ARK ROYAL
WEALTH MANAGEMENT

Helping Successful People Make Smart Decisions About Money

SUMMER 2021

REFLECTIONS ON THIRTY YEARS OF ADVISING CLIENTS

Monday August 5, 1991 wasn't notable in any way. George Bush (the elder) was President, six weeks earlier Michael Jordan and the Chicago Bulls had won their first NBA title, and the S&P 500 closed at 385. That's also the day I began my financial advisory career at First Union National Bank. At the time, I had no idea how fulfilling, interesting and rewarding this profession would be. I've formed lifelong friendships with both clients and fellow professionals. And I'd like to think I've spent three decades helping make an impactful difference in the lives of the clients I've served.

I was incredibly lucky to have several people who had a significant influence on my career. John Clougherty is a friend and mentor. John introduced me to someone in Wachovia's trust department at a time when I was unsure of what career path to take. That introduction helped connect me to that first job in the First Union trust department.

Wayne Jordan was my first boss at First Union. Wayne hired me and exhibited tremendous patience as I learned the basics. He was generous with his time and helped me learn the fundamentals of relationship management.

I met Linda Patchett in the late 1990s. I'd only vaguely known of the RIA world when I met Linda; she opened my eyes to a different world of financial advice. Linda nudged me to explore how I might practice as a fee-only financial planner and introduced me to the NAPFA planning community, a group that continues to make me better at my craft every day. Linda also supported my formation of Ark Royal Wealth Management, insisting my success as a business owner was a forgone conclusion when I was unsure of it myself.

I'm grateful to John, Wayne and Linda (and many others along my trek) for their guidance and support. Like Warren Buffett, I get to tap dance to work every day. Two of my children are now CFPs in their own right, and it's incredibly enriching to watch their career development and success.

I'm grateful for the opportunity to serve the best clients anyone could ask for. People who value trusted advice and are appreciative of our work on their behalf. We have the privilege of working with people who are both interested in us, and who are also very interesting. I'm excited about the decade ahead, continuing to help clients achieve financial success and independence.

"I'm grateful for the opportunity to serve the best clients anyone could ask for. People who value trusted advice and are appreciative of our work on their behalf."

Mike with Linda Patchett—Summer, 2021

WHAT ARE STRUCTURED PRODUCTS AND SHOULD I CONSIDER THEM FOR INVESTMENT?

As a financial advisor, I'm inundated with pitches from purveyors of investment products. Over the last few months I've seen a flurry of emails from "structured product" or "buffered portfolio" providers. They tout guaranteed income payments and / or a promise that you won't lose money—in short, offering only the upside potential of the markets. These features dazzle unsuspecting investors. **Our advice—if something sounds too good to be true…**

Let's examine structured products and dig deeper on whether these products have merit. Structured products are a type of derivative investment (using that term takes a bit of the shine off doesn't it?) in that their value is derived from a combination of other investments.

Some asset managers focus on manufacturing investment products that they can easily sell, instead of whether the solution addresses an investor need. The allure of getting upside with limited or no downside certainly sounds appealing on its face, and thus probably easily sold.

Let's look under the hood at how a hypothetical structured product we'll call Buffered Index Fund of America (BIFA) gets constructed, assuming we have $100,000 to invest.

BIFA starts with a zero-coupon bond. A zero-coupon bond does not pay periodic interest (unlike normal bonds which pay every 6 months). All the "income" from the bond is instead paid at maturity. "Zeros" are sold at a discount from face value.

If BIFA purchased a 5-year zero coupon bond with a 3% effective rate and a $100,000 face value, the cost of the bond would be $86,000 with a guarantee of receiving $100,000 in 5 years.

Next the BIFA buys a S&P 500 call option. A call option is the right (but not the requirement) to buy the S&P 500 at a specific price, let's say at 4450. If the S&P 500 is higher than 4450 we make a profit; if it goes lower we let the call option expire and lose only the cost of the option. The call option allows BIFA to profit if the market goes up. Buying call options might cost the management firm running BIFA $10,000, leaving $4,000 profit for the asset manager. This profit doesn't flow through to the end investor. You might think $4,000 isn't much, but it equals 4% of the investment, which we view as excessive.

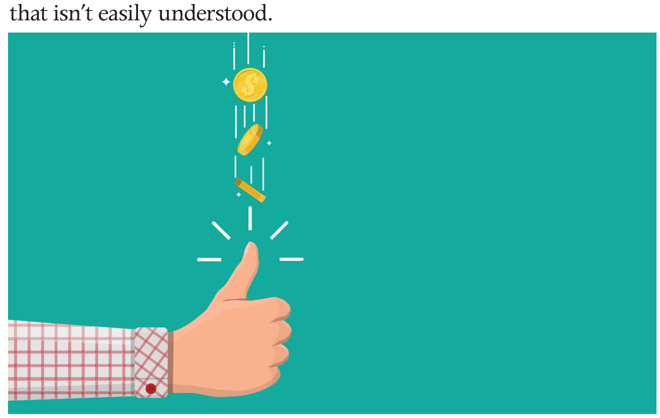
BIFA can also make money for the asset manager (not the client) in two other ways. Depending on market returns, caps and the cost of the options, the asset manager can make money on the performance of the market. Here's how: These products generally have a cap on the S&P 500 upside participation. What does this mean exactly? A solicitation I received in January 2020 for a one-year structured product had a cap of 13% (before the fee of .79%) with downside protection absorbing loss of 9%. The S&P 500 returned 17.25% for that period. Chances are the firm offering this product used an option strategy that enabled them to keep as profit some of the 4.25% excess return over the cap!

