The Mallard Flyer

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Notices

Paul's Schedule /Newark Office:
Paul and Pam will be on vacation from August 2-4, and August 21-25.

Mark will be on vacation from July 17-21.

Bill's Schedule / Hockessin Office:
Bill will be on vacation with his family in Cape May, NJ from July 17th through the 21st.

Next Newsletter:
The next newsletter is expected to be mailed in early October 2006.

A Good Short-Game

William D. Starnes

More than half a golf game takes place on the putting green, but novice golfers would much rather spend time at the driving range than at the putting green. At the driving range, the adrenaline flows as you work on your swing, trying to **outdistance** your buddy, and trying to ignore each frustrating slice or shank. And alas, you run through your bucket of balls before you know it. However, those who focus on a **good short-game** (i.e., on the green), typically show patience, steadiness, and an ability to remove themselves from the distractions of the crowd (think giant rainbow wig), media, or themselves.

Asset allocation is just as simple, slow, and boring as the putting green. This is why, like novice golfers, novice investors like to skip right over it. Instead, they prefer to spend their efforts on the sexy stuff, like security selection and market timing.

When investing, there are many areas we can concentrate our attention on: interest rates, security selection, asset allocation, economic reports, market timing, etc. However, it has been well documented that you get **the biggest bang for your buck**, by focusing on asset allocation. The classic study by Gary Brinson demonstrated that more than 90% of the variation in investment returns is due to asset allocation, and less than 10% to timing and stock selection. Al-

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Mallard Announcements

Pictures of **Bill Starnes** and his family appeared in the June 2006 issue of *Delaware Parent*, a publication of ***The News Journal***. The pictures accompanied an article titled "Finding the right balance: Dads also struggle to give both work and family 'good quality time'. In the article, Bill was quoted regarding how he has structured his business life to achieve the best quality family life, and observations he sees within his own practice. The pictures were taken outside of Bill's new Hockessin office.

We are proud that Mallard is listed as one of the **Top Wealth Managers** in the country in ***Wealth Manager*** magazine's July/August 2006 issue. The rating is based on the average 'client relationship' of the firm. Mallard's $840,000 level puts it at #304 of the 439 included in the survey. We are very thankful to our clients who are the key to our success.

Bill Starnes has volunteered to teach a course titled ***Create Your Own Spending Plan*** on Monday, July 10th from 7-8 pm at the Lamborn Library (the downstairs portion of his building). The course is based upon his Audio Seminar Series CD titled ***Creative Budgeting*** and is offered through the Delaware Money School.

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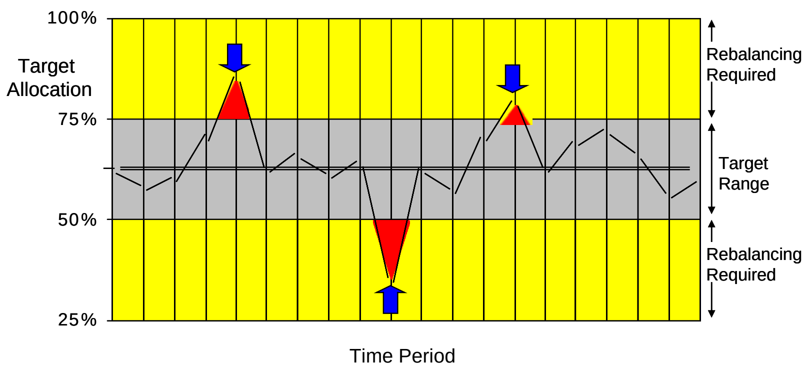
though this has been replicated and confirmed in subsequent studies, the results are still contested—and they should be. However, regardless of how much asset allocation contributes to your returns - 80%, 90%, or otherwise – it would be irrational to deny that this **<u>is still a very important aspect of your investment strategy</u>**, and therefore to your returns. So not only is it very important, but it is also the aspect of your strategy that we, as individual investors, have ***<u>the most control over</u>***.

Asset allocation is a means of spreading your investment risk across many different types of securities, thus reducing overall portfolio risk and subsequently increasing portfolio returns. In your own case, this means deciding how much of your total investment assets you should place in stocks ***versus*** bonds/cash, and of the stock amount, how you split it among different classes of stocks – such as international, smaller-cap, or larger-cap – or different styles of stocks – value, growth, etc. Again, at the most basic level, asset allocation is the decision of how much of your investments you are willing to put at risk (i.e., in stocks). At Mallard, we use a variety of methods to assist our clients in this decision.



