

As mentioned in the last newsletter, required minimum distributions (RMD's) from IRA's, 401(k)'s, 403(b)'s, etc. have been suspended for 2009! This applies to everyone required to take distributions, regardless of income, age, or filing status. So, whether you are 75 and required to take \$50,000/year from your IRA, or 5 and taking \$500/year from your inherited IRA, you do not have to take your distribution in 2009. This is a very unique situation creating some rare planning opportunities.

But, it is possible that you still take a distribution even though you are not required to. There are three primary reasons you would do this: income tax savings, estate tax savings, and tax diversification. Also this consideration generally applies to clients who are wealthier, older, and have substantial assets in their retirement plan. Obviously, if you are taking RMD's because you need the cash-flow, this reduces the planning opportunities.

### Income Tax Savings

Say that you are age 75 and generally take \$50,000/year (according to the IRS distribution table). Your IRA is your largest asset. You have \$30,000 of taxable Social Security, and \$5,000 of investment income. Generally you would be in the 25% federal tax bracket and paying about \$10,000 year in federal income taxes on your "taxable income" (income after deductions and exemptions).

Without this \$50,000 required minimum distribution, you would have NO TAXABLE INCOME and pay NO FEDERAL INCOME TAXES! Wow, this would seem like the greatest gift one could ask for. But it may be possible that you want to pass on this gift in order to get a better gift. Consider further that instead of withdrawing your \$50,000 RMD, you could withdraw just \$10,000 from your IRA and end up with a tax bill of only \$217. This would be like paying a 2% tax on the withdrawal. Even taking \$20,000 would still amount to a tax rate of only 9% on this withdrawal. When could you ever get access to your IRA dollars at a cost of 2% - 9%? Perhaps never again!

The same argument could apply to an older client in the 33% tax bracket who because of the waiver of

minimum distributions, sees a unique opportunity to gain access to his IRA dollars cheaply (at say a 15% - 25% tax rate).

Even if your tax rate does not drop, there are many who think taking out excess dollars at their existing tax rate would be a bargain if Congress has to raise tax rates in the future to finance government spending. Of course, this is a big unknown.

### Estate Tax Savings

It may also make sense to take withdrawals even at your current income tax rate if the purpose is family gifting. By reducing your estate by the income taxes paid and the gifts, it is possible to save more in *estate* taxes than are paid in *income* taxes on the withdrawal.

### Tax-Diversification

Some clients have the bulk of their investment assets in tax-deferred retirement plans (i.e. IRA's, 401(k)'s, etc.) subject to future ordinary income tax rates and the whims of Congress. These dollars are much more vulnerable to the ever changing government policies than is outside money. For example, in 1986 the government put a special 15% excise tax on "excess retirement plan money" (later repealed). It may make sense to be diversified by account type (IRA vs. Roth vs. taxable account).

Tax diversification can be obtained by taking withdrawals in 2009 even though not required and putting the money in a non-retirement investment account. Or better yet, by performing a Roth IRA conversion with part of the IRA you will convert all future earnings from the converted dollars from taxable to tax-free.

I know it is hard to swallow the idea of paying a certain tax now for an uncertain tax benefit later. But by creating taxable income now through additional non-required withdrawals, it is possible to lower your total lifetime tax liability and to increase your level of tax diversification.



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



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## Notices

### Newark Office:

Pam will be on vacation from April 13th-17th. Ed Mink will be on vacation from May 11th-22nd. Paul will be at the NAPFA National Conference in Washington, DC from June 3rd-6th.

### Bill's Schedule / Hockessin Office:

Bill will be at the NAPFA National Conference in Washington, DC from June 3rd-6th.

### Next Newsletter:

The next newsletter will be mailed in early July.

# THE MALLARD FLYER

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## A Nice Twelve Year Rut?

Paul S. Baumbach

In March 1998 I first published an article discussing the annual letter from Warren Buffett to the shareholders of Berkshire Hathaway. This is the twelfth annual such article. Buffett has led the company since 1965, and during that time Berkshire's book value has grown at a 20% annualized pace, while the S&P 500, with dividends, has grown at a 9% annual pace. His is an enviable record, and over the years Warren's letters have included useful insight, and some humor. 2009 is no exception.

