April 2019

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Notices

Spring Break
Bill will be away the week of April 15th with his family in Hilton Head, South Carolina. The office will remain open all week.

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.

Use ShareFile
When sending confidential information to us, please remember to use the **secure *ShareFile* link** contained at the bottom of each of our email signatures. This link is also located at the top of every page of our website.

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MALLARD ADVISORS LLC
Comprehensive Financial Planning & Wealth Management Solutions

THE QUARTERLY MALLARD CALL

When Investment Returns Don't Matter (Much)

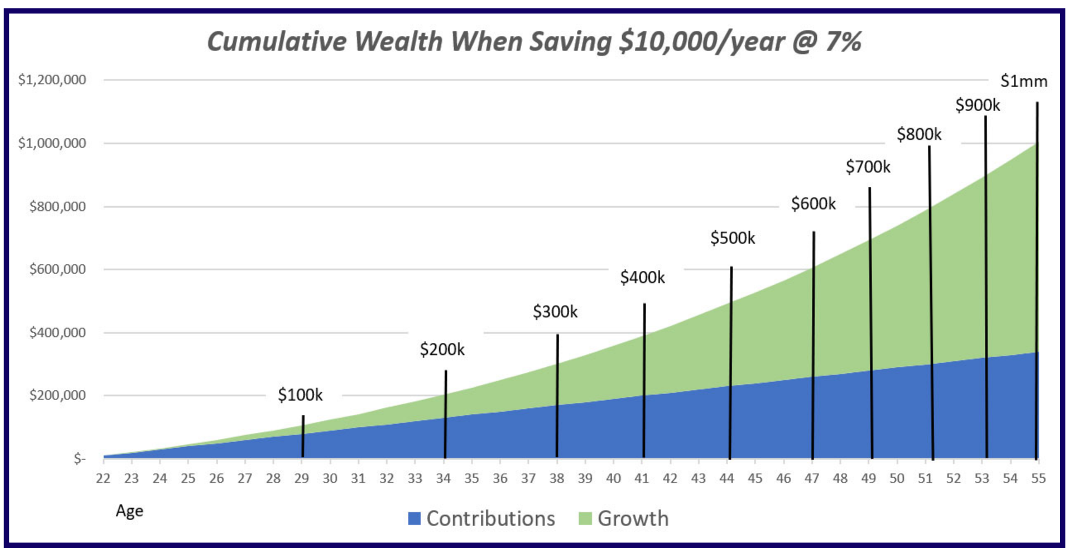
William D. Starnes

Earning high investment returns may be exciting and are certainly helpful in building wealth over time, but there are times when investors should be cognizant of their large irrelevance. The time I will focus on today is when you set sail on your "maiden voyage".

Maiden Voyage
The maiden voyage of a dingy is the first journey of a very small vessel. Regardless of how much the wind blows, the dingy will not make it across the ocean. In this context, I am referring to the new saver who has not accumulated much of a portfolio balance. Think of how a 20% annual return on a $1,000 balance will lead to growth of $200 over the course of this new saver's first year. This, no doubt, is a very good year and while the percentage returns are high, the additional capital as a result of these high returns will not move the financial independence needle very far.

So, the question is, what will really impact a new saver's ability to build wealth - saving or investment returns? Let's say my son sets an arbitrary goal to achieve a portfolio with a value of $1 million. If he were to invest $10,000 every year (increasing this amount by inflation each year) beginning at his age 22 and earned a 7% annual return, he would accumulate $1 million by his age 55. See the chart below for a visual illustration of this*.

The chart below shows how long it would take to reach each $100,000 along the way. Notice how the first ten years are mostly made up of the savings themselves (and not the earnings). Also, notice how each $100,000 is achieved in less time than the last. In fact, it's shocking to see that it will take seven years to go from $0 to $100,000 yet in the same amount of time, you can go from $650,000 to $1 million (a $350,000 increase). The first $100,000 takes the longest amount of time to accumulate because you are not getting much help in the way of investment returns. It is not the return that is important in the early years, but the amount saved.



