Scholar Financial, LLC

Frequently Asked Questions

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Welcome to Scholar Financial, LLC

As the owner of Scholar Financial, LLC, I wish to welcome you to our firm.

These “Frequently Asked Questions” are designed to provide you with important information regarding our services and your investment accounts. I encourage you to read through this document and then retain it as a resource.

Scholar Financial, LLC is a boutique fee-only investment advisory and financial planning firm committed to serving a select number of clients. We are pleased that you have decided to join our firm, or that you are considering becoming a client. We we look forward to serving you.

Sincerely,

Ron A. Rhoades, JD, CFP®
Co-Manager, Financial Advisor
Scholar Financial, LLC

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How long has Scholar Financial, LLC been providing investment advisory services?

From 2001 through 2011, Ron Rhoades was a co-founder and principal of a fee-only registered investment advisory firm for ten years, where he served as its Director of Research, Chair of its Investment Committee, and as Chief Compliance Officer.

In 2011 Ron formed his own investment advisory firm. As part of business succession planning efforts, his firm has merged, and then unmerged, with other investment firms over the years. Scholar Financial, LLC was formed and began operations in early 2023.

Dr. Rhoades is also an Associate Professor of Finance, and Director for the Personal Financial Planning Program within the Gordon Ford College of Business at Western Kentucky University.

Where is Scholar Financial, LLC located?

Scholar Financial, LLC is located in Kentucky, but is available to serve clients throughout the United States. Scholar Financial, LLC's home office is in Bowling Green, Kentucky (located about an hour north of Nashville, Tennessee).

Clients' schedules and pandemics permitting, we travel each late Spring and Summer to confer with clients who are in the eastern half of the United States (*i.e.*, generally, Louisiana to Wisconsin to Maine to Florida and all states in between).

We also schedule Zoom conferences and/or telephone conferences with our clients who reside elsewhere, and upon request.

Who else constitutes the Scholar Financial, LLC team?

Cathy Rhoades is our Client Services Director. She is the primary point of contact in our firm for clients who call and need assistance with cash flow needs, understanding client statements, and scheduling telephone conferences or meetings with Ron.

What services does Scholar Financial, LLC provide?

The goal of Scholar Financial, LLC is to provide select clients with truly objective investment and financial life advisory services for highly reasonable fees.

Scholar Financial, LLC provides financial planning and investment advisory services to select individual clients, families, and trustees. Our services may include:

- Investment plan design and ongoing investment management;
- Executive compensation planning;
- Employee benefits planning;
- Financial planning;
- Tax planning and management;
- Estate planning recommendations;
- Asset protection planning recommendations;
- Risk planning and management;
- Philanthropic and/or charitable gift planning; and
- Closely held business and professional firm consulting.

Specific services for each type of client are described in Scholar Financial, LLC's Form ADV Part 2A, which is available upon request.

All clients receive individual consultations with Dr. Rhoades. All clients also receive the benefit of Dr. Rhoades' continuing study of macroeconomic conditions and his historical and forward-looking analysis of the capital markets, with a view toward estimating long-term returns of certain asset classes.

Clients also receive the benefits of Dr. Rhoades' research with regard to the deployment of capital in ways to reduce various risks, his knowledge of methods to reduce the tax drag on investment returns, his due diligence reviews of specific investment products, and his expertise with regard to other matters affecting client's investments and financial planning needs.

How are your services different from those I would receive at other financial services firms?

Scholar Financial, LLC is an investment advisory firm, not a broker. We do not sell any investment products. We do not sell any insurance products.

Fee-Only. We do not receive fees from brokerage firms, investment product manufacturers, or insurance companies. The only fees we receive are those paid by our own clients.

Independent. By remaining independent, we avoid the major conflicts of interest so commonly seen in Wall Street's brokerage and investment banking firms.

Fiduciary. We are a fiduciary to you. We are legally bound to act in your best interests at all times during the course of our relationship. In the broadest possible sense, our goal and duty is to be your advocate – in every area of your life in which we are allowed to be a part. This is an obligation we take very seriously.

Prudent Investor Rule. Unlike many other investment advisory firms, we commit to management of your investment portfolio in adherence to the prudent investor rule. This is a very high standard for the duty of care which we adhere to – and much higher than the simple "reasonable basis" required by general securities laws. (Clients may, if they desire, "opt out" of the prudent investor rule for all or part of their investment portfolio, should they desire to engage in speculative investment strategies or investments; however, we don't recommend this.)

Highly Knowledgeable. Dr. Rhoades is an attorney-at-law (Member, The Florida Bar), where he practiced in the field of estate and tax planning. He is also a Professor of Finance in the Gordon Ford College of Business at Western Kentucky University, and serves as Program Director for its Personal Financial Planning Program. Dr. Rhoades has taught or is currently teaching classes in: Retirement Planning; Applied Investments; Advanced Investments; Personal Finance, Financial Plan Development (capstone course); Estate Planning; Principles of Finance; Employee Benefits; Money & Banking; Legal and Regulatory Aspects of Personal Financial Planning; Risk Management & Insurance; and Business Law I & II.

Dr. Rhoades is the author of several books and hundreds of articles. He has spoken numerous times at industry conferences. He has often quoted in industry and consumer magazines and newspapers. His forthcoming book, *Mastering the Art & Science of Investing*, will likely be published in late 2023.

Low Fees. Our fees are well below the industry average for fees charged by similar investment advisory firms. We can do this because we keep our internal costs low – we work out of our home, for example, and use our membership in certain fee-only advisor organizations to secure discounts on software and other needed infrastructure.

Scholar Financial, LLC's Code of Ethics

Scholar Financial, LLC has adopted a Code of Ethics that establishes policies for ethical conduct for all our personnel. Our firm accepts the obligation not only to comply with all applicable laws and regulations but also to act in an ethical and professionally responsible manner in all professional services and activities. Our policies include prohibitions against insider trading and circulation of industry rumors, among others.

We periodically review and amend our Code of Ethics to ensure that it remains current, and we require all firm access persons to attest to their understanding of and adherence to the Code of Ethics at least annually.

Our firm will provide a copy of its Code of Ethics to any client or prospective client upon request.

Ron A. Rhoades is a member National Association of Personal Financial Planners (NAPFA) and as such adheres to the NAPFA Fiduciary Oath, providing:

> "The advisor shall exercise his/her best efforts to act in good faith and in the best interests of the client. The advisor shall provide written disclosure to the client prior to the engagement of the advisor, and thereafter throughout the term of the engagement, of any conflicts of interest, which will or reasonably may compromise the impartiality or independence of the advisor. The advisor, or any party in which the advisor has a financial interest, does not receive any compensation or other remuneration that is contingent on any client's purchase or sale of a financial product. The advisor does not receive a fee or other compensation from another party based on the referral of a client or the client's business."

In addition, we strive to adhere, at all times, to a strict set of obligations to each and every one of our clients:

- **Objectivity and Loyalty**
  - To have no allegiance to any company, product, or service – we represent you and your best interests shall always remain paramount.
- **Integrity**
  - To always act in accordance with our Code of Ethics.

- **Honesty**
    - To deliver important advice even if it may create discomfort for you in the short-term. The people we work with prefer us to be honest whenever we encounter what seem to be unrealistic expectations or a pattern of living beyond one's means, or a disconnect between stated goals and financial or purchase decisions.
- **Professional Care**
    - To get to know you, your personal goals, your struggles and challenges around money, and to tailor our recommendations so that they help you create an abundant and less stressful financial life.
- **Due Diligence**
    - To offer you an open architecture structure in which we customize an Investment Plan for you, created using the tools in our toolbox which add value for your situation and resulting from our extensive, ongoing due diligence review of selected investment strategies and investments.
- **Utmost Good Faith**
    - To always act with perfect candor, openness, and honesty toward you.
    - To avoid any concealment or deception, however slight, toward you.
- **Full Transparency**
    - To provide writen disclosure to you prior to, and during the course of, our relationship of any conflicts of interest which will or reasonably may compromise the impartiality or independence of our services to you.
- **Professionalism**
    - To treat you with respect, professionalism, honesty, and to maintain a nonjudgmental attitude toward the goals and information you present to us.
- **Confidentiality**
    - To treat your information in the strictest confidentiality.
- **Regulatory Compliance**
    - To comply with the statutes and regulations that govern my actions, and also to go beyond that compliance because of the relationship of trust and confidence formed with you.

“Can I Do All This Myself?

Ultimately, we believe that the investment discipline that we educate and guide our clients on is not “rocket science.” Indeed, we recognize that many of our clients have the intellectual ability to both learn and practice our investment philosophy for their own investment portfolios.

However, we also recognize that there are limitations to what individual investors can manage in light of other professional and personal obligations. We live in a complex financial world where the capital markets are in a constant state of flux, new investment offerings appear every day, and complex tax laws further complicate investment design and management. Dr. Rhoades spend many, many hours each year researching current and new investment strategies and products, monitoring our clients’ investment portfolios, and reviewing new estate and tax laws that may affect our clients’ portfolios.

We are also aware that individuals rarely remove their emotions completely out of the investment decision-making process. It is often the emotional “knee-jerk” reactions to short-term events that cause so many individual investors to underperform over time.

As your trusted, expert advisor, we provide services that seek to help you navigate this complex financial world by:

- Providing trusted counsel to counter emotional reactions to market events or other life events;
- Avoid repeating past mistakes in relation to your portfolio, such as holding onto a stock for too long;
- Reviewing other aspects of your financial life that affect your portfolio and your financial needs, such as your lifetime goals or asset protection needs;
- Planning for the needs of your spouse, children, or other people (and pets) important to you in the event that something should happen to you; and
- Helping you to relax and enjoy life, without watching your investment portfolio every day; and
- Assisting you to further identify and pursue your lifetime goals, so that you may better enjoy the journey.

What is Scholar Financial, LLC’s Investment Philosophy?

What We Do <u>Not</u> Believe In. We do not believe in the concept of “hot” stocks or in seeking short-term returns from any investment. Nor do we believe in attempting to “time” the market by continually trading in and out of stocks. We believe that such strategies are the results of certain activities by the mass media, an emphasis on consumerism, and the tendency of our society to promote certain beliefs about, and “gut reactions” to, the market and the economy that are essentially behavioral in nature. We believe that these and other such strategies are at best unproductive and at worst destructive for those investors seeking to obtain the peace of mind and freedom to enjoy life that results from financial security.

What We Do Believe In ...

