ARK ROYAL
WEALTH MANAGEMENT

Helping Successful People Make
Smart Decisions About Money

FALL 2017

STAR BRIGHT, STAR BLIGHT—REPRISE

In April 2002, I wrote a newsletter column for the bank where I worked titled "Star Bright, Star Blight." That article focused on how prevalent Morningstar ratings were in mutual fund advertisements and how dependent do-it-yourself investors were on Morningstar. As I wrote then:

> *"Despite Morningstar's acceptance, I believe the emphasis investors place on high Morningstar rankings is ill-advised, especially since few investors endeavor to explore beyond the rating itself. I have four key reasons why I believe investors are blinded by the star shine.*
>
> 1. *The star rankings are entirely backward looking*
> 2. *Few investors understand the Morningstar ranking formula*
> 3. *Evidence suggests attaining 5-star status attracts significant new money, which is usually detrimental for existing shareholders*
> 4. *Investment styles go in and out of favor, chasing 5-star performance is likely to result in inferior investment returns."*

In my 2002 article, I referenced several academic studies that indicated the star rankings had little or no predictive value. Over the last fifteen years, even more research has confirmed this. The most recent study was performed by the Wall Street Journal in an article published in late October (The Morningstar Mirage). The *WSJ* found that going back to 2003, of funds awarded the coveted five-star rating only 12% did well enough over the succeeding five-year period to maintain that ranking. About the same percentage (10%) performed so poorly they got the rock bottom one-star rating. In essence, relying on Morningstar to pick top performing funds has been no better than a coin flip.

Unfortunately, it isn't just do-it-yourselfers who suffer from chasing star ratings. Many financial advisors also rely on the star ratings for recommendations they make to clients. The Journal article quotes an Illinois pension board member whose Morgan Stanley advisors touted fund ratings as the reason for a fund's inclusion in the pension portfolio. "Our brokers thought it was one of the best measurements we had available to decide whether the fund is worth investing in," said board secretary Mary McDonald.

The Journal article quotes some current and former Morningstar employees who contend some advisors use the ratings as a crutch. "It's a cover-your-ass type of service," said Samuel Lee a former Morningstar strategist, "if something goes wrong the advisor can shunt the blame to Morningstar."

Morningstar, a public company with revenues of over $1 billion annually, receives millions of dollars in licensing fees from fund companies referencing the star ratings in their advertising. However, Morningstar CEO Kunal Kapoor claims the company operates independently from fund companies.

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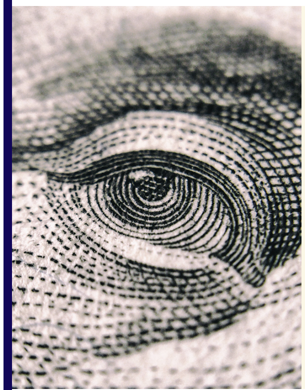
As the validity and predictive value of the Morningstar system comes into question, how might the company respond? Perhaps they'll take the advice of House of Cards character Frank Underwood—if you don't like how the table is set, turn over the table. By unveiling a "new and improved methodology" Morningstar can reset the time periods they are measured by, essentially playing for time.

What about my investment experience? I long ago decided to ignore Morningstar ratings both personally and professionally. In June 2002 I moved to another firm and soon initiated an overhaul of the firm's investment offering to an evidence-based investment strategy using Dimensional Fund Advisors. The result transformed the investment experience of clients and the firm went from one that perpetually operated in the red, to one that was solidly profitable.



KEEPING ONE EYE ON WASHINGTON

The last two months of the year promise to be more eventful than usual as Republicans work toward passage of a new tax bill. As of this writing few precise details are known, but it appears lower tax rates for many are likely.

