THE INTELLIGENT INVESTOR | By Jason Zweig

Meet Suze Orman's Newsletter Guru

What business has an estimated one million clients, operates on the fringe of securities law and can say just about anything without immediate consequences?

It is the investing-newsletter industry. And the public should approach newsletters with caution, even when they come with a celebrity endorsement.

Just ask followers of Suze Orman, the personal-finance icon. In March 2011, she and Mark Grimaldi, an investment manager in Wappingers Falls, N.Y., launched a monthly newsletter called The Money Navigator. Ms. Orman has since given away more than 50,000 trial subscriptions to the newsletter, which costs $63 a year and now reaches 65,887 subscribers. She and Mr. Grimaldi are 50-50 owners, according to Mr. Grimaldi and Ms. Orman's spokeswoman.

Mr. Grimaldi also manages a mutual fund called Sector Rotation, which has about $25 million in assets. His firm, Navigator Money Management, oversees a total of about $120 million in the fund and other accounts, according to its financial filings. That makes it a minnow in the money-management business.

The cover story in the December issue of the Money Navigator, adapted from a November 2011 article in the newspaper Investor's Business Daily, said "Sector Rotation produced an average annual return of 10.25% from August 31, 2002, to October 31, 2011, vs. 5.47% for the S&P 500 Index, according to Morningstar."

Yet the Sector Rotation fund wasn't launched until Dec. 31, 2009. The earlier return, Mr. Grimaldi says, was produced by the model portfolio of one of his other newsletters, not the Sector Rotation fund itself. Mr. Grimaldi says the newspaper misinterpreted the numbers he provided.

This week, after inquiries from The Wall Street Journal, Money Navigator told readers: "We apologize for not catching this error prior to publication."

According to Alexa Auerbach, a spokeswoman for Morningstar, the firm didn't produce any of the data attributed to it. An Investor's Business Daily editor said the paper has corrected the error.

Mistakes can matter. Robert Plaze, deputy director of the division of investment management at the Securities and Exchange Commission, declined to comment on questions specifically related to the Money Navigator newsletter. However, he said, "Generally speaking, the SEC does not regulate the publishers of financial newsletters, but they are subject to the antifraud provisions of the [Securities Act of 1933]."

Under those provisions, securities lawyers say, newsletter publishers must not make statements they know—or reasonably should know—are false or potentially misleading.

Mr. Grimaldi didn't respond to emails seeking comment on whether his newsletters' statements conform to securities-law provisions. Ms. Orman declined to address specific questions about the newsletter or Mr. Grimaldi's background. "Mark Grimaldi is my trusted partner in The Money Navigator," she said in an emailed statement. "He is ethical, honest and achieves stellar results that consistently outperform the market. I'm proud to be able to provide our newsletter to people who are looking for solid financial advice."

A table in the December issue of Money Navigator compares the performance of two of Mr. Grimaldi's portfolios to the Standard & Poor's 500-stock index since 2001. In 2009, according to the newsletter, the S&P 500 returned 19.79%; Mr. Grimaldi's capital appreciation portfolio beat that, gaining 24.58%.

According to S&P, however, the index returned 26.46% in 2009—meaning Mr. Grimaldi's portfolio trailed rather than beat the index. In nine of the 10 years cited, the newsletter understated the performance of the S&P 500. "I'm not perfect," Mr. Grimaldi says. "We don't claim to be."

This week, after inquiries from the Journal, the Money Navigator newsletter informed readers that the 2009 return for the S&P 500 was a "typographical error."

In a news release issued in March 2007, Mr. Grimaldi said one of his newsletters had "been ranked #1 by Hulbert Financial Digest" for the five years through 2006. Hulbert, a tracker of newsletter performance, is owned by MarketWatch, a division of Dow Jones & Co., publisher of the Journal—as are several other newsletters that compete with Money Navigator. Mr. Grimaldi's other newsletters, although not the Money Navigator, have featured the claim "Ranked #1 & Recommended by Hulbert Financial Digest!"

Mark Hulbert, editor of the digest, says his publication "doesn't make recommendations" and that "no matter how I slice and dice the data, I cannot support [Mr. Grimaldi's] claim of being No. 1 for that five-year period." According to Mr. Hulbert, Mr. Grimaldi's highest rank from the digest over that period was 25th out of 110.

Mr. Grimaldi says he ranked No. 1 over that period: "I'll say that to my grave."