Personalization. Our investment strategy is based upon the analysis of your unique situation and goals. In designing your investment plan, we rely upon the information provided by you and your other professional advisors; this information may pertain to your financial situation, estate planning, tax planning, risk management planning, short-term and long-term lifetime financial goals and objectives, investment time horizon, and perceived current tolerance for risk.

Strategic Asset Allocation. The information you provide to us becomes the basis for a strategic asset allocation that we believe will best meet your needs and goals. Strategic asset allocation is based on Modern Portfolio Theory. This strategic asset allocation is composed of select asset classes and is meant to be long-term oriented. In other words, your allocation should be only adjusted periodically, such as when some major event like a job change occurs or upon attaining various ages. Your strategic asset allocation and the overall portfolio weightings between equities (stocks, stock mutual funds), fixed income, and other asset classes are based upon your needs, desires, perceived risk tolerance, and investment time horizon.

Asset Class Selection. We incorporate those asset classes that we believe, based upon historical data and our own proprietary analysis, will possess attractive combinations of return, risk, and correlation over the long term. Our selection of asset classes is driven by research into global asset classes by such academics as Professor Eugene Fama, Sr. of the University of Chicago Booth Graduate School of Business and the Center for Research in Security Prices, Professor Kenneth French of Dartmouth College, and many other academics and researchers.

Multi-Factor Investing. Scholar Financial, LLC's investment advice regarding your asset allocation is also based upon the utilization of several different asset classes to reduce portfolio volatility over long periods of time. We diversify your portfolio among various asset classes and then among individual investments. We may also seek to tilt the equities portion of your portfolio towards value and small capitalization stocks and companies possessing high "profitability" relative to book value, considering the high probability of greater long-term returns of such stock asset classes relative to the broad equities market. This tilting is based upon research that has shown that this strategy, combined with a somewhat lower allocation to equities and a higher allocation to high-quality fixed income investments, usually results in a "smoother ride" for our clients.

Evidence-Based Investing. Finally, Scholar Financial, LLC's investment philosophy is firmly rooted in the belief that the capital markets are fairly efficient as to the pricing of individual securities (although not always rational as to overall asset class valuations) and that the investors' gross returns are determined principally by asset allocations decisions. A focus is provided on developing and implementing globally diversified portfolios, principally through the use of low-cost and tax-efficient stock mutual funds, high-quality fixed income investments, and (when appropriate for the client) low-cost mutual funds holding a diverse array of publicly traded REITs.

[For clients who possess a $2 million or greater allocation to equities (i.e., stocks or stock mutual funds) in a taxable account (i.e., not a 401k, IRA, or Roth IRA account), the use of a highly diversified portfolio of individual stocks may be recommended in order to secure potentially greater reductions in the "tax drag" upon investment returns.]

Tactical Asset Allocation is Rarely, if Ever, Undertaken. While tactical asset allocations are not generally undertaken, in recognition of the principle that asset class bubbles can occur due to irrational group behavior of investors collectively, Scholar Financial, LLC may occasionally suggest a lowering of allocations to a particular asset class in situations where the longer-term expected returns of the asset class are not offset by the higher risks the present in the asset class. However, it is believed that such recommendations will be very rarely undertaken.

What Annual Return Can I Expect?

There are no guarantees to investing. Therefore, we would never guarantee any return on an investment portfolio. No firm should. In fact, the Securities and Exchange Commission prohibits doing so.

Historically, the financial markets provide an overall rate of return (over time), which justifies investors entrusting their assets to them. Real rates of return are impacted by the effects of inflation, taxation, fees and other investment expenses, cash inflows and outflows to and from the investment portfolio, and rebalancing within the portfolio.

Scholar Financial, LLC periodically calculates updated projections of expected returns by asset classes. These projections are just that – what we believe are the most likely long-term (15-year) average annualized returns of the asset classes. However, the actual range of returns – even over 15-year time periods – can be quite large, and is heavily influenced by a variety of factors, including the growth (or lack thereof) in the global economy.

As stated above, there can be no guarantees. In undertaking these projections, we take into account the present valuation levels of various asset classes, applying both quantitative and qualitative analysis, through our own proprietary research and modeling.

How Do Scholar Financial, LLC's Fees Compare with Brokerage Firm Fees?

We believe the "total fees and costs" of our clients are typically 25% to 75% lower than the "total fees and costs" individual investors bear when working with the typical traditional "full service" brokerage firm.

We believe our fees are very competitive, on average, as to other fee-only investment advisory firms offering similar services. Many investment advisers charge 1% of "assets under management." Our fees are much lower.

All of our fees can be found in our Form ADV, Part 2A, which is provided to our prospective clients and is available upon request. We can also provide a client services (fee) agreement to prospective clients for their review.

What Other Fees and Costs Might I Incur?

We want to make note that in addition to our reasonable fees as detailed in your Master Fee Agreement, you will incur other investment fees and costs.

Generally, Scholar Financial, LLC does not recommend to clients pooled investment vehicles which possess sales loads (i.e., sales commissions) or 12b-1 fees or surrender (redemption) fees, unless the limited choices available to the client [such as limited choices within a client's 401(k) plan] dictate such. Scholar Financial, LLC seeks out mutual funds, ETFs, and other investment products that possess low total fees and costs.

Fees charged by third parties may include:

- The annual expense ratio of a mutual fund or exchange-traded fund; which includes: (A) fund management fees; (B) fund expenses (for custodial services, printing and distribution of retports, accounting and legal fees, etc.); and (C) for some funds – 12b-1 fees;
- Service or account charges charged by the "custodian" of funds (banks or brokerage firms), such as debit balances, annual account fees, postage/handling fees, and account termination fees;
- Contingent deferred sales charges (also known as "surrender fees");
- Mortality and expense charges assessed within an annuity contract or life insurance policy; and/or
- Commission or transaction fees earned by a custodian firm for securities transactions.

All fees paid to Scholar Financial, LLC for our advisory services are separate from the fees and expenses charged to beneficial-interest-shareholders of mutual fund shares by the investment company or by the investment advisor managing the mutual fund portfolios. A complete explanation of the expenses charged by the mutual funds is contained in each mutual fund's Prospectus and Statement of Additional Information. Clients are encouraged to carefully read each fund's prospectus.

For retirement plan sponsors, the fees of other service providers are separate and additional to the fees paid to Scholar Financial, LLC. Scholar Financial, LLC seeks to connect plan sponsors with low-cost, third party administrators, record keepers, custodians, and providers of investment education services to plan participants. All fees charged by such service providers are separate from the fees charged by Scholar Financial, LLC.

Is Scholar Financial, LLC Compensated by Any Other Sources?

Scholar Financial, LLC does not accept fees from any non-clients for providing investment advisory services or other advisory services.

Scholar Financial, LLC does not accept compensation from any client referrals, nor does it pay any referral fees to others.

Scholar Financial, LLC may receive an economic benefit from a non-client, such as a custodian or mutual fund company or other investment product provider, when providing investment advisory services to clients.

Our Relationship with Schwab.

A "Custodian" is a brokerage firm or bank that holds your investment assets. This ensures that your assets are held in a safe place. Scholar Financial, LLC does not accept "custody" of client assets – this is for your protection. A custodian, such as Schwab, provides you directly with quarterly statements of your accounts. In addition, you possess online access to view your accounts at any time.

Whenever you receive quarterly (or monthly, or annual) statements from Schwab, or from any other custodian, you should carefully review these statements. Look at the holdings, as well as any transactions. If you don't understand anything, just contact us and we will explain it to you. In other words, "trust but verify."

Our firm may receive economic benefit from the Custodian (the Schwab Advisor Services division of Charles Schwab & Co., Inc.) in the form of various products and services they make available to Scholar Financial, LLC and other independent investment advisors that typically may not be made available to a "retail investor." These benefits may include the following products and services (provided usually without cost to Scholar Financial, LLC, or sometimes for discounted fees or via a Custodian's payment of part of a third party's fees):

- Receipt of duplicate client statements and trade confirmations;
- Research related products and tools;
- Access to trading desks serving our clients;
- The ability to have advisory fees deducted directly from a client's accounts (per written agreement with each client) (***Our deduction of fees from clients' accounts at Schwab is undertaken via our request to Schwab; Schwab reviews this request to ensure the fees are reasonable, in order to safeguard its customer's assets***.)
- Resource information related to capital markets and various investments;
- Access to an electronic communications networks for client order entry and account information;

- Access to mutual funds with no transaction fees and/or select investment managers;
- Assistance with back-office functions, recordkeeping, and client and compliance reporting;
- Educational conferences and events;
- Technology, compliance, marketing, legal and business consulting services;
- Publications on practice management and business succession; and
- Discounts on marketing, research, technology, and practice management products or services provided to our firm by third-party providers, including but not limited to access to employee benefits providers, human capital consultants, and insurance providers.

In addition, **Schwab** may provide regional periodic, or national annual conferences at which Scholar Financial, LLC's employees may attend, or other educational online programming. Scholar Financial, LLC pays its own transportation and hotel costs to attend such events, but the educational programming and occasional meals and/or entertainment at such events may be provided by the Custodian either free of charge or for a fee lower than that charged by similar industry conferences.

Therefore, there is a conflict of interest since our firm may have an incentive to select or recommend a Custodian based on our firm's interest in receiving these benefits rather than your interest in receiving favorable trade execution.

As a fiduciary, our firm endeavors at all times to put the interests of its clients first. It is important to mention that the benefit received by our firm through participation in a **Schwab's** independent advisor program does not depend on the amount of brokerage transactions directed to **Schwab as** Custodian, and the selection of **Schwab as** Custodian is in the best interests of our clients since the selection is primarily supported by the scope and quality of services as well as the financial strength of the custodian, and the cost of services provided as a whole – not just those services that benefit only our advisory firm**.**

Our Relationships with Dimensional Funds, Avantis, Vanguard, TIAA, and Other Investment Providers.

Scholar Financial, LLC most commonly recommends the no-load, passively managed, asset class based mutual funds and exchange-traded funds (ETFs) developed by Dimensional Fund Advisors ("DFA"), Avantis Investors® ("Avantis"), and Vanguard, and fixed deferred annuities through TIAA. We do not receive cash compensation for these recommendations, nor do we receive any commissions on the sale of the mutual funds or ETFs. Scholar Financial, LLC is not contractually or otherwise committed to use any mutual fund or ETF and may use other mutual funds and ETFs as it deems appropriate for its clients.

