REAL WORLD INVESTMENT IDEAS FOR REAL PEOPLE

6 FAILED BELIEFS THAT ARE DAMAGING YOUR FINANCIAL WELL-BEING, AND WHAT TO DO ABOUT IT

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AN ARTIFEX FINANCIAL GROUP WHITE PAPER

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About the Author

I am a founding partner of Artifex Financial Group, a fee-only financial planning and investment management firm based in Dayton, Ohio. Artifex Financial Group was established in 2006 and helps middle class and affluent clients establish sound financial plans and manage their money in a manner consistent with their goals and dreams. When my business partner, Darren Harp, and I started to plan for this business, I had spent 15 years in the financial services field, Darren had 8 years of experience, and we were both fed up with the current state of the industry. We had both seen our share of fiduciary conflicts, investment mismanagement, and just poor advice coming from some of the most respected firms in the business. We pledged then and there to provide the following service to our clients:

- Our firm would be established to primarily care for the middle class and affluent client. Since Dayton, Ohio is where we started, we figured that the largest segment of the underserved market is in this demographic and that have historically received the worst advice from our competitors. Our clientele is either under the age of 40 and focused on growing their wealth, or over the age of 60 and concerned about planning for retirement. We have no investment minimums, and normally provide total wealth management services for a reasonable flat fee. That said, the average net worth of our clients is between $500,000 and $2,000,000.

- We would no longer hold licenses to sell any products, and would adopt the National Association of Personal Financial Advisors pledge to be Fee-Only and fiduciaries for our clients. This has proven to be the right strategy for us, and one I wish I had adopted 20 years ago. Not only do we sleep better at night, knowing that we do not have any conflicts of interest and that our decisions are always in the client's best interest, but I believe that independence and objectivity result in better results for our clients.

- We would have a skeptical view of any product provider, service provider, financial salesperson, Wall Street firm, mutual fund family, insurance provider, etc. who want access to our clients' money. We are gatekeepers for our clients. We know the dark corners and dirty secrets of the profession, and will use our knowledge to our clients advantage.

- As much as we love the business, we will treat it as a business, as we need to perpetuate our advice for generations to come. Furthermore, our advice and experience has real value for people, and we should never be afraid to be paid appropriately for it.

We are pleased with the results thus far. We've grown to serve 250 clients, over 600 accounts, over $100,000,000 in assets managed, 3 office locations and now employ 4 individuals who share the same vision we have.

Why am I writing this?

As much as we knew when we began, we've learned more since starting our firm and actually doing business the right way. From an observer's and a practitioner's standpoint, I feel that the things I will share with you in this white paper are essential to know. I've seen these concepts work, and we preach them every day here at Artifex Financial Group. Additionally, I wanted to have something to provide to current and prospective clients to give them a little feel for our perspective and why we're different.

Belief #1 - Mutual Funds are Investing

Technically speaking, yes, mutual funds are investing. And if they are the only thing available in your company 401 (k) or retirement plan, you'll have to do the best you can with them (a caveat here, have the plan options reviewed by a competent fiduciary advisor, using a screening tool, such as the fi360 database). However, mutual funds are only decisions to let an investment manager do the investing for you.

In reality, mutual funds are NOT:

- Investments
- Asset classes
- Stocks
- Bonds
- Fixed baskets of stocks or bonds (normally)
- Predictable, reliable, easy to forecast, or easy to analyze.

What are they then?

- Shares of a pool of investments, subject to change at any time
- A decision on the investor's part to hire someone else to manage their money in a particular way (domestic or foreign stocks, large, small, mid, value, growth, bonds, real estate, etc.)
- Subject to "style-drift", subject to over-concentration, and subject to size impairment issues (where the fund basically ends up looking like an index).
- They can be expensive, depending on the share class you purchase (some fund families have 6 or 7 different share classes, with different expense ratios, etc.).
- They can serve the purpose of giving you exposure to a broad asset class, but be careful that this is really what you want.

We do use mutual funds in our practice, but they tend to be focused, institutional-level, no-load, low expense and demonstrate a long and consistent track record. We also prefer lower turnover (less trading) funds that tend to buy and hold their investments (with a possible exception for bond and specialty funds, where a more active style may make more sense).

One of the tools that we use is the Fiduciary Analytics database, which grades mutual funds and their fund families according to 11 criteria that generally indicate that a fund or fund family meet certain standards prior to our consideration.

