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Inside This Issue

Mallard Advisors

Comprehensive Financial Planning & Wealth Management Solutions

The Quarterly Mallard Call

Numbers You Should Know

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It is easy to get lost in numbers, projections, and spreadsheets. Getting so deep into the weeds is an easy way to lose sight of where you are headed and what figures are really important to stay focused on. When it comes to your physical health, there are several very important numbers: your blood pressure, weight, BMI, cholesterol. When it comes to your finances, there too are also several very important numbers that can signal your financial well-being.

There are several important numbers and I will review one in turn which include:

1) Your Savings Target
2) Your Equity Allocation
3) Your Marginal Tax Rate (not bracket)
4) Your Mortgage Interest Rate
5) Your Credit Score
6) Your Total Annual Lifestyle Spending

1. Your Savings Target

Saving is clearly the single most important factor in determining your future financial security. This is because saving ensures you are living below your means and without savings, you would have no money to invest. First, you have to move from an attitude where saving is painful to one where you obtain a sense of satisfaction and accomplishment from saving. This move can come sooner if you set up a process for regular saving and you see the results—more choices now and in the future. The big question, however, is HOW much should you be saving given your situation.

Rule of Dumb: Save 10% of your income.

The amount you should be saving each month or year is determined by many factors and therefore, there is no simple rule of thumb answer. While young people who have not yet begun to save should aim to save at least 10% of their income, that does not hold true for everyone else. Instead, at Mallard, we evaluate our client's financial security considering every known detail in order to calculate the needed savings rate. Some employed clients don't need to save at all (having done well), while others should be saving 30% of their income as a result of falling behind over time. Perhaps a divorce, business failure, or the desire to live for today for too long resulted in being behind the curve. Some clients with regular monthly income

Continued On Page 2

Announcements

Bill is Quoted in *U.S. News & World Report*

On Monday, March 23rd, Bill was quoted in an article titled *7 Bad Investing Habits That Are Holding You Back* by Kate Statler in ***U.S. News & World Report***. Bill mentioned how comparing your performance to the wrong benchmark (e.g., S&P 500) is inappropriate and harmful to your realized investment results.

Notices

Bill will be out of the office June 18th—26th to realize a long-time dream of taking his family to Yosemite and surrounding Sierra Nevada area.

Use ShareFile

When sending confidential and/or financial information to us, please remember to use the **secure *ShareFile* link** contained at the bottom of each of our email signatures rather than using the attachment function of your email software.

Mallard E-Mail Update

Are you receiving our e-mail newsletters (which are different from this quarterly newsletter)? If not, let us know by sending an e-mail requesting to be added to our e-mail newsletter list.

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should be focused on their monthly savings percentage, while others, due to their highly variable income, need to be focused on an annual savings target (in dollars).

Only real financial planning that considers all of the details of your situation will provide the correct answer to how much you should be saving. You must know this number and keep it in the forefront of your mind.

2. Your Equity Allocation

Your equity allocation is the percentage of your TOTAL portfolio that is allocated to stocks. This number is important because it determines the risk and the expected return from your portfolio. This target should also be consistent with your risk tolerance - which can help to determine the amount of stocks you can comfortably hold - even while the going is tough.

Rule of Dumb: Subtract your age from 100 to determine your equity allocation.

While age is correlated with lower equity allocations (i.e., risk), this is because many investors become more conservative as they age. However, I have worked with several older clients (in their 80's) who have equity allocations over 75% because they are very risk tolerant and have a high risk capacity (i.e., the financial security to absorb risk).

How do you determine your equity allocation? There are some excellent risk tolerance surveys out there, or consider the following questions: What emotion do I feel more of when I think about investing - fear or euphoria? How much of my portfolio am I willing to subject to the risk of the stock market for the chance at achieving higher returns? Knowing this – your tolerance for downward fluctuation in your portfolio and investing accordingly - is critical to your life-long investment success.

Once you get your risk tolerance right and accept (and stick with) this, investing is easier and higher returns are far more likely than the investor who keeps changing strategies. You will feel confident with your chosen equity allocation, and no longer feel like you must change it every time the markets change direction.

