



# THE MALLARD FLYER

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## Notices

### Paul's Schedule /Newark Office:

The Newark office will be closed on January 16th. Paul and Mark will be attending the TD Waterhouse conference in Florida from February 1st through the 4th.

Paul expects to be in New Orleans on a service trip during the last week of March.

### Bill's Schedule / Hockessin Office:

Bill will be out of the office on Friday, January 20th.

### Next Newsletter:

The next newsletter is expected to be mailed in early April 2006.

## Misinformation

William D. Starnes

The media—print, television, the Internet—are the main sources of investment information for most of us. With all of the available information from these sources, it is easy to assume we're getting all we need from these sources, and that we can use this information to form opinions about politics, what the weather is going to be like tomorrow, and how we should invest.

Media companies are businesses. Their job is to make money, just like most other businesses. They all want to make a profit, and the big source of profit is advertising. And the larger the audience, the more advertising dollars they can command.

So, the media company's logical strategy, therefore, is to reach and retain as many sets of eyeballs as it can. There are lots of ways to do this, but the biggest one for investment-oriented sources is creating a sense of urgency—especially urgency that appeals to the two main drivers of investor psychology: greed and fear. The buttons most frequently pushed are in stories purporting to name the next stock that's poised for huge gains (greed), and warnings of impending disasters (fear). If you've ever watched CNBC, you know exactly what we're talking about. Each "segment" lasts just a few minutes and usually proceeds at a breakneck pace, with guests and hosts always focusing in on "actionable" information.

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## Mallard Announcements

### Mallard's Financial Planning Division opens an office in Hockessin, DE

The financial planning division has acquired new office space in downtown Hockessin, DE starting January 1, 2006. Bill, Sherry, and our other related office help will be moving to this location while Paul and the rest of the Wealth Management Division will continue to work out of our Newark office location. This new location is far closer to both Bill and Sherry's personal residences.

The building itself (see the picture to the right) is located on the corner of Valley Road and Old Lancaster Pike. It is owned by the Lamborn Library Association whose charter is to maintain the historical structure and provide use of the main floor to civic and other groups. It is the location of the original Hockessin library and is next to the new Hockessin Library.

Bill's new contact information is shown at the top of this page. In addition, directions can be found on our website on the link titled "Hockessin Office".



## Misinformation...Continued From Page 1

So not only is the media in the business of convincing you that your financial position depends on factors outside of your own control, but they are in the business of leading you to believe that the information they provide today, or this hour, is somehow relevant to becoming a successful investor. As it happens, the opposite is true. And certainly, focusing on “buy-and-hold”, “investing for the long-term”, and “minimize your investment costs” will not be the headlines that attract subscribers—or please advertisers.

As a simple illustration, the following is a list of cover stories over a 12-month period from Money magazine:

- “Funds to Sell—and Why?”
- “8 Strategies to Improve Your Returns Now” and “5 Safe Stocks”
- “How to Build the Perfect Portfolio”, and “12 core Funds / 10 Solid Stocks”
- “The Right Way to Invest Now”
- “10 Best Funds to Buy Now”
- “13 Top Stocks and Funds to Buy Now”
- “Great Stocks for This Market”
- “Retire Rich! Our Exclusive 60-Minute Plan”
- “Today’s Hottest Tech Stocks”
- “7 Best New Funds”
- “Midyear Investing Special: Blue Chips to Buy \*Hot Tech\* Smart Bonds”
- “The Ultimate Retirement Guide”

The popularity of articles with headlines like “The Right Way to Invest Now” or “Five Stocks to Avoid” confirms something about the tone the media is trying to establish. You don’t want to miss out on “the next big thing” and perhaps even more importantly, you don’t want to get caught making a big mistake.

Fear-oriented headlines become more common during shaky market environments, and the greed-oriented pieces usually show up more often when things are going well. This makes perfect sense: by appealing to the prevailing emotions of investors at any point in time, the media is more likely to attract and retain subscribers, which enables them to attract more advertisers and charge higher rates, and that’s good for the bottom line.