DFA provides Scholar Financial, LLC with access to a software program that enables us to generate risk and return data relative to their indexes and funds. This program assists Scholar

Financial, LLC in providing analyses and data to clients and potential clients. DFA also provides an on-going education program through webinars on advanced topics, educational conferences that provide analytics and current research data, and a proprietary website of articles, research, and analytical tools. While Scholar Financial, LLC pays its own hotel and transportation costs when attending such conferences, DFA provides the education and occasional meals to Scholar Financial, LLC's employees at no charge.

Avantis provides education and insights through publicly available information on its web site. Vanguard provides education and insights through its web site for investment advisers, and may provide Scholar Financial, LLC with access to view client accounts. TIAA may provide Scholar Financial, LLC with online access to view client accounts.

We base our recommendations solely on our investment strategy, founded in Modern Portfolio Theory, which emphasizes a diversified portfolio allocated among various asset classes. DFA, Avantis, Vanguard, and TIAA are just four investment providers Scholar Financial, LLC may recommend for client portfolios; other providers of investment vehicles may be recommended. Investment recommendations are determined by Ron A. Rhoades, who employs a due diligence process in selecting the investment securities we recommend to clients.

How Does Scholar Financial, LLC Manage any Conflicts of Interest?

Scholar Financial, LLC actively seeks to avoid material conflicts of interest that may jeopardize our independent professional judgment on your behalf. For example, we do not accept any commissions, 12b-1 fees, or other cash or other monetary compensation from any mutual fund companies or product providers. We sell no investment products, nor do we sell any insurance products.

We also seek to proactively manage, in order to keep our clients' best interests paramount, any conflicts of interest that we cannot avoid.

For example, the decision to pay off a mortgage, or gift substantial amounts to children or charity may generate a conflict of interest for us (as our compensation is determined, generally, by the amount of assets upon which we provide advice). In such situations, our approach is straightforward – what is best for our client? The approach we take is – "What would we tell our own parents, or our brother or sister?" This methodology in managing any remaining conflicts of interest is designed to keep your best interests paramount at all times. We are professional advisors to our clients and we take our role as fiduciaries very seriously.

Are there any activities that Dr. Rhoades is involved in that may impose restrictions on his ability to service clients?

Western Kentucky University Faculty: Ron A. Rhoades serves as Director of the Personal Financial Planning Program and as Associate Professor – Finance within the Gordon Ford

College of Business, Western Kentucky University, located in Bowling Green, KY. Dr. Rhoades currently teaches courses such as Personal Finance, Applied Investments, Financial Plan Development, Legal and Regulatory Aspects of Personal Financial Planning, and Estate Planning. Ron also undertakes research and writings, including the writing and publication of books, articles, blog posts, online courses, and course materials.

This full-time faculty position is not anticipated to present for any client any conflict of interest, except as it imposes limits upon Dr. Rhoades' time. No students of Ron A. Rhoades are permitted to become clients of Scholar Financial, LLC while they are students at Western Kentucky University. Clients who contact Scholar Financial, LLC can be put in contact with Dr. Rhoades, with return calls occurring either in the evening, weekends, or in the event of an immediate need at sometime during the day.

Ron A. Rhoades is an estate planning attorney, but he does not accept new clients to his practice as an attorney. Some current Scholar Financial, LLC advisory clients may also be Ron A. Rhoades, P.A. legal clients. The activities associated with this law firm and service to existing clients involve estate planning, occasional speaking engagements, and occasional consulting services to other financial services firms. These activities are not likely to materially impact Dr. Rhoades' availability. All legal fees charged by Ron A. Rhoades, P.A. are separate and distinct from all advisory fees charged by Scholar Financial, LLC.

The Committee for the Fiduciary Standard and other Activities: Ron also serves on the Steering Committee for *The Committee for the Fiduciary Standard* and as an advisor to *The Institute for the Fiduciary Standard*. He has also served on various other committees within these organizations and is often requested to speak at conferences hosted by these associations and others throughout the country. He also undertakes occasional visits to the U.S. Congress and/or U.S. Securities and Exchange Commission and/or U.S. Department of Labor on behalf of these or other organizations, in which he advocates for the proper application of fiduciary duties to all personal financial advisors. Ron also sometimes participates in various committees and/or task forces of the *Certified Financial Planner Board of Standards, Inc*., the *National Association of Personal Financial Advisors* (NAPFA), and the *Financial Planning Association* (FPA).

Does Dr. Rhoades Receive Compensation From Any Other sources?

Ron receives compensation as a faculty member of Western Kentucky University.

Ron may receive an honorarium, be reimbursed for travel expenses, or may have registration fees for attendance at a professional conference reduced or waived for certain speaking engagements.

Ron may receive fees relating to consulting engagements to other financial services firms with regard to the fiduciary standard of conduct and/or investment due diligence.

Ron may receive compensation associated with the publication of any books and/or online courses he has authored.

Ron also receives compensation from legal services provided under Ron A. Rhoades, P.A.

Scholar Financial, LLC does not believe the receipt of such honorariums, reimbursements, or other compensation directly influences the advice Scholar Financial, LLC provides to its clients.

What Are Scholar Financial, LLC's Minimum Qualifications to Become a Client?

In order to become a client of Scholar Financial, LLC, prospective clients must generally meet all of the following criteria:

- You desire trusted, expert advice;
- You desire to be a proper steward of the wealth entrusted to your care;
- You are willing to pay a reasonable fee for professional advice;
- You are willing to commit to conferences, at your home or place of business (or via Skype or similar arrangement, or telephone conference), once a year;
- For individual clients and couples who receive financial advisory services in addition to investment advisory services, you desire and need financial life coaching; and
- You possess investment authority over some personal publicly traded investment assets (stocks, bonds, funds, annuities, CDs, etc.).

What is the Process of Engaging Scholar Financial, LLC?

Most initial conferences occur in-person, although some clients opt to undertake conferences via web conferencing or telephone.

Step 1: Client Questionnaire. For most clients, we request that you complete a Questionnaire, which we will provide to you. Your answers to this Questionnaire assists Dr. Rhoades in making our first conference highly productive.

[For institutional clients (endowment funds, etc.), trustees of irrevocable trusts, and/or qualified retirement plan sponsors, an email is sent with an appropriate set of questions.]

Step 2: Introductory Zoom or Phone Conference. Generally, once you inquire, a Zoom conference or telephone conference is scheduled with Dr. Rhoades during evening hours or on a weekend day. The purpose of this introductory call or web conference is to generally review a prospective client's planning needs, and to answer questions. During this conference, Dr. Rhoades seeks out the client's personal history, a delineation of their goals and values. A discussion may occur about certain financial planning issues. You are invited to answer questions.

No charge or obligation exists for this introductory Zoom or phone conference.

> **While prospective clients may desire to engage Scholar Financial, LLC's services following this conference, we urge clients to wait and take time to digest the information gleaned from the prior conference.**
>
> **The hiring of an investment and financial advisor is a very important decision. Important decisions, especially those involving money, should never be undertaken emotionally or in haste.**

Step 3: Relationship Decision Conference. During this conference, the prospective client asks additional questions. The client and Dr. Rhoades determine whether to proceed to enter into a professional advisor-client relationship.

What happens After I Become a client of Scholar Financial, LLC?

Dr. Rhoades prepares an Investment Policy Statement and presents a list of specific investment recommendations and action steps for each of your investment accounts. Investment steps are then implemented, either by you or with the assistance of Scholar Financial, LLC.

During the initial year (or two years, depending upon the program in which you are enrolled), a series of conferences may be held. These conferences may address additional action steps, current status of proposed action steps, and various financial life-planning issues.

E-mails and telephone conferences: You may contact Dr. Rhoades by e-mail or telephone at any time, for advice on matters that do not require extensive time or analysis. Calls and e-mails are usually returned during evening hours or on weekends, due to Dr. Rhoades's obligations with students at Western Kentucky University.

Subsequent Year Conferences: At the conclusion of your first or second year as a client with Scholar Financial, LLC all investment and financial life planning issues will likely have been reviewed at least once. At this time, the number of conferences, and the conference agenda, becomes more flexible to address investment and financial life issues as they arise and to periodically review prior planning undertaken.

Review conferences may also include Dr. Rhoades's review of the investment policy statement, preparation of changes thereto if required, a review of any revised due diligence analysis undertaken by Dr. Rhoades with respect to investment strategy and investment products, and subsequent preparation of minutes of the conference and action steps for implementation by you or by Scholar Financial, LLC.

For the second and subsequent years, it is suggested that review conferences with Dr. Rhoades occur at least once each year in most instances. If you possess a more dynamic financial life situation or desire greater coaching, more frequent conferences may occur.

When Do You Conduct Portfolio Reviews and/or Rebalancing?

Portfolio reviews and rebalancing of your portfolio, for the "assets under management" (i.e., held at Schwab) and "assets under advisement" (i.e., held at other custodians, including 401(k) providers) with Scholar Financial, LLC, will be undertaken quarterly. These reviews are undertaken by Dr. Rhoades to ascertain if the values in any asset class have strayed beyond their target minimums or maximums, and for purposes of meeting a client's anticipated future cash flow needs.

Even if one or more asset classes fall outside their target minimums or maximums, Scholar Financial, LLC may determine not to rebalance the asset class for various reasons. These reasons include the avoidance of short-term capital gains, deferring long-term capital gains realization, minimization of transaction costs, or our view on whether the asset class is undervalued or overvalued relative to historic norms, our view of the level of the macroeconomic risks to which the asset class may be exposed, and certain other criteria.

