ARK ROYAL
WEALTH MANAGEMENT

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The Moneyball of Money Management

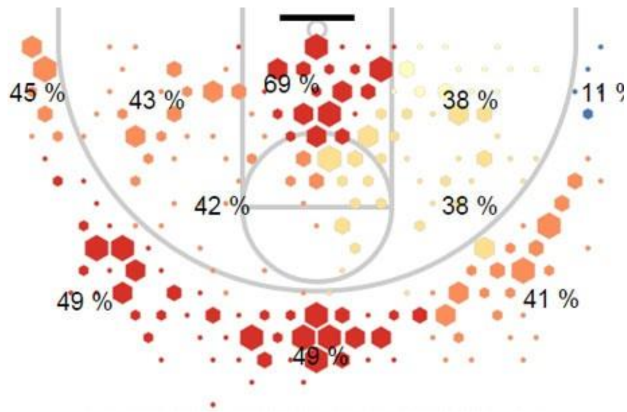
Last year I started working with a new client who is a successful Division I basketball coach. Prior to meeting with Bob (not his real name) he provided statements from his current financial advisor for me to review.

When we met several weeks later I explained the difference between my markets-based investment approach and the “try to pick the best fund” approach employed by his current advisor. “I get it,” he said, “you’re a man-to-man guy and he’s a zone guy. Both have their place, I’m okay with that.” Knowing that Bob was one of the country’s leading proponents of using analytics in game strategy and scouting, I reframed my approach.

“Bob, if two decades of analytics indicated college basketball teams playing man-to-man defense win 75% of the time, would you play zone?” “Of course not!” he replied. I then proceeded to show him the latest SPIVA research that showed how a markets–based investment strategy has produced consistently superior results. It was an “A-ha” moment, and a key factor in his decision to become a client.

College basketball coaches operate in a world very similar to mutual fund managers. The difference between success and failure is razor-thin and the competition is smart and hard-working. Basketball coaches looking for an edge, a competitive advantage, are increasingly using statistical analysis.

If Kalamazoo State knows that Klondike U’s best player shoots 62% from a certain area of the court, but only 30% everywhere else, they can adjust their defense to put the odds of success ever so slightly in their favor.



The concept of using analytics in sports was popularized in the Michael Lewis book (and Aaron Sorkin movie) *Moneyball*. While baseball can best be described as an individual sport masquerading as a team sport and thus uniquely well-constructed for statistical analysis, other sports have adopted similar approaches.

Measuring mutual fund manager performance is even more analytics friendly than baseball. Fund managers all have the same universe of stocks to pick from and performance history is readily determinable. And the best part is you don’t have to be good in math, SPIVA does the calculation work for you!

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Navigating the Alphabet Soup of Financial Advisor Credentials

When dealing with something we know little about, whether it be a legal problem, finding a medical expert or assistance with our personal finances, the natural reaction is to look for some independent source that bestows some level of professional credibility on those providing the service.

Today, there are nearly 80 financial advisor designations, and separating the wheat from the chaff for the average consumer is very difficult. Many designations are just empty titles that don't mean much.

Candidates pay a fee for a nice, framed credential that is practically hollow in terms of rigor. For example, the Certified Senior Advisor (CSA) credential comes from a real organization, the Society of Certified Senior Advisors, but merely indicates that the "expert" studied how to communicate with (and market to) seniors.

Earning the "Certified Retirement Financial Adviser" credential does involve financial training, but it's a self-study or four-day course and only requires passing a 100-question multiple-choice exam. Incidentally, the organization that oversees the CRFA is owned by a firm that sells a seminar for marketing annuities to seniors.

So what's a consumer to do? According to AARP's "Guide to Selecting a Financial Advisor" consumers should focus on the three designations that truly matter; CFP, CFA or PFS. These credentials are the ones that take a significant amount of time and expertise to master before the designation is awarded.

The CFP (certified financial planner), PFS (personal financial specialist) and CFA (chartered financial analyst) designations demonstrate a proven level of competency within financial planning and investing. Each of these credentials also require meaningful on-going continuing education.

A quick overview of these credentials:

A Certified Financial Planner (CFP) has to complete 18 to 24 months of study, pass a rigorous ten-hour exam and work for three years as a financial planner or do a two-year apprenticeship with a CFP professional before earning the designation. The CFP exam pass rate is about 63%.A CFP can be equated to a doctor who practices internal medicine, a generalist on personal finance. (Full disclosure, I am a CFP.)

A Chartered Financial Analyst (CFA) has to pass three, six-hour exams and have four years of qualifying work experience to earn the title. The CFA exam pass rate is 42-53%.The CFA is a more specialized certification focusing on investments, not on overall personal finance. In that way it is akin to a physician specializing in dermatology or radiology.

A Personal Financial Specialist (PFS) is a CPA who has completed extra educational requirements focused on personal finance. A PFS must be a CPA, must complete 75 hours of financial planning education over a 5 year period and pass the PFS exam; a 5 hour, 160 question multiple-choice exam. The PFS exam pass rate is 60%.

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The Moneyball of Money Management (cont.)

But what about the theory that you or I can find the John Wooden or Dean Smith of money management, the guy who has the investment equivalent of five national titles and 17 consecutive 20-win seasons? Unfortunately, there's no statistical evidence that supports that approach. In fact, evidence suggests just the opposite. More often than not, selecting a fund that has outperformed for a five year period results in underperformance over the next five year cycle.

That's why we advocate an investment approach that is market-based, that eschews attempting to pick only the best stocks and instead focuses on academically tested tilts that have higher expected return (size, value and profitability) and exploit inefficiencies resulting from compelled trading. And while drawing analogies between sports and investing can help in understanding our approach, we believe there's one big difference. By embracing a markets-based approach, investors opt out of a zero sum game (for every winner there is a loser) to one that simply requires capital markets to continue to work as they have for over a century.

Navigating the Alphabet Soup of Financial Advisor Credentials (cont.)

Here's a quick overview of two less common credentials, ones that probably enhance the advisor's image rather than providing real benefit to clients:

Accredited Investment Fiduciary (AIF): AIF candidates complete an online self-study program followed by a 6 hour, instructor led classroom session. There is no testing during either of these levels. Upon completion of the classroom session, candidates can sit for the AIF Examination; a 90 minute, 60 question multiple choice exam requiring a score of 75% to pass. The pass rate for the exam is about 74%. The AIF designation requires a very modest 6 hours of annual continuing education. Interestingly, there is no requirement that AIF designees actually serve their clients in a fiduciary capacity.

Certified Investment Management Analyst (CIMA): CIMA candidates must pass an initial 2 hour qualifying exam consisting of 50 multiple choice questions. After completing either an on-line self-study or classroom program candidates must pass a 4 hour, 100 question multiple choice exam. The exam has a cumulative pass rate of 86%. CIMA requires 40 hours of continuing education every two years.

In the News

- Ark Royal Wealth Management is pleased to welcome Lisa Shirley to the firm as our Client Service Consultant effective April 1. Many of you know Lisa from our having worked together for over a decade at another firm. Lisa has a passion for college basketball and live music, has seen Bruce Springsteen perform live 33 times and is a 13 year veteran of the financial services world. Lisa brings proven talent as someone who enjoys working with clients, with high follow through and attention to detail. She will be a tremendous resource to clients of the firm. Please join me in welcoming Lisa, who can be reached at lshirley@ark-wealth.com.

- Mike Palmer will be speaking to the Bulls & Bears investment club at Fearrington Village April 8. His presentation is titled "Understanding Risk." If you are interested in Mike speaking to your civic group or investment club please let us know.

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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