Knowing your equity allocation is important because this must be a conscious and purposeful decision to take on a certain amount of risk. You should be committed to this decision regardless of what is going on in the world.

3. Marginal Tax Rate, not Bracket

Every financial move has a tax-related consequence. This requires advisors to understand not only the tax laws themselves, but also their clients' tax rates. But what is meant by tax rates? In most tax software, you will see the "effective tax rate" which is simply the total tax bill divided by total income. This is useless when doing tax planning.

Rule of Dumb: Accelerate income into the 15% marginal tax bracket and defer deductions.

The marginal "tax bracket" is simply the top tax rate for each bracket of income. This is better than effective tax rate, but can still be very misleading because it does not necessarily say anything about the rate at which YOU ACTUALLY pay taxes. Finally, we have the **marginal "tax rate"**. This is the actual percentage of income that is lost to taxes. How is this different from the marginal "tax bracket" published in IRS booklets? The marginal "tax bracket" does not take into account the realities of the tax law. Due to phase-out effects like miscellaneous itemized deduction thresholds, in many situations a client's marginal "tax rate" may be different from the client's "tax *bracket*". For example, you may be in the 15% marginal tax bracket, but if you earn $1 of additional income, and lose 21% of it to federal taxes, then your true marginal tax rate is 21%. How could this be different? Additional income can result in the loss of tax credits, phase-out of deductions, or AMT.

The bottom line is that only marginal "tax rates" should be used to compare tax planning strategies. For example, if you want to know whether to do that Roth conversion, IRA withdrawal, annuity investment, sale for a capital gain or loss, etc., then the marginal "tax rate" is what should be used. In fact, the marginal tax rate is really the only rate that should be used for financial planning scenarios. Unfortunately, this can be very difficult for most people to calculate, especially when trying to model different tax planning scenarios.

Knowing your marginal "tax rate" is helpful in knowing if you should consider working, accelerating taxable income via a Roth conversion or IRA distribution, or harvesting some capital gains.

4. Mortgage Interest Rate

If a bank would loan you $100,000 against the value of your home with a 0% interest rate with a 30-year payback period, would you borrow the money? What would you do with the funds? Knowing your mortgage interest rate and comparing this number to current mortgage rates, the expected return from your portfolio, or the cost of borrowing elsewhere helps you make the best decisions.

Rule of Dumb: Pay off your mortgage as fast as you can.

Naturally, in our above example, if you had a 0% mortgage interest rate, would you really pay it "as fast as you can"?

It is easy to end up on auto pilot and have your mortgage payment automatically paid every month, thereby missing the opportunity to refinance. You should know your current mortgage interest rate and current market rates and consider refinancing if current rates are about 1% lower than your mortgage interest rate.

5. Your Total Lifestyle Expenses

Most people have no idea how much money they spend in a year. Even those who do think they know generally have not included (and annualized) the expenses that occur every so often. For example, have you included future cars and big home improvement projects into your monthly budget by setting aside a reasonable amount in a separate account each month so that when that expense arises, the cash is available?

If you are not accounting for these types of expenses, this can make it difficult to create a spending plan, retirement budget, or to remain disciplined with your spending. It is difficult to know what you spend with so many moving parts that may occur randomly. However, knowing the total amount of your lifestyle expenses that will continue for the rest of your life is mandatory if you are going to do any long-term planning.

Again, lifestyle expenses include all controllable expenses that you likely hope to continue into the future. Therefore, they do no include current mortgage/debt payments, college expenses, or income taxes.

Rule of Dumb: In retirement, you should expect to spend 70% of your pre-retirement income.

Who thinks this way? Most clients want to at least maintain their existing lifestyle. This rule of thumb is dumb, as it doesn't apply to anyone. For some, it overstates their retirement lifestyle and for others it understates it. Don't use a rule; instead know your on-going total lifestyle expenses and reflect on how these may change at the time of major milestones, such as retirement or a move into a retirement community.

6. Credit Score

Your credit score is a three digit number derived from your credit reports to determine your credit worthiness.