According to fi360.com, here are the top 10 fund families ranked by % of scored funds in the top quartile of their peer group as of March 31, 2017:

RANK (OUT OF 248)	FUND FAMILY	% OF SCORED FUNDS IN TOP QUARTILE OF PEER GROUP
1	Boston Partners	91.67%
2	Schwab ETF's	85.71%
3	Flexshares Trust	73.33%
4	TIAA-CREF Asset Management	72.62%
5	Harding Loevner	66.67%
6	Dodge & Cox	66.67%
7	Value Line	64.29%
8	Dimensional Fund Advisors	63.33%
9	Commerce	62.50%
10	Vanguard	61.10%

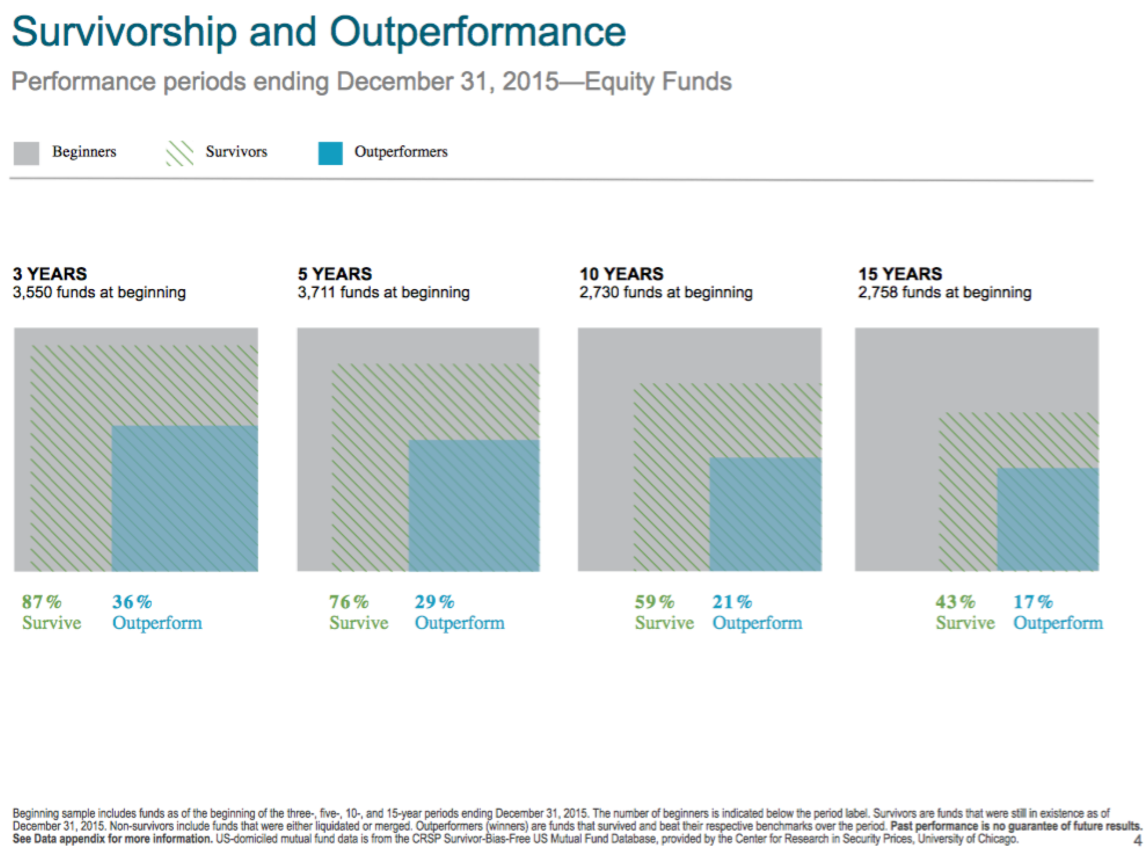
Some observations:

1. How many fund families on this list did you recognize? My guess is that most people recognized 2 or maybe 3 on this list. Why do you suppose that is? Most of these are no-load funds and as such, are not pushed by many brokers or commission-focused investment firms.

