October 2013

Mallard Advisors

Comprehensive Financial Planning & Wealth Management Solutions

The MALLARD FLYER

Inside This Issue

The Tao of Investing

Paul S. Baumbach

In many areas of life, intense activity and constant monitoring of results represent the path to success. **In investment, that approach gets turned on its head.** The Chinese philosophy of Taoism has a word for it: "wuwei." It literally means "non-doing." In other words, the busier we are with our long-term investments and the more we tinker, the less likely we are to get good results.

That doesn't mean, by the way, that we should do nothing whatsoever. But it does mean that the culture of "busyness" and chasing returns promoted by much of the financial services industry and media can work against our best interests.

But it's not just Chinese philosophy that cautions us against busyness. Financial science and experience show that our investment efforts are best directed toward areas where we can make a difference and away from things we can't control. So we can't control movements in the market. We can't control news. We have no say over the headlines that threaten to distract us.

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Mallard is Splitting and Growing

It has been over ten years since we (Paul and Bill) formed our partnership. Since that time, our practices have grown, and we have opened two offices. This partnership was originally formed to provide idea sharing, cost savings, and a bigger presence. However, over time these benefits have lessened due to our growth and separate office locations. At this time, we both feel it makes more sense to simply separate our unique practices into two firms. This is not only due to the lessened benefits of our partnership mentioned above, but also for easier operational/regulatory management of the entire firm. It also makes future succession planning easier. This separation will be completed by December 31, 2013.

Bill's firm (Hockessin Office) will continue to be called Mallard Advisors, LLC, and Paul's (Newark Office) will become Mallard Financial Partners Inc. No changes to clients, services, or methodologies will occur as a result of this change. This is because over the years we have maintained separate clientele and operations anyway.

As far as other changes go, they will be minor. There will be some (forthcoming) administrative paperwork for clients to complete. There may also be some marketing changes (website, logo, newsletter, etc.). The Hockessin Office will maintain www.mallardadvisors.com while the Newark Office will use www.mallardfinancial.com.

While we know this change is important and inevitable, we also have mixed feelings due to our mutual respect for each other and the nostalgia associated with the "early days" of our business.

If you have any questions pertaining to this change, please feel free to contact either of us.

Bill Starnes & Paul Baumbach

Notices

Newark Office:

Alan, Ed, Paul, and Susan will be attending the NAPFA Conference in Philadelphia October 9-11. Paul and Pam will be on vacation in Puerto Rico December 4-9.

Hockessin Office:

Bill will be at the NAPFA Conference in Philadelphia from October 9th—11th. He will also be attending the ACA Conference in Tuscon, AZ November 6th-8th. The Hockessin Office will be closed November 28th & 29th as well as the week of December 23rd.

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The Tao of Investing...continued

But each of us can control how much risk we take. We can diversify those risks across different assets, companies, sectors, and countries. We do have a say in the fees we pay. We can influence transaction costs. And we can exercise discipline when our emotional impulses threaten to blow us off-course.

These principles are so hard for people to absorb because the perception of investment promoted through financial media is geared around the short-term, the recent past, the ephemeral, the narrowly focused and the quick fix. We are told that if we put in more effort on the external factors, that if we pay closer attention to the day-to-day noise, we will get better results.

What's more, we are programmed to focus on idiosyncratic risks—like glamour stocks—instead of systematic risks, such as the degree to which our portfolios are tilted toward the broad dimensions of risk and return. Ultimately, we are pushed toward fads that the financial marketing industry decides are sellable, which require us to constantly tinker with our portfolios.

You see, much of the media and financial services industry wants us to be busy about the wrong things. The emphasis is often on the excitement induced by constant activity and chasing past returns, rather than on the desired end result.

Four years ago a major television network asked me to be available for their market panel. In their solicitation, they included these directions: ***The aim of the segment is to advise investors where they can "make money now", and I look for something a bit spicier than the same-old "proper allocation/diversification strategy***." Think about that. In preparing this program, the media is **not** looking for the best advice, but rather the 'spiciest.' On one level this makes sense, for media is paid by advertising, and advertisers want viewership to be maximized.

We are all human. No matter how hard I try to avoid it, I rubberneck and glance at an accident across the median when driving down the highway. We all have some level of attention deficit disorder, and we can't help noticing flashy things. Today's media and financial industry specialize in grabbing our attention.