But it isn’t good for investors. In a 1999 issue of Fortune Magazine, an anonymous writer penned a notori-

ous piece entitled, “Confessions of a Former Mutual Funds Reporter.” The writer said, “We were preaching buy-and-hold marriage while implicitly endorsing hot fund promiscuity.” Why? Because, “Unfortunately, rational, pro-index-fund stories don’t sell magazines, cause hits on Web sites, or boost Nielsen ratings.”

The problem is that we tend to perceive the most risk once the market has already gone down a lot and the media companies know this, so their emphasis during these times is often on all the things investors should fear. After all, this is what investors are thinking about.

The problem with this is that after the market has already declined sharply is usually the worst possible time to be selling: the prevailing fears of investors have already been priced into the market, and oftentimes valuations are far more attractive than they were before the decline began (when, ironically, everyone felt that there was very little risk out there). In other words, **when the outlook is the worst, future returns are likely to be the highest.** So the increased fears promulgated by the media effectively encourage investors to do the worst possible thing: sell when we should be holding or possibly even buying.

The good news is that you have much more control over your financial well being than the media or headlines would lead you to believe. **It is things like how much you save, how much you earn, your asset allocation, and if you re-balance your asset allocation periodically that are controllable and will over time improve your financial security.**

Finally, **there are some excellent media sources out there including:** Jane Bryant Quinn of *Newsweek* Magazine, Jason Zweig of *Money* Magazine, and Jonathan Clements, whose column appears in the *Wall Street Journal*. Excellent books include *A Random Walk Down Wall Street* by Burton Malkiel, *The Four Pillars of Investing* by William Bernstein, and *Common Sense on Mutual Funds* by John Bogle.



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

On January 5<sup>th</sup> several clients joined Mark and me to hear **John Neff** speak to the Philadelphia Financial Analysts Society. Neff ran the Vanguard Windsor fund for thirty-one years, during which it outperformed the S&P 500 by more than 3% a year. With a record like that, when you speak, people listen.

Despite retiring from Vanguard Windsor over ten years ago, he remains sharp as a tack. He had several yellow, ruled pages of notes, and yet he quoted prices and earnings estimates from memory. I can only hope that I am half as sharp at his age as he is now.

He is **bullish on US stocks in 2006**, and part of the reason is that he feels the US economy will be fine in 2006, growing from 3% to 3½%. He feels that consumers are not overstretched, and that they will enable the US economy to continue to expand in 2006. **Neff described the US economy as ‘near ideal’.**

John Neff is pleased with the earnings from US companies in 2006. He expects them to grow from 8% to 10%, down from their 2005 growth rate of the mid-teens. He expects wage increases will be only moderate, and productivity improvements will enable US companies to grow their earnings at a higher rate than GDP in 2006.

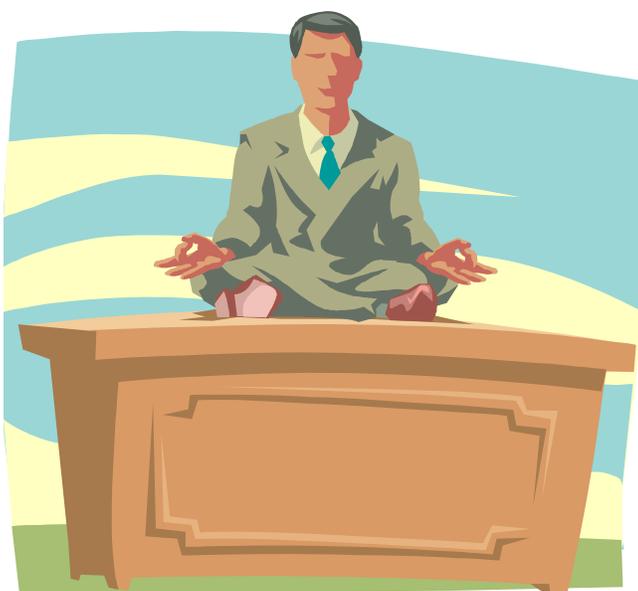
**Neff expects inflation to cool in 2006**, and come in around 2.5% (versus about 3.5% in 2005). He expects energy prices to cool, which should bring overall inflation much closer to ‘core inflation’ which is a hair over 2%. He considers a 2.5% inflation rate to be ‘very livable’.