2. As lower-expense funds, their parent firms do not tend to advertise much (except for maybe Schwab & Vanguard).

3. Much of the time, the best mutual funds are the ones most investors are least familiar with, or totally unaware of.

4. As you can see from the chart on page 5 entitled "Survivorship and Outperformance", only 21% of equity mutual funds outperform their benchmark after 10 years, and only 60% survive that timeframe.



Source: Dimensional Fund Advisors

Our goal is to differentiate luck from skill, and build client portfolios that are largely immune from hard-to-predict factors such as streaks, trends, and "black box" methodologies. We prefer scientifically-based, low cost funds that depend on a process, rather than a star manager.

In conclusion, use mutual funds where it makes sense, but maintain a skeptical eye toward them and consider consulting with a fiduciary fee-only advisor to give you guidance and keep watch on your portfolio. As soon as a fund changes managers, or experiences style drift, it's time to reevaluate it. If we see a fund fall too far in it's fiduciary score, we take a hard look at it. There are always PLENTY of choices if you are going to buy mutual funds.

Belief #2 - Stocks are risky

OK, sometimes certain stocks ARE risky. Their prices get ahead of them, or their earnings fall short, they enter a period of mismanagement, they lose their market position to competitors, etc. But to say that "stocks are risky" is shortsighted and based more on fiction than fact. If you are looking for growth in your pot of money, you better consider the value that OWNING offers you as an investor. It's fundamentally a question of OWNING versus LOANING.

Stock shares represent an ownership interest in a going concern. Bonds, on the other hand are nothing more than loans to companies, governments, and institutions. Whereas the growth in a stock portfolio stems from the business operations of a company and how successful they are in the marketplace, the value of a bond is reliant on the cash flow of the issuer (ability to pay), the interest rate represented by the coupon, and market interest rates. Not only that, but pricing bonds and buying them at a fair price is a whole lot more complicated than buying a stock or an exchange-traded fund (ETF).

Don't get me wrong, we buy a lot of bonds. Bonds of all types. U.S. Treasury bonds are still one of the safest investments you can buy and one of the things that really saved our clients portfolios during the last significant market correction in 2008.

But there are times (maybe now) when bonds may be more of a risky asset than stocks. Long term maturity bonds almost always are, since their values are particularly sensitive to interest rate changes in the economy. It's all a matter of evaluating what economic environment you are in at the moment. RELATIVE RISK is the key here. Be flexible in your thinking, don't adhere to strict guidelines on asset allocation and historical measures.

Additionally, individual baskets of stocks, properly diversified, are NOT riskier than mutual funds or indexes.

Look at this chart:

This is an actual chart of our Large Cap Core stock portfolio, which we use for client accounts, from 10/27/2008 through 5/12/2017 You can learn more about this model at [Artifex Folios](). Notice that this managed basket of stocks (33 holdings as of this date), experienced less of the downside volatility of the S&P 500 Index, and has generally outperformed it annually since inception . This is not rocket science. We just bought quality names and diversified across industries. Companies like Procter & Gamble (PG), General Electric (GE), Costco (COST), Mc Donalds (MCD), IBM, and Johnson & Johnson (JNJ). We prefer dividend paying companies who are growing their earnings in this model and we don't trade very often.

An added advantage to the way we set this up, is that we can buy this model for very large or very small accounts cost-effectively. We utilize the latest technology available to investment advisors today to offer something unique to our clients. It relieves us of having to rely too heavily on mutual funds.

I'll repeat, stocks are not more risky than mutual funds, and they are only relatively riskier than bonds. Yes, they fluctuate more, but if you need growth in your portfolio, there's no substitute over the long run.

Belief #3 - Bonds are safe

Bonds ARE safer if they are investment-grade, issued by high-quality corporations or governments, and are insured (in the case of municipal bonds). The safest are those issued and backed by the U.S. government.

The problem is that bonds:

1. Are incredibly hard to price when you try to sell them or buy them, as you enter the "black box" of the bond desk and myriad traders who are trying to skin you alive.
2. Are opaque in terms of analyzing them. They require as much research as most stocks or mutual funds.
3. Are subject to interest rate and economic risk. Particularly worrisome now is the fact that bond interest rates have fallen consistently over the last 30 years and are now at their lowest levels in a generation. There's nowhere to go but up on interest rates. And guess what happens to the prices of existing bonds, that is, the ones in your portfolio? Prices of existing bonds go down, sometimes significantly, when interest rates rise.
4. Do default occasionally - they aren't a sure bet (unless backed by the US Treasury).

