

INSIGHTS

INVESTMENT OVERVIEW

FEE ANALYSIS 101

There are few industries where the lack of transparency is as pervasive as it is in wealth management. Having been structured as a fee-only advisory firm for more than thirty years, Rinehart Wealth & Investment Advisory has been a pioneer in providing customers with a clear understanding of fees. That being said, there remains substantial ambiguity around the *total* cost of investment management relative to wealth advisory work, as well as a lack of comparability across the advisory industry, perpetuated by opaque and ambiguous compensation structures. In an attempt at financial lucidity, we will provide a brief history and overview of investment management fees, explain the variations in investment management fee structures, and outline a framework for comparing investment management fees.

BRIEF HISTORY & OVERVIEW OF INVESTMENT MANAGEMENT FEE STRUCTURES

Up until the early-1990s, brokerage firms and broker-dealers were the only way for individual investors to gain access to financial markets due to prevalent informational asymmetries and an inability to transact directly on the exchanges. With respect to individual and non-institutional clients, broker-dealers are registered with the U.S. Financial Industry Regulatory Authority (“FINRA”) and are subject to the Suitability Standard, which simply requires broker-dealers to make

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WEALTH ADVISORY OVERVIEW

WHY YOU SHOULD CARE ABOUT TAX PLANNING

Tax planning is a critical component of any individual’s comprehensive financial plan. The term tax planning is often used, but its meaning is not always understood. Tax planning is the exercise of arranging your financial affairs in an effort to minimize taxes. As wealth is accumulated, taxes become an even greater expense for most individuals. Therefore, planning to reduce taxes is a critical part of the overall financial planning process.

March and April are always busy as we work to provide CPAs with the information they need to get tax returns filed by April 15th. Although clients may be happy to have their return finalized, this newly-filed tax return contains a wealth of information about an individual’s financial situation, as well as opportunities for tax planning to improve their tax situation for the current year.

COMMON STRATEGIES USED IN TAX PLANNING

At each annual meeting, we ask clients to execute a Tax Authorization form that allows your CPA to share your annual tax return with your Wealth Advisor. Upon receipt of your tax return, we begin our review process to identify opportunities to strengthen your financial position. While not all taxes can be mitigated, understanding your tax situation and planning several years in advance can prove to be very advantageous with regards to the various strategies that can be utilized, which

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INVESTMENT TEAM

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WEALTH ADVISORY TEAM

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SPECIAL POINTS OF INTEREST

- Stock & Strategy Spotlight
- Monthly Index Review
- Around Rinehart

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investment recommendations that are deemed to be “suitable” for the client in terms of the client’s financial objectives, constraints, and unique circumstances. Financial advisers, on the other hand, are registered with the U.S. Securities and Exchange Commission (“SEC”) and are subject to the Fiduciary Standard, which requires an adviser to act solely in the best interest of that client at all times. There are specific requirements made for financial and investment advisers under the Fiduciary Standard, including the stipulation that advisers must put their clients’ interests above their own.

As the industry has continued to mature alongside monumental technological advancements, such as the proliferation of publicly-available, lower-cost investment management solutions, there has been a concurrent evolution in the financial advisory business model. Electronic trading platforms and global access to real-time financial market data have rendered commission-based brokerage practices obsolete or, at the very least, deficient relative to contemporary, full-service investment management and financial advisory firms. For clients and consumers, the most immediate and direct benefit has been a secular decline in fees and increased transparency amongst industry participants.

INVESTMENT MANAGEMENT FEE STRUCTURES

Transparency is paramount to effectively evaluating and comparing advisory fees and compensation structures relative to performance across the investment management industry. A transparent fee structure provides sufficient detail explaining *how* a firm’s advisory

fees are calculated, as well as the applicable fee schedules used to calculate *how much* the firm will be charging in management fees. We have provided descriptions for three popular advisory fee and compensation structures.

FEE ONLY

Fee-only advisers charge a singular fee based on assets under management (“AUM”), hourly rates, or flat fees (e.g., a flat retainer fee). Fee-only compensation structures provide transparency because they eliminate potential conflicts of interest, as the adviser is *only* and *directly* compensated by the client. A fee-only adviser only generates/earns income by managing client portfolios and ensuring that each client is satisfied, thereby aligning the adviser’s interests with those of the client.