The December issue of the Money Navigator recommended that readers with 20 or more years to retirement put 15% of their money into Mr. Grimaldi's Sector Rotation Fund. It also recommended that readers with five to 20 years to retirement put 15% of their money into the fund.

The fund invests mainly in exchange-traded funds, or ETFs, and has outperformed 80% of its peers since inception, according to Morningstar. It charges a 1% management fee, most of which Mr. Grimaldi is waiving, he says.

The Money Navigator discloses that Mr. Grimaldi and his firm are paid to manage any readers' assets that go into the fund. The newsletter's recommended portfolios include funds from several firms other than Mr. Grimaldi's.

"Our readers want ETFs," Mr. Grimaldi says, "and I couldn't find another fund that invests in them that I like as much, not even close. If people object, they don't have to invest in the fund or buy the newsletter."

Thanks to Ms. Orman, many people don't have to buy the $63-per-year newsletter; they get it for free.

"There's millions of people out there who would benefit from this newsletter," Mr. Grimaldi says. "Suze and I are just trying to get some good advice out to them."

Agence France-Presse/Getty Images

Author and personal-finance expert Suze Orman.

THE INTELLIGENT INVESTOR | By Jason Zweig

Can 'Skin in the Game' Pose Conflicts?

Investors often complain that mutual-fund managers don't put their own money at risk and thus don't have enough "skin in the game."

Fund manager Daniel J. Rice III might have too much.

With his co-manager, Denis J. Walsh III, Mr. Rice oversees $4.5 billion in energy investments at **BlackRock**.

There isn't any doubt that Mr. Rice is good at his day job. His $953 million **BlackRock Energy & Resources Fund** has outperformed 96% of its peers over the past decade, according to Morningstar.

But Mr. Rice moonlights as an oil man. Those dual roles could conflict, say some experts in securities law. Mr. Rice and BlackRock disagree.

In 2005, Mr. Rice founded and became the principal investor in **Rice Energy**, a family firm. Mr. Rice's sons serve as chief executive officer, chief financial officer and chief geologist. A subsidiary, Rice Drilling B, operates in Pennsylvania's Marcellus Shale, a rich vein of oil and gas deposits.

Here's where some observers say Mr. Rice's interests might collide.

Rice Drilling B is a partner in a joint venture to develop natural-gas wells with **Alpha Natural Resources** (stock-market value: $2.3 billion).

In late 2009, Alpha was less than 2% of assets in Mr. Rice's biggest fund at BlackRock. But after Alpha teamed up with his family firm in early 2010, Mr. Rice's BlackRock fund acquired another 3 million shares, topping out at 9% of assets.

BlackRock says more than two-thirds of the position resulted from Alpha's acquisitions of companies the fund already owned and that the rest of the purchases were driven by cash inflows at the fund.

The law in this area is tricky. "There's probably no rule that requires that under these exact, specific conditions, you may not invest this way," says Tamar Frankel, a law professor at Boston University. Still, "people who hold other people's money must manage for the other people's benefit and may not have interests that conflict with theirs," she adds.

Mr. Rice's activities, say legal experts, might pose such problems. Imagine that the venture between Rice Drilling and Alpha blew up. Could that create losses for Mr. Rice's fund investors? Might his family ties to Alpha make it harder for him to reach objective decisions about buying or selling its stock for his funds?

"BlackRock is a fiduciary to our clients," says a spokeswoman, "and all employees are obligated to always put our clients' interests first."

BlackRock's decision to invest in Alpha had nothing to do with Rice Energy's relationship with the company, the spokeswoman says.

Instead, the investment "relates to the fact that [Alpha] is a leading global coal company and currently the world's third-largest metallurgical coal supplier." An Alpha spokesman declined to comment.

BlackRock "maintains a rigorous compliance program...designed to assist BlackRock and its employees to comply with all applicable laws and regulations," says its spokeswoman. Employees must "pre-clear" every personal investment and outside business activity with the firm's compliance department—and Mr. Rice did so, she says.

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While the Rice family ventures aren't giant, they aren't tiny. Last summer, Rice Drilling B raised $60 million in a private debt offering under Regulation D, a federal rule that lets issuers sell securities without registering them with the Securities and Exchange Commission. That was the 25th largest of 392 such energy offerings in the U.S. last year, says an expert on unlisted financings, Robert Hunt of FormDs.com.