'We're certain, for example, that the economy will be in shambles throughout 2009 – and, for that matter, probably well beyond – but that conclusion does not tell us whether the stock market will rise or fall.' Here Warren reminds us of two facts—the US and world economies are in bad shape, and stock markets do not move in lock step with the economy. Indeed, in March 2009 the economy did not get any better (especially for the 660,000 people who lost their jobs in March), and yet stocks rose 8% or more. Panicked investors fled stocks last year and have remained in cash in the past few months due to the current economic plight. Most have forgotten, or never knew, that stock prices generally reflect the **future** prospects for companies and economies, and stock markets typically recover well before the overall economy and before employment does.

Stocks are cheap. '... the market value of the bonds and stocks that we continue to hold suffered a significant decline along with the general market. This does not bother Charlie [his colleague] or me... Whether we're talking about socks or stocks, I like buying quality merchandise when it is marked down.' Later he discusses business prospects for subsidiary GEICO, however the comment also covers stocks: 'As we view GEICO's current opportunities, Tony and I feel like two hungry mosquitoes in a nudist camp. Juicy targets are everywhere.' The stress that most investors have been feeling is due to their focus on the very short-term. The losses in their stocks and stock funds provide quite a silver lining—they have created wonderful bargains for new purchases. Many investors, however, don't have the luxury of being able to make additional purchases, especially those who are already retired. In the article on 'firewall investing,' I provide an ap-

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## Mallard Announcements

Newsletter Delivery—Would you like your newsletter sent via e-mail? If so, give us a call to be added to our newsletter e-delivery list. You will receive the newsletter several days earlier than the mailed version.

Newark Night—Mallard will have a booth at Newark Nite on June 6<sup>th</sup>. Stop by the table and say hello.

Delaware Money School—Paul will hold an educational talk on "How to Retire (Remain Retired) in a Bad Market" on June 10<sup>th</sup> at the Newark Senior Center. Please let us know if you would like to attend.

proach that removes much of the stress of bear markets even for retirees.

Alternatives to stocks are risky. Many nervous investors have moved money from stocks to cash and bonds. 'Clinging to cash equivalents or long-term government bonds at present yields is almost certainly a terrible policy if continued for long.' While these investors have heard and felt that cash is king, 'Approval, though, is not the goal of investing. In fact, approval is often counter-productive because it sedates the brain and makes it less receptive to new facts or a re-examination of conclusions formed earlier. Beware the investment activity that produces applause; the great moves are usually greeted by yawns.' Buying stocks while stocks are falling never feels good—it feels quite foolish. Yet by doing so, you are taking advantage of a sale. With investing, when you wait for everyone to do something, you will never get a sale price. 'The ups and downs neither cheer nor bother Charlie and me. Indeed, the "downs" can be helpful in that they give us an opportunity to expand a position on favorable terms. I hope this explanation of our dealings will lead you to think similarly.'

Our recent and current problems are significant, but are not unprecedented. '... never forget that our country has faced far worse travails in the past. In the 20<sup>th</sup> Century alone, we dealt with two great wars (one of which we initially ap-

peared to be losing); a dozen or so panics and recessions; virulent inflation that led to a 21½% prime rate in 1980; and the Great Depression of the 1930s, when unemployment ranged between 15% and 25% for many years. America has had no shortage of challenges. Without fail, however, we've overcome them... Though this path has not been smooth, our economic system has worked extraordinarily well over time. It has unleashed human potential as no other system has, and it will continue to do so. America's best days lie ahead.' Indeed. The challenges are great, as are the attempts to fix and heal the problems.

When do you expect the US economy to recover to its late 2007 levels? Five years, ten? Let's assume, and I think that this is WAY too pessimistic, that it will take ten years for the economy to recover, and for US companies and stock prices to get back to their levels from late 2007. If so, then stocks will (during the upcoming ten years) return 7% plus their dividend yield (2% or more) annually for that decade. Compare that 9% annual return to a ten year Treasury bond, which will return less than 3% annually for ten years. Buffett's long-term optimism makes great sense in 2009. I think I'll keep reading and reporting on his annual letters for awhile longer.

