

# THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

## A “Buy-and-Manage” Investment Philosophy



**HARVEY ROWEN** is the Founder and CEO of Starmont Asset Management in San Ramon, Calif. He has more than 30 years’ experience in the financial services industry, having formerly served as President of Merrill Lynch Trust Company and as President of Retirement Plan Services for Charles Schwab & Co. Prior to that, Mr. Rowen served as an Attorney with the Securities and Exchange Commission, Staff Counsel to the U.S. Congress and Senior Consultant with Stanford Research Institute. He holds an accounting degree from UCLA, a law degree from Boalt Hall School of Law University of California, Berkeley, and an MBA from New York University. Mr. Rowen serves on the board of the California, Berkeley, Center for Law, Business and the Economy, and he is Chairman of the Investment Monitoring Committee, Jewish Community Foundation of the Greater East Bay. He is a former board member of the Haas School of Business, University of California, Berkeley.

### SECTOR — GENERAL INVESTING

**TWST:** You have an extensive background, having served as President of Merrill Lynch Trust, President of Retirement Plan Services for Charles Schwab, and an attorney with the SEC and Congress. Why did you start Starmont?

**Mr. Rowen:** I got to a point in my life where I wanted to take my educational background, and my experience and my expertise, and be in a situation where I could use all that to help people with their finances. My wife likes to tell me that the two most important things in people’s lives are their health and their wealth, so we are like people’s wealth doctor. We try to make sure that their wealth is in good shape so that people can lead the lives they want to lead. And so I did this and it’s been a real joy. It’s the classic case of doing well by doing good.

**TWST:** How would you describe your investment philosophy?

**Mr. Rowen:** At Starmont our goal is to preserve and grow our clients’ net worth so they can have the lives they want to lead. We believe that long-term investment results are best pursued through compounding reasonable gains and avoiding major losses. We do that by constructing and managing a diversified, tax-sensitive investment portfolio, using traditional and alternative investments.

**TWST:** You said you use both traditional and alternative investments. Would you explain both those vehicles?

**Mr. Rowen:** Traditional investments are generally thought of as stocks and bonds, and we use both domestic and international equity and fixed income in our client’s portfolio. That’s the way we started this firm in 1998 because from 1926 until 2000, the domestic stock market, as measured by the S&P 500 index, was up on average 10% a year. So you could use stocks in your portfolio for gains, for growth. You could use bonds in your portfolio as a shock absorber, the way a shock absorber works on a car. So when the stock market hits the bumps in the road that it traditionally hits, the bump wouldn’t be too severe because you have bonds to make it less severe. You can construct a portfolio like that, and you could do well for your clients. Since 2000 things have not been that way. The decade of the 2000s was not up 10% a year on average; it was actually a decade in which the S&P 500 was negative. As that has happened, we have had to look for other ways of generating value for our clients. One of the ways we looked at was hedge funds, generally considered an alternative investment. We did not like hedge funds because they were not regulated, they were very expensive — with “2 and 20” as the normal fee structure for a hedge fund — they were not

transparent, and they were not liquid, so there was really nothing good about hedge funds as far as we could see. However, we've been able to find mutual funds that are hedge fund-like in the way they behave, which means that they can go anywhere, they can invest in anything, they can short the market as well as go long. But because they are mutual funds, they are regulated. They are required to file their holdings with the SEC, so they are transparent. They are not terribly expensive, given what they do, and they are liquid. You can sell them any day. We have been using those since the great crash of 2008, and they have been doing reasonably well for us in what is a very difficult market environment.

**TWST: Do you invest all of your clients in the same general portfolio?**

**Mr. Rowen:** No, we don't. We think that each client's needs are unique. We have a disciplined approach to putting together an investment portfolio. It has six steps to it. One of the first steps is to set the client's objective. What does a client need? In order to know that, we need to know where they are in life today, where they are trying to get to, how long they're going to have to get there — their age — etc. Based upon that analysis, we develop what we call a single integrated strategy, a consolidated portfolio for them, and then within that consolidated portfolio, we select the investments to fund the asset allocation that we have agreed to with the clients. We determine how much is going to be in stocks, how much is going to be in bonds, how much is going to be in alternative investments, such as alternative mutual funds, real estate through REITS commodities,

That's what we do. As one of our clients said, "You guys don't pick the horses, you pick the jockeys, and you let the jockeys pick the horses." We think we have the best jockeys in the country picking stocks and bonds for our clients.