And what about the downside? If in fact the S&P 500 had lost 10%, investors would have lost only 1% (remember there was 9% downside protection). That means the asset manager lost that 1% right? Wrong! By matching a zero-coupon bond maturity with the end of the outcome period of the structured product, the firm had no downside exposure and actually ended up making an extra $1,000 on my $100,000 investment. My loss, was their gain!

Sounds like a game of coin flip with the asset manager calling "heads I win, tails you lose."

There are all sorts of variations on structured products using myriad indices, caps and buffers. But they all share one important element—the complexity of the product is largely hidden from the average investor.

We believe there are far better solutions available to investors that give them a better chance of a successful investment experience and would advise consumers to steer clear of any investment offering that isn't easily understood.



THREE SIMPLE WORDS

Inevitably, when I first meet someone casually or socially and the conversation turns to what I do for a living, the next question is some variation of "where's the market headed?"

I suppose the [Merrill Lynch] and [Smith Barney] ads conditioned folks that keen insight was required to be successful in the investment markets. {*Editorial note: apparently neither firm was very good at managing their own capital as both were acquired during the financial crisis of 2008–09; Merrill Lynch by Bank of America and Smith Barney (which was owned by Citigroup) by Morgan Stanley.*}

I suspect brokers who can tell a great story about making a killing in Dumbledore Inc. are far better at landing new clients than I am. The fact of the matter is I don't have the foggiest idea what the market will do in the near term, nor do I know which stocks are likely to be the star performers in the coming months. "I don't know," is a simple, truthful but hardly engaging response for dinner party conversation.

The good news is not knowing doesn't prevent me from having a successful investment experience. By aligning my portfolio with the market (think S&P 500 index), I'm making a bet on capitalism, rather than a handful of stocks. While the future is unknowable, I believe markets will likely behave more or less like they have for the last 100 years.

SHOW ME THE (CASH) MONEY

One of actor Tom Cruise's most famous roles was as a sports agent Jerry Maguire.

When we initially start working with clients, I often think of the [memorable scene] when Cruise is trying to secure football star Rod Tidwell (played by Cuba Gooding, Jr.). Rod wants Jerry to show him how committed he is and implores him to "show me the money."

A key part of our financial planning is to understand our clients' cash flow and—especially in retirement—plan future cash flows strategically and efficiently. While the specificity of our clients' budgets run the gamut, all are intuitively saving more than they spend. We can help bring clarity to the cash flow process (progress, not perfection) and it all starts with "showing us the money."

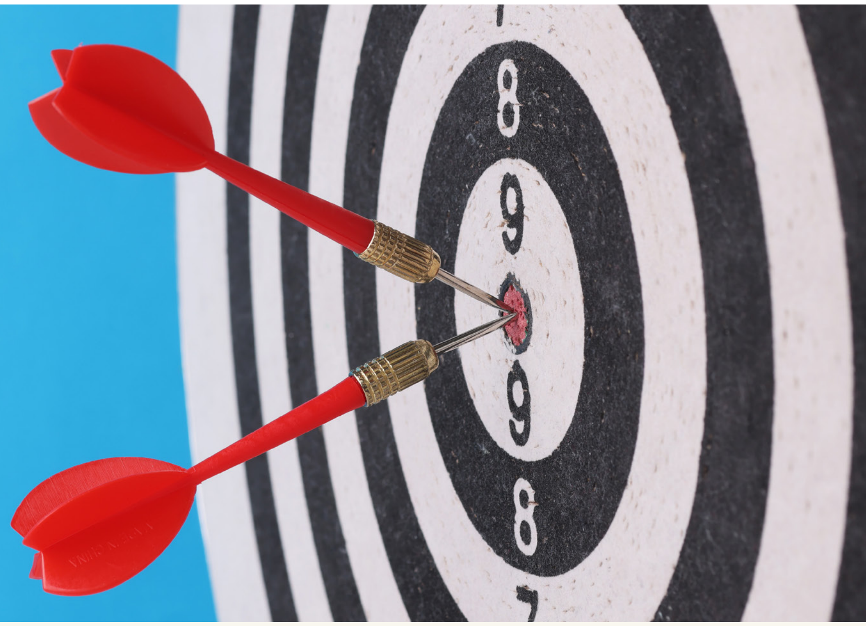
> We can help bring clarity to the cash flow process (progress, not perfection) and it all starts with "showing us the money."

BEHIND THE SCENES

Zachary Palmer recently passed the Certified Financial Planner exam. Zach is a Financial Planning Associate with Modera Wealth Management in Charlotte, NC. Congratulations Zach!

We are pleased to welcome **Nick Ross** as our new intern. Nick is an Apex native and junior in the Poole School of Management at NC State. Please join us in welcoming Nick to Ark Royal.

> *"Show me the incentive and I will show you the outcome."*
>
> CHARLIE MUNGER



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