**John Neff admits being puzzled by long-term interest rates**, which are about 4.55% for long-term

treasuries. He feels they ‘deserve’ to be about 1% higher (which would bring down bond prices), and that factors such as the budget deficit and high rate of corporate borrowing should be pushing rates higher. While fielding questions, he suggested that decreased appetite by foreign banks and foreign investors for US treasuries could lead to the rate increase he has been expecting and predicting for some time.

A clear bull for 2006, Neff considers the strongest factor going for US stocks is the complete absence of attractive alternatives. Bonds and real estate do

not offer compelling value to John. He considers stocks to be quite attractive, trading at only 15.5 times his estimates for 2006 earnings, which is considered reasonable. He likes the stock buybacks, strengthening balance sheets, strong cash flow, and increasing dividends from many US companies. **He expects to see US stocks rise about 8% in 2006, with a further 2% or so from dividends.** Not bad, if it happens this way.



To complete this pilgrimage to gurus for their 2006 outlook, I traveled to the PIMCO website and read the **monthly column from Bill Gross**, manager of the largest bond mutual fund. He, too, is bullish, but on bonds and not stocks.

Gross acknowledges that we currently have a ‘flat yield curve’, with short term rates no lower than intermediate term rates. He notes, however, that this point typically coincides with a peak in interest rates, and therefore a time that **bonds should produce attractive future returns**. He calls these times ‘Bond Bear Mar-

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ket Bottoms’.

He expects the US economy to slow (if not enter a recession) within twelve to eighteen months, and for the Fed to begin cutting the Fed Rate by late summer. As such, he appears to consider bonds to be likely to ‘earn their coupon’ in 2006, such that intermediate bonds yielding 5% should return 5% or so in 2006, with neither substantial price increases or decreases.

Based on Bill Gross’ outlook, bond investors can consider it ‘safe to enter the waters’, and emphasize at least intermediate bonds. They should prepare to cut back on high-yield bonds, as these could suffer tough times when the US economy slows.

*The man with two watches never knows what time it is. What should you do* when one respected ‘guru’ sees the economy gathering steam in 2006, while the other sees it running out of steam? John Neff is shorting (betting against) long-term bonds, while Bill Gross appears to be adding to them. Long-time financial planner George Marotta has been quoted as saying “when faced with two choices, make half a mistake”.

I like the fact that there is disagreement between John Neff and Bill Gross, and for that matter from many other noted market strategists. Rarely do market seers concur (it doesn’t sell papers nor does it boost cable ratings). As such, we are all exposed to regular, contradictory market predictions. Mallard has always advocated an ‘all-weather’ approach, which is partially prepared for most situations.

That said, we are strategic allocators, which means that while we establish long-term investment allocation targets for our clients, we regularly tweak them, depending on the markets and our outlook. We se-

lectively identify the insight that comes from ‘trusted sources’, focus on those which makes sense to us, and then incorporate these in our recommendations and actions.

John Neff shared several compelling insights. With a 7% jump in the last two months, foreign stocks beat the pants off US stocks in 2005. We have been, and will continue to trim our foreign stock holdings, harvesting gains, and redeploying some of these profits into US stocks, which appear to offer some of the potential that John Neff sees.

*“Mallard has always advocated an ‘all-weather’ approach, which is partially prepared for most situations”*

We have been consistently impressed by Bill Gross’ skill managing bonds, and we back up this confidence with dollars. We have invested a substantial amount of money in bond funds that Gross manages, based on our conviction (or is it merely a hope?) that his finger is on the pulse of the bond market, and money entrusted to

him will be better able to sidestep painful surprises in the bond markets.

I recognize that John Neff could be correct (and Bill Gross could be wrong), and that bond yields will rise up to 1% over the next year. However, I am not overly concerned with this scenario, as the impact of this change, should it occur, would be modest, perhaps a 5% decline. Further, we would hope that should this occur, Bill Gross would recognize it earlier than most, and reposition his funds (our clients’ money) appropriately, to minimize the negative impact.

Investors (and financial advisors) need to identify whose opinions they trust, and to what degree. The next step, and sometimes the most difficult, is to then act on these convictions. Best wishes for 2006, however it unfolds!

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