**TWST: So you pick managers, not investments?**

**Mr. Rowen:** Correct. We pick the people who are going to pick the specific investments. And a number of these portfolio managers that we use for our clients have been selected recently as "Portfolio Managers of the Decade" by Morningstar. So we think we're doing a pretty good job of picking these portfolio managers.

**TWST: Do you provide guidance for the managers in terms of sectors or weighting specific vehicles? Or do you let the portfolio managers make all the decisions?**

**Mr. Rowen:** The latter. We don't focus on sectors; we let these portfolio managers do that. Then we measure these portfolio managers against two benchmarks. One of the benchmarks is how are they doing versus the part of the market that they're in? For example, if we have a portfolio manager who is investing in domestic large-cap value stocks, we're going to measure that portfolio manager's performance against the performance of the Russell 1000 Value Index. We want that manager to be able to beat that index over some reasonable period of time; it doesn't have to be every month or every quarter, but over some reasonable period of time, that manager should do better than that index.

Second, we want that manager to beat other managers who are

### Highlights

*Harvey Rowen follows a "buy-and-manage" investment philosophy, thereby minimizing his clients' costs and tax exposure. He favors long-term investments that avoid major losses and compound reasonable gains through a diversified, tax-sensitive portfolio of both traditional and alternative investments. Mr. Rowen recommends patience in today's environment, explaining portfolios light in equity may be the best option, given market volatility. He outlines his firm's investment process as well as the major considerations he takes into account when designing clients' portfolios, and choosing the money managers who manage them.*

*"What we do particularly well here is identify portfolio managers who have been very good in both up markets and down markets in picking stocks or bonds. We have a list that we call the best-of-breed list. We believe these are the best portfolio managers in the country."*

or gold or other asset classes. We reach an asset allocation with our clients that we agree to, and then we look at specific investments to put our clients in to fund that asset allocation. What we do particularly well here is identify portfolio managers who have been very good in both up markets and down markets in picking stocks or bonds. We have a list that we call the best-of-breed list. We believe these are the best portfolio managers in the country. Normally we get to them by using institutional-class, no-load mutual funds because we think there is more information available on that kind of an investment vehicle than on other kinds of investment vehicles.

investing in that part of the market. Morningstar has an index for the domestic large-cap value portion of the market that measures how all of the managers that Morningstar tracks are doing, and we want our manager to beat that index over some reasonable period of time. If they're not, then we have to find out why. And if we don't like the reason, we have to pick a different manager.

**TWST: Failure to perform as you expect is one reason you would change a manager. Are there other reasons?**

**Mr. Rowen:** There are. We will change a manager or we will change the use of that particular investment vehicle if one of

three things happen. The first thing is if the manager leaves, retires or goes off to run a hedge fund. If the manager is no longer available to us, we're obviously going to stop using that fund and look for a different manager. The second reason might be if something happens in our client's life, either positive or negative, that causes us not to want to be in that particular investment. Third is if something happens in the economy or in the markets themselves, we might make a change. That happened, for example, in December of 2007. We thought that we needed to substantially

about that now than we used to because our discovery is that clients are 100% risk tolerant when the market's going up, and they are 100% risk adverse when the market's going down. So we have to take what they say with a grain of salt and try to make some reasonable decisions about that on our own. We take all of that, put it all together, and then we come up with what we think is a proposed asset allocation that will meet those objectives, accomplish what the client wants to accomplish and do so within what we think is their tolerance for risk and volatility.

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reduce our exposure to the equity market, so we started selling equity funds in tax-advantaged accounts in December of 2007 and in our taxable accounts in January of 2008. We continued to sell equities through the first six months of the year so that when Lehman Brothers went into bankruptcy in September of 2008 and the market proceeded to go down 40% in the next six months, our clients mostly missed that decline because we had already cut back their exposure to equities.