Well, so what? **How much harm is caused by this short-term focus?** This is difficult to measure; however we can see how poorly individual investors fare, compared with the underlying investments. Earlier this year market research firm Dalbar studied individual investors' results for the past 20 years. Stock investors underperformed the S&P by almost 4% a year, and bond investors underperformed a bond index by over 5% a year. The table shows how much $100,000 would have earned after being invested for 20 years through 12/31/2012.

Category	Individual Return	Benchmark Return
Bonds	$122,000	$342,000
Stocks	$230,000	$485,000

The difference is stark, with stock fund investors earning less than half as much as the benchmark, and bond fund investors earning only about a third. These lower returns come from investors following the headlines, buying the stock or stock fund that has just done extremely well, just in time to buy at the peak, and of course the painful opposite—selling at the low.

So what can we do? Just say no. View the financial industry's enticements and the financial media for what they are, advertisements and finance-related entertainment. They are NOT advice, and NOT analysis. Most importantly, they are distracting to good investing habits and principles.

In Taoism the student is taught to let go of factors over which he has no control and instead go with the flow. When you plant a tree, you choose a sunny spot with good soil and water. **Apart from regular pruning, you leave the tree to grow.**

Good investing is incredibly easy to describe and incredibly difficult to execute. We must identify the proper level of risk, build the portfolio with this level of risk, rebalance regularly (pruning), and then let it grow. Letting it grow means disregarding the noise of the financial press and financial firms. They are driven by building **their** fortunes, not ours.

Let's commit to turning off the financial press noise, and making our investing trees grow well.

[***Portions of this article come from "The Art of Letting Go," a May 2013 article by Jim Parker, a Vice President at Dimensional Fund Advisors.***]

Paul Baumbach is the Director of Investments at Mallard Advisors' Newark office.

Planning with a Commitment to our Future Self

William D. Starnes

I occasionally enjoy a good ***Looney Tunes*** cartoon with my boys, and recently saw one where Sylvester the pussycat was trying to gain some willpower over his desire to eat Tweety Bird. Joining B.A. (Birds Anonymous) was a public commitment to stop being a "bad ol' puddy tat", and an important part of his recovery. However, his will was weak (after all he is a pussy cat) and he was bombarded with TV and radio commercials about succulently prepared mouth-watering birds. He then took his commitment a step further and chained himself to the radiator. This is much like what Odysseus did when he tied himself to the mast so that he could listen to the enchanting song of the Sirens without sailing into the rocky coast of their island.

What do Sylvester and Odysseus have to do with retirement planning? They demonstrate the importance of using a "<u>commitment device</u>" to stick to their well-conceived plans. This article has been inspired by the writings of behavioral economists, including Richard Thaler (via the book *Nudge*) and Daniel Goldstein.

A commitment device is one of the ways we can get our "current selves" to keep a commitment that we make to ourselves when we are focused upon what we really want for the good of the long-term (to our "future selves"). This technique helps prevent us from doing something we will regret when we are in the heat of the moment.

Living within our means is a classic (yet unequal) battle between the current self and our future self—in other words, between immediate gratification and delayed gratification. The current self doesn't want to restrain spending; he wants the immediate gratification that comes with the enjoyment of travel and buying new "stuff". Yet the future self wants the current self to rein in the spending and instead save so that he can retire in comfort. If your future self were standing next to you as you are about to purchase the new (fill in the blank) that you don't really need, what would he say? Perhaps, "Bill, what are you doing? You need to know that I am 83 and don't have money to buy the medicine I need!"

Unfortunately, <u>it is the current self that is really in charge, isn't it?</u> It is our current self that is fully present while our future self can barely be imagined. Our current self is being asked for things (e.g., from our kids), or is bombarded with advertisements enticing us to spend. An excellent example playing on our current self's desires is the new *Verizon* commercial that shamelessly states "There is nothing like that feeling of getting something new…(especially) that thrill of getting a new phone". The wireless customer then opens the box over and over as the light and sound of heaven pours out. Our present selves are junkies for the euphoric high of consumption, only to leave our future selves in a serious pickle. Worse, some of us will even kill-off our future selves in order to rationalize the joy of spending now. Have you ever said, "I could be dead in a year anyway; therefore, I might as well enjoy myself". Worse, is if this self-deception goes on year-after-year (i.e. repeat until broke).

So a commitment device is used because resisting temptation is hard, and because we know (deep down) that **<u>we must protect our future selves</u>**. What are some examples of commitment devices that are used in the world of retirement planning to give more power to our future selves?

