The Mallard Flyer

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July 2005

Notices

Paul's Schedule:
Paul will be on vacation on August 4-5. Mark is on vacation 7/18 to 7/22, and 8/5 to 8/8. Several of us plan to attend the October 6-8 NAPFA Northeast conference in Boston.

Bill's Schedule:
Bill will be on vacation with his family in Cape May, NJ the week of July 11th. Sherry will be on vacation the week of August 8th.

Next Newsletter:
The next edition of *The Mallard Flyer* is scheduled to be mailed in early October.

The Joy of Gifting

William D. Starnes

One of the greatest joys of my financially independent clients is gifting a portion of their wealth to children or grandchildren. Doing this while alive provides enjoyment and the ability to receive thanks. Some ways of gifting are better than others, and in this article, I would like to outline some gifting strategies.

The Joy of Gifting
People gift to others for a variety of reasons that are typically not driven by tax savings such as:

- Privacy—Lifetime gifts are not open to public scrutiny, unless, of course, you wish to make them so. In contrast, a will becomes a public document, available to anyone who wishes to see it. Lifetime giving assures your privacy.
- Protection from the claims of your own creditors
- The enjoyment of seeing the child receive and enjoy the gift
- To see how well the child manages the gift

The 2001 Tax Act increased the exclusion amount for gift-tax purposes to $1 million each year (even though the applicable exclusion amount for estate tax purposes increases in years 2004 through 2009). The top gift tax rate is 47 percent in 2005. In 2011, the gift tax rates revert to pre-2001 Tax Act levels.

Tax-Free Gifting
Most of you have heard that you can gift $11,000 each year without any gift-tax liability. What does this mean? Basi-

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Mallard Announcements

New Audio Seminar Series CD
As you know Bill has recorded two audio CD's as educational tools for clients: *Basic Estate Planning* & *Creative Budgeting*. Bill is adding a third to the series titled *Seven Secrets of Financial Independence* by Bert Whitehead, JD, MBA. This presentation has been made available for distribution to our clients by Bert Whitehead, a nationally known fee-only financial advisor. Bert is the founding member of the Alliance of Cambridge Advisors of which Bill is a member. Bert's recording is practical, enjoyable, and educational. You can either pick up a copy at our office or request one be mailed to you.

Estate & Beneficiary Summary
We have also introduced the Estate & Beneficiary Summary as a practical component to our Basic Estate Planning CD. Now after listening to the CD you can record your personal account contact, estate, and beneficiary information on the one page summary. The summary is then placed in your Personal Financial Tracker. If you'd like a copy of the Estate & Beneficiary Summary and Basic Estate Planning CD, please call our office.

cally, if one person gives one person more than $11,000 of valued property or cash in one year, they are responsible for reporting the transaction to the IRS on form 709 with your income tax return. However, you won't pay any actual tax until you have gifted more than $1 million (the amount of the lifetime gift tax exclusion). Therefore, gifting more than $11,000 is simply a debit against your lifetime exemption.

As you can see, gift taxes really only apply to those who are making very large gifts.

So how much can you gift?
You can make gifts totaling up to $11,000 to any one person or entity during the tax year, or $22,000 if the gift is made by both you and your spouse without eating into your lifetime gift-tax exclusion. This can be done for an unlimited number of individuals.

For example, a married couple with three married children and six grandchildren could gift a total of $264,000 ($22,000 x 12) in a single year to these individuals. This is because the married couple can give $22,000 to each person. Since there are twelve people (three children, three spouses, and six grandchildren) receiving $22,000, this amounts to $264,000.

Take advantage of qualified transfers
Qualified transfers are specific types of gifts you can make that are exempt from the federal gift tax. A qualified transfer is any amount you pay on behalf of someone else, either as tuition (but not room and board) to an educational institution or to pay medical expenses to a medical care provider. This is a great way to help your children or grandchildren through college or to help your elderly parents get the proper medical care they deserve.

Therefore, you can make both the annual exclusion gifts of $11,000 PLUS qualified transfers in a year.

Retaining Control Over Gifted Property
One of the benefits of making qualified gifts (say to a university) is that you know the money will be put to the use you intended. This can be very important especially when making gifts to minors.