**TWST: What are the major factors you consider when putting together a portfolio for a client?**

**Mr. Rowen:** We always start out with, "What's the purpose of the money in their portfolio? What do they want to accomplish with that money." Is this to pay for children's education? Is it to buy a vacation home? Is it to retire at a certain age? We have to understand what the goal is. Money isn't an end in itself — you can't eat it, you can't live in it, you can't do those kinds of things. Money is a means to an end, and we have to understand from our clients what that end is. We also have to understand their

**TWST: Is a retirement portfolio different than other types of portfolios?**

**Mr. Rowen:** It's not so much the asset allocation, it's where do you put the money? We take all of our clients' accounts and, for purposes of managing, we consider them to be one gigantic consolidated portfolio. In that portfolio, we are likely to have a taxable account, which is normally a family trust. We are likely to have IRA Rollover accounts and perhaps a 401(k), which are tax-deferred accounts. When we decide which specific investments to put into which kind of account, there is definitely a difference. What we have been doing, given the current tax laws, which unfortunately are about to change, and with rates going higher, is using taxable accounts — when we think the return is going to be through growth and appreciation — that we're going to have to sell eventually to get cash. We've been putting those investments in taxable accounts because the long-term capital gains rate has been 15%, whereas things that throw off income, like bonds, we've been putting in a tax-deferred account so we don't pay taxes on them as they throw off that income.

*"If a client had a portfolio that was 60% equity and 40% fixed income, today it's 50% equity, 50% fixed income. If the markets continue to have problems and decline, we're prepared to cut that back even further."*

current situation. Are they employed and, if so, what is their income? Are they close to retirement? Are they looking to take some time off? What is their age? What's been the longevity history of their family? We do a lot of planning for our clients. Our planning software says that the average male is going to live to be 91, and the average female is going to live to be 93. We want to see if that comports with the family histories of the clients. We want to know a little bit about their attitude toward risk and return because those are two sides of the same coin. We tend to ask less

That's how we use the taxable account versus the tax-deferred account. The tax-deferred account is normally some kind of a retirement vehicle, whether it's an IRA, a profit-sharing plan or a 401(k).

**TWST: In general, has your investment strategy changed over the last several years with the changes in the market?**

**Mr. Rowen:** It definitely has. As I said, we made a substantial reduction in the equity allocation in our clients' portfolios in December of 2007 and for the first six months of 2008 so that

when the bad things happened, our clients were considerably out of the equity market. In April of 2009, we took a look and thought March may have been the bottom. Then we began to dollar-cost-average back into the equity markets, so our clients were back in the equity market and rode that big, big, big upturn in 2009. The same thing was true through the first three and a half months of

market went down some more. The market is very sensitive, and that sensitivity is heightened by the volatility. So you're going to see big swings because of that. Clients would do better if the market were less volatile and a little more calm.

**TWST: What advice would you give investors in terms of how to invest in such a volatile, swinging market?**

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this year. In January, February, March and the first half of April, our clients were in the equity market to a considerable extent. Those were up months, and that was great. Then of course the market turned with a vengeance starting in the middle of April, and May and June were just very bad months. So just recently, we cut back our clients’ equity allocations by 10 percentage points. If a client had a portfolio that was 60% equity and 40% fixed income, today it’s 50% equity, 50% fixed income. If the markets continue to have problems and decline, we’re prepared to cut that back even further. So yes, the asset allocation changed, but also the nature of the investments changed. As I mentioned earlier, we’re now using these hedge fund-like mutual funds so that we have managers who can actually short the market and maybe make some money when the market’s going down. We have managers who are investing in alternative asset classes, like gold, which has been very good for them. So we are using different asset allocations and different investment vehicles, given what’s been going on with the markets.

**Mr. Rowen:** I would say two things. First of all, they should decide whether they should be managing their portfolio or whether they should have a professional managing their portfolio. If they decide they want to do it themselves, they need to be very diligent. They have to watch this market closely because of the volatility, and they have to be patient because we’re going to have big ups and big downs. You have to be patient with this market until things calm down and perhaps we go back to more “normal” times or the “new normal” that some are talking about. Because of the law of negative numbers — that is, if your portfolio goes down 33%, you have to earn 50% on what’s left just to get even — I would say the most important thing and something we stress here is to avoid the big hit to your portfolio. That probably means being a little lighter weighted in equities than they might be under more normal times.