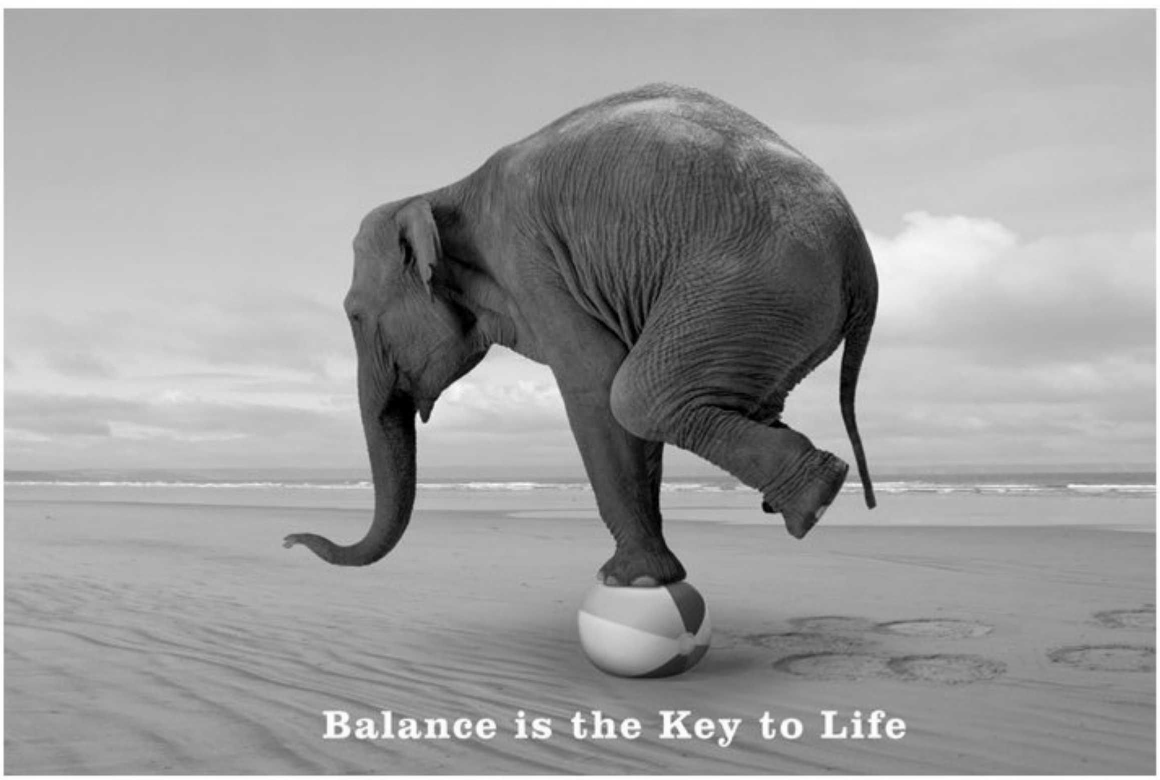
Behavioral finance economists have documented various psychological biases investors possess which can negate the ability of an individual investor to adhere to a strategic asset allocation during times of strong market advances or declines. It is essential that you are able to withstand declines in the value of the overall investment portfolio, which declines we believe are largely unpredictable. Moreover, you should be prepared to accept Scholar Financial, LLC's recommendations to rebalance your portfolios at the time of review conferences, without knowing whether a "market bottom" has been reached, in order to reap some of the benefits of our strategic asset allocation strategy. Also, changing the portfolio allocation mix during market bottoms to a more conservative strategic asset allocation can result in long term damage to the likely achievement of the your financial goals.

At the same time, you should also be prepared to accept our recommendations to rebalance their portfolios at review conferences following strong market price advances, in effect "taking gains off the table," and again never knowing if a "market top" has been reached or if even stronger market price advances await. We believe one of the ways we add value to our clients is by applying our insights and wisdom to facilitate such a disciplined approach to rebalancing, as we seek to counter various behavioral biases investors possess which frequently result, without the aid of a financial advisor, in the investor "selling low" and "buying high."

REPEAT AFTER ME … "BUY LOW. SELL HIGH."

However, at times a modification to a your strategic asset allocation may be recommended. Changes in the your strategic asset allocation will likely result in transactions in your portfolio, and these transactions could have tax consequences for your account and result in additional transaction fees incurred by you.

Additional Portfolio Reviews Upon Request: Portfolio reviews are additionally undertaken upon request by you when special cash needs arise or when additional cash or securities are added to your investment portfolio. Scholar Financial, LLC will respond to such requests within a reasonable period of time. Please permit 3-5 business days to transpire in order to have cash funds transferred to your checking or other designated account.



How Do I Establish a New Account or Transfer My Existing Accounts to the Custodians Whom Scholar Financial, LLC Utilizes?

We shall assist you to establish accounts with the custodians whom we utilize, if you do not already have accounts with those custodians. We shall complete all of the paperwork for your review and signature, and submit that paperwork to the custodians on your behalf.

Should a transfer of an account be needed from your present custodian (i.e., brokerage firm) to one of the custodians we utilize (Schwab), we shall complete the paperwork for you. After your review and signature, we shall submit the forms to Schwab or other custodians we may use. These custodians will then contact the brokerage firm, which holds your current account.

Most account transfers occur through the “ACAT” system. The Automated Customer Account Transfer System (ACATS) is the National Securities Clearing Corporation's (NSCC) central processing system for the transfer of positions and accounts between brokerage firms that are participants of the NSCC's ACAT program. The ACAT system allows brokerage firms to enter, review, and settles account transfers in a fully automated manner.

The ACAT transfer is supposed to take between five to eight business days. However, in our experience, account transfers can take much, much longer – weeks or even a few months. There are numerous factors which slow down the process, including account names which are not identical, the other brokerage firm taking a long time, etc. We will take these time factors into account when we assist you to transfer positions from one brokerage firm to another.

How Do You Conduct Trading in My Accounts?

Whenever changes are to be made in your portfolio, after receiving approval from you, we will undertake the trades on your behalf in any of your Scwhab accounts. In all instances, we will generally discuss any trades with you, prior to undertaking them.

Most of the trades we conduct for you are undertaken through online secure trading directly with the custodians. By using electronic systems, the “transaction fees” of custodians are substantially reduced. On occasion, we may call the custodian with you on the line to give the required approval for trading.

For your accounts held at financial institutions other than Schwab, you will be given guidance on what transactions to undertake. You must undertake those transactions.

How Do I Set Up Online Access to My Accounts?

We will establish your accounts at Schwab with secure online access, so that you may view account information updated daily.

How Do I Change My Address and Other Contact Information?

Please contact us promptly to notify us of your address and/or phone number change. We will update your accounts and your information within our system.

We will also assist you in updating your address at the custodians utilized to safeguard your assets (we will prepare forms for your review and signature).

Keeping your address and phone current with Scholar Financial, LLC and the custodian(s) of your assets will help ensure that you experience no lapses in service.

How Do I Deposit Money Into My Investment Account?

You can make a deposit to your investment account by check or through an electronic ACH (Automated Clearing House) transfer from your bank account. Make checks for investment payable to the name or title of your investment account and always include the account number on the memo line. Electronic transfers through an ACH transfer may be established at your request through a form submitted to the custodian with your signature and designated bank account information from which to debit the amount to be invested.

Scholar Financial, LLC cannot and does not accept any investment checks made out to our firm.

**Note: If you mail a check for investment made payable to Scholar Financial, LLC, we are required by law to mail the check back to you within three business days.*

Where Should I Mail My Checks for Investment?

It is best to transfer money directly from your bank account, to Schwab. Cathy has forms that authorize you to transfer money back and forth.

If you choose to mail a check to Schwab, you should send them directly to the custodian (Cathy will provide you with the address). We recommend sending checks with a tracking service provided by either the US Postal Service, UPS, or FedEx to ensure that your check does not get lost in the mail.

How Do I Initiate a Withdrawal, or Monthly Withdrawals, From My Account(S)?

It is best to set up periodic (monthly, or otherwise) withdrawals from your account, transferred directly from your Schwab (or other) accounts to your checking account. Cathy can assist you to establish these transactions.

Many of our clients have established automatic monthly transfers from their investment accounts to their checking accounts. If you desire to have automatic monthly withdrawals or contributions, we will assist you in preparing and submitting the forms to the custodians. Should the need arise to change the monthly withdrawal amount or timing, we will assist you in undertaking the appropriate paperwork to effect the change.

You may also request a checkbook on some of your accounts. While this can be utilized, we request that you contact us to discuss withdrawals from your accounts. This enables us to plan for such withdrawals, ensuring that cash is available. It also enables us to determine whether any aspects of your Investment Plan may be affected by such withdrawals. We will also verify that such withdrawals occurred in your account(s).

How Are Required Minimum Distributions from My IRA Accounts Taken?

Each year (commencing with the year in which you turn age 73, or age 75 commencing in 2032) your IRA custodian (Schwab, etc.) will send you a notice indicating that you have to take a required minimum distribution.

We also keep track of this required distribution, in our system. We typically advise taking the distribution in the fall of each year (usually in November), but an earlier distribution may be undertaken in order to fulfill a cash distribution or other need. We will contact you each year to discuss how to best undertake this distribution.

Required minimum distributions can be taken by a check mailed directly to you, by ACH transfer to your bank account, or by a transfer from your IRA to another investment account at the same custodian.

If you are age 70½ years or older, you can also use part of your required minimum distribution (or up to $100,000 each year) from your traditional IRA account to undertake a transfer directly to charity. This is, generally, a tax-efficient means of effecting a charitable distribution. Scholar Financial, LLC can guide you in undertaking these "qualified charitable distributions," and prepare the necessary paperwork for you. We recommend that you undertake these transactions not later than November of each year, as custodians (such as Schwab) often receive a large number of requests late in the year, and may not get to your request if it is submitted too late.

Does Scholar Financial, LLC Prepare Tax Returns or Estate Planning documents?

As part of our services we may identify tax and estate planning issues that require further consideration or review. However, we prefer to work with your current CPAs or attorney, with regard to the preparation of tax returns, certain tax planning issues, and the preparation of estate planning documents. Dr. Rhoades is happy to review the work undertaken by your other professional advisors, to ensure it meets your goals and desires.

Unlike many other investment advisory firms, and nearly all brokerage firms, Scholar Financial, LLC does accept the responsibility to design and manage your investment portfolio in order to reduce the "tax drag" on your investment returns, over the long term (*i.e.,* over many years).

How Does Scholar Financial, LLC Ensure That My Personal Information Remains Confidential?

We are always concerned about preserving the confidentiality of your information and the security of all data. We have adopted numerous safeguards to ensure data security, including employing vendors to provide our firm with a more secure database for client documentation storage.

We do work with other companies, including brokerage firms (Schwab, TIAA, Vanguard, etc.), data aggregation services, and others, in order to serve you better.

Please refer to the Privacy Policy previously provided to you as part of our Firm Brochure (SEC Form ADV, Part 2A), or contact us to obtain a copy.

What Additional Safeguards Are In Place To Protect My Investment Assets?