- A public commitment such as announcing on Facebook that your plan is to retire in Monaco within 10 years.
- The SMART (Save More Tomorrow) Program which allows 401(k) savers to commit today to save a chunk of their future raise in their 401(k)'s.
- Having an advisor to hold you accountable to your long-term plan. In fact, it has been found that the best way to enforce self-control and reduce procrastination is to have an "external rule enforcer", such as an advisor, friend, or spouse who can give rewards/punishments.
- Executing an Investment Policy Statement

Commitment to our Future Self...continued

(which says you will hold to a prudent and appropriately designed portfolio for your long-term plans through thick or thin).

- The use of Target-Date Funds which force changes in asset allocation over time.

To one degree or another these are all excellent tools, but even with great tools we still postpone retirement planning. Some would say it has more to do with denial, self-deception, procrastination, or impudent goals. However, behavioral economists would say it is more a lack of belief about our future. We are not able to imagine being retired (or older). We even find it hard to believe. We can't or don't want to imagine ourselves sitting in doctors' offices, relying on eldercare services, or sitting in a nursing home bed.

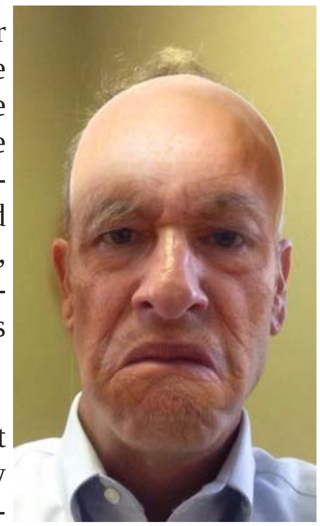
My Current Self

But perhaps we should. Perhaps this will make our future selves more real. Perhaps this will give our future selves a louder or more powerful voice. How can you make the reality of your future self more concrete?

One way used by retirement planners (including myself) is to attempt to illustrate potential futures of clients under different savings targets and therefore spending patterns. It is certainly possible to see what type of standard of living you would end up with if you maintained your current course versus deferring some consumption and saving more. So, perhaps seeing (and imagining) that our retirement age must be pushed back by five years, or our lifestyles cut by $30,000/year (in retirement) will help open our eyes to the stark reality of our future.

There are also free phone apps such as ***Age My Face*** that will show you what you will look like when you get older. Talk to your aged self by looking at the picture. If you can better visualize yourself old, perhaps you will gain some leverage towards making a change. These tools help us to really reflect upon what life will be like in the future when we are older and don't have the resources for family, healthcare, lifestyle, etc. Ask yourself what will happen if you don't save enough for retirement? What will life be like in the future if you keep spending your income and have little savings? What will this cost you in your relationships, your self-esteem, etc.? Visualize this clearly and experience what it will feel like to be poor and old. By really reflecting on these things and their associated feelings, you will gain some leverage for moving towards positive change.

My Future Self ? !



If you know you are not saving enough; if you know you don't have an emergency cushion; if you have revolving credit card debt – then your present self has been in charge.

Give your future self a gift - know you must make a change (no matter how small) right now for the benefit of your future self. See your future (if you don't change), experience how it feels, then take a step towards financial security by making a change that your future self would want.

I wish all the best to your current and your future selves.

Bill Starnes is the managing partner of Mallard Advisors' Hockessin office.

Investment Outlook and Review

September began with the possibility of U.S. military intervention in Syria; it ended with the probability of a federal government shutdown. In between those anxieties, the Vanguard 500 Index managed to rise 3.1% for the month. Credit the Federal Reserve, which surprised financial markets worldwide with its decision to keep "quantitative easing" going at current levels for another month.

Now this monetary policy has been upstaged by fiscal policy as Congress clashes over the budget and began a partial non-essential government shutdown (just after the quarter ended) with the furlough of 800,000 federal workers.

Over the last quarter, large cap U.S. stocks have risen over 5% and are now up 20% for the calendar year and the last twelve months. These gains have occurred even as the U.S. economic recovery remains only moderate and corporate earnings growth has slowed.

International markets improved in the third quarter following a rocky start to the year, particularly for emerging markets. Emerging markets as a group rose in the third quarter by 5% and developed international markets significantly outperformed U.S. larger-cap stocks with a return of 10%.

Finally, core bonds in aggregate were modestly positive for the quarter thanks in large part to a rebound in September in part due to investor risk-aversion in the face of an impending budget stalemate (and looming debt-ceiling standoff). Let's recall that the mere mention of the possibility of the Treasury tapering its bond purchases (i.e., quantitative easing) this summer led to a spike in bond yields not seen for nearly 20 years. It was painful, but an overreaction.