**TWST: Tell me about “the new normal.” What are your views on what that might be?**

**Mr. Rowen:** “New normal” is a phrase that PIMCO coined. Bill Gross and his people at PIMCO, probably the

*“You have to be patient with this market until things calm down and perhaps we go back to more “normal” times or the “new normal” that some are talking about.”*

**TWST: We are seeing continued volatility in the market. Is volatility bad?**

**Mr. Rowen:** We think volatility is bad because it makes the market very unsettled, and when you have a very unsettled market, the least little thing can set it off for really big moves, mostly to the downside. May was the perfect example of that. We had the Greek sovereign debt problem and the market started to drop. We had the “flash crash” of the stock exchange and the market went down some more. We had the BP oil spill and the market went down some more. We had North Korea and South Korea facing off against each other because of an incident and the

best bond house in the country, say that things have changed. They believe that going forward the government will be much more involved in the economy than it has been in the past. There’s going to be increased regulation that’s going to lead to decreased profit margins, which is going to lead to decreased stock prices. Just recently, Gross quantified that. Whereas the S&P 500 index was up 10% a year on average from 1926 to 2000, Gross is now saying that we can expect 3% a year on average for the next few years. That is a vastly reduced return in equities if you believe that Bill Gross and PIMCO are correct.

**TWST: What is your view? Are they correct?**

**Mr. Rowen:** No one knows. We know that certainly the last decade was a very poor decade for equities, certainly for domestic equities. International and emerging markets did better; small cap did better than large cap. There are ways of cutting and dicing up the market so that maybe you didn't do quite as poorly as the S&P 500 did, but it was certainly not up 10% a year on average. So it looks like we are in a situation in which returns on equities are going to be muted. We don't know if muted means 3% or some other number, but we are continually exploring other asset classes at Starmont to see if there are ways of adding value to our clients' portfolios.

funds rate at basically zero, and all these interest-bearing accounts, whether they're savings accounts or money market accounts or CDs, are all giving us returns of under 1% annually. Now we're lucky in the sense that the inflation rate is also under 1% annually, so those accounts are not losing very much to inflation. However, we think inflation will be a problem down the road, so cash is not going to be a really good place to be. On the other hand, over the last 25 years or so, up until the 2008 crash, Americans were not saving enough. They were spending too much. They were not putting enough away for a rainy day or for retirement, for example. Certainly one place to put away money is in both the equity market and the bond market. We think that

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**TWST: You don't advocate the buy-and-hold philosophy. Why not?**

**Mr. Rowen:** Starmont is very much a buy-and-manage firm. We continually assess our clients' situations and the market situation. We review our clients' portfolios periodically, and we make tactical changes, if we need to do that, based upon the factors I mentioned to you. We do what we think of as “buy and manage” rather than “buy and hold.” We don't like to do a lot of trading; trading brings costs with it. We hate two things at this firm: We hate costs, and we hate taxes, so we try to minimize those as much as possible. But within that framework, we are

Americans should continue to have money in the equity market and the bond market, though both pose challenges at the moment. We've talked about the equity market. The bond market also poses challenges down the road because the Fed cannot hold the fed-funds rate at zero forever. At some point in the game, they will start raising interest rates, and when interest rates go up, the value of outstanding bonds will go down. So there is going to be a challenge with bond investments when the Fed starts raising interest rates. But yes, people should be saving more and spending less. We have seen the savings rate in the United States go up since the 2008 crash, and I think that's a good thing.

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constantly looking at our clients' portfolios. We evaluate those portfolios in terms of the economy, the market and our clients' lives. If we think tactical changes need to be made, we make them. Just last week, we made a tactical change. We lowered everybody's equity allocation 10 percentage points.

**TWST: Do most Americans invest enough in the market? Should we be looking at putting our money into the market rather than keeping it in savings accounts, for example?**

**Mr. Rowen:** I'm not a big proponent of savings accounts at the moment because they don't return anything. Cash basically is getting a zero return because the Fed has the fed-

**TWST: You mentioned that unfortunately we're going to see higher taxes. We're also looking at changes in real estate taxes, the end of the Bush tax cuts and changes in the death tax. How will all of that impact investors?**

**Mr. Rowen:** As I said before, we do a lot of planning for our clients. We don't give them a financial plan, a big 55-page book, because we don't think it makes sense to tell somebody that 20 years, six months, three weeks, four days and six hours from now, you're going to be worth “X” amount of money out to two decimal points, based upon the zillions of assumptions that go into all of these plans. We do a lot of planning and we use what we generate in that planning as road maps. We want to see if our

clients are on the right road, and what that means is that their money does not die before they do. Things that make your money die sooner are things like higher taxes. Interest rates can cut both ways. If you're investing in things that generate interest at higher rates, you get more for your money; but on the other hand, if you are in bonds, as interest rates go up, outstanding bond values go down, so that's a problem.