Obviously, the easiest way to make a gift is to write and hand over a check. Of course, this gives the person total discretion over the use of the money. That may be fine in many cases, such as birthday gifts. However, you likely don't want to hand over $22,000 to your 18 year old grandchild in the hopes that they will use the money for college; when instead, they are in the process of "finding themselves" via world traveling and experimenting with mind altering substances. It only takes a little reflection to know what each of us would have done with that kind of money at the same age.

Typical solutions to this quandary are to make the gift to a 529 college tuition plan, Coverdell Education Savings Account, a trust, or an UTMA (Uniform Transfer to Minors Act) account. The money is still a gift subject to the annual exclusion limit of $11,000, but a custodian of the assets is named to oversee these funds until the child reaches the age of majority (such as 21) or to ensure the funds are used for college.

Eliminate future appreciation from your estate
One of the most common reasons for gifting is to remove an appreciating asset from your estate. An appreciating asset is one that is increasing in value over time. Removing the asset today keeps any appreciated value out of your estate later. The amount that may be subject to gift tax will likely be less today than it will be in the future.

Example(s): Darcy purchased some real estate for $500,000. Five years later, the property is worth $800,000, and she expects that it will double in value during the next five years. Darcy wants to give the property to her daughter, Ellen. If Darcy wants to save estate taxes, she should make the gift now instead of later. Now, only the $800,000 will be subject to gift tax, and in five years (assuming she is correct) $1,600,000 will be subject to gift tax.

However, lifetime giving results in the carryover of your basis (generally, basis is the property's cost) in the property to the recipient (as opposed to a gift at death that usually results in a new basis of fair market value on the date of your death). This means that the recipient may recognize a larger capital gain when the property is sold than the recipient would have if he or she received the property from you at death. Be sure this consequence is acceptable before making this type of gift.

So, gifting can be fun, not only for the recipient, but also for the giver.

Bill Starnes is the managing partner of Mallard Advisors' Financial Planning Division

Investing Secrets

Paul Baumbach

A client recently asked us how we research stocks. As I answered, I recognized that this presents a wonderful opportunity to share our philosophy on researching and selecting individual stocks.

Our approach to stock picking is rooted in the academic study of efficient markets. This view holds that in areas such as large US stocks, there are too many individuals and institutions researching these companies to leave room for a deterministic method of 'beating' the market. Charles Ellis wrote about this in his book 'Winning the Losers Game'; I discussed his conclusions in our December 1997 newsletter. **We win by not losing**, by staying invested while minimizing our costs (transaction, income tax, …). Where we add special/additional value is in sticking to our knitting. Mallard's preference is for companies that exhibit consistent results in stock portfolios with a lower-than-market exposure to growth and technology. [Like Warren Buffett, we have nothing against growth companies, but recognize that we rarely have an advantage in selecting superior stocks in these sectors.] To the extent that we wish a portfolio to more closely match the overall market, we supplement our individual stock picks with managed (mutual fund) solutions with expertise in these areas.

Our approach to selecting individual (primarily large- and mid-cap US) stocks does not require extensive research. **Most stock research these days is very short-term in its perspective**, and often provides us more of a reverse-indicator (avoid stocks current research prefers and vice versa) due to our contrarian leaning. It is quite possible that for "frothy" growth markets, our approach will lag the markets, however we aim to hold up well in poor and normal markets. We consider this to be an acceptable tradeoff.

Our approach leans more on ensuring that we are not overpaying, and therefore looks first to the '**Mallard ratio**', which is the PE (current **P**rice divided by next year's projected **E**arnings) divided by the sum of the projected future earnings growth rate and the dividend yield. If a stock's PE is 20, earnings are expected to grow at 15% annually and the stock has no dividend, the Mallard ratio is 20/15 or 1.3. We like to see Mallard ratios no greater than 1.0 before we buy a stock. This is our first level of filtering, or our first pass at 'vetting' stock ideas we pick up from clients, media, … We also look at how the stock complements the rest of the portfolio, and the 'quality of management'. However regardless of how good management is and how the stock complements the portfolio, if it is too expensive, we'll pass.

Our approach is definitely long term, and as such we are not regularly scouring the markets for the next strong stock. Rather, when it is time to harvest a stock (strong recent gain, diminished future prospects, …) or when there is new cash to invest, we **then** search for an attractive new crop to plant in the field.

It may appear boring, but I believe our approach to individual stock selection tilts the odds of winning the loser's game in our clients' favor.