Pay attention to and work to improve your credit score. I once had a $70 medical related expense (that I thought I paid) go into collections. I found out later that the medical place incorrectly keyed my credit card information. I ignored it for years due to the small balance and the fact that when I tried to pay it again, I was treated like a deadbeat (and I was incredulous). Don't let your ego get in the way of maintaining the best possible credit score. Your credit score can have a big impact on the interest rates you get for consumer or mortgage loans. Insurance companies are also using your credit score to determine premiums and coverage amounts.

Thankfully, these scores are far more available to consumers these days with www.creditkarma.com providing a free credit score from Transunion and Equifax. They also provide a free credit report. Lenders are also offering free credit scores to their best customers as a perk. You can also pay for it at myfico.com for $20.

Rule of Dumb: Check your credit score every year.

Your credit score isn't static. Your credit score can change at any point in time based on something you did, something you didn't do, or something someone else did. If you close an account, your score will change. If you miss a credit card payment, your score will change. If you apply for an auto loan, your score will change. You can check your scores as often as desired at www.creditkarma.com

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At Mallard, we have developed a new ***Financial Roadmap*** report which includes all of the **Numbers You Should Know** that I have reviewed in this article.

If you are a full-service client, we will review this report at each of our meetings in order to monitor your financial well-being.

Bill Starnes is the founder and senior advisor at Mallard Advisors, LLC

The first quarter of the new year brought positive returns overall, and more than the usual amount of anxiety along with them. As shown in the table below, balanced investors (40%-60% equity portfolio) earned over 2% this quarter and 7% over the last year.

As our readers know, we use low-cost asset class funds to implement client investment strategies. We use asset classes as the building blocks for our asset allocation strategy in order to manage risk and to achieve a high degree of diversification. For example, most investors with an asset class portfolio will own more than 12,000 stocks across about 50 countries. The following is a summary of the major asset class returns over the last year.

The S&P 500--a measure of larger-cap U.S. stocks—was up 1% for the first three months of 2015, after losing almost 1% on the last day of the quarter. However, as you can see in the table below, only inflation hedges fared worse than larger-cap U.S. stocks this quarter.

Diversification away from U.S. larger-cap stocks was certainly rewarded this year after a three-year period when U.S. larger-cap stocks seemed like the only game in town. The best performing asset class thus far has been U.S. smaller-cap stocks. The Vanguard Small-Cap Index gave investors a 4.8% return during the first three months of this year.

Total Return as of 03/31/2015

.	March	YTD	Last 12 Months
PORTFOLIOS**			
60% Equity	-0.5%	2.2%	7.5%
40% Equity	-0.2%	2.1%	7.1%
STOCKS			
Larger-Cap	-1.6%	0.9%	12.6%
Smaller-Cap	1.2%	4.8%	9.7%
International - Developed Mkts	-1.5%	4.0%	-1.1%
International - Emerging Mkts	-2.1%	2.1%	2.9%
Real Estate	1.7%	4.7%	24.0%
Inflation Hedges*	-3.8%	-1.4%	-15.7%
BONDS			
Investment Grade Bonds	0.4%	1.6%	5.5%
Emerging Local Market Bonds*	-3.4%	-3.8%	-11.4%

** 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.*

International stocks also added value with returns of 4% (in dollar terms) as measured by the broad-based Vanguard Total International Stock Market Index. Again, these returns were obtained even with a continuing strong U.S. dollar. Emerging markets stocks of less developed countries, as represented by the Vanguard Emerging Market Stock Index, fared less well than developed markets, but still gained about 2% for the quarter.

Looking over the other investment categories, real estate investments, as measured by the Vanguard REIT Index, was up 4.7% for the first quarter, even after falling over 1% on the final day of the quarter.

Inflation hedges, as measured by the Natural Resources Index, continued their losing ways, dropping 1.4% of their value in the first quarter, largely because of a continuing drop in oil prices. Commodities have lived up to their volatile reputation as the most heavily tracked commodity indexes are still down nearly 50% since the beginning of 2008.

As the good times in the markets seemingly never end, now is probably a good time to accept a different outcome for the near future – where the party ends (for a while). This is not a market timing prediction, just a reality. The equity markets are volatile; therefore, portfolio values are volatile.

As always, our motivation is to stay clearly focused on our clients and their best interests. We do this by maintaining a disciplined investment philosophy (regardless of what is going on in the markets), risk management, tax integration, clear communications, and a high level of service.