Total Return as of 09/30/2013

	September	3nd Qtr	YTD	Last 12 Months
PORTFOLIOS**				
60% Equity	3.2%	4.7%	9.6%	11.0%
40% Equity	2.5%	3.3%	5.7%	6.6%
STOCKS				
Larger-Cap	3.1%	5.2%	19.7%	19.2%
Smaller-Cap	5.7%	9.2%	26.5%	30.0%
International - Developed Mkts	7.2%	10.3%	9.8%	17.1%
International - Emerging Mkts	7.2%	4.8%	-6.6%	-0.3%
Real Estate	3.3%	-3.0%	3.1%	5.6%
Inflation Hedges*	4.1%	9.5%	4.0%	4.1%
BONDS				
Investment Grade Bonds	1.0%	0.5%	-2.0%	-1.9%
Emerging Local Market Bonds*	4.5%	-0.4%	-9.2%	-5.8%

** Each asset class is represented by a relevant Vanguard Index fund except for Inflation Hedges where the Morningstar Category average for "**Natural Resources**" is used, and for Emerging Local Market Bonds where **PIMCO Emerging Local Bond** is used.*

*** Each portfolio is represented by a Vanguard Lifestrategy Index fund.*

One beneficiary of the Fed's ultra-loose monetary policy has been housing. According to CoreLogic, an analytical services firm, about 15% of U.S. households have mortgages that are under water, i.e., their house is worth less than their mortgage, which is typically their biggest liability. This is a significant improvement from the 26% reported back in late 2009 and 22% about a year ago. That is good news.

Considering all that has gone on over the last year, **<u>most investors would be quite surprised to know that their total returns over the last year have been very good</u>**. Conservative investors (40% equities) have likely earned between 6.0%-7.0% and more aggressive investors (75%-80% equities) have earned total returns between 16%-17%. Not only is perception of recent returns off base, but the expectations one year ago (as we hung out over the fiscal cliff) were downright abysmal with many investors fleeing the market all-together in order to avoid what they considered inevitable.

Investment Outlook & Review ~ continued

LOOKING FORWARD

According to the Leuthold Group, the U.S. market is rated as anywhere from mildly overvalued to very overvalued relative to other developed markets. Not surprisingly, after five years of heavy selling, investors have been buyers of U.S. equity mutual funds during 2013. Leuthold research (which is also supported by Dalbar and Morningstar) finds that individual investors have, on average, been buyers of stocks at high valuations. In other words, historically, investors buy high and sell low. Today, they are buying.

Right now, the debt ceiling fight in Washington and the partial shutdown of the federal government have become uppermost in investors' minds. If the worst comes to pass, this will have a major impact on equity prices. According to *Hidden Levers*, a research firm that attempts to evaluate the impact of various events on the markets, there is a 5% chance of no compromise on the debt ceiling. If this comes to pass, they see a 25% drop in equity prices that might offer investors some good buying opportunities amid the frustration and fear.

Mallard Disclosures

We want all of our clients to know that we have three disclosure documents available upon request (plus we provide updates due to any material changes). These three documents are:

- **Mallard Business Continuity Plan**—this was created to help ensure we are able to maintain and continue essential business operation in the event of an emergency.
- **SEC Disclosure Form**—This is used to disclose important information about our business to current and future clients (and to the SEC).
- **Privacy Statement**—This is a statement that describes the three limited circumstances in which we share client information with others.

Questions About the Shutdown

As you have no doubt heard, the United States government shut down at midnight (Eastern) October 1, 2013. There are many questions and concerns about this situation, but here are some basics.

What happened? In short, Congress did not pass any of their appropriations bills. These bills provide money to various federal agencies. Federal law requires agencies, without these funding laws in place, to close.

How long will this last? As with other shutdowns, this is largely up to the two major parties and their ability to reach whatever deal is necessary to get the bills passed. If we look at history, the two most recent government shutdowns happened in the Clinton administration. One only lasted five days, and the other lasted three weeks.

What's closed, what's opened? Not every public service is shut down entirely, as not every agency requires appropriations to function. Social Security and Medicare are not affected, active duty military continue to function, as does the Department of Defense, as do intelligence, law enforcement, and our embassies overseas.

How is this different from the debt crisis? They are different situations, but one can affect the other. The debt crisis relates to the separate matter of establishing how much money the U.S. Government can borrow in order to fund its various agencies and programs. Treasury Secretary Jack Lew says the debt ceiling crunch is coming soon (possibly as early as mid-October). Barring an increase in the nation's borrowing limit, Treasury won't have enough cash on hand plus revenue to pay all the country's bills in full and on time.