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We are spending a lot of time right now answering questions like, “Should I take gains in my taxable account in 2010, when the long-term capital gains rate is 15%, instead of waiting till 2011 or later, when the long-term capital gains rate could rise to 20% if nothing happens with the Congress — or even higher if President Obama can get his favorite tax legislation through?” The same thing is true with income taxes, which are scheduled to go up in 2011 if nothing happens, and will go up even higher if the Obama tax proposal goes through. Should we do exactly the reverse of our normal advice, i.e., take income in 2010 and defer deductions until 2011 because tax rates are going to be lower in 2010 than they are in 2011? There is a lot of that conversation happening with our clients and with our clients' CPAs. We involve our clients' specialists in these kinds of conversations. We think they are part of the team that is designed to serve our clients, and we want to make sure the right teammates are in those discussions. We're talking to our clients about their estate plans. There is no estate tax in the United States of America in 2010. If

now to talk about what we can do if Congress does not take any steps to change that this year before they adjourn. We are waiting until later in the year to see if Congress is going to do anything, but if they don't, there is an awful lot that could happen after the election between November and the end of the year to try to minimize and mitigate the kinds of hits that our clients are going to be taking starting in 2011 on the tax front.

**TWST: We are also still dealing with the scandals involving large Wall Street firms. Will that also bring about changes in the market and impact the individual investor?**

**Mr. Rowen:** I think the answer is yes and yes. The Regulatory Reform Bill has passed the House, passed the Senate, gone to Conference, come out of Conference, passed the House in its revised form and is waiting for action by the Senate. Assuming it passes the Senate later on this month, the president will sign it into law, and there will be significant changes in the way the financial institutions and investments are regulated. For example, derivatives are going to come out of the dark. They will have to be traded on exchanges and be regulated by appropriate regulators. Some loopholes have been carved out in the negotiations, but it's better than none of the derivatives being regulated. We are going to see a consumer financial protection agency that will not be an independent agency, as I would have favored. It's designed to regulate the kind of abuses we saw in the mortgage and credit card markets, for example, and in other areas where consumers

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somebody is going to die and is interested in leaving a large inheritance to their beneficiaries, this is the year to die because in 2011 the estate tax comes back if Congress does nothing. The exemption, which was \$3.5 million a person, or \$7 million a couple in 2009, goes to \$1 million a person or \$2 million a couple. So couples can pass along a lot less under that law than they could last year, and the tax rate goes up from 45% to 55%. There is going to be a gigantic tax hit in the estate area, and we're meeting with our clients and our clients' estate planning lawyers right

have been taken advantage of by people who are more sophisticated than they are. I think that regulation is a good thing.

Besides working for the SEC, as you mentioned, I worked for the United States Congress for a period of time; I actually drafted some legislation that I helped get through a Democratic House, a Democratic Senate and signed into law by a Republican President, and that had major impacts on regulation by the SEC over stock markets and stock brokers. I think this regulatory reform that's passing now is going to add onto that. I

think that's all positive, and I think Congress will do basically the right thing, maybe not as much as some of us might like. The congressman that I worked for has passed away, and there's been a book written about him. One of the chapters is about the securities legislation I helped write, and I'm quoted in there, which I'm very pleased to be. That book should be out in the fall. So I know how the Congress works, I know how Washington works, and I think, yes, we're going to see this regulation get passed. Yes, I think it's going to benefit investors and all consumers, and I think that's all positive.

**TWST: What other important issues should investors be aware of over the next year or so?**

**Mr. Rowen:** We're in a very volatile environment. It's like a person with a bruise on their arm — anytime that bruise gets bumped intentionally or unintentionally, there is this involuntary reflex to pull it out of the way as fast as possible, and we're seeing that in the market. The market's got a bruise. I think the 2008 market caused that bruise; I think that bruise got exacerbated when we had the flash crash, and the stock exchange computers went crashing and the Dow Jones Industrial Average went down 700 points in 20 minutes and then up 700 points in 20 minutes. Things are very uncertain, and I think investors have to be aware of that. They have to be a little more cautious than maybe they were in past times when investing their money in the market.