Rice Drilling's joint venture operates dozens of gas wells in the Marcellus. It ranked 24th in production among active operators there last year, based on publicly available data.

Mr. Rice's family firm competes in the same region as several companies in Mr. Rice's mutual funds, including **Cabot Oil & Gas**, **Chesapeake Energy**, **Consol Energy**, **EQT** and **Range Resources**.

"This is a quagmire of potential conflicts of interest," says Ms. Frankel of Boston University. "When you are both acting as a fiduciary for others and investing for yourself, you may win if your investments on behalf of others lose."

To avoid potential conflict, Mr. Rice agreed "to recuse himself from all decisions made by all Rice Energy entities" involving the Alpha joint venture, says the BlackRock spokeswoman. He also avoids taking "material information about the joint venture that could restrict BlackRock's ability to trade in shares of [Alpha]."

The Boston Globe

BlackRock energy-fund manager Daniel J. Rice III

Mr. Rice owns 1% of Rice Energy. The rest is held by the Dan Rice Irrevocable Trust. He isn't a trustee, but his children are the sole beneficiaries.

Mr. Rice, the BlackRock spokeswoman says, "is not involved in any of the day-to-day operations of Rice Energy."

Asked why Rice Energy's website describes Mr. Rice as "managing general partner" and "principal investor," Mr. Rice said through the spokeswoman that the family company "hasn't changed that page for a few years."

"Dan's commitment to BlackRock's clients and his track record prove that he is wholly able to fulfill his role as an investment manager at BlackRock," says the firm's spokeswoman.

BlackRock's funds have never disclosed his private activities, she adds, because they are "not required" to.

"Maybe if the [joint venture] is very small, they might have a plausible argument that any potential conflict isn't material," says Thomas Hazen, a professor of securities law at the University of North Carolina at Chapel Hill. "But if I were an investor in these funds, I would want [these potential conflicts] disclosed."

THE INTELLIGENT INVESTOR | By Jason Zweig

A Fund Manager's Home Cooking

BlackRock Star Steps Down After Sideline Comes to Light

Mutual funds bombard investors with detail—but still don't always tell them what they need to know.

Consider the case of Daniel J. Rice III, co-manager of several **BlackRock** funds that invest in energy and other natural-resources stocks. Experts say his personal dealings raise questions about what information investors are entitled to and how closely the fund industry monitors its employees.

Christophe Vorlet

As this column reported two weeks ago, BlackRock hasn't disclosed in any of its public filings that Mr. Rice also has a multimillion-dollar side business in the energy industry. A BlackRock spokeswoman says the firm didn't disclose these relationships because it isn't required to.

A subsidiary of Mr. Rice's family company, Rice Drilling B, is a partner in a joint venture to develop natural-gas wells with **Alpha Natural Resources**, a publicly traded coal and natural-gas company based in Bristol, Va., according to Alpha's filings.

Before that deal, Mr. Rice's biggest BlackRock fund had less than 2% of its assets in Alpha. Afterward, its position in Alpha rose to more than 9%. The BlackRock spokeswoman says the fund's investment in Alpha had nothing to do with Mr. Rice's family ties.

Alpha, like many coal stocks, has been tanking—and taking the BlackRock energy funds with it. Alpha has trailed indexes of coal and other energy stocks by 30 to 70 percentage points over the past year.

Mr. Rice hasn't been hurt too badly by that drop, however. According to a Securities and Exchange Commission filing, he has only $100,000 to $500,000 of his money riding on his two largest mutual funds combined.

His outside interests are much larger—and their coffers are bulging. In recent years the Rice family has invested more than $65 million in Rice Drilling B—at least 130 times greater than Mr. Rice's stake in the BlackRock funds. The family business has attracted $135 million from outside investors in the past year, including $60 million from individual investors and $75 million from a private-equity fund.

"The disproportion between [Mr. Rice's] tiny investment in his own mutual funds and the huge stake in his family business suggest that he has a lot of skin in the game, but most of his skin is in a different game from his public investors," says George Loewenstein, a behavioral economist at Carnegie Mellon University who is an expert on conflicts of interest. "He has most of his skin in a game that they can't even play."

Mr. Rice, through the BlackRock spokeswoman, declined to comment on the details of his personal dealings or fund-management activities.

