ARK ROYAL
WEALTH MANAGEMENT

Helping Successful People Make Smart Decisions About Money

SUMMER **2016**

THE ORACLE OF OMAHA—REDUX

I'm always excited to see what pearls of wisdom come from the Berkshire Hathaway annual meeting and this year's event didn't disappoint. Warren Buffett took dead aim at "investment consultants," a band of vagabonds that includes most financial advisors. Buffett's comments were directed specifically at pension and endowment "consultants," many of whom also ply their trade to high-net-worth investors. Here's a small part of Buffett's commentary:

> *It seems so elementary, but I will guarantee you that no endowment fund, no public pension fund, no extremely rich person wants to believe it. They just can't believe that because they have millions of dollars to invest that they can't go out and hire somebody who will do better than average. I hear from them all the time. These supposedly sophisticated people, generally richer people, hire consultants. And no consultant in the world is going to tell you 'just buy the S&P 500 and sit.' You don't get to be a consultant that way and you certainly don't get an annual fee that way. The consultant has every motivation in the world to tell you 'this year we should concentrate more on international stocks' or 'this manager's particularly good on the short side' and so they come in and they talk for hours and you pay them a large fee and they always suggest something other than just sitting on your rear end and participating in American business at low cost....I've talked to huge pension and endowment funds and taken them through the math, and then they go hire consultants and pay them a lot of money. It's unbelievable. The consultants always change the recommendations a little bit from year to year, they can't change them 100% because then it would look like they didn't know what they were doing the year before, so they tweak them from year to year. And they come in and they have lots of charts and Powerpoint presentations. The net result of hiring professional management is a HUGE minus...all the commercial push is behind telling you ought to be doing something different today than you were doing yesterday.*

Buffett's right. I've been involved in enough of these "beauty competitions" both as an advisor and as a board/committee member to see how consultants work and how they appeal to the baser instincts of investors. As Buffett noted, more often than not, it's these "sophisticated" investors that have a penchant for investment complexity (hedge funds, alternative investments) and who shun markets-based investment strategies in the mistaken belief that such strategies equate to settling for "average."

THREE THINGS ARE NEARLY UNIVERSALLY TRUE WHEN IT COMES TO INSTITUTIONAL MONEY MANAGEMENT:

1. People confuse investment complexity with investment acumen.
2. People never tire of the appeal of a good story.
3. People too often confuse activity with achievement.

And as Buffett so eloquently points out, following a consultant's recommendations usually only works to the betterment of one party...the consultant.

ARK ROYAL WEALTH MANAGEMENT
3700 NATIONAL DR. SUITE 218 ≈ RALEIGH, NC ≈ 27612 ≈ P(919)710-8665 ≈ MPALMER@ARK-WEALTH.COM

CAN YOU TRUST THE NUMBERS?

One of the old jokes in the accounting profession is, "What is 2+2?" The punchline is "What do you want it to be?" Unfortunately, the investment advisory world has something akin to the 2+2 riddle, only it isn't a joke.

One of the main reasons people hire a financial advisor is to get better investment performance than they could get by managing their own portfolio. *Advisor Impact* recently surveyed nearly 15,000 investors and found that investment returns were the number one consideration in selecting their investment advisor. Given the importance clients place on it, one might think investment advisors would be exceedingly transparent in how they report performance. Unfortunately, that's not the case. A recent survey by *Cerulli Associates* found that asset managers are "fudging their way to success through opaque reporting." According to Tony Griffiths, the author of the Cerulli research, "clarity—or a lack thereof—is the issue."

I experienced this problem firsthand at a former employer. The firm's chief investment officer initially opined that the firm could affirm GIPS compliance. GIPS is the industry accepted standard for investment performance reporting. However, limitations in the firm's reporting system prevented a daily transmission of investment data, a key requirement of GIPS compliance. The firm could only report investment values to the performance vendor monthly, resulting in performance reports that weren't accurate. Accountants aren't the only ones who can make 2+2=5!

Here are some key points to consider the next time your investment advisor provides you with an investment performance report for your portfolio(s).

- Is the performance reported individually for each fund your specific account's performance or simply a restatement of the fund's reported performance? While this may seem like a distinction without a difference, in reality it can be significant. I've even seen situations where an "investment consultant" reported a fund's performance for a five-year period, even though the fund listed had only been in the client's account a little over two years! Of course, the five-year performance figure was above the benchmark, but the fund had woefully underperformed the benchmark during the period the client had been invested in it.
- Is the performance report net or gross of fees?
- Does the performance report accurately reflect any fund or manager changes?
- Is the performance report time-weighted or dollar-weighted?
- If a benchmark is included for comparison, make sure it is an appropriate benchmark. Investment consultants often engage in "benchmark cherry-picking"—using a benchmark that provides the most favorable comparison. If a blended benchmark is used, make sure the advisor explains how the blend captures changes in asset class weightings over time. Some performance reports apply the current allocation weights to all time periods. For example, small cap stocks started at a 10% weight, but at the end of the reporting period had grown to 20%. If the increase is the result of new investment rather than growth, the historical performance for earlier time periods may be overstated.

2+2=5

We believe investors should focus on how they're doing relative to stated goals (whatever you and your advisor determine those to be). However, any investment performance reports provided by your advisor should be accurate, easily understandable and transparent.

> "We believe investors should focus on how they're doing relative to stated goals."