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**TWST: Tell us more about your background. How did you become so involved in the markets?**

**Mr. Rowen:** I've always been interested in the financial side, so I got a degree in accounting from UCLA, and I got a law degree from the Boalt Hall of Law, University of California, Berkeley. My best class in law school was securities regulation. My law school professor, who was one of the leading securities regulation professors in the country, got me a job at the SEC in Washington, D.C. I learned a lot about the industry while I was at the SEC. The SEC asked me to be on a task force to report to the Congress about the impact of institutional investors on the markets. Until the 1960s, the markets were really designed for individual investors who would trade very small amounts of stock. It wasn't until the 1960s, when the institutions got in, that we started to see a lot of the large investors investing, and lots and lots of shares being traded. The question was whether or not the markets could handle that. That report went up to Congress and this congressmen, who I mentioned who has now passed away and whom the

book has been written about, was in charge of the Committee of the House of Representatives with jurisdiction over the SEC. He decided to do a study based upon this report, and I was asked to come up to the Hill and become a member of his staff to work on that study. We spent two years studying the securities industry, starting out with the recommendations of the report, which had to do with the fact that the stock market was closing one day a week because it couldn't keep up with the volume, and that was not good. And we looked at the fact that the the commissions stockbrokers were charging their customers were fixed by the New York Stock Exchange instead of being opened up to competition, and we thought that wasn't good. There were a lot of things going on that we didn't like. I spent a lot of time in New York, meeting with the heads of the various major brokerage firms, and the major banks and trust companies, and the stock exchanges. Then we developed this report and got it approved by our Committee. It was decided to turn the report into a bill. We drafted a bill and dropped that in the hopper. It took us another couple of years to get that legislation through.

At the end of four years, I had been immersed in the securities industry. I decided that I really loved this industry. It was fascinating, but I loved the business side much more than I loved the legal side. I went back to Stanford Research Institute, here in California, as a Senior Consultant, consulting

to the financial industry. One of our clients was Merrill Lynch. Merrill Lynch asked me to come to New York and run their planning area so they could plan for what we thought was going to be a very different future, much more competitive than it had been in the past. I went back and did that. I ended up getting an MBA degree in finance at NYU and starting a private bank for Merrill Lynch in London and a private bank for Merrill Lynch in Geneva, and then starting and running the Merrill Lynch Bank and Trust Company in the U.S. All those vehicles were designed to give Merrill Lynch customers a place to hold and invest their money that was a bank instead of a stock brokerage firm, because there were customers who preferred that and there were some customers who were required to do that because they were institutions that were required to use a banking institution.

I did that for a period of time and then decided that it was time to come back to California, where my family was located. I took a job with Charles Schwab, running their Retirement Plan Services division, got very much involved with

401(k) plans and other kinds of retirement plans. But unfortunately those were the days when Charles Schwab was not giving advice, and I missed the advice-giving aspect of that business. By starting Starmont, I was able to use my experience and expertise to do well for clients and also be back in an environment where I was actually giving advice to people based upon that experience and expertise. I enjoy it immensely, and our clients tell us how much they appreciate what we're providing them. The number one thing we provide our clients over time is peace of mind. They have the sense that professionals understand them, understand the markets, are putting the two together, are watching out for their best interests, and that gives them peace of mind to go off and do other things instead. I reported to Chuck Schwab when I worked at Schwab, and Chuck used to say, "We are the guardians of our customers' dreams." I liked that. I think that's a great definition if you are handling other people's money. I think that's exactly what we are doing, and that's the way we behave here at Starmont. It gives us a great deal of personal satisfaction, our clients like it a lot, and so it's a great environment to be in.

**TWST: Is there anything you would like to add?**

**Mr. Rowen:** Times are tough. Hopefully things will get better. Americans are resilient people, and the U.S. is a resilient country. I think we're going to fight through this, and come back and continue to prosper, and I think there is an opportunity here for your readers to prosper as well.

**TWST: Thank you. (LMR)**

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