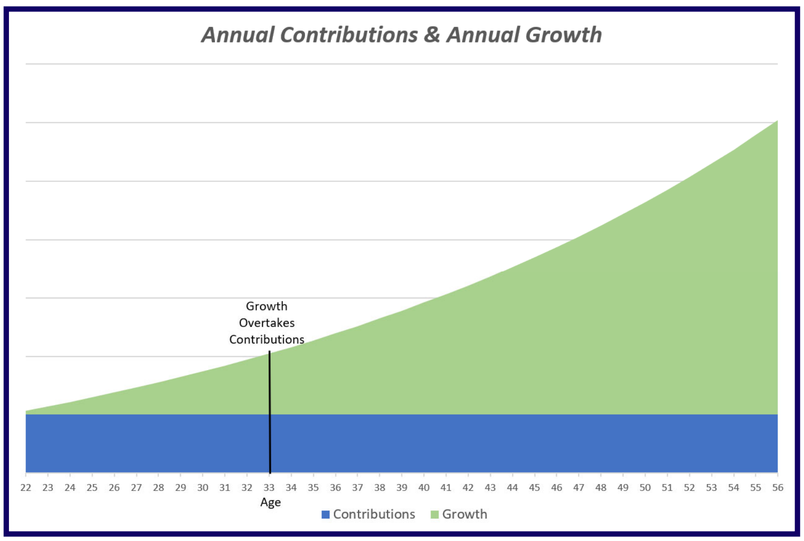
** See the 12/10/2018 blog post on **Get Rich Slowly** for more on this concept.*

When Investment Returns Don't Matter (Much)...continued

If you invest $10,000 each year (adjusted annually for inflation) at a 7% annual rate of return, you'll go from $0 to $100,000 in about seven years and about 75% of that $100,000 will come purely from savings alone. In fact, even if your returns are very high (say 9%) each year, most of the portfolio value (70%) will be the result of savings and not investment returns.

Once you have selected and implemented your investment plan, you don't have control over returns in the short run. Nor do you know how the sequence of returns will unfold. Therefore, the focus must be on what you can control: savings.

However, patience will pay off and in time the portfolio growth in a particular year will be larger than the contributions for that year. Assuming a fixed annual return of 7%, after just 11 years the annual growth will be larger than the annual contribution of $10,000 (see graph at right). It is then that things begin to take off for this saver and investment returns really begin to matter - but it is only because the cumulative contributions form a foundation for the growth to matter.



Benjamin Franklin once said (and I am paraphrasing) our happiness comes about not by rare good fortune, but instead by the "little advantages" we do each day.

Regular saving, even if small, is an example of one of these little advantages.

Unfortunately, many new investors are naive enough to believe they will become rich by investing a few bucks in a cryptocurrency. Ten years ago investors believed their house appreciation would negate their need to save, and ten years prior to that investors would just buy an internet company and sit back and wait for financial security to set in. None of these things ever happened (except for the lucky few).

New savers on their maiden voyage always seem to think it is the gusts of the wind that are important rather than a focus on increasing the size of their boat and sails.

The top Googled money-asking question over the last year was ***how to save for a house***. This was followed by how to save for … retirement …. car … college … wedding, etc. People want to know how to save. We know Americans don't save enough with savings rates between 5%-10%. In the 60's, 70's, and early 80's, savings rates were over 10%. The culture has changed to an emphasis on consumption for today over saving for tomorrow.

Hopefully, the Google answer to each of these questions was, "By living beneath your means and saving the difference". Some will say that the high cost of living makes it impossible to save more. I would argue that if your pay was cut by 10%, you would still survive. Your lifestyle would be lower, but you would continue to make it. So, if your income can be cut by 10%, then you can cut your own income by 10% by saving it.

There was a great book titled ***Stop Acting Rich and Start Living Like a Real Millionaire*** by Thomas Stanley. The book made a case for the fact that you can't simultaneously ACT rich and BECOME rich. If you are not financially independent already, then stop acting like you are and start living a life that is true to your income by living beneath your means and saving the difference.

The great investor, Benjamin Graham, said that happiness is "living well within one's means."

Living within your means is honest. It is being true to yourself and your income. Most importantly, it is most likely the only way to build wealth, as opposed to hoping that a small investment (be it real estate, stock, or a cryptocurrency) will balloon into providing financial security. That is not a plan for financial security. That is a fantasy.

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

Why We Prepare Taxes

Every year I am amazed to find powerful reasons why it is important that we prepare tax returns for our clients.

Tax preparation done by an advisor **familiar with your personal and financial situation** is what can lead to great results. Also, because we prepare tax projections late in the year, **we know what to expect** at tax preparation time. This year there are two examples of how being a tax-focused advisor added value to our clients' financial lives.

First, many clients over age 70, who are taking the standard deduction, don't get a benefit from out of pocket charitable contributions. Therefore, we have helped them to establish Qualified Charitable Distributions (QCD's) from their IRA's whereby the IRA distribution goes directly to the charity ***tax-free***. I have written in detail about this in a blog post that can be found on our website. In that post I mentioned the following, "The IRA custodians, like TD Ameritrade, are NOT required to identify the QCD on your 1099-R tax form. Therefore, unless you specifically tell your tax preparer about the QCD, they will end up reporting this transaction as a *fully taxable* distribution, which would *negate* the benefit of this tax planning strategy!"