Ok, even though we understand that our asset allocation has the biggest impact on our **<u>long-term returns,</u>** we still have to tolerate the shorter-term risk that comes with our decision to put a certain percentage of our capital at risk (i.e., into stocks). The reality of market risk is ubiquitous – TV, radio, internet, magazine, etc. However, we must turn this risk to our advantage by recognizing the difference between the short-term risk inherent in participating in the markets, and the long-term returns garnered by tolerating this shorter-term risk. We take advantage of it by rebalancing our portfolios back to their targets, or even over-balancing. However, once made, it is best to stick with your chosen asset allocation through thick and thin including rebalancing back to your targets on a regular basis.

As shown in the chart on this page, rebalancing back to your target range forces you to sell at higher prices, and buy at lower prices. This goes against our very nature. Even worse, when you are selling, you will likely be reading some very compelling reasons to buy, and while you are buying, others will consider it an act of lunacy. However, it all will act in the best interests of your long-term portfolio return.

Therefore, we must also do our best to constantly remind ourselves of the vicissitudes of the market. William Bernstein describes a superb metaphor for this in his book *The Four Pillars of Investing*. "(Think of the stock market as) an excitable dog on a very long leash in New York City, darting randomly in every direction. The dog's owner is walking from Columbus Circle, through Central Park, to the Metropolitan Museum. At any one moment, there is no predicting which way the pooch will lurch. But in the long run, you know he's heading north-east at an average speed of three miles per hour. What is astonishing is that almost all of the market players, big and small, seem to have their eye on the dog, and not the owner."

All of these aspects of your investment strategy (asset allocation, security selection, and timing) are not mutually exclusive, they must work together.

Easy solutions to selection and timing can be made by using a static asset allocation, a buy-and-hold philosophy, and an all-index approach. We, on the other hand prefer to go the extra mile by doing high quality due diligence on stock pickers (i.e., fund managers), and asset class valuations. This work allows us to add value beyond the all important asset allocation decision. And although we are aware that attention to asset allocation provides the biggest bang for your buck, we are also committed to finding outstanding fund managers where even a small edge can add up to big rewards over time. **<u>This allows us to have both a good short game and a good long game.</u>**

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

Due to an abundance of situations that we have been encountering in recent months, I have decided to beef up our **support for people considering rolling over their retirement plan balances**. In late June, 25% of GM workers in Newport, Delaware accepted a buyout package to retire early. These retirees, and most retirees, find themselves asking, 'What should I do?'

CPA Ed Slott has written a book The Retirement Savings Time Bomb…And How to Defuse It. The book is a bit dry, however it is written for both the layperson and the professional. It includes some wonderful information on what to consider in this situation, and how best to proceed, once you decide what to do. In this article I will focus on the factors that you need to consider when determining what to do with your retirement plan balance (after you have retired, or after the plan was cancelled). In the next newsletter I will present tips and techniques in Executing a Successful Rollover.

There are **three primary choices**. You can do a **Rollover**, transferring the money into an IRA. You can **Stay Put**, leaving the money within the plan, or even rolling it into a plan at your next job. Finally, you can **Take a Lump Sum**. There are strengths and weaknesses of each approach. How do you decide the right path for you?

Slott presents ten **factors to consider**. He cautions against using any as the sole factor, but rather review them all and identify the ones which are the most important to you, and select the choice which offers the most strengths for the factors which matter most to you. I distill Slott's ten factors down to five.

How old are you and how healthy are you? The IRA offers the greatest ability to stretch wealth out, and to maximize after-tax wealth. The younger you are and the healthier you are, the stronger is the reason to choose a Rollover. IRAs offer greater flexibility with beneficiary designations. If your age is advanced and/or your health is poor, you may find that a Rollover will help you best match your designations to your wishes.

How much money will you need, and when will you need it? If you won't need the money for several years, then you will likely want to either choose a Rollover, or to Stay Put. If you need a lot of money soon (say you retired early at age 50, and have a pension and Social Security which won't begin for 15 years), then you may need to Take a Lump Sum.

