MALLARD ADVISORS LLC

Comprehensive Financial Planning & Wealth Management Solutions

THE QUARTERLY MALLARD CALL

January 2021

Inside This Issue

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The Lessons of a Very Instructive Year

William D. Starnes

It would be hard to imagine a stranger year in the U.S. investment markets than the one just passed, or a year that did a better job of defying logic. Once in a very great while, there comes a year in the economy and the markets that may serve as a tutorial—in effect, a master class in personal finance. Two thousand twenty was just such a year.

On December 31, 2019, the Standard & Poor's 500-Stock index closed at 3,230.78. This past New Year's Eve it closed at 3,756.07, some 16.3% higher. In the end, an investor holding the Vanguard 500 Index (VFINX) for the entire year who also had dividends reinvested would have realized a total return of **18.3%**. Looking at the table below, it is hard to believe how few **red** percentages there are. Real estate is the only major asset class that is down for the year.

From these facts alone, you might infer that the U.S. stock market had quite a good year. As indeed it did. What should be so incredibly instructive to the long-term investor is ***how it got there.***

From a new all-time high on February 19th, the market reacted to the onset of the greatest public health crisis in a century by going down roughly a third in five weeks. The Federal Reserve and Congress responded with massive intervention, the economy

Continued on page 2

Summary of Asset Class Total Returns (as of 12/31/2020)

Asset Class*	Ticker	One Month	Three Months	12 Months	*Annualized* 3 Year	5 Year	10 Year
GLOBALLY DIVERSIFIED BALANCED PORTFOLIO**							
60% Equity / 40% Bond	DGSIX	3.5%	10.9%	11.6%	7.3%	9.0%	7.2%
STOCKS							
Larger-Cap	VFINX	3.8%	12.1%	18.3%	14.0%	15.1%	13.7%
Smaller-Cap	NAESX	7.4%	27.1%	19.0%	11.1%	13.5%	11.9%
International - Developed Mkts	VGTSX	5.8%	16.9%	11.2%	4.9%	9.0%	5.1%
International - Emerging Mkts	VWO	5.9%	16.9%	15.3%	5.9%	11.7%	3.1%
Real Estate	VGSLX	2.8%	9.2%	(4.8%)	4.8%	5.5%	8.5%
Inflation Hedges	*	8.2%	24.4%	16.4%	2.8%	10.2%	1.4%
BONDS							
U.S. Investment Grade Bonds	VBMFX	0.2%	0.6%	7.6%	5.3%	4.4%	3.7%
Global Bonds	VTABX	0.4%	1.0%	4.5%	5.1%	4.5%	-

** 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. All data is provided by Morningstar and includes reinvested dividends.*

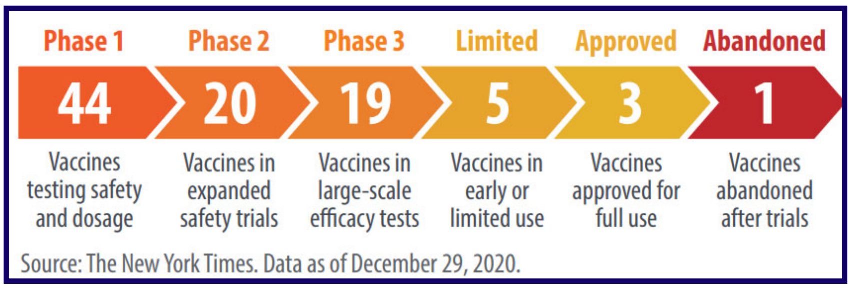
** All returns are net of (i.e., after) fund fees, and include reinvested dividends.*

** Past performance is not indicative of future results.*

*** This portfolio is represented by the DFA Global Allocation Fund (60% Equity / 40% Bond) - DGSIX* learned to work around the lockdowns—and the result was the S&P 500 regained its February high by mid-August.