Even if you tell your tax preparer, they may assume the 1099-R reduced the taxable distribution by the amount of the QCD thereby also leading to paying tax on the donation. I have personally experienced professional tax preparers saying they were sure the 1099-R was already adjusted for the QCD. They were wrong. In other words, taxpayers could easily be paying tax on IRA distributions going to charity when they should not - either because they don't tell their preparers, or worse, the tax preparers assume the 1099's are correct when they are not. Tax preparers sometimes blindly follow the tax forms submitted to them. In their defense, they are preparing hundreds of returns for clients they may only vaguely know at the height of their busy season.

At Mallard we identify the tax savings associated with a QCD, we assist with the implementation of the QCD at TD Ameritrade, and finally, we prepare the taxes to ensure that the QCD is reported correctly on the tax return so that the tax savings are realized. This is the way it is meant to be.

Second, while preparing a tax return for a client, I noticed that a distribution from an annuity was coded as fully taxable. Because I know this client, and am familiar with the annuity sold to her many years ago, I was certain that this was incorrect. I called her insurance broker to point out my concerns and he promptly addressed them. The insurance company made an error when they failed to include $100,000 of previously taxed value (cost basis) in their tax reporting. In other words, this client would have had $100,000 of additional taxable income over the life of the annuity. The tax cost (depending on the recipient's tax bracket) could have been anywhere from about $20,000-$35,000. Would a tax preparer have known this, or would they have blindly followed the tax forms? Unfortunately, it is likely the latter.

We at Mallard are not perfect either. **We make mistakes**. However, I have found that the biggest mistakes are when you blindly follow tax forms. It is possible to question the tax forms when you know what to expect (as a result of year-end tax planning), and you know your clients well.

Because of our knowledge of the many details of our client's financial lives, we have opportunities to discover tax benefits for our clients. We work with our clients to implement proactive tax saving strategies, avoid costly mistakes, and alleviate negative tax-time surprises.

Taxes should not be a once-a-year discussion, but instead should be woven throughout the framework of the financial planning relationship. This integration leads to better results than when you have a disconnect between your personal finances and your tax situation.

Market Commentary

The long, painful market decline in the last month of 2018 seemed to promise more of the same for the new year of 2019, but at the end of the first quarter, the results couldn't have been more different. The U.S. market, measured by a variety of indices, posted its biggest one-quarter gain since the third quarter of 2009. This proves once again (as has been proven many, many times over) that you cannot extrapolate market returns from one month to the next, or expect that down or up trends will lead to more of the same.

Just about every investment asset class rebounded thus far in 2019 with all stock asset classes earning mid-double-digit returns as can be seen in the table below. Over the last one, three, and five years, the U.S. stock market has been booming which may lead one to wonder why they have any international stocks at all. However, it is important to remember the following:

1. International stocks help provide valuable diversification benefits, exposure to global growth, and opportunities presented by leading companies in other markets.
2. Recent performance is not a reliable indicator of future returns.

As a reminder, during the "lost decade" (the period from 2000-2009), large U.S. stocks lost 9.1%. However, during the same time period, international stocks earned 17% (while Emerging Markets earned 154%). Looking beyond just this one time period, if you look at performance for each of the 11 decades since 1900 (and ending in 2010), the U.S. market outperformed the world market in five decades, and underperformed in the other six. This is why you must diversify globally— as both asset classes should provided positive returns over the long-term, but at different (unpredictable) times.

The American Institute for Economic Research provides evaluation of the business cycle. Its indicators can give us a sense for the strength of the economy. Last month, they reported that "the outlook remains moderately positive, though with a heightened degree of caution." Well, they sure have their bases covered. All in all, this means there appears to be no immediate threat to the economy.

Total Returns as of 03/31/2019

				Annualized	
	Month	**YTD**	**12 Mos**	**3 Years**	**5 Years**
GLOBALLY DIVERSIFIED BALANCED PORTFOLIO**					
60% Equity / 40% Bond	0.7%	8.4%	2.2%	7.3%	4.8%
STOCKS					
Larger-Cap	1.9%	13.6%	9.4%	13.4%	10.8%
Smaller-Cap	(0.9%)	16.2%	5.5%	12.7%	7.8%
International - Developed Mkts	0.7%	10.2%	(5.3%)	8.0%	2.7%
International - Emerging Mkts	1.9%	11.3%	(6.9%)	9.7%	3.4%
Real Estate	4.2%	17.3%	19.9%	5.6%	8.6%
Inflation Hedges*	(0.1%)	11.7%	(5.0%)	8.0%	(1.4%)
BONDS					
U.S. Investment Grade Bonds	2.0%	2.9%	4.4%	1.9%	2.6%
Global Bonds	1.8%	3.1%	5.2%	3.2%	4.2%

** 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.*

*** The portfolio is represented by the DFA Global Allocation Fund (60% Equity / 40% Bond) - DGSIX*