Bonds are useful for income, and to reduce the volatility in a portfolio. We typically buy bonds with less than 10 year maturities to limit the interest rate risk. We also will use bonds in a laddered, "asset dedication"strategy where we match the maturity price of a bond with a client's future budgetary need. So we know that as long as the issuer remains solvent, the client will receive the face value at maturity.

Remember that bonds are loans. You are loaning money to the issuer, and they are paying you interest on that loan. You don't own anything, although you do receive preferential treatment in most cases if the issuer becomes insolvent. Unless interest rates are declining, or their is a "flight to safety", bond portfolios don't typically grow at nearly the same rate as a stock portfolio. Inflation-adjusted, they may not grow at all.

10 Year Treasury Rate - 54 Year Historical Chart

As of May 8, 2017

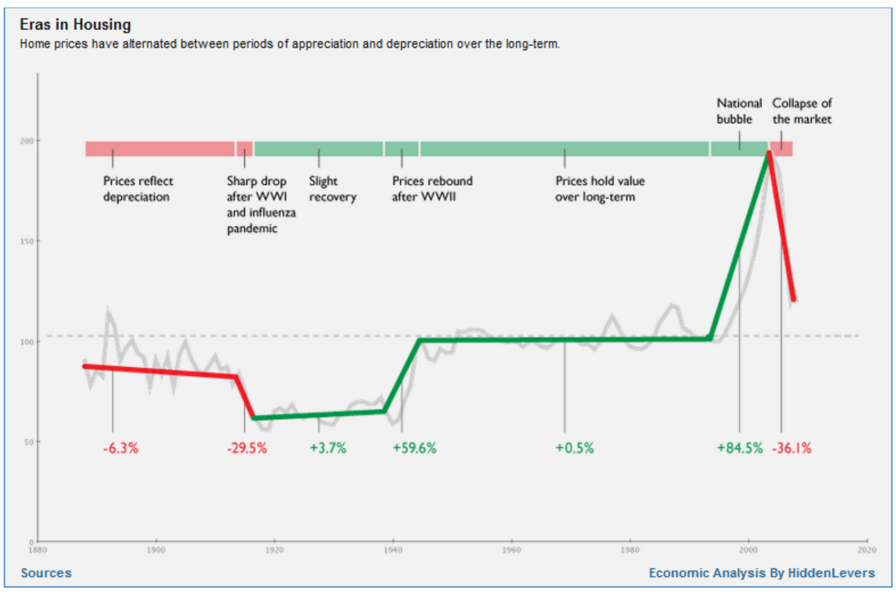
Source: macrotrends.net

http://www.macrotrends.net/2016/10-year-treasury-bond-rate-yield-chart

The chart above shows that bond yields are at their lowest in over 50 years. For people that invested in bonds at any time from around 1983 until today, their portfolios have held steady or increased in value significantly. The next direction for bond yields is UP. It's entirely possible that we are entering a period where more active management of bond portfolios is necessary, and that they may not look so safe when their prices are falling.

Belief #4 - Homes are a good investment

Here's a harsh reality. Homes are not a good investment. Maybe that's not so hard to believe after the 2008 financial crisis, when many of us watched our home values take an alarming turn for the worse, and our equity in those homes decline along with it. But for us children of the 50's and 60's, we were raised to believe that the family home is perhaps the best investment you can make. During the 1990's and part of the 00's, home values rocketed to the moon. Of course Wall Street and the banks couldn't help but fuel this mania, inventing new products and financial tools to enable this folly. Now the residential housing market is trying to find it's way back to the mean average...and having a heck of a time doing it. The following chart was provided by Hidden Levers, an econometric forecasting think tank and software provider in New York:



What it shows is that the long term, inflation-adjusted increase in residential housing values is practically flat. Yes FLAT. For those who had an opportunity to enjoy the fabulous run in the 90's, you should realize that that was an anomaly. A house is a place to live. At the present time, it may make more sense financially to rent than to buy, but the considerations when buying/owning a home should be:

1. All-in (property tax, insurance, financing costs, etc.), is it cheaper for a similar property than renting?

2. Am I going to be in the property for at least 5 years?

3. Since equity in a home tends to deliver substandard returns, can I finance at least 70-80% of the home's value?

Understand that my comments are applicable to home ownership as an investment. Income-producing real estate is another matter. REIT's and directly-owned investment properties MAY be good investments, depending on the situation. Statistics show that income properties are generally good diversifiers and growth investments.