FEE BASED

Fee-based compensation structures are similar to fee-only models in that they charge an annual fee for advisory and/or investment management services; however, fee-based structures do not prohibit the receipt of commissions or outside compensation for using investment products or services. This can reduce transparency into the true underlying costs, which creates uncertainty regarding the objectivity of fee-based compensation structures.

COMMISSION

Commission-based compensation structures are inherently biased and fraught with potential conflicts of interest, as they provide limited transparency into how the fees and expenses being paid by the client relate to the true cost of the advisory services provided by the firm.

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MONTHLY INDEX REVIEW (USD TOTAL RETURN)

DATA AS OF MAY 31 ST 2017	MAY 2017	2017 YTD	2016	2015
S&P 500	1.41%	+8.66%	+11.96%	+1.38%
Dow Jones Industrial Average	0.71%	+7.47%	+16.50%	+0.21%
NASDAQ Composite	2.67%	+15.72%	+8.87%	+6.96%
Russell 2000	-2.03%	+1.48%	+21.31%	-4.41%
MSCI Emerging Markets	2.98%	+17.34%	+11.60%	-14.60%
MSCI EAFE	3.81%	+14.40%	+1.51%	-0.39%
Barclays US Aggregate	0.77%	+2.38%	+2.65%	+0.55%

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INTERNAL INVESTMENT FEES

Many individuals continue to struggle with comparing management fees given the aforementioned multitude of compensation models, many of which are purposefully vague and obscure when it comes to fully disclosing the true, comprehensive fees clients incur. For example, a firm that receives commissions for using certain mutual funds is incentivized to use those investments as much as possible, regardless of whether or not it is cost-efficient for its clients.

While Rinehart is a fee-only adviser, we do invest in various investment strategies that charge underlying management fees and expenses, such as mutual funds, exchange-traded funds (“ETFs”), and separately managed accounts (“SMAs”). The annual management fees for mutual funds and ETFs are not recorded as explicit expenses within investment portfolios because these expenses are typically recorded as an accrued expense and netted out against the value of the investment portfolio when calculating the net asset value (“NAV”) per share, which both mutual funds and ETFs are required to do on a daily basis. Therefore, the performance of

the underlying investment portfolio of the mutual fund or ETF is reduced by these accrued expenses, which translates into an additional management fee for investors.

Due to Rinehart’s investment philosophy of mitigating diversifying across multiple asset classes according to long-term asset allocation strategies, it is virtually impossible to avoid incurring internal fees without sacrificing risk-adjusted performance.

Therefore, we focus on minimizing internal management fees and improving the total portfolio’s efficiency by incorporating individual stock selection and direct ownership of individual fixed income issues (i.e., bonds) wherever possible, thereby eliminating an additional layer of internal management fees and expenses.. Specifically, Rinehart believes in minimizing the impact of internal management fees by utilizing individual security selection and lower-cost passive management (i.e., ETFs) within efficient asset classes, while utilizing high-quality active management in inefficient asset classes, such as emerging market equities within International Equity and alternative investment strategies within Hybrids.

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STOCK & STRATEGY SPOTLIGHT

NAME	TICKER	2017 YTD
Triangle Capital Corp.	TCAP	-0.33%

DESCRIPTION & INVESTMENT THESIS

Triangle Capital Corp. (“TCAP”) is a business development company (“BDC”) that focuses on providing customized financial solutions to companies operating in the lower middle market, which is highly fragmented and underserved by commercial and investment banks. As a result of the exodus of larger banks from this market, the BDC industry has experienced significant growth over the past five years, with non-banks having increased their respective market share from 50% in 2000 to almost 90% as of 2015. Although BDCs have increased their market share, they have only penetrated a very small portion of the total addressable market, suggesting that there is still substantial opportunity for organic growth within the BDC industry. Due to its experienced management team and efficient operating model, TCAP has an impressive track record of a consistently generating low double-digit returns on equity (“ROE”), as compared to high single-digit ROE for comparable dividend-paying BDCs. Furthermore, TCAP has consistently covered its industry-high dividend with net operating income (“NOI”) and has never cut its dividend. Recently, TCAP has traded near the lower end of its historical average on a price-to-book value (“P/B”) basis, which is extremely attractive given the company’s aforementioned operating history and proven track record.