Perfect Foresight

Before we take the great investment returns for granted, let's get some perspective. Assume you had a vision on January 1st, 2020, that foretold all events of the coming year (other than stock market news). You absolutely knew a novel coronavirus would travel through the world resulting in a global pandemic. This pandemic would kill 1.7 million people worldwide by year end. You knew that this event would result in the shuddering of businesses, and as a result an immediate spike of the unemployment rate, which would move from under 4% to over 14% in less than three months. There would be stockpiling, lock-downs, stay-at-home orders, masks, the need for grocery delivery, social distancing, cancellation of travel/vacations, political division, protests and violent rioting, government relief measures, tanking oil prices, working at home, wildfires, and a very divisive presidential election.



Source: The New York Times. Data as of December 29, 2020.

Question: Having this perfect foresight, what would you have done with your portfolio on January 1st, 2020? Buy more stocks? Doubtful. Hold your portfolio? Doubtful. Sell? YES!! Of course, you would sell with this information in hand. You would be a fool not to, right?

Yet, as mentioned above, the U.S. stock market (as measured by the Vanguard 500 Index) earned a total return of 18.3%. In the end, even knowing all of the terrible news of 2020, selling everything on January 1st, 2020, would have sorely hurt your portfolio returns.

The lifetime lesson here: ***Even with perfect foresight, the economy can't be forecast, and the market cannot be timed.*** If this is true, then how can the study of economic commentary, market forecasting, and the like provide you with instruction on beating the market? It seems obvious that the better approach would be to develop a sound long-term financial and investment plan and stick to it—come hell or highwater. This year has proven once again that this approach has enduring value.

There are two corollary lessons worth noting and they are: (1) The velocity and trajectory of the equity market recovery essentially mirrored the violence of the February/March decline. (2) The market went into new high ground in midsummer, even as the pandemic and its economic devastations were still raging. Therefore, ***"waiting for the pullback" once a market recovery gets under way, and/or waiting for the economic picture to clear before investing, turned out to be formulas for significant underperformance,*** *as is most often the case*.

The American economy—and its leading companies—continued to demonstrate their fundamental resilience through the balance of 2020, such that all three major stock indexes made multiple new highs. Even cash dividends appear on track to exceed those paid in 2019, which was the previous record year.

Meanwhile, three vaccines were developed and approved in record time, and were going into distribution as the year ended. There seems to be good hope that the most vulnerable segments of the population could get the vaccines by spring, and that everyone who wants to be vaccinated can do so by the end of the year, if not sooner.

Politics & Portfolios

The second great lifetime lesson of this hugely educational year had to do with the presidential election cycle. To say that it was the most hyper-partisan in living memory wouldn't adequately express it. Adherents to both candidates were genuinely convinced that the other would, if elected/reelected, precipitate the end of American democracy.

I talked about this in detail in the October issue of this newsletter, attempting to convince investors to not let politics drive investment strategy. While our clients tend to follow this advice, it would seem obvious that anyone who exited the market in anticipation of the election got thoroughly (and almost immediately) skunked.

Let's now face it: even if you knew who would be elected in advance, it would be unlikely that this information would help you make reliable predictions about the direction of the stock market. The enduring historical lesson: ***never get your politics mixed up with your investment portfolio.***

Margin of Safety

The pandemic has been financially difficult for many people, but especially small business owners and their employees. Even with a responsible amount of emergency cash and government benefits, displaced employees may still struggle to stay afloat.

2020 provided a painful reminder regarding the importance of having any kind of margin of safety. A margin of safety is generated by maintaining an appropriate amount of liquid cash. It is only by maintaining a margin of safety that we can better protect ourselves from the unexpected. Cash provides the margin of safety needed to allow you to keep a business running, weather a job loss, get by until your disability kicks in, or having the option for someone to stay at home with the children.

Income disruptions can have deep and painful implications from the inability to meet your essential needs for food, transportation and housing to losing your physical health and emotional well-being if you can't afford healthcare.