In addition, we ensure the privacy of your information and the security of your investment accounts through the following additional safeguards:

1. **Again, We Utilize Independent Custodians to Safeguard Your Assets.** For all of our clients' assets, we utilize independent custodians to take "custody" of our clients' accounts. These include TD Ameritrade Institutional, and on occasion other custodians (such as Vanguard for certain annuities, 401k plan sponsors, etc.). This is for your safety.
2. **We Do Not Accept "Custody."** Our firm does not accept "custody" of our client's securities.
    a. We can view our clients' accounts through secure online computer connections.
    b. We can also (with client authorization) undertake trades in a client's accounts (useful in order to reduce transaction costs).
    c. Some custodians, TD Ameritrade primarily, will permit us to withdraw our fees from our client's accounts with the client's authorization. These transactions are closely monitored by the custodians to ensure that our client's trust is not abused.
    d. Other than the fee withdrawals, we cannot remove assets from our client's accounts, nor transfer cash or securities to any account that the client hasn't previously authorized. Any transfers of cash or securities from accounts held at TD Ameritrade or other custodians are closely monitored

by the custodian and are undertaken in accordance with the custodian's procedures.

3. **Schwab – SIPC, Insurance Protection, and Financial Strength.** Brokerage accounts maintained with Schwab are protected by the Securities Investor Protection Corporation (SIPC). The SIPC protects brokerage accounts of each customer when a brokerage firm is closed due to bankruptcy or other financial difficulties and customer assets are missing from accounts. SIPC protects brokerage accounts of each customer up to $500,000 in securities, including a limit of $250,000 on claims for cash awaiting reinvestment.
    a. Schwab provides additional "excess SIPC" coverage. Up to an aggregate of $600 million of additional securities protection is provided through insurance, which is issued primarily by London insurers. This coverage provides you protection against brokerage firm insolvency and does not protect against loss in market value of the securities.
    b. In addition, we monitor the financial strength of Schwab (a publicly traded company) and other custodians we may utilize. We believe Schwab to be both strong and stable at the present time.
4. **Mutual Fund Complexes.** We also undertake due diligence on the mutual fund complexes we recommend to our clients, including reviews of their compliance history, financial strength, and audit procedures. This is part of the extensive due diligence we undertake before recommending investment products to our clients.
5. **Disaster Recovery Planning.** Like every other financial services firm, we possess a "disaster recovery plan." An essential part of this plan was the uploading, through a secure link, of nearly all of our current client's data and records to a secure online storage facility. We are able to operate from any location, at any time, in order to continue to provide services to our clients should a natural disaster occur.

Are There Other Steps I Can Take to Ensure the Confidentiality of My Information and the Protection of My Investments?

Despite the best efforts of any firm to safeguard client's assets, fraud, such as that which occurs through forgery, could still occur either within our firm or elsewhere. While we hope that you trust our firm and we will make every effort not to betray that trust, we believe it is important for you to *verify your investment holdings on a regular basis*.

While all of our files are subject to examinations by securities regulators (i.e., the State of Kentucky, for example), it is simply not feasible for the any other regulatory body to frequently inspect investment advisory firms and to verify all of the clients' holdings.

Accordingly, and in addition to the compliance-related checks undertaken to safeguard client assets, here are some steps you can undertake to assist us in guarding against fraudulent activities:

Review Your Quarterly (or Monthly, or Annual) Statements – Always. Please review your monthly statements and trade confirmations, which you will receive directly from Schwab, Vanguard, TIAA, or other custodians. Should you detect any unauthorized trading in your account, or unauthorized transfers of cash or securities, please contact Ron A. Rhoades immediately. We've never had any unauthorized withdrawals or transfers by any of our past or current team members from our clients' accounts. With your assistance in verifying monthly your account holdings, and reviewing any transactions, this will greatly deter any likelihood that this will occur in the future.

Should You Be Assisted by another Family Member or Trusted Friend? If you feel you are not as "detail oriented" as you should be, it is probably a good idea to have a duplicate copy of your brokerage account monthly statements and trade confirmations sent to a trusted family member or tax professional and request that they review them for you.

Check us out! All registered investment advisers post information about their firm and advisors on the Investment Adviser Public Disclosure website. You can start your search by inputting our firm name "Scholar Financial" in the firm tab at http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_OrgSearch.aspx, and by searching "Ron Rhoades" under the individual adviser tab

The Securities and Exchange Commission ("SEC") and the North American Securities Administrators Association ("NASAA") sponsor this online database. It provides instant access to an investment adviser's Form ADV, Parts 1 (information for SEC monitoring purposes) and Parts 2A and 2B (disclosures to investors). Investment advisers file Form ADV to register with the SEC, and at least annually thereafter.

Watch Out for E-Mail Solicitations and Internet Fraud. The Internet is a low-cost way for scammers to reach millions of people. Unsolicited e-mail messages offering you investment opportunities that sound too good to be true probably are. Online bulletin boards and electronic investment newsletters are also fertile ground to disseminate false information on thinly traded stocks for a pump-and-dump scheme. Treat information from unknown sources on the Internet with great suspicion. If you ever have a question regarding any solicitation offer you may receive, please contact us.

Watch Out for Investment Scams – Red Flags. Although the product and the approach may vary, there are warning signs that many Ponzi schemes and other investment scams have in common. Look out for:

- Unexpected telephone calls, letters, emails or even personal visits from strangers – especially friends and acquaintances from organizations to which you belong – who offer promises of quick profits on your investment.
- Promises that you can double your money within a short time.
- Promises that an investment can never lose money.
- Promises that an investment is "guaranteed."
- Pressure to act quickly, such as "this offer is only valid for a limited time" or "we are only permitting a few investors to take advantage of this opportunity."
- Any solicitation to invest in any overseas "business opportunity" or "investment" or to assist with any currency or money exchange or transfer.

If you are approached, be ready to say, "I'm not making a decision today."

We are happy to assist you in evaluating any investment opportunity presented to you. In so doing, we have assisted several of our clients in the past few years avoid investment scams and rip-offs.

Watch Out for Seminars that Target Seniors. Four out of five investors age 60 and over have received at least one invitation to a free investment seminar in the past three years - and three out of five received six or more. The invitations often promise to educate you about investing strategies, avoiding taxes, or managing money in retirement. Usually with an expensive meal provided at no cost.

The SEC, FINRA, and state securities regulators sent investigators to these events, and the results were disturbing. "Every rock that we turned over seemed to have a bug or a worm crawling out underneath," says former SEC Chairman Christopher Cox. "In each of the sweeps we conducted, we found significant fraud."

The luncheon and dinner seminars often tout expensive, tax-inefficient products such as equity-indexed annuities (also known as fixed indexed annuities), equity-indexed life insurance, and variable annuities. Don't be suckered into the often-deceptive sales pitches for these products, or for their often-illusory guarantees.

Avoid Product Salesmen and Proprietary Investment Products: Lastly, there are a lot of "financial advisors" who masquerade as trusted advisors, when in reality they possess *no substantial training* in investments, portfolio construction, taxation, and undertake no due diligence. Sadly, most "financial counselors" (and similar titles) don't possess a fiduciary duty to act in their clients' best interests, or even if they are "fiduciaries" they often don't understand what that truly means. We are working to change that, through advocacy in Washington, D.C., with *The Committee for the Fiduciary Standard*, but it's likely to be a long struggle to greatly enhance consumer protection. Our best advice for now remains – avoid product salespeople and work instead with fee-only investment advisors, such as our firm.

Also be aware that many securities and investment firms, major wire houses (large brokerage firms), and even banks push their employees to sell proprietary mutual funds, hedge funds, annuities, and insurance products of affiliated companies. Such products are seldom "the best" that are out there, are often more expensive for the client, and very profitable for the securities firm, bank, or other institution. Avoid proprietary investment products.

We are committed to safeguarding your assets, but in a world full of con men, scam artists, and greedy financial services firms, it's also up to you to protect yourself.

How Can I Obtain a Copy of Scholar Financial, LLC's Form ADV Part 2A and 2B?

Our firm's Form ADV, Part 2A and 2B contains a more detailed discussion of conflicts of interest, as well as an overview of our investment philosophy and the qualifications of our advisors. We encourage you to review this document before undertaking any commitment to utilize our services.

Please contact any member of our firm, and we will be happy to mail or e-mail to you a copy of our most recent SEC Disclosure Document (Form ADV, Part 2A and 2B), which contains information about our firm, our advisors, our professional services, and conflicts of interest.

What Should I Do If I Become Dissatisfied with Your Services?

We strive, at all times, to provide you with proactive, flexible, value-added, and enjoyable wealth management services. Should you, at any time, become dissatisfied with the level of service provided to you, we ask that you contact us as soon as possible to discuss your concerns. We will seek to address your concerns as quickly and effectively as possible. We shall do everything within our power to restore your faith and confidence in our firm.

We provide you the rights to end our working relationship at any time. If you decide to do so, we ask that you adhere to the terms outlined in your client services agreement in terminating our relationship. We will do what we can to make the transition process as smooth as possible.

How can I get the most benefit from your services?

Our services work best when our clients are willing to learn, grow, and take action in order to accomplish their goals, and when there is a gap between where they are now and where they want to be. Most of our clients are individuals and families who desire ongoing professional assistance and coaching in the creation, implementation, and management of strategies that will help them accomplish their life goals, as they may exist now or develop in the future.

Over the years, we have found that we can work most effectively with people who share some or all of the following characteristics:

- A desire to live a more meaningful life;
- An open mind and a willingness to creatively brainstorm with your advisory team – to engage in a continuing dialogue about the goals that drive your life values;
- An understanding that there are many ways to live and an openness to exploring your choices;
- A willingness to make a shift in behaviors if it furthers your long term goals;
- Recognition that your advisors don't have all the answers, and that wealth management – like life – is not an exact science;
- A desire to be a conscious and prudent consumer;
- Realistic investment objectives and a willingness to communicate those expectations to your advisory team clearly;
- A willingness to accept the investment returns offered by the market, recognizing that there is no foolproof way to "beat the market" or achieve above-average performance;
- A commitment to ignoring all "financial pornography" (CNBC, financial magazines, well-intended co-workers, friends, relatives, and neighbors);
- A commitment to hold up your end of the engagement by delivering financial information and other requested relevant information as well as completing the necessary tasks in a timely manner;
- A recognition that big goals can be achieved by making small changes consistently over time; and
- A willingness to delegate unwanted work to a professional financial advocate on an ongoing basis.

Appendix A: 10 Questions You Should Ask Any Financial Advisor

In 2008 the SEC commissioned a report about broker-dealers and investment advisers, which included a section on how consumers viewed them. The SEC highlighted that most consumers were satisfied with their financial services professional.