The differences between BlackRock and Rice Drilling B are stark in other ways. While BlackRock is the world's largest asset manager, with $3.7 trillion under its roof, Mr. Rice's family company has raised capital through some firms that have run afoul of regulators.

Last summer, Rice Drilling B sold $60 million in debt under Regulation D, a federal rule that allows issuers to sell stocks or bonds in "private placements" without registering them with the Securities and Exchange Commission or state regulators.

Among the dozen firms that Rice Drilling listed as selling the debt were one whose president's securities license was revoked in Arizona, and two that were fined by regulators for allegedly improper marketing of other private-placement offerings.

The BlackRock spokeswoman said the firm wasn't involved in the sales and didn't buy any of the debt.

Yet an online invitation to a conference call for the offering last July included a link to a modified version of Mr. Rice's BlackRock biography. Bankers at **Harbor Light Capital Group**, one of the hosts of the conference call, didn't respond to requests for comment.

"He is very close to the hot, red area of using one's position as a fiduciary to benefit oneself," says Tamar Frankel, a law professor at Boston University. "If you look at other money managers in his position, I don't remember anyone who has gone that close."

Not all legal experts are alarmed by Mr. Rice's outside activities. "It certainly has the potential for conflict of interest, but more details about the specific circumstances could prove that these transactions were fair," says Thomas Hazen, a professor of securities law at the University of North Carolina at Chapel Hill.

Still, when asked this past week about the potential conflicts between Mr. Rice's family firms and his funds, BlackRock said Mr. Rice will soon step down as co-manager of its energy mutual funds. The firm added that he has also agreed not to serve as an officer at his family firms or to participate in their fundraising activities.

The Rice family companies, said BlackRock, have agreed not to refer to Mr. Rice's BlackRock affiliation when they raise capital in the future.

BlackRock said it is confident that no actual conflicts of interest arose. However, the firm said, it is making the changes to eliminate "any possible appearance of conflict."

"My reputation is of the highest value to me, and I don't want there to be even the perception of a conflict of interest," Mr. Rice said in an emailed statement. "That is the reason for my decision to step down from managing mutual funds and work with BlackRock to further enhance procedures governing my association with Rice Energy."

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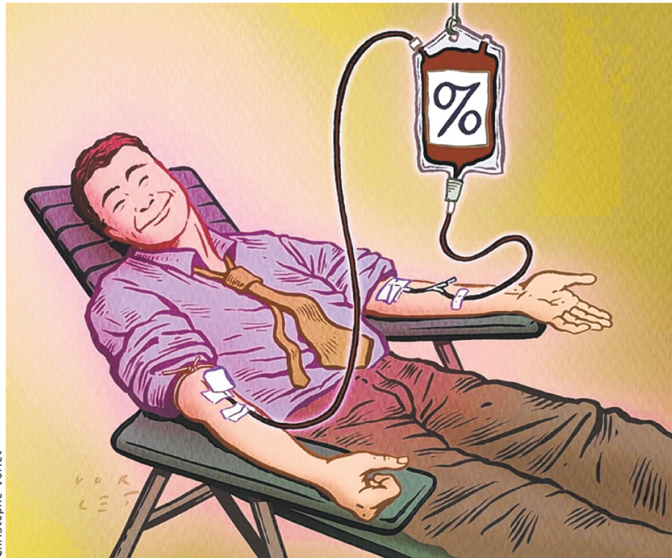
High Rates? Are You Delirious?

Have today's insanely low interest rates driven investors insane? Three closed-end funds offered by **Cornerstone Advisors** of Asheville, N.C., show that some investors have come to believe the impossible: that high yields can persist in a world where central banks have squashed down bond rates to next to nothing.



Christophe Vorlet

These people have deluded themselves into believing they are earning fat yields. In reality, they merely are getting their own money back—and you can't turn a fantasy into fact just by wishing it were so.

At Cornerstone, investors are receiving "distribution yields" of roughly 22% of net asset value, and the shares trade for much more than the value of their underlying assets. According to the WSJ Market Data Group, the Cornerstone funds are the three highest-yielding of the 657 closed-end funds in the U.S.

Most of the yield at Cornerstone, however, doesn't come from its investments. In past years, it came from giving investors some of their original assets back. Now, it comes out of money the funds' investors have just added.

In each of the past five years, the **Cornerstone Progressive Return** fund distributed more than 10 times as much in dividends and other payouts as it earned in net investment income.