The third great lifetime lesson of this hugely educational year is that ***life can turn on a dime and it is best to maintain a margin of safety with a buffer of cash.***

Finding Out What We Are Made Of

One thing that is remarkable about 2020 is what we are capable of. The brilliant scientists at pharmaceutical companies have developed three effective vaccines so far. People volunteered for vaccines while in trial so that safety could be tested. Americans were financially generous with 2020 looking like a very strong year for charitable contributions. We all learned to appreciate front-line workers for their courage and service. People discovered new passions, and we all realized how important family and friends are.

As we look ahead to 2021, there remains far more than enough uncertainty to go around. Is it possible that stocks are overvalued (see the graphic on the next page) - particularly those of the largest growth companies? If so, might the coming year be a lackluster or even a somewhat declining year for the stock market?

Yes, of course it's possible. Now, how do you and I—as long-term investors—make an investment plan out of that possibility? My answer: just as we wouldn't have in 2020, even if we had perfect foresight, we still wouldn't, because we can't. Our strategy, as we enter 2021, is entirely driven by the same steadfast principles as it was a year ago—and will be a year from now.

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

A Bright Spot to Park Excess Cash

With interest rates so low, most individuals are earning next to zero on their new cash deposits regardless of type—checking, savings, CD's. This is not likely to change anytime soon. The Federal Reserve has stated their aim is to keep inflation "[moderately above 2% for some time]."

In other words, your cash deposits are earning less than inflation and therefore your "real" (after inflation) returns are negative!

One cash account often overlooked are U.S. Savings Bonds—specifically I Bonds. New I Bonds will pay you whatever inflation is. Right now that is 1.68%, which is much higher than the yield of a 5-year CD.

In other words with an I Bond, if inflation runs at 2%, you will receive a 2% return. If inflation flares up, you get pure inflation protection.

Better yet, these bonds are state tax-free, and federally tax-deferred. Each individual can purchase $10,000 of I Bonds in any one calendar year at the Treasury Direct website. They must be held for at least one year, and can be held for as long as 30 years. If they are redeemed within five years, there is a nominal penalty.

Market Commentary

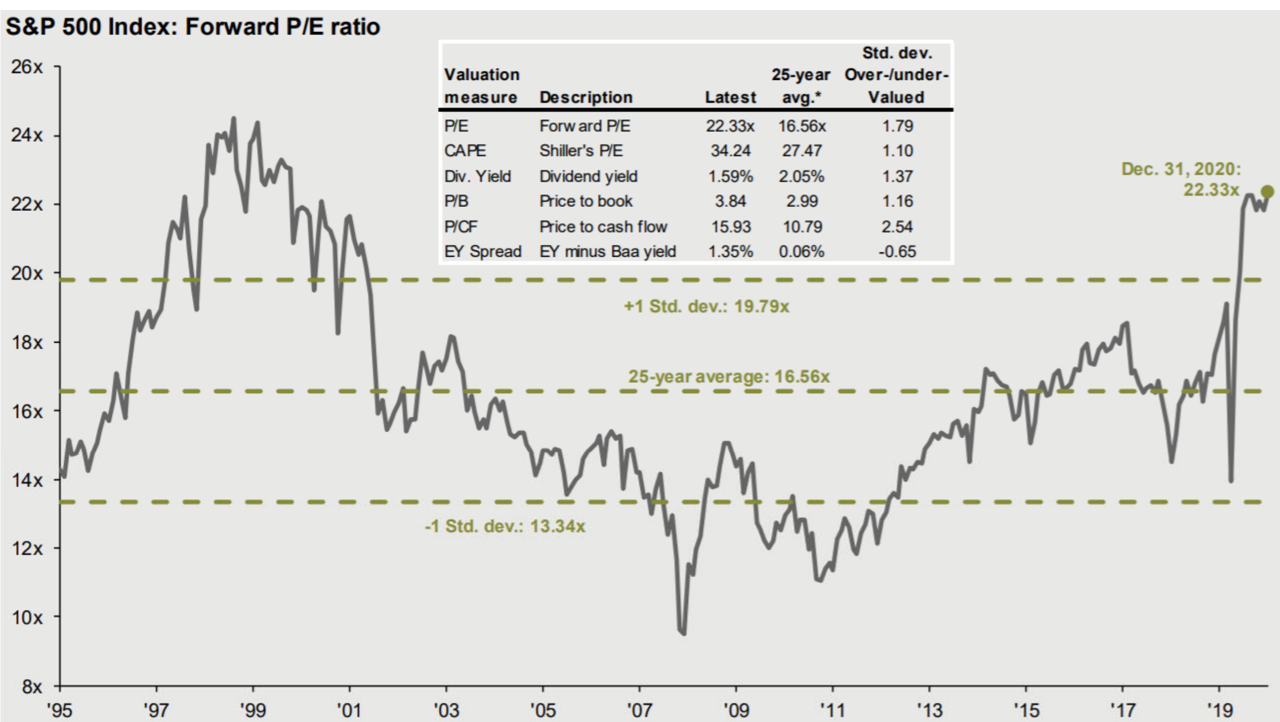
2020 was just a terrible year. Most of us are beyond tired of social distancing, foregone vacations, and not spending time physically interacting with our friends, children, grandchildren, brothers, and sisters. However, the stock markets (both domestically and internationally) had a very good year.