Yet, within the report was a startling fact. Thirty percent of the consumers who used financial advisors stated that they paid no fees to their advisor! In other words, they thought their broker was giving them recommendations for free. (Given that investment advisers provide written statements of their fees to their clients, typically quarterly, it would appear that the percentage of clients of brokers (i.e., registered representatives of broker-dealer firms) that didn't understand that they were paying fees was actually much higher.

I sometimes review the investment portfolios of individual investors and plan sponsors. I uncover, and add up, all of the fees and costs of the investment products many brokers and insurance agents recommend, as part of that process. And I discern the likely compensation the individual investor has paid to, and continues to pay, to the broker-dealer firm or insurance company. When I reveal this information to the individual investor or plan sponsor, they are often stunned. (Yes, some individual investors I have met with believed that their broker or insurance agent was their "friend" and was providing all of his or her recommendations "for free." Wall Street firms are masters at hiding their fees.)

Far too many financial advisors today hold themselves out as "fiduciaries." While being a fiduciary is important, it is not enough for the consumer to ask just that question.

So, I created this list of ten TOUGH questions every consumer of investment or financial planning advice should ask. Whether the consumer is an individual investor, plan sponsor, endowment fund manager, foundation investment committee member, or trustee.

> **To aid in your understanding the importance of each question (and, candidly, also as a means to promote my own firm), I provide my own responses to these questions (as the principal of Scholar Financial, LLC).**

What Questions Should I Be Asking a Financial or Investment Advisor? And … What Are Your Answers to Such Questions?

1. Will you and your firm be a fiduciary at all times during our professional relationship? And will you provide me with a copy of your Form ADV, Parts 2A and 2B, and your own U-4?

Yes.

While being a "fiduciary" is very important, unfortunately in the United States the regulation of fiduciaries in the realm of investment and financial advice still permits many fiduciaries to possess substantial conflicts of interest. Much more is needed … read on.

Every investment adviser is a fiduciary, by law. As such, you should request from your investment adviser three documents for your review:

Form ADV, Part 2A (the "firm brochure" that describes its services, fees, conflicts of interest, and more).

Form ADV, Part 2B (information about the firm's individual advisors).

Form U-4 (the financial advisor's employment history and a record of any disciplinary activity).

2. Are both you and your firm a fee-only advisor?

Yes.

Why is this important? Under existing securities regulation in the United States, you can be a "fiduciary" and still sell investment and insurance products. This puts the financial advisor in a conflicted role – trying to represent the client (the purchaser of financial products) and the product manufacturer (the mutual fund company, insurance company, etc.) – at the same time. In my view, it is just not possible to be a bona fide fiduciary if you wear "two hats" at the same time. No person can serve two masters.

Fortunately, there are many financial advisors who are "fee-only." They don't sell any investment or insurance products. As a result, the conflicts of interest they possess are far less numerous.

Conflicts of interest in financial services, truth be told, are best avoided, as it is very, very difficult to "properly manage" conflicts of interest. (See my blog post, Fiduciary Papers #6.)

My best advice to consumers … always seek out a "fee-only" financial and/or investment advisor. You can find them via the National Association of Personal Financial Advisors, XY Planning Network, Garrett Planning Network, and the Alliance of Comprehensive Planners.

3. Will you provide advice and/or management of my investment portfolio under the tough standard of the prudent investor rule?

Yes.

By way of explanation, the duty of due care a fiduciary investment advisor possesses generally requires that the investment advisor possess a "reasonable basis" for her or his investment strategy and investment product recommendations. What does this mean? Ask different financial and investment advisors, and you will likely get different answers.

As a result, Scholar Financial, LLC agrees to adhere not just to the fiduciary standard of due care, but also to the tougher "prudent investor rule." (Adherence to the prudent investor rule shall not lower, nor abrogate, our duty of due care, in any way.)

While the requirements of the prudent investor rule are many, there are two key requirements that can be derived – and applied – to a client's investment portfolio:

First, the requirement to avoid or minimize idiosyncratic risk, absent a good reason to assume such risk. In other words, through broad diversification, seek to eliminate or minimize the inherent risk of many individual securities (stocks, corporate bonds, etc.). To minimize terminal wealth dispersion (and improve the likelihood of the attainment of the client's lifetime financial goals), this means diversification by holding hundreds, and even thousands, of different equities (stocks). (Broad diversification can also assist in tax-efficient investing, compared to concentrated portfolios of equity holdings.)

Second, the requirement to avoid a "waste" of the client's assets. In my view, this means maintaining tight control over the fees and costs the client incurs in connection with various investment products. It also means seeking to minimize the long-term tax drag on an investment portfolio's returns. It can also means avoiding or substantially minimizing permanent losses in a client's portfolio that might be incurred due to a lack of adequate diversification.

(Note that Scholar Financial, LLC's individual clients may choose to have the prudent investment rule not apply to a portion of their investment portfolio. For example, a client may desire to retain a significant stock position in one or more companies, even though that is not Scholar Financial, LLC's advice.)

4. Are you a Certified Financial Planner™ (CFP®), Chartered Financial Analyst (CFA®), or a CPA/Personal Financial Specialist (CPA/PFS®)?

Ron is a Certified Financial Planner™ (CFP®).

Why is this important? This is one of the three broad-based financial certifications or designations which, in Ron's view, denote the acquisition of a significant foundational knowledge of investments and financial planning concepts.

Ron is also an instructor for financial planning and investments courses to university students. He teaches courses in Personal Finance, Applied Investments, Estate Planning, Legal and Regulatory Aspects of Personal Financial Planning, and Financial Plan Development (capstone course). He has previously taught courses in Advanced Investments, Retirement Planning, Capital Markets, Principles of Finance, Risk Management and Insurance, and Business Law I and II. Ron also serves as Director of Western Kentucky University's Personal Financial Planning Program. (See "https://ronrhoades.com/about/ for more information.)

There are literally hundreds of designations and certifications in financial services. Be certain to seek professionals with certifications that require hundreds, if not thousands, of hours of study – to ensure the certification "has teeth." The three certifications listed in the question, above, meet this requirement.

5. Will you NEVER recommend to me any proprietary product, nor any investment or insurance product for which you, your firm, or any affiliated firms receive any material compensation, including but not limited to commissions, 12b-1 fees, payment for shelf space, or any other form of revenue sharing?

Yes, I make that solemn commitment.

There is no need for a financial advisor today to recommend any proprietary product, nor to recommend investment or insurance products which benefit either the advisor, her or his firm, or affiliates of his or her firm.

There are many thousands of mutual funds, ETFs, and other investment vehicles in existence today. When a financial advisor works for an asset management firm or insurance company that manufactures investment products (such as mutual funds, ETFs, annuities, cash value life insurance, etc.), such a firm or company encourages the financial advisor to recommend proprietary products. This creates a conflict of interest that often taints the advice that is provided.

It is far better that the financial advisor be truly independent – and able to survey the entire universe of investment and/or insurance products to discern those few that best meet the needs of her or his clients.

Again, being “fee-only” means avoiding the conflicts of interest that result from recommending such proprietary products, and recommending products that pay commissions or provide revenue sharing to the advisor or her/his firm (or affiliates).

6. Will you utilize an independent custodian (such as an discount broker-dealer firm, such as Schwab, Fidelity, Vanguard, etc.), and will you avoid taking custody over my assets (except for deduction of fees supervised by the independent custodian), in order to better ensure that my investment assets are protected? Will you ensure that the independent custodian provides to me, directly to me from the independent custodian, monthly or other periodic reports that verify my holdings?

Yes.

Please be aware that Scholar Financial, LLC is provided, with respect to accounts its clients hold at Schwab, and with client consent, the ability to deduct our fees from clients’ accounts. In certain instances (such as traditional IRA accounts), this can be a tax-efficient means of paying for our services. In all such instances, the custodian (Schwab) monitors fee deductions from client accounts in order to seek to spot any irregularities.

Why is this important? Having an independent custodian, who directly provides clients with statements on their accounts, is an important safety measure for you, the client. This substantially diminishes the risk that your “financial advisor” (however licensed) might engage in theft of your assets, or engage in a “Ponzi scheme.”

It is a best practice for you to always review your monthly (or quarterly) statements from the independent custodian. In short, “trust … but verify.”

If you detect unusual activity, or a transaction that you don’t understand, query your advisor. If suspicions remain, seek a second opinion from a different advisor – quickly.

If you detect any theft or other taking of property from you, don’t hesitate to contact a federal or state securities regulator.

The North American Securities Administrators Association (NASAA) provides this good list of “warning signs of fraud.“

The U.S. Securities and Exchange Commission regularly provides “Investor Alerts and Bulletins.”

7. Will you provide to me a summary of the academic evidence that supports the investment strategies that you recommend to me?

Yes.

Scholar Financial, LLC utilizes “evidence-based investing” as its core investment philosophy.

A summary of evidence-based investing is provided in the Investment Policy Statement we prepare for each of Scholar Financial, LLC’s clients.

Evidence-based investing will be explained, in detail, in Professor Rhoades’ forthcoming book, *Mastering the Science and Art of Investing: Multi-Factor Strategies for Portfolios Both Prior to and During Retirement*, expected to be published by late 2023.

8. If I engage you to design and/or manage my investment portfolio, will you provide me with an Investment Policy Statement that describes the investment strategy recommended and which establishes a strategic asset allocation for me?

Yes.

Why is this important? While not required by law, every individual investor (or trustee, or endowment fund manager) should possess an Investment Policy Statement. Not only does your investment advisor agree to abide by its terms, but the document also can provide you with a plan for what will occur when market valuations go substantially up, or down. This helps you – and the investment adviser – adhere to the discipline of strategic asset allocation and portfolio rebalancing.

An Investment Policy Statement can be one pages, or many, many pages. It usually addresses the time horizons over which the investment portfolio is to be utilized, and sets forth an asset allocation (by asset classes, and/or by specific investments). The Investment Policy Statement also typically identifies types of investments which the investment advisor will not invest in. Accordingly, the Investment Policy Statement provides the client with assurance that the portfolio will be managed by the investment adviser under a defined set of criteria and a common understanding.

9. Will you provide to me a written estimate of the total fees and costs (including your investment advisory fees, annual expense ratios of mutual funds and ETFs, and transaction costs relating to trading – either by you or by mutual funds and ETFs or other pooled investment vehicles that you recommend to me) that I will incur in connection with my investments?