What will your income tax bracket be during retirement? If your income taxes are likely to rise during retirement (perhaps due to pensions, Social Security, and required minimum distributions), then you may want to Take a Lump Sum and pay tax at today's lower levels. If, however, your income is likely to fall by retirement, then a Rollover or Staying Put will enable you to avoid taxes today, and pay lower taxes tomorrow. That said, if the amount in the plan is small, then so will be the income taxes, and it may be far simpler to Take a Lump Sum.

What is your estate plan? If your estate is sizeable, and subject to estate tax, there could be advantages to Taking a Lump Sum. In this strategy, you could shift wealth to a spouse to maximize their use of the Unified Credit, and you could pay the income tax up front, both to enable your heirs to avoid paying income taxes on the inheritance, and to shrink your taxable estate, and reduce your estate taxes due. If your estate plan calls for using a **Roth IRA** for the wealth in your employer retirement plan, then you would first have to do a Rollover.

Will you be working again, and is creditor protection important to you? Employer plans offer some unique strengths. All provide a high level of creditor protection (in case you file for bankruptcy, for instance), greater than for IRA balances in over half of the states, including Delaware. Many provide access to loans. If either of these features is important to you, then Staying Put could be right for you.

Slott notes that "**the best retirement distribution, investment, and withdrawal options are in the IRA**". In the next newsletter, I will wrap-up this series by examining what to do, and what to avoid, if you decide to Rollover your company retirement plan balance into an IRA.

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

There is a theory that computer games enable kids to "try out" actions within realistic situations without suffering the permanent consequences of real life. In "practicing" life choices without the finality of consequences, they can see how satisfied they are with the results, and, if they wish, try again and again. Later, in real life situations they can be confident **with risk** and make choices based on pseudo-experience. That sounds good to me! And what better area of my life to gain cheap experience and confidence than in finances?

At a recent seminar I was introduced to a new website: '**www.dinkytown.com**. It is my new favorite toy. This site has user-friendly **calculators for almost any financial situation** you could encounter. The comprehensive list of categories includes Mortgages, Loans, Credit Cards & Debt, Auto, Investments, Retirement, Insurance, Taxes, Savings, Personal Finance, and Business. A sample of the calculators I found interesting are: Section 125 Cafeteria Plan (how much should you put away by category and the tax advantages), Emergency Savings Calculator (how much would you need as a cushion to fall back on), Don't Delay your Savings (the impact of when you start saving), Auto Rebate vs. Low Interest Financing (what you are really paying for that car), Lease vs. Buy, and Retirement Income (how much monthly support your retirement savings can provide you).

The input fields are described in a user-friendly way, not excessive and yet comprehensive enough to make the scenario realistic. There is a glossary with each calculator to explain what each variable is, so that you can accurately estimate the value.

Take for example **Should My Spouse Work?** You input gross wages (it knows how to calculate taxes), 401k savings, and expenses (transportation, childcare, clothing, food, cleaning, etc.), and it will show you what your take-home pay will be. You can then adjust the information to answer your questions… what would my spouse's gross income need to be to make working financially worthwhile? What can I afford to pay for childcare? How far away could I work? In this calculator you generate a pie chart that shows what your gross salary pays for, not simply a table of numbers (pie charts speak to me).

Another aspect of the website that I liked is that it is **universal and objective.** The site is maintained by KJE Computer Solutions, LLC, so I'm pretty confident they are not trying to sell me a home loan or investment vehicle. Their product is selling the programs to professionals (as financial calculators on their company's website, for instance), and so they are committed to having the calculators accurate. There is **no charge** to use the calculators on-line for personal use. They are constantly introducing new calculators. They have even provided a place to make suggestions for future calculators.

I have enjoyed testing the calculators and plan to use them to supplement future research. They are a great way to test out circumstances and figure out what realistic options are available. These are neither right for everyone, nor do tools like this replace professional advisors. Rather they fill in the gap in the middle. Tax preparation software is not needed by most taxpayers who use the 1040EZ form or those who complete their paper forms by hand, and such software is insufficient for complicated tax situations. In between, however, it serves a good purpose. Dinkytown similarly can be very helpful in exploring many common financial questions.

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