With all the consistently grim economic news (the economy hit recession territory in the first quarter of the year and the second quarter was the worst GDP performance on record) it's hard to remember that, if you ignore the brief bear market of early 2020, we are really continuing a long bull market that started back in March of 2009. This is a remarkable run. Bear markets tend to occur about every 3.5 years, and the previous record was 9.5 years from November 1990 to March of 2000.

At the same time, few would argue that stocks are cheap right now. As seen in the graphic below from JPMorgan Asset Management, by almost all measures, the U.S. stock market is considered overvalued. With interest rates and bond yields at rock bottom, many professional investors have decided that stocks are the only way to make money in their investment portfolios thereby driving up prices. Current valuations suggest that we should be cautious about expecting high returns from large U.S. stocks for much longer. Most people realize the underlying economic fundamentals are shaky at best. The unemployment rate is now 6.7%, and 787,000 Americans filed for unemployment last month.

Nobody can predict when or how the bull market will end, how deep the inevitable (sooner or later) bear market will be, or, really anything other than the fact that all past downturns were followed by upturns which took the markets and the economy to surprising new heights. We certainly saw that dynamic play out during 2020.

As always, we are here if you would like to talk about anything at all. Thank you, as always, for being our clients.



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	22.33x	16.56x	1.79
CAPE	Shiller's P/E	34.24	27.47	1.10
Div. Yield	Dividend yield	1.59%	2.05%	1.37
P/B	Price to book	3.84	2.99	1.16
P/CF	Price to cash flow	15.93	10.79	2.54
EY Spread	EY minus Baa yield	1.35%	0.06%	-0.65

Source: FactSet, FRB, Robert Shiller, Standard & Poor's, Thomson Reuters, J.P. Morgan Asset Management.
Price-to-earnings is price divided by consensus analyst estimates of earnings per share for the next 12 months as provided by IBES since December 1995, and FactSet for December 31, 2020. Current next 12-months consensus earnings estimates are $167. Average P/E and standard deviations are calculated using 25 years of IBES history. Shiller's P/E uses trailing 10-years of inflation-adjusted earnings as reported by companies. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Price-to-book ratio is the price divided by book value per share. Price-to-cash flow is price divided by NTM cash flow. EY minus Baa yield is the forward earnings yield (consensus analyst estimates of EPS over the next 12 months divided by price) minus the Moody's Baa seasoned corporate bond yield. Std. dev. over-/under-valued is calculated using the average and standard deviation over 25 years for each measure.
Guide to the Markets – U.S. Data are as of December 31, 2020.

J.P.Morgan Asset Management