For example, the FTSE NAREIT ALL REIT Index reports the following returns for the last 9 years (through year-end 2016):

YEAR	NAREIT ALL REIT INDEX	S&P 500 INDEX	NASDAQ COMPOSITE
2008	-37.34%	-37%	-40.54%
2009	27.45%	26.46%	43.89%
2010	27.58%	15.06%	16.81%
2011	7.28%	2.11%	-1.8%
2012	9.59%	12.3%	18%
2013	3.21%	32.39%	40.12%
2014	27.15%	13.69%	14.75%
2015	2.29%	1.38%	6.96%
2016	9.28%	11.96%	8.87%
Average	**8.50%**	**8.71%**	**11.90%**

So, commercial and income-producing real estate can offer diversification benefits in an investment portfolio. Expect your home to act like a bond, however. In the best case.

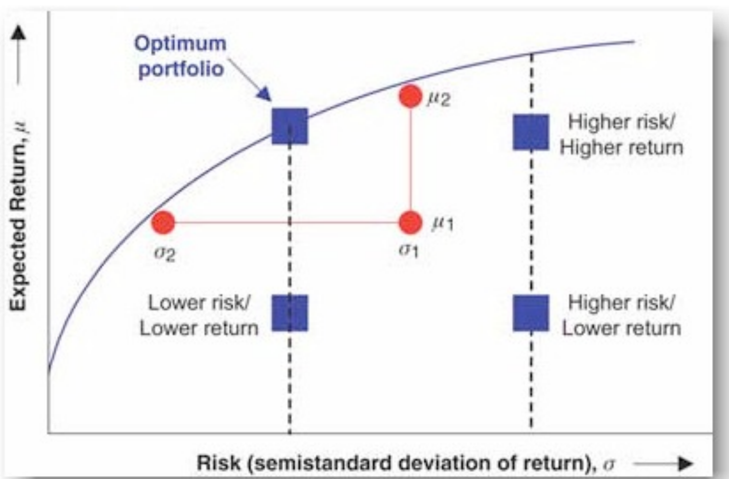
Belief #5 - Modern Portfolio Theory is my salvation

Well, you'd almost think so, based on how enthusiastically Wall Street and every other large institution has embraced this concept. The theory itself makes sense. Unfortunately it became co-opted into "mean-variance optimization" software programs and turned into a sales tool to gather assets for brokers and other folks who largely make their living from selling things.

At some point in your investing life, you've probably been given a "risk tolerance questionnaire" and then provided with a slick, confidence-building presentation with neat pie charts and "efficient frontier" graphs showing you how this very refined, detailed asset class investing strategy was going to help you have a portfolio that rode out the drops and clung to the advances a lot better than you could possibly do by not moving your money to the person who showed you the report. Am I right?

Diversification makes sense. But over-diversification for the sake of taking advantage of historically-observed correlation benefits is nonsense. These reports and presentations provide a degree of confidence that is not borne out in reality. As I said before, the only thing that cushioned the dramatic decline in 2008 was bond allocations. All asset classes of stocks fell in tandem, including international.

Who Doesn't want a piece of that Optimum Portfolio?



Yes, we all want the "Optimum" portfolio. Just remember, investing is as much an art as it is a science. Be very wary of anything that presents itself as fail-safe or based too much on backtesting and "science". For a good dose of reality, read Nassim Nicholas Taleb's book "The Black Swan" about the limits of predictive statistics.

Belief #6 - My broker, insurance agent, banker, etc. is a financial planner

The belief that everyone who calls themselves a financial planner actually **is** one is perhaps the most dangerous belief an investor can have. Assuming you've made the decision to hire someone to assist you with financial matters, whether it's a comprehensive plan, a retirement income plan, investment analysis or management, tax planning, insurance planning, etc., you better be sure you've hired a **real** financial planner.

Even credentials can be misleading. Many CFP certificants who hold securities licenses or who are employed by a broker-dealer (think Merrill Lynch, Morgan Stanley, UBS, LPL, Raymond James, Edward Jones, etc.) are not client fiduciaries, and cannot be, due to FINRA and industry regulations that only require their recommendations to be "suitable" and not "client-first" or fiduciary in nature.