Paul Baumbach is the managing partner of Mallard Advisors' Wealth Management Division

Ameritrade To Purchase TD Waterhouse

Bill Starnes

As reported on Wednesday, June 22, Ameritrade has announced that they intend to purchase TD Waterhouse with the new firm named TD Ameritrade. As brokerage customers of TD Waterhouse, you will likely have questions about how this merger will affect your services and costs. Naturally, no matter how tenacious the tiger (us), he is nervous when he walks among elephants (big brokerage companies).

The big picture is that no matter what the elephants do, the tigers will always be fast and flexible enough to stay far ahead of the elephants and it will not matter what the elephants do. Our attention will always be on finding the best discount brokerage services for our clients as the changes play out. We are in a very good position in that it is relatively painless to move from one discount broker to a better discount broker if necessary.

I am realistic, but hopeful. Realistically, I know that a merger will bring about short-term, minor, irritating changes such as changes in account statement format, form changes, and possibly account numbers and

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Limit Your Losses

Pam Baumbach

Recently Paul and I were victims of credit card fraud. Since we still had our credit cards we can only assume our name, number, and expiration date were scammed from a receipt or from the internet. Fortunately, we caught it quickly, notified our bank immediately and the loss was minimal and covered by the credit card company. I did learn a few helpful things from the experience.

- Check your statements quickly and carefully – I discovered the two $50+ charges about 3 weeks apart, and almost missed them.

- Notify the bank as soon as possible – you are responsible for doing everything you can to prevent further loss and can be held financially responsible if charges are incurred after you identified the fraud but before you notified the bank, since you could have prevented the loss.
Notify the credit bureaus – the credit bureaus have three types of credit fraud alerts they can put on your credit report.

1. The first is if you suspect you may be or might become a victim of fraud or identity theft. You can call the credit bureau and with a verbal request they will put notice on your report for 90 days. The notice will inform potential creditors that they should contact you personally before honoring any credit requests.
2. The second is if you are a confirmed victim of fraud. You must make your request in writing and include a copy of a law enforcement report, and the credit bureaus will keep the notice on your report for seven years. We did this.
3. The third is for military personnel, and will have a notice to call the applicant before issuing credit.

- Call your bank when traveling – let them know to expect charges in another geographical area. Non-local charges are a warning flag for fraud. If they suspect fraud and can't reach you, they may put a hold on your account – disrupting your vacation.

- Notify any vendors that automatically submit charges to that account - when you freeze the account number, automatic charges will not be processed, and you may become delinquent in your account payments.

- Limit your internet purchases to a few, low credit line cards – if someone tries to use your credit card, they will only be able to use the purchasing credit of one card.
Do not use a debit card on the internet – it is more inconvenient to have to close and reopen your checking account than a credit account. Also, you do not want to tie up your cash while resolving the fraud.

While these hints may help you after you are a victim, good practices will increase the chances it will not happen in the first place. Be a responsible consumer: check your statements faithfully, keep your financial information secure, know what you purchase, and be watchful. And finally, when it happens to you – act quickly!

For contact information for reporting credit card fraud, go to our website www.mallardadvisors.com, and choose **Web Links** from the list of choices on the left.

Pam Baumbach is the Client Services Manager of Mallard Advisors' Wealth Management Division

Ameritrade To Purchase TD Waterhouse...continued

commission schedules. I am hopeful in that Ameritrade is a well respected (and rated) discount brokerage company with outstanding technology and people. They are experts in merging companies which bodes well for this merger. Specifically, they have merged with five companies since 2001 including National Discount Brokers Corp, Datek Online, and Bidwell & Company. TD Waterhouse has also shown some selectiveness by walking away from talks with E*Trade over how E*Trade planned to run the company. I would expect that a merger will allow TD Waterhouse to remain competitive in their cost structure due to the economies of scale that the merger will provide. Finally, TD Waterhouse has the larger Institutional team with $42 billion in assets versus $4 billion at Ameritrade. Therefore, I would expect that changes on the Institutional side (which is what we care about) will be minimized.

In the very short-term you can expect nothing to change since the deal will not close for about six months. After that, it will take several months for the resulting changes to manifest themselves. Again, I expect minor changes. If however, we feel that a better option is available elsewhere, this tiger will dart between the elephants.