Yes, upon request by any client.

Scholar Financial, LLC has several programs for clients. Our most common engagement for individual clients is under our “SF Wealth Advisory Program,” in which we provide comprehensive financial advice over time, combined with investment portfolio management. Our highly competitive fees are 0.5% of the first $2,000,000, and 0.15% of the amounts over 0.15%. We keep our fees low by avoiding many of the underlying infrastructure costs born by larger firms, and we concentrate on providing services that truly add value to our clients.

Institutional clients (endowment funds, etc.) and trustees of irrevocable trusts are provided fees of 0.40% of the first $3m, and 0.15% thereafter, for portfolio design and management services.

Further information on all of our services and fees can be found in our Form ADV, Part 2A, available upon request. Simply email advisorinfo@scholarfinancial.llc, and we will be pleased to send you same.

Scholar Financial, LLC, as part of its due diligence, seeks to identify mutual funds, ETFs, and other investment and insurance products which possess very low total fees and costs, as academic research has concluded that the higher the fees and costs of an investment (relative to other similar investments), then (on average) the lower the returns provided to the owner of that investment product.

There are many “hidden” fees in pooled investment vehicles (mutual funds, ETFs, etc.), including various transaction costs and opportunity costs. While these hidden fees cannot always be quantified, they can be estimated.

By combining all of the fees and costs associated with the management of your investment portfolio and the products within it, you can be provided a “total fees and costs” estimate.

Scholar Financial, LLC’s goal is that the “total fees and costs” born by our individual clients, for comprehensive financial planning and investment portfolio management, is well under 1% annually, and it is often far less for much larger portfolios.

10. Will you design and manage my investment portfolio with a view toward long-term tax efficiency, in order to reduce the "tax drag" upon investment returns?

Yes.

Scholar Financial, LLC regards tax-efficient investment portfolio design and management as essential for nearly every client.

I remain aghast at the large number of brokers and investment advisory firms that don't engage in tax-efficient portfolio design and management. It is not what you make, it's what you keep – after fees and taxes – that is most important.

In general, tax-efficient portfolio management aims to minimize taxes on investment gains and income while still achieving the investor's investment goals. Some of the strategies commonly used to achieve this include tax-loss harvesting, asset location optimization, and tax-efficient fund selection.

According to various studies, tax-efficient portfolio management can add between 0.5% and 1.5% annually to after-tax returns, depending on the circumstances. For example, a study by Vanguard found that tax-efficient strategies added an average of 0.75% annually to after-tax returns for a balanced portfolio of stocks and bonds.

(Certain clients, such as endowments and foundations, are exempt from tax concerns.)

BONUS QUESTION: Will you, upon my request from time to time, put the answers to my questions above (and any others I possess) in writing?

Yes. See the above! IF A FINANCIAL/INVESTMENT ADVISOR AND HIS/HER FIRM DOES NOT ANSWER AFFIRMATIVELY TO ALL OF THE QUESTIONS SET FORTH ABOVE, OR STATES THAT THEY CANNOT PUT THEIR ANSWERS IN WRITING, THAT IS A HUGE RED FLAG (WARNING SIGN) TO YOU!

This page represents the personal views of Ron A. Rhoades, JD, CFP®, and does not necessarily reflect the views of any institution, firm, organization, motley crew of pirates, cult, or gang, to which Ron has ever belonged to or ever been kicked out of.

To subscribe to Ron's blog, please visit www.ronrhoades.com.

To learn more about Scholar Financial, LLC, please email AdvisorInfo@ScholarFinancial.com and request a copy of Ron's Form ADV, Part 2A and 2B, which details the firm's services and fees. Some of this information is also found on the FAQ portion of this web site.

To learn more about Western Kentucky University's innovative B.S. Finance (Personal Financial Planning track) degree program, its Personal Finance Summer Camp for high school students, and its dual credit Personal Finance course for high school students, please email Ron at ron.rhoades@wku.edu.

Appendix B: FAQ Regarding Dimensional Fund Advisors

Scholar Financial, LLC utilizes mutual funds from Dimensional Fund Advisors (DFA), although funds from other mutual fund companies (such as Avantis, Vanguard) may occasionally be utilized. Our extensive due diligence on mutual fund selection has shown that DFA mutual funds are among the “best in class” mutual funds available. In this appendix, we offer answers on some of the most frequently asked questions regarding Dimensional Funds Advisors.

Is there a “concentration risk” in consolidating the majority of assets with a single mutual fund company?

Investing with a single fund company that actively picks individual securities can overexpose a client to specific sectors or investment styles that the manager favors, limiting the risk reduction offered by diversification. To achieve the broadest possible diversification, the various strategies of Dimensional Funds Advisors seek to invest in every eligible stock in each stock asset class in which the funds invest. Typically, this means constructing asset allocations that own several thousand stocks. With Dimensional, you are not relying on a star manager to generate results; you are relying on capital markets.

How is the security of my investments ensured by DFA?

The structure of Dimensional’s mutual funds provides protection against malfeasance of employees and offices by having all assets held at a custodian that is separate and independent from Dimensional, as well as regulated by US banking laws. Additionally, Dimensional adheres to its own fiduciary duty to shareholders of the mutual funds by virtue of its status as an investment advisor.

Who watches and regulates mutual fund investment companies?

Dimensional’s mutual funds are a separate investment companies, each registered with the SEC. Each mutual fund is also subject to an annual review its Board of Directors. The Board also annually reviews and renews the investment advisory agreements in place with Dimensional. This Board is comprised of a majority of individuals who are independent directors and not affiliated with the investment advisory activities of Dimensional. Separate from the mutual funds are the registered investment advisory firm of Dimensional Fund Advisors, regulated by the U.S. Securities and Exchange Commission. DFA Securities Inc. is a broker-dealer whom distributes the mutual funds and is registered with and regulated by the Financial Industry Regulatory Authority (FINRA).

Mutual funds and exchange-traded funds are, in essence, heavily regulated and monitored. It has been very, very rare that any client’s funds have been stolen by mutual fund managers. (In fact, I cannot discern any time that this has occurred, in the history of mutual funds. This is in large part due to the requirement that mutual funds utilize an independent custodian.)

(Scholar Financial, LLC does NOT recommend any hedge funds, nor private equity investments, in part because these types of investments are not as heavily regulated or monitored.)

How is Dimensional monitoring market timing, a practice detrimental to long-term investors?

Market timing involves, in most cases, the relative slowness of mutual fund share prices to reflect the price changes of underlying securities, particularly in international stocks. Dimensional has implemented a “fair value pricing” policy, designed to mitigate this issue.

What is Dimensional Fund Advisors policy regarding Disaster Recovery?

Dimensional has its own Business Continuity and Disaster Recovery Plan which provides written guidelines designed to sustain the firm’s critical functions and to restore further operational function as soon as possible following a disaster. As part of this plan, Dimensional has implemented the following:

- Critical data pertaining to trading, operations, and client service systems is backed up daily.

- In a serious event, such as an earthquake or fire, the Business Recovery Team serves to communicate and coordinate with Dimensional’s various offices to ensure the quick resumption of critical functions such as trading, fund operation, and telecommunications. A backup worksite would be activated and critical personnel would be deployed to other sites to further ongoing recovery efforts. The Business Recovery Team will also communicate to Dimensional’s clients – either via website postings or phone numbers – the nature and current status of the emergency.

- Dimensional also holds offices throughout the world – in Austin, Charlotte, Sydney, London, Chicago, and Vancouver – which are part of any major recovery scenario.

Appendix C: An Introduction to Factor-Based Investing

The following are excerpts from a draft of Dr. Rhoades' forthcoming book, *Mastering the Art & Science of Investing.*

<u>Excerpt from *Chapter 16: Factor-Based Investing, Generally*</u>

Over the decades, researchers have uncovered hundreds and hundreds of different characteristics - "**factors**" - which may determine the returns of different types of investments. Yet, many of these factors are not robust (persistent), and other factors may be too expensive to implement in the attempt to secure higher returns for the investor.

Despite the overwhelming evidence in favor of "passive" investment management, certain anomalies exist in which subsets of stocks, formed around certain financial characteristics of corporations, can possess a high probability of outperformance of the overall stock market over very long periods of time. In essence, **factor-based investing** can be utilized to "beat the market" – over very long periods of time. Factor-based investing is sometimes referred to as "**smart beta investing**" or "**strategic beta investing**." Factor-based investing is also sometimes referred to as "**evidence-based investing,**" although factor-based investing may be better thought of as a subset of the principles underlying evidence-based investing.

A **"factor"** is a characteristic of a stock or bond that influences the returns of that stock. It is said to be a "driver of returns." These characteristics are often found from various financial data about a company or its stock or bonds. Examples include price-to-earnings ratio, or gross profits-to-assets, market capitalization, duration (of a bond), or financial strength rating.

There are "economic factors" that are not discussed in this opinion letter, such as short-term interest rates, term or credit spreads, expected inflation, measures of industrial production, GDP growth, employment rates, etc. The ability to use such economic factors in portfolio design and management to lead to superior returns is suspect. Instead, this paper concentrates on the factors discerned from the financial data of a corporation, following observations by many academic researchers over the past five decades, including the research of Professors Eugene Fama, Sr. (a winner of the Nobel Prize in economics) and Kenneth R. French. These professors first postulated the Fama-French 3-Factor model in 1993, in which they synthesized the research of other professors to provide a better explanation of the firm or stock pricing characteristics that contributed to the expected returns of stocks (on average).[1]

The **Fama-French 3-Factor Model** includes these three generally accepted factors:

(a) **The equity factor** – which might be stated as follows: Over any given 20-year period, a diversified basket of stocks (such as might be found in a "total U.S. stock market index fund") has a very, very strong probability of outperforming a diversified basket of high-

[1] Eugene F. Fama and Kenneth R. French, Common risk factors in the returns on stocks and bonds, Journal of Financial Economics 33, 3-56 (1993).

quality bonds (or, alternatively, 1-month U.S. Treasury securities, which provide a "risk-free" rate of return).

(b) **The size factor**, also called the small cap risk premium or the small cap factor, which might be stated as follows: Over any given 20-year period, a highly diversified basket of small company stocks (*i.e.,* stocks with a "market capitalization" of less than $2 billion, for U.S. stock market purposes) has a very, very strong probability of outperforming a diversified basket of U.S. stocks.

