2007-09</u>	<u>% Change</u>
Bubble High	381.17		14,164.53	
Initial Drop	198.69	47.87	6,547.04	53.78
"Hope" Rally High	294.07	48.00	9,791.71*	49.55*
Ultimate Low	41.62	89.08	????	????
Days from Initial Bottom to "Hope" Rally High	155		183+?	

Source: Westwood Capital and market data \*as of 9/17/09

By John Churchill • Registered Rep, October 2009



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