ABOUT RINEHART

Rinehart Wealth & Investment Advisory is an experienced, boutique Registered Investment Advisor dedicated to independent, comprehensive wealth management. Founded in 1985 by Mary Rinehart, the firm, from its inception, has had a singular focus: to provide highly customized investment management and financial planning solutions to clients.

Boutique Firm:

Being a boutique wealth management firm allows us the flexibility to provide more personalized service and offer unique investment solutions to clients in a Fee-Only environment.

Team Approach:

Because each client’s situation is different, the team of advisors is hand-selected to ensure areas of expertise are appropriately aligned with the client’s specific needs and interests.

Proprietary Investment Research:

The differentiating factor of our portfolio management process is the proprietary investment research driving the portfolio construction. All investment research and analysis is done entirely in-house by our Investment Team.

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Below, we have provided a comparison of two hypothetical portfolios, including a RWIA Sample Balanced Portfolio, which illustrates the aggregate impact of these cost minimization strategies on portfolio-level internal management fees. This can be done by reviewing the positions held in an investment portfolio and determining whether or not the underlying holdings have investment management fees. By calculating the weighted-average expense ratio of the underlying investment portfolio and adding the corresponding advisory fee, investors should be able to approximate the total, comprehensive cost of investment management.

As can be seen in the examples provided in Table I, Rinehart is able to lower internal management fees by approximately 15 basis points (“bps”), or 0.15%, through in-house, proprietary individual stock selection at no additional cost to our clients, while also concentrating our use of actively-managed investment strategies within specialized, inefficient asset classes. We believe that our in-house stock selection and lower internal investment management fees should positively contribute to improved long-term risk-adjusted returns (i.e., alpha) relative to portfolios with higher internal investment management fees, including any outsourced investment services, such as individual stock selection.

CONCLUSION

Rinehart is a fee-only, independent registered investment adviser (“RIA”) and generates 100% of its management fees by charging an annualized percentage of the total AUM of a client’s investment portfolio. This singular fee covers any and all financial planning and investment management services, including: strategic asset allocation development; portfolio construction and implementation; in-house stock selection; independent review and analysis of external managers; and comprehensive performance reporting. Therefore, we are incentivized to protect and grow each client’s investment portfolio, while also providing the highest-quality customized wealth management and financial advisory solutions.

Rinehart focuses exclusively on after-fee (“net”) portfolio-level performance, which is why we incorporate investment-specific fee analysis into our investment recommendations: the Investment Team will only recommend investing in a managed investment strategy if it has the necessary conviction that the strategy will generate sufficient alpha to justify its management fee. If an external portfolio manager or strategy is selected for client investment portfolios, the expense ratio charged by that strategy is separate and distinct from Rinehart’s advisory fees, and Rinehart does not receive any form of commission or referral fees for investing in the strategy.

TABLE I: COMPARISON OF HYPOTHETICAL PORTFOLIO INTERNAL MANAGEMENT FEES

PORTFOLIO-LEVEL COMPOSITION OF UNDERLYING HOLDINGS TYPE	WEIGHT	AVERAGE ANNUAL NET EXPENSE RATIO	WEIGHTED ANNUAL NET EXPENSE RATIO
RWIA SAMPLE BALANCED PORTFOLIO			
Cash & Cash Equivalents	1.00%	-	-
SMAs	22.50%	0.25%	0.06%
Mutual Funds	27.94%	1.01%	0.31%
ETFs	14.99%	0.22%	0.03%
Individual Stocks	33.57%	-	-
TOTAL	100%		0.39%
HYPOTHETICAL PORTFOLIO #1			
Cash & Cash Equivalents	1.00%	-	-
SMAs	22.50%	0.25%	0.06%
Mutual Funds	34.67%	1.01%	0.39%
ETFs	41.84%	0.22%	0.10%
Individual Stocks	0.00%	-	-
TOTAL	100%		0.54%

Source: Morningstar® - Rinehart Wealth & Investment Advisory

WEALTH ADVISORY OVERVIEW

WHY YOU SHOULD CARE ABOUT TAX PLANNING

can include the following:

- **Timing of Deductions:** Schedule A lists the deductions that were taken in the prior year. Taxpayers who are subject to the alternative minimum tax (“AMT”) may lose the benefit of some of their deductions. If that is the case, it may be a good idea to accelerate or delay some income or deductions wherever possible to avoid triggering the AMT. One example would be to prepay or defer state income taxes to maximize tax savings.
- **Timing of Income:** If possible, postponing income by maximizing retirement benefit plan contributions can be an effective strategy, especially if you are in a higher tax bracket.