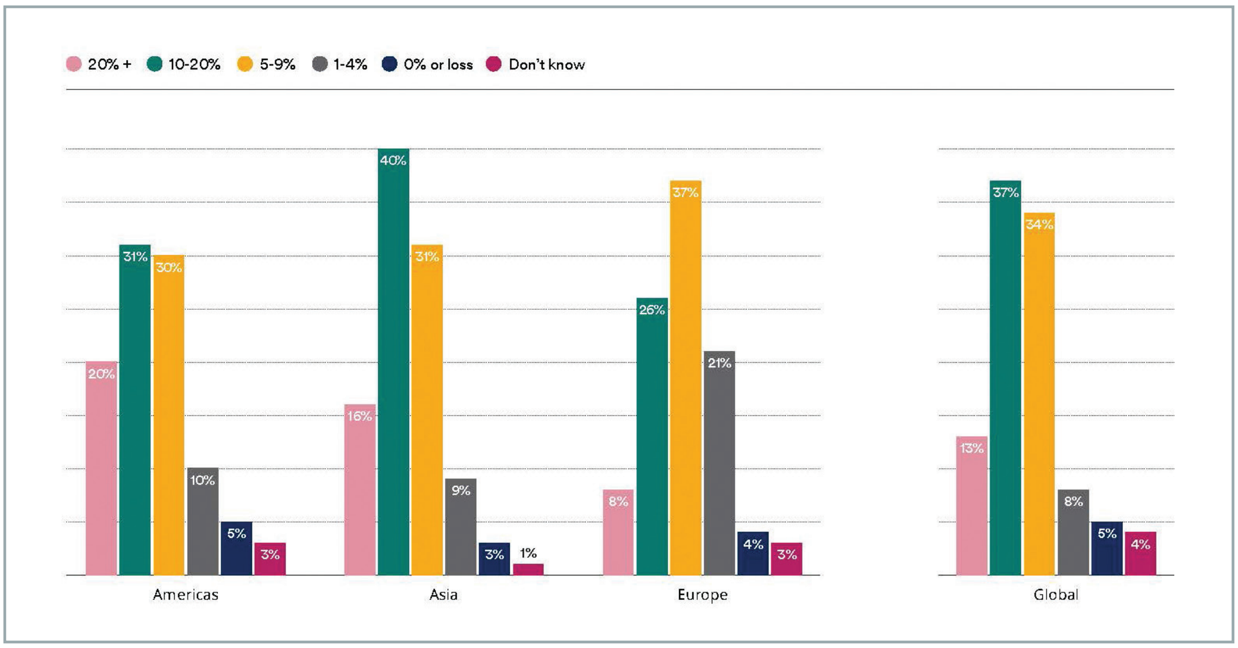
Should lower rates become a reality, it could provide some unique planning opportunities. For example, lower rates might make Roth IRA conversions particularly appealing. We will be monitoring the legislative developments and should circumstances warrant, be in touch with clients about strategies that might have application to them.

THE IMPORTANCE OF REASONABLE EXPECTATIONS

Schroders, a European investment bank, recently released their 2017 Global Investor Study. As with most surveys of this kind, there were some interesting findings. More than 22,000 respondents from 30 countries across the globe participated. Among the more interesting highlights were:

- **There is significant demand for investment education.** 88% feel the need to improve their investment knowledge.
- **China shows the most interest in investing.** Nearly 45% of Chinese respondents claimed an intention to invest their disposable income next year.
- **People have unrealistically high annual return expectations.** 13% expect at least a 20% annual return on their total investment portfolio. Given the strength of equity markets over the last seven years it seems highly unlikely a 20% return is in the offing in 2018.

AVERAGE ANNUAL RETURN EXPECTATIONS ON TOTAL INVESTMENT PORTFOLIO OVER NEXT FIVE YEARS



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ESTATE PLANNING DOCUMENTS EVERYONE NEEDS

A recent survey by *Caring.com* found that only 42% of U.S. adults currently have estate planning documents such as a will or living trust. For those with children under the age of 18, the figure is even lower, with just 36 percent having an end-of-life plan in place.

Interestingly, most couples believe if they die without a will, the surviving spouse inherits everything, but this is only true in 16 states. In North Carolina, if you leave behind a spouse and children, intestate succession laws divide the estate equally between them. In addition, if you become disabled and cannot make financial or health decisions, your family must petition the court to appoint someone to make those decisions; in an already potentially stressful family situation, this adds more burden and cost to the family.

Unless you want the government to decide how to distribute your assets or to appoint someone to make your important decisions if you become disabled, we recommend you have these basic documents:

LAST WILL AND TESTAMENT

This document disposes of your property after you die; it is a multi-functional document that determines who is entrusted to settle your estate (Executor/Personal Representative), names your beneficiaries and how to distribute your property (directly or in trust), names the guardians of minor children (if applicable), and names trustees if beneficiaries receive property over time through a trust.

DURABLE POWER OF ATTORNEY

This document allows someone to step into your shoes to make financial decisions—as basic as paying your bills to as complex as selling assets or making gifts. Because the document is durable, the power of attorney will continue in the event of your incapacity or inability to make personal decisions. The document can require that doctors deem you incompetent for it to become effective (called Springing), but that is not necessary.

HEALTHCARE DIRECTIVES

This document is similar to a Durable Power of Attorney but governs just healthcare decisions. You can select a health care agent to make health decisions for you. NC offers standardized forms that you can address to help your agent make decisions in line with your treatment preferences.

In addition, we recommend several other strategies to help your loved ones navigate this difficult event as painlessly as possible.

- We recommend using an attorney that specializes in estate work.
- Make sure your beneficiary designations (401-k, IRA, life insurance, etc.) align with your estate wishes.
- Let your loved ones know where your legal documents are kept.

Perhaps most importantly, especially for women who survive their husbands, make sure you are familiar with the family financial situation. Far too often, widows are left unprepared and uniformed about important financial matters.

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IN THE NEWS

Mike Palmer's *Kiplinger.com* column "Back-to-School, Consider a Roth IRA" appeared in September.

We are pleased to welcome our new intern, Blake Johnson. Blake is a sophomore at NC State majoring in business.

Lisa Shirley recently attended "Springsteen on Broadway." It was her **34th time seeing "the Boss"** in concert.

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