(c) **The price factor**, also called the value risk premium or the value factor, which might be stated as follows: Over any given 20-year period, a highly diversified basket of value stocks (*i.e.*, stocks which possess a low price-to-book ratio, or relatively low price—to-earnings, price-to-sales, or price-to-cash-flow ratios) has a very, very strong probability of outperforming a diversified basket of U.S. stocks.

The above model for discerning high probabilities of "outperforming" the entire stock market has been added to, with three additional factors, which now form **the Fama-French 6-Factor Model**[2]:

(d) **The profitability factor** – a particularly robust factor, which might be stated as follows: Over any given 20-year period, a highly diversified basket of "high profitability" stocks (*i.e.*, stocks which possess high profits in relation to the size of the corporation's assets or equity) has a very, very strong probability of outperforming a diversified basket of U.S. stocks.

(e) **The investment factor** – which remains somewhat controversial, which might be stated as follows: Over any given 20-year period, a highly diversified basket of "low investment" stocks (*i.e.*, stocks of companies in which extra cash is returned to shareholders mostly, rather than being invested into expanded production or new products or services or in acquisitions) has a very, very strong probability of outperforming a diversified basket of U.S. stocks.

(f) **The momentum factor** – which likely can be utilized to time the trading of securities, but not as an isolated factor – and which might be stated as follows: Over any given 20-year time period, using momentum factor to delay (for 1-6 months) the sales of stocks with positive momentum (i.e., the stock has outperformed the market over the past 6-12 months), or to delay purchases of stocks with negative momentum, will likely add to the portfolio's returns.

It should be emphasized that the Fama-French 6-factor model is only a model of explaining the returns of various collections of stocks (*i.e.*, asset classes formed using one or more of the factors). No asset pricing model is perfect. Additionally, changes in the world of business (stated differently, changes in the corporate landscape) and widespread knowledge and application of the factors[3] can lead to future results from factor applications that differ from historical returns data.

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[2] Eugene F. Fama and Kenneth R. French, Choosing factors, Journal of Financial Economics, vol. 128, no. 2, pp. 234–252 (2018). *See also* Eugene F. Fama and Kenneth R. French, A five-factor asset pricing model, Journal of Financial Economics 116, 1-22 (2015), which excludes the momentum factor. The Fama-French factors are now beta (equity factor), size (small cap factor), book-to-market (price, or value factor), profitability, investment, and momentum.

[3] *See, e.g.*, McClean, R.D., and Pontiff, J., Does Academic Research Destroy Stock Return Predictability?, Journal of Finance, Vol. 71, 5-32 (2016).

Other factors have been identified, which possess *modest* academic support and which are used by some mutual funds and ETFs, including:

(g) **Quality factor –** a combination of the profitability factor with a steady history of earnings growth, or a good balance sheet (low amounts of debt) or other attributes;

(h) **Low-volatility factor** (or anomaly) – a diversified basket of low-volatility stocks may outperform a diversified basket of high volatility stocks over long periods of time; and

(i) **Carry factor –** which, when applied to stocks, essentially states that a diversified basket of high-dividend stocks possesses a strong probability of outperforming a diversified basket of low-dividend stocks (this factor is very closely correlated with the value factor).

Hundreds of other "factors" have been "discovered" through academic research, but only those stated above appear, at the present time, to be robust[4], persistent, and investable in a cost-efficient manner.

Excerpt from *Chapter 19: The Price Factor: In Search of Value Stocks*

A study for the period from January 1992 through June 2017 examined the price factor using quintiles, while also breaking the data set by size. The average excess monthly returns are then shown:

	Growth Stocks			Value Stocks	
	1	2	3	4	5
Small	0.21%	0.92%	0.97%	**1.15%**	**1.20%**
2	0.61%	0.87%	0.91%	0.94%	0.98%
3	0.59%	0.89%	0.89%	0.92%	1.13%
4	0.78%	0.88%	0.79%	0.95%	0.78%
Large	0.61%	0.74%	0.77%	0.47%	0.83%

[4] By robust, this author means that the factor is likely to be observed to provide an addition to the returns of an investment portfolio, over and above the exposure to the equity factor obtained through the purchase of a low-cost total stock market index fund. The Fama-French 6-factor model has been the subject of a large body of academic research and has found support in research studies in many different geographic markets, although not all factors are deemed additive to returns in every market. As summarized in Mesut Doğan, Mustafa Kevser, Bilge Leyli Demirel, "Testing the Augmented Fama–French Six-Factor Asset Pricing Model with Momentum Factor for Borsa Istanbul", *Discrete Dynamics in Nature and Society*, vol. 2022, Article ID 3392984, 9 pages, 2022. https://doi.org/10.1155/2022/3392984: "The five-factor model was tested for countries with developed stock markets, including North America, Europe, Japan, and the Asia Pacific, and it was concluded that the model was more successful in explaining the change in average returns. For instance, Lin concluded that the five-factor model outperformed the three-factor model in the Chinese market over the period 1997 to 2015, whereas the important investment factor was redundant. Huang, in compliance with the results of Lin, determined that the five-factor model was superior to other asset pricing models in the Chinese market over the period 1994–2016. Leite et al. investigated the Fama–French three-factor, four-factor, and five-factor models for developing countries. The results of the research study indicated that the four-factor and five-factor models outperformed the three-factor model. The value factor seemed unnecessary in the presence of profitability and investment factors, and the size factor was effective in average stock returns. In his research study on 18 different developing countries, Foye concluded that the five-factor model outperformed the three-factor model. Nonetheless, profitability and investment premiums were not distinguishing enough for Asia. Cox and Britten asserted that the five-factor model best explained the cross-sectional returns in the Johannesburg stock market, and the profitability factor was more consistent than the investment factor. Ali et al. tested the Fama and French three-factor, five-factor, and six-factor and Carhart's four-factor models for the Pakistan stock market over the period 2003–2016 and concluded that the Fama and French five-factor model explained the abnormal change in returns better than other models. At the same time, according to the research study, the profitability factor was effective in explaining the average returns. According to Mosoeu and Kodongo, the profitability factor was effective in explaining stock returns in countries such as Australia, China, and South Africa; however, research studies conducted in the American and Japanese markets differed. Guo et al. detected that the factors of size, value, and profitability had strong impacts in explaining the average returns for the Chinese stock market; however, they concluded that the investment factor had a weak impact. Zaremba et al. tested the Capital Asset Pricing Model, Fama and French three-factor asset pricing model, Carhart's four-factor asset pricing model, and Fama and French five-factor asset pricing model over the period 2000–2018 for Poland, which was categorized as a developing country. According to the results of the research study, the four-factor model performed better than the other models. In their research study, conducted on the Japanese market over the period 1978–2014 employing the GMM method, Kubota and Takehara concluded that the Fama and French five-factor asset pricing model was not the best pricing model." [Citations omitted.]

Source: Tim Mooney, "Size and Book-to-Market: Comparing Factor Loadings, Characteristics, Methodologies, and Time Periods," utilizing stock return date from CRSP for stocks listed on the NYSE, NASDAQ, and AMEX, excluding financial firms, utilities, ADRs, closed-end funds, preferred stocks, REITs, and stocks with a price of less than $1. Book value data obtained from Compustat. Data is for the period January 1992 through June 2017. **Past performance is not a guarantee of future returns.** The results are hypothetical results and are NOT an indicator of future results and do NOT represent returns that any investor attained. Indexes are unmanaged, do not reflect management or trading fees, and one cannot invest directly in an index.

As seen in the chart above, small value stocks possessed the highest average monthly excess returns. Mid-cap value stocks also performed well. Among large company stocks, there was a more modest degree of higher returns for value tilting.

Value stocks tend to outperform growth stocks ...

There is pervasive historical evidence of value stocks outperforming growth stocks. Data covering nearly a century in the US, and nearly five decades of market data outside the US, support the notion that value stocks—those with lower relative prices—have higher expected returns.

Recently, growth stocks have enjoyed a run of outperformance vs. their value counterparts. But while disappointing periods emerge from time to time, the principle that lower relative prices lead to higher expected returns remains the same. On average, **value stocks have outperformed growth stocks by 4.1% annually in the US since 1927 ...**

There are several risk-based explanations for the price factor (also called "value risk premium") (i.e., because of the greater risk of value stocks, greater returns exist):

- Value stocks are often found in companies often possess more debt. Companies with more debt find it harder to meet their obligations during recessions.
- Value stocks are sometimes in companies that are already in financial distress.
- Value stocks may face more earnings risk, than growth stocks.
- Value stocks are often found in companies that have larger amounts of assets to enable production. During economic recessions, this can result in nonproductive assets, which drags upon returns.
- Even on a diversified basis, value stocks (as an asset class) tend to fall further in value than growth stocks during major economic downturns.

There are several explanations for the price factor offered by the field of behavioral finance:

- Investors naively extrapolate past growth when evaluating a company's stock, and thus overreact to that information, resulting in a situation where the stock gets overpriced.
- Investors tend to overreact to good news about a company, often causing the stock price of a growth stock to exceed its intrinsic value.

Investors tend to overreact to bad news about a company, often causing the stock price of a value stock to be less than its intrinsic value ...

Excerpt from *Chapter 24: Factor Correlations*

By combining these factors in an investment portfolio, the risk of underperformance, relative to the entire stock market, is minimized during shorter time periods. This is because each these factors tends to work best at different times. In essence, "multi-factor investing" reduces the risk of going through an extended period of underperformance. For investors that are averse to long periods of potential underperformance of a few investment strategies, such an approach can serve to calm them and help them stay invested in common stocks for the long run ...

Combining exposures to multiple drivers of returns — otherwise known as factors — can lead to a fund that has higher returns, lower volatility, and lower costs.

A fund's returns may possess a lower degree of volatility, especially when the factors utilized in the fund's construction possess less correlation to each other. During certain time periods, an exposure to a factor can result in an extended period of underperformance relative to the overall market. For example, this occurred during the period from 2010-2021, when growth stocks generally outperformed value stocks. Yet, during the same period, exposure to the high profitability factor, if also provided by the fund, would have increased the returns of the fund.

In essence, multi-factor funds, which simultaneously target two or more factors (other than the equity factor itself), employ the power of diversification.

THIS IS THE END OF "FREQUENTLY ASKED QUESTIONS" by SCHOLAR FINANCIAL, LLC.

Should you possess specific questions about Scholar Financial, LLC's services, processes, and/or investment philosophy, please contact us directly.

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