THE IMPORTANCE OF YEAR-ROUND TAX PLANNING

Unfortunately, a lot of individuals fail to understand the importance of tax planning until they make a mistake that can cost them an unnecessary tax burden. Often taxpayers may not even be aware of these mistakes or possible tax savings opportunities. The key to effectively minimizing taxes is to plan ahead for future financial transactions.

ANOTHER CPA ADDITION AT RINEHART

Given that new tax legislation is introduced every year and the complexity of the U.S. Tax Code, effective tax planning can be challenging. However, if done properly it can provide significant benefits to your overall financial picture. At Rinehart, we believe tax

“Stability leads to instability. The more stable things become and the longer things are stable, the more unstable they will be when the crisis hits.”

- Hyman Minsky

WHAT IS TAX-EFFICIENT INVESTING?

Tax efficiency measures how much of an investment’s return is left over after taxes are paid. The more your portfolio returns are derived from income (i.e., interest and dividends) rather than price appreciation, the less tax efficient it will be. Tax planning is extremely important when customizing investment portfolios to ensure that they are as tax efficient as possible. This requires giving consideration to the location of assets, which is why we hold tax-efficient investments in taxable accounts and tax-inefficient investments in tax-advantaged accounts because doing so should add value to the portfolio over time.

From tax-free income through the use of municipal bonds to strategic asset location, we are always looking for ways to minimize the impact of your tax obligations and believe that tax efficiency is essential to maximizing returns.

planning is an extremely important component of your comprehensive financial plan for maximizing your after-tax investment returns. Therefore, we recently hired Michael Means to join our Wealth Advisory team as the third CPA on our staff. Michael has almost nine years of experience in public accounting, concentrating on high net worth individuals and closely-held businesses where quarterly and/or annual tax planning was a large focus. Michael holds a Bachelor of Business Administration in Accounting & Finance and an MBA with a focus in Accounting from Winthrop University. He is currently spearheading a whitepaper on tax planning and efficient after-tax investing, which will be out this fall.

Now that tax season is over, it is a good idea to ask your Wealth Advisor about unexplored opportunities to enhance your financial plan. Our team has broad and deep financial knowledge and can provide advice on a wide range of issues.

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AROUND RINEHART

RINEHART CELEBRATES GARDEN DEDICATION

The Rinehart family celebrated Mary's dedication of a fairy garden to the Duke Mansion. It was a lovely evening to introduce an extraordinary garden to the portfolio of amazing horticulture and design at one of Charlotte's best and most historic hidden gems.



39TH ANNUAL ESTATE PLANNERS DAY

Rinehart and Maybry McShane were proud premier sponsors of the 39th Annual Estate Planners Day held at Queens University on May 18th.



Leah Maybry served her seventh year on the Steering Committee, which brought nationally-recognized experts in the fields of estate planning, tax, accounting, insurance, and economics to speak at the one-day conference.

It was the perfect opportunity for continuing education, as well as networking with other professionals in our community.

RINEHART TEES OFF AT CROSSNORE GOLF CLASSIC

Earlier this month, Rinehart was a proud sponsor of the Hugh Fields Crossnore Children's Golf Classic in support of the Crossnore School & Children's Home.

Everyone enjoyed a beautiful and fun-filled day on the pristine course of the Linville Golf Club, and we were thrilled to support such a wonderful cause!



ECONOMIC OVERVIEW LUNCHEONS

We would like to thank everyone who joined us for our First Quarter Economic Overview Luncheons!

We continue to get positive feedback from these in-person and interactive presentations, and we look forward to hosting them every quarter!

UPCOMING CLIENT SURVEY

Please be on the lookout for our client survey, which we will be sending out later this month!



RINEHART WELCOMES THOMAS MACK!

We are excited to have Thomas Mack join Rinehart this summer for an internship with our Investment Team!

Thomas is currently a rising senior at Wake Forest University majoring in Economics, and we look forward to introducing you to him throughout the summer!

Rinehart Wealth & Investment Advisory

Wealth management is our only business; therefore, our attention is undivided and our intentions are transparent.

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