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I MISSED IT: SEVEN YEARS OF ABYSMAL STOCK FORECASTS AND I STILL MANAGED 8% RETURNS

I admit it, I'm not very good at predicting stock market movements. A whole lot's happened the last seven years, and I missed all of it.

Here's a recap of some of the calamities, doom, gloom and apocalypses that spooked the market in the seven years between January 2009 and December 2015:

FEBRUARY 2009

S&P 500 down 6% for the month, Wall Street Journal headline reads "How low can stocks go?"

MAY 6, 2010

"Flash Crash" Dow plunges 9% intraday, closes down 348 points

OCTOBER 3, 2011

S&P 500 down 3% as stocks close out worst quarter since 2008 financial crisis

JUNE 1, 2012

S&P 500 sinks 2.5% on lousy jobs report

JUNE 24, 2013

Stocks fall 1.5% over fears Fed will taper stimulus efforts

OCTOBER 15, 2014

Dow plummets 460, ends down 2% over fears of Ebola

AUGUST 25, 2015

Dow plummets 588 points, over concerns about China slowdown.

This year we've had more of the same:

JANUARY

Worst start to year ever, S&P down 5% for month

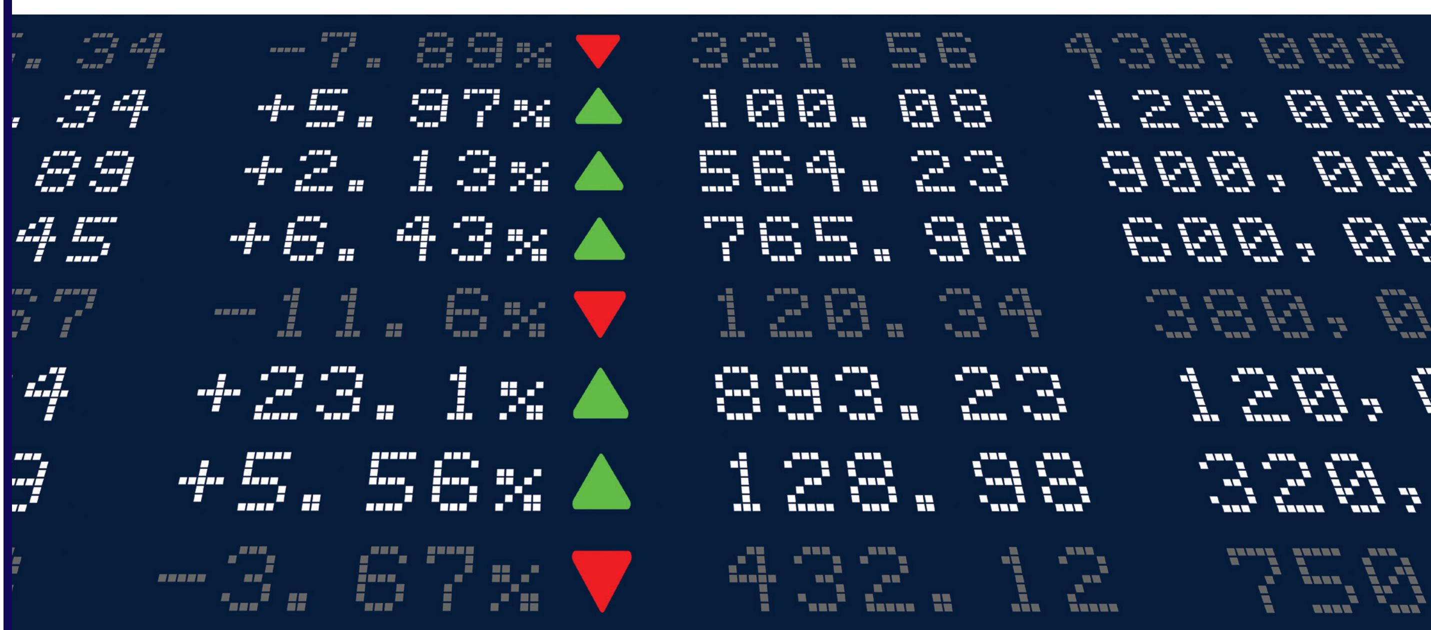
JUNE

Brexit fears take S&P down nearly 10% in two days

Amid this turmoil, what did I do? I stayed invested. I was present in the market day in, and day out. The only changes I made were to rebalance my allocation back to target weights once a year. No changes in my funds, no efforts to time the market, just boring investment discipline. As a result, my personal portfolio (which is about 90% equity) returned 8.02% annualized for the period 2009–2015. I'm required to add the disclaimer that past performance is no guarantee of future results, but hopefully you get the larger point.

Lots of things can distract one from achieving a successful investment experience. Don't let the belief that you need to be a good forecaster be one of them.

> "Amid this turmoil, what did I do? I stayed invested."



IN THE NEWS

Mike Palmer will be teaching an evening "Introduction to Behavioral Finance" class at Wake Tech Community College this fall. Please let us know if you'd like more information.

What's the Optimal Asset Allocation for Individuals Entering Retirement? There's been some interesting research on this topic by both academics as well as financial planners. We've created a compilation of several of these studies. If you'd like a copy, send us an email and we'll send you a copy.

The CORNERSTONES *of* ARK ROYAL WEALTH MANAGEMENT

To nurture a culture that puts our client's interest first—always

To be truthful at all times, to be intellectually honest with ourselves and with our clients, even if it isn't what they want to hear

A commitment to lifelong learning, and a passion for applying our wisdom efficiently and effectively every single day

Align what you say, what you do and what you think to honor yourself, your family and our firm

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