In 2008 and 2009, for example, 93% of total distributions were return of capital—giving shareholders their own money back (after subtracting the manager's fees, of course).

By the end of 2010, assets had shrunk to just $55 million from $132 million in 2007. At that rate, the fund would pay out its entire portfolio by 2014 or 2015—a kind of high-yield hara-kiri.

"If you keep throwing out more income than you can possibly make, someday your assets will go to zero," says Mariana Bush, a closed-end fund analyst at Wells Fargo Advisors. "And so will your management fees."

So, in 2011, the managers of Cornerstone Progressive Return raised $41 million in a "rights offering," a deal available only to existing investors that enabled them to buy one extra share for each three they already owned. That fresh capital injection helped the fund sustain its yield at more than 20%.

Last month, the fund raised $49 million in another rights offering. The prospectus says Cornerstone may turn around and pay much of that money back out to the same people who put it in.

Like a mutual fund, a closed-end fund is a pool of investments. But a closed end generally has a fixed number of shares, which trade on a stock exchange, where their prices can deviate from the underlying value of their holdings. Usually they trade below that value.

Most closed ends distribute varying amounts of dividends and capital gains. But roughly three dozen closed-end funds have "managed distributions" like Cornerstone's, seeking to pay out a flat rate of income regardless of market returns.

None comes close to Cornerstone's 20%-plus rates, which are "not reasonable or sustainable," according to Ms. Bush of Wells Fargo Advisors. And while rights offerings are fairly common, she says, they are "very unusual" among managed-distribution funds.

The magical payout machine at Cornerstone works roughly like this: Say you have $1,000 invested. You buy into the rights offering, shelling out another $250 or so to get extra shares. Cornerstone then pays out 20% or more in distributions, causing the value of each share to shrink accordingly.

The end result: You own more shares of a fund that is worth less, and most of the income you "earned" came from the money you put in yourself.

Cornerstone's prospectuses disclose that much of its payouts "will not represent yield or investment return on the fund's portfolio."

Still, Mike Taggart, an analyst at Morningstar, says he has received many emails from Cornerstone investors who believe that they are earning 20% yields and don't understand that these funds are simply giving them their own money back.

"People see the 'yields' on these funds and they jump in," he says, "and it makes me sick."

Regarding such a switcheroo as "income" is like making an interest-free loan and then telling yourself, as the debtor pays back only your principal, that you are earning a generous return on your money.

Cornerstone's portfolio manager, Ralph Bradshaw, didn't respond to requests for comment.

Cornerstone Progressive Return has 93% of its assets in the shares of other closed ends, many trading below the value of their assets. The largest holding, at 4.9%, is the **Eaton Vance Tax-Managed Global Diversified Equity Income** fund.

But while you could buy the Eaton Vance fund this week at a 14.3% discount to its net asset value, meaning that each $100 of its investments cost you less than $86, Cornerstone traded at a 10.3% premium. That means you had to pay $110 to get $100 in underlying assets.

That isn't all. Because most of its portfolio is in other funds that charge their own expenses, the effective annual costs at Cornerstone reach 2.5%, according to its prospectus—roughly double those of the typical closed end.

Investing has sunk to this: People are willing to pay a big premium for the privilege of getting their own money back, after fat fees, without interest—apparently because it gives them the illusion of earning a high yield.

Desperate people do desperate things. Investors who are starved for yield do desperately stupid things.

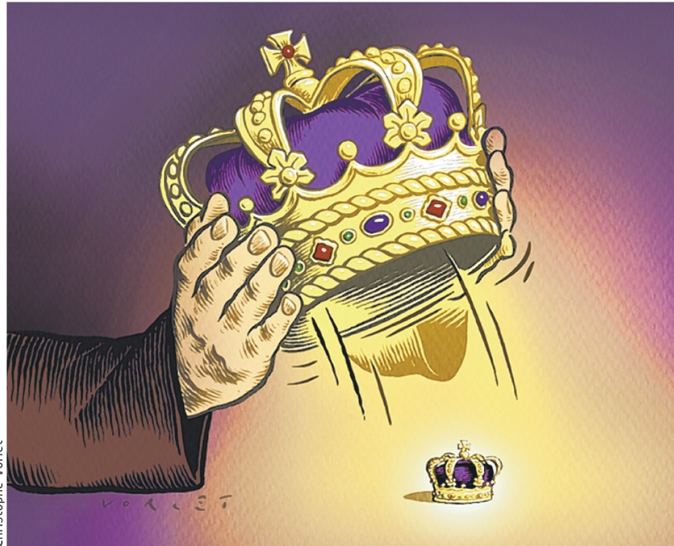
THE INTELLIGENT INVESTOR | By Jason Zweig

Will These Royal Yields Rule?