Unfortunately, there is no restriction on someone calling themselves a financial planner. so what should you do?

Here are my recommendations:

1. They must be competent. 10 years of experience is a must. 10 years of their own experience. Not as part of a team.

2. They must at least be a practicing Certified Financial Planner certificant, although a CPA, PFS, or EA could be acceptable, depending on your particular needs (tax, investment, etc.). However, don't be impressed with the "alphabet soup" of credentials. Many of them in the financial services / brokerage industry mean nothing. Absolutely nothing. The most important criteria is experience and knowledge, and the ability of the person to DELIVER.

3. They should be a member of the National Association of Personal Financial Advisors, NAPFA, as NAPFA is the only credentialing organization that requires their members to be fee-only, and pledge to be a client fiduciary. The also are the only organization that requires that their members be RIA's (Registered Investment Advisors) and to not hold licenses to sell products. A member must also submit a financial plan for peer review to prove that they can actually perform financial planning.

4. Their fees should be transparent. A Fee-Only advisor will make sure this is the case. There will be no hidden fees or a cost structure you are not aware of. At the risk of repeating myself, compensation and a "Client-First" Fiduciary guarantee are critical here. Compensation models lead to conflicts. For a humorous and insightful look at the minefield of traditional financial services providers, watch this clip from Last Week Tonight with John Oliver:

Danger signs to watch out for:

The following are a little tongue-in-cheek, but after years of living in and observing the financial services profession, I've come to realize that it is mostly a sales business and one built on appearances and manipulation. As such, if your broker or advisor exhibits any of the following characteristics, <u>beware:</u>

1. His or her house cost more to build than your child's school.

2. His car is worth more than your house.

3. His watch is worth more than your car.

4. His suit is a custom-tailored Italian job complete with $500 cufflinks and $1000 shoes.

5. His office is replete with awards and certificates on the wall, and possibly even pictures with famous people or politicians (believe me, these are mainly "bought and paid for" and designed to encourage your confidence).

6. He or she is a name-dropper

7. He or she may engage in a lot of "client appreciation" events and "seminars" (i.e. sales presentations). Some of these may even be sponsored by a University or held on the campus of a college to provide additional "credibility"

8. Their offices may be full of walnut and marble, beautiful art, and have a general "air of success". Not that this one is a deal-breaker, but just be aware that sometimes this is nothing more than "stage scenery".

Some of the best advisors I know dress professionally, but comfortably, have offices that are clean and professional, but not overwhelmingly so, and keep the "wall of fame" to a minimum. They also drive older cars, or pretty average, non-showy cars, and live in homes they can actually afford. For additional perspective on this point, read "The Millionaire Next Door" by Thomas J. Stanley. It's actually a good primer on the mental attitude many millionaires exhibit as they tend not to care to much about "the show" and what other people think.

In Conclusion

Just like sound financial planning, this paper really doesn't have a conclusion. It's intended to be thought-provoking, and hopefully behavior-changing. If you see the merit to the various ideas presented here, do yourself a favor and contact a Fee-Only Fiduciary advisor to help you with your financial planning and investments. Since I'm the one who wrote this, and my purpose is to not only impart some wisdom to you, but to encourage you to use the services of Artifex Financial Group, I hope you contact me, or someone at my firm. If you would like to contact someone else, that' fine too, but please go to www.napfa.org for an advisor referral.

Best wishes for a successful financial future!

Recommended resources:

Periodicals and reference materials:

Smart Money Magazine

Kiplinger’s Personal Finance Magazine

Money Magazine

The Financial Times - Great for a worldwide economic perspective

Barron’s

Value Line Research - Available at most public libraries - useful for stock research

Hidden Levers, **www.hiddenlevers.com** - econometric modeling

Dimensional Fund Advisors **- http://us.dimensional.com/individuals**

Books to get started (in order of priority):

Why Smart People Do Stupid Things With Money, Bert Whitehead

Everyone Believes it, Most Will Be Wrong, Morgan Housel (Amazon.com e-book only)

The Black Swan, Nassim Nicholas Taleb

The Millionare Next Door, Thomas J. Stanley

Value Investing, Martin J. Whitman

The Number, Lee Eisenberg -(for retirement planning)

Security Analysis, Graham and Dodd

Mr. Market Miscalculates, James Grant

Asset Dedication, Stephen J. Huxley and J. Brent Burns