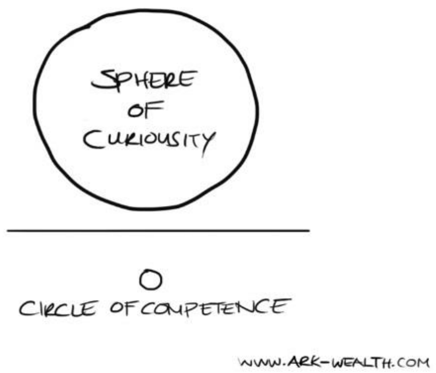
ARK ROYAL
WEALTH MANAGEMENT

THE ARK Winter 2016

## Curiosity v. Competence

I get lots of questions from folks about the variety and scope of my reading. I was fortunate to have parents that encouraged reading at an early age - a task certainly more challenging for parents in today's digital age!

That foundation created what I call my "sphere of curiosity." Lots of diverse things capture my interest, which causes reflection, which catapults a curiosity feedback loop. Experience has taught me there's a big difference between a sphere of curiosity and a circle of competence. As I've aged, my former has gotten bigger and my latter has gotten smaller!




In over two decades of working as an advisor, I've observed that successful people (and the best clients) possess a keen self-awareness of the limits of their capabilities. Too often people err in believing one's circle of competence is largely a product of intelligence, rather than experience.

I was reminded of this in a humorous way during the college football bowl season. Allstate aired television ads featuring "Mr. Mayhem" recreating do-it-yourself home disasters perpetrated by actual policy holders. Mr. Mayhem, is shown with a chain saw in hand and says "I watched two minutes of a nine minute tutorial, then rented the biggest chain saw I could find." The commercial ends with the tree he's cutting down plowing into his home!

In the investing / personal finance realm, I've seen the same DIY disasters afflict folks who substitute Money magazine recommendations or CNBC ideas for the guidance of a professional advisor. Unfortunately, the feedback isn't as immediate as in the Allstate commercial, but can be every bit as damaging. It's easy in today's "news everywhere world" to mistake news for actionable intelligence.

Warren Buffett frequently talks about the circle of competence concept. He's opined many times about his willingness to forgo investment opportunities due to his self-described limited circle of competence. As Buffett observes, most people's (including professional money managers) problem is in admitting what they don't know.

Few things are as important as one's financial security. As a financial advisor, the "art" of my craft is educating clients while making sure they don't operate outside their circle of competence. When it comes to personal finance and investing, self-awareness just might be your most important attribute.

## A Manifesto for the Successful Client

Nick Murray is a retired financial advisor who now writes an investment newsletter for advisors. In his November newsletter Murray penned a column with the heading "They Think / But We Know." I believe it serves as an excellent "owner's manual" for prospective clients. These basic ideas put in proper context just what it is a great financial advisor does for those he / she serves. With a tip of the hat to Nick Murray, I've taken his list of dualities and expanded on them a bit.

- Prospective clients often seek an investment advisor primarily for a portfolio. Ark Royal Wealth Management (ARWM) knows a portfolio without a financial plan is a rudderless ship.
- Prospective clients think investment success is governed by market outlook. ARWM knows investor behavior and adhering to an investment philosophy is far more critical.
- Prospective clients often think headlines move markets. But ARWM knows the difference between news and information.
- Prospective clients often think this time is different. But ARWM knows this too shall pass.
- Prospective clients may be distrustful of Wall Street and view it as nothing more than Las Vegas on steroids. But ARWM knows that our $18 trillion economy is deep, diversified, innovative and the envy of the world.
- Prospective clients often think a financial advisor should be judged by "outperformance." ARWM knows our job is to keep them from making the mistakes that may impair their family's economic security.
- Prospective clients often measure "risk" by the potential for market decline and mistakenly equate that with "loss." ARWM knows declines are inevitable, temporary and impossible to time. We believe that the equity premium accretes to the few investors with the discipline to stand firm when others are losing their conviction.
- Prospective clients often view stocks as ticker symbols that dart from green to red like hummingbirds. ARWM knows stocks are businesses managed by very smart people in pursuit of rational business objectives and subject to transparent and objective financial standards such as earnings, dividends, and cash flows.
- Prospective clients often long for the good old days. But ARWM knows that progress is unrelenting and never have so many of the planet's inhabitants lived safely, securely and with political and economic freedom. We believe, as John F. Kennedy observed, that no problem of human destiny is beyond human capacity to solve.