Investors reaching for yield should always bear in mind the warning label on stepladders: "DANGER. DO NOT STAND ON TOP STEP."

Just look at what happened this past week to investors in several so-called royalty trusts. These instruments, which collect and distribute income from oil and gas or mining properties, are among the highest-yielding in the stock market, with payouts averaging 9%.

But last Wednesday, the "unit," or share, price of **Hugoton Royalty Trust** fell 8% after it announced a cut in its dividend; on Tuesday, **San Juan Basin Royalty Trust** also cut it payout, knocking its shares down 5%. And **Dominion Resources Black Warrior Trust** fell 6% this past week after it declared a dividend cut the previous Friday.



Christophe Vorlet

Many people—especially older, conservative investors hoping to rejuvenate their shriveled bond portfolios—might not realize what they are buying when they invest in these rare, peculiar and suddenly popular instruments.

There are some 30 royalty trusts, with a combined market value of roughly $12 billion; at least seven have sold their shares to the public for the first time in the past year.

By design, they have no employees or physical assets, and most will cease to exist in 20 years or less. Their only value consists in the income they distribute. But their future payouts may well be a ghost of the yields that appear so attractive to today's investors.

Why are the yields on royalty trusts all but doomed to dwindle?

Unlike the more-familiar master limited partnerships, which often own or operate energy, mining or other assets, the typical royalty trust holds only the right to receive income from a fixed number of properties.

Once the trusts are set up, they are frozen and can't acquire any new interests to replenish their stream of income.

When their share prices are cheap, as many were in early 2009, royalty trusts can be a great investment.

But timing is everything, and many of these trusts are far from bargains today. Wells and mines tend to become depleted with each passing year, making a decline in yield almost inevitable unless commodity prices boom.

When there is no money left to pay out, most of the trusts will disappear—and, unlike bonds, they won't give investors their original principal back at the end.

So, when the financial statements of these trusts use the word "depletion," they mean it. According to Standard & Poor's, between 2007 and 2011, Hugoton Royalty Trust's dividends shrank to $1.41 from $2.09; San Juan Basin Royalty Trust's, to $1.40 from $3.59.

"Unfortunately, most people who buy [royalty trusts] don't realize that they tend to be depleting assets," says Tyson Halsey of Income Growth Advisors, an investment firm in Charleston, S.C. "They end up being bad for retired people who think they are getting a fixed-income alternative."

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The trusts themselves, to their credit, make no attempt to hide any of this. In their financial statements, they forthrightly disclose detailed estimates of the likely income available for future payouts to investors.

In their latest annual reports, for example, **BP Prudhoe Bay Royalty Trust** and **Whiting USA Trust I** calculated that the current value of their future cash available for distributions was $1.4 billion and $109 million, respectively.

Yet this week the total market value of BP Prudhoe stood at $2.3 billion; Whiting USA I, at $123 million.

That means investors remain willing to pay 61% more for a stake in the BP trust than all its future cash flows are likely to be worth, and they are shelling out 13% more for Whiting than Whiting itself says they will probably earn from it—before tax.

How can share prices remain stubbornly above what the trusts are worth?

First, the trusts are thinly traded, making it cumbersome and costly for hedge funds and other "short sellers" to bet against them and bring their prices back into line with their fundamental value.

Second, their yields are so high that some investors seem determined to buy them on that basis alone—regardless of today's prices or tomorrow's returns.

"People buy into [royalty trusts] for the sake of the yield," says a representative of Hugoton's trustee. "If the yield gets cut, the market tends to dry up."

Do investors understand that they are often overpaying? "In some cases, they probably don't," says an official at BNY Mellon, which acts as trustee for 15 of these vehicles, including BP Prudhoe Bay Royalty Trust. "I wouldn't argue with that. That's why it's so important for investors to review the [financial] filings."

When you see 9% yields in a 1% world, don't let the word "royalty" fool you into thinking you have just found the king of all income investments. One of the most basic laws of financial physics still applies: Those who stretch too far for yield will probably topple.