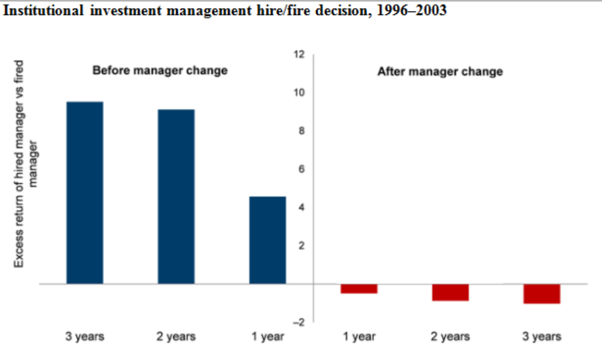
Quote of the Quarter – "Real knowledge is to know the extent of one's ignorance." - Confucius

## The Fired Beat the Hired - Is the “Smart Money” Really That Smart?

One of the benefits of having over two decades of investment experience is valuable perspective on what leads to a successful investment experience. Without question the biggest trap many investors fall victim to, even perceived “sophisticated” institutional investors, is one of placing too much emphasis on past performance. Whether hedge funds or mutual funds, time and again I’ve seen investment selections made predominantly on the basis of a noteworthy 3, 5, or 10 yr. track record.

And nearly as often I’ve seen the investor flummoxed and frustrated two or three years later when the fund with the great performance history fails to reproduce stellar results. And it’s not just my personal observation; this pattern was documented in academic research by researchers Amit Goyal and Sunil Wahal (see chart below) who observed similar results when looking at defined benefit plans.

**Institutional investment management hire/fire decision, 1996–2003**




Source: “The Selection and Termination of Investment Management Firms by Plan Sponsors,” Amit Goyal, Sunil Wahal (*The Journal of Finance*, Volume 63, Issue 4, printed August 2008). Data: 8,775 hiring decisions by 3,417 plan sponsors delegating $627 billion in assets; 869 firing decisions by 482 plan sponsors withdrawing $105 billion in assets. Analysis covers the period 1996 through 2003.

Presumably these pension plans, many representing Fortune 500 companies, employed experienced financial consultants to advise them on the management of their funds.

And yet the research shows even in cases where professional consultants plied their expertise, the newly hired manager underperformed the fired manager by 1-2% per year.

So why do intelligent, experienced professionals fall victim to this phenomena?

There are many factors that cause the performance chase to abound.
When you oversee large sums of money — like a pension, endowment, foundation or family office — there’s never a shortage of funds looking to pitch you. New investment opportunities are seemingly endless. There’s always a new shiny object to draw your attention. The temptation is always there to make changes to your portfolio

Secondly, we love a great story. We also want to believe that intelligence and hard work get rewarded in investing, just as they do in other facets of life. When you combine these you get what most successful money managers excel at - crafting an interesting and compelling narrative of their stock selection prowess, combined with an impressive resume.

Finally, investment officers and consultants have to justify the fees they’re being paid. Doing nothing, even when it’s the right thing to do, isn’t easy when others expect to see short-term results. It may be counterintuitive, but activity doesn’t always equate to achievement. For years, I’ve counseled endowment and foundation boards to have their investment managers provide prospective performance of not just the fund managers they currently employ, but also the fund manager that they replaced. Rarely does this concept get implemented, probably to the great relief of the consultants whose “value minus” would likely be exposed.

## In the News

- Ark Royal Managing Principal Mike Palmer appeared on WRAL-TV5 in early January discussing the market reaction to events in China.

- Mike Palmer will be teaching “Roadmap to Retirement” workshops during the year. See our website for details on times and locations.


## 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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