*Paul Baumbach is the managing partner of  
Mallard Advisors' Investment Advisory Division*



## Firewall Investing

We have always stressed the importance of the balance of stocks and bonds within an investment portfolio. I have refined that recently, introducing the concept of a Firewall. In this mini-article, I provide an introduction of the approach.

Picture placing a high wall, a Firewall, between your portfolio's "safe stuff"—money markets, CDs, and bonds/bond funds—and the rest of the portfolio, with its stocks and stock funds. How can this prepare you for an extended down (bear) market for stocks, even if you are retired?

Let's begin by examining a typical retiree's portfolio, starting with some specific figures. I find that most investors, by the time they are retired, have built their bond allocation (the safe stuff) to 30% or more, all safely behind the firewall. We and most advisors recommend that retirees limit the annual withdrawal rate in their first year of retirement to 5% or less of the portfolio (\$30,000 for a \$600,000 portfolio). Finally, most balanced portfolios provide a yield (annual dividends plus interest, but excluding gains and losses) of 2% or more a year.

When a bad stock market, such as the current one, arrives, how long can the safe stuff hold out? In the first year, the retiree needs to withdraw 5%. However 2% of this comes from the portfolio's yield, leaving 3% that needs to come from behind the firewall. As long as the retiree begins with 30% or more behind the firewall, they should be able to last almost a decade before they are forced to sell a single share of stock.

Certainly retirees need to sell their stocks and stock funds over time. Most retirees do not, however, need to sell them while stock prices are down. With a strong firewall, you can well afford to wait a long time for higher prices, and to sleep better at night.

I will be presenting this strategy at a seminar on June 10<sup>th</sup> at 7pm at the Newark Senior Center, as part of the Delaware Money School program of free financial educational seminars. In June we will post a PDF file of the handout on the web. Contact Diana at the Newark office to sign up for the seminar, to receive the web address for the location of the handout, or to receive it by mail.

As Fee-Only financial and investment advisors, Paul and I believe strongly in the transparency of our fees via full written disclosure, sending invoices, and quoting our fees in dollars. Unfortunately much of the financial services industry is not quite as transparent—including mortgage brokers. Most mortgage brokers sell—they sell access to bank money and therefore work for lenders and not consumers. Therefore, with mortgage interest rates hitting all time lows and refinancing up, working with an honest mortgage broker is imperative.

Mortgage brokers help borrowers select loans, shop for the best deal among lenders, and compile all of the required documents. They make their money in a variety of ways but most typically through some combination of markup of the interest rate offered, charging of points and fees. Since consumers don't know what the markup is on the interest rate, consumers therefore don't know what they are paying these brokers for their services.

Worse, many brokers participate in what is known as "sunshine blowing", an unethical practice of quoting prices that can't be delivered. This involves dozens of tricks used to raise the prices once the application process has begun. One trick is when customers allow the rate to "float" with the market until close to the closing date. They generally don't receive the rate because their bargaining power is gone and competitor shopping is impossible. The broker pockets the difference.

Brokers earn about \$3,000-\$4,000 per transaction.

There are some mortgage brokers who are "Up-Front" with their fees (UMB). They belong to a professional association called The Up-Front Mortgage Brokers Association" and agree to fee transparency. UMB's charge a fee that is negotiated at the beginning of the loan process and won't change. This fee

may be a fixed dollar amount, a percent of the loan, an hourly charge or some combination of these (just like fee-only financial advisors). While the out-of-pocket fee may be \$3,000, you will, however, receive the actual "wholesale" interest rate received from their lender—no markup. These rates are typically 3/8% below the "retail" rates quoted elsewhere..

To find an upfront mortgage broker go to [www.upfrontmortgagebrokers.org](http://www.upfrontmortgagebrokers.org). You can search for an UMB by state which will include mortgage brokers that are out of state, but licensed to do business in the state queried. I have thus far received good service from Rick Hutchison who is licensed in Delaware.

I would suggest obtaining three good faith estimates on the same day (after 10am but before noon). This is because rates change daily and you want an apples-to-apples comparison. Refuse to pay application fees. Instead agree to only the appraisal fee and credit report. Request your settlement papers a day or two in advance of settlement and compare all closing costs against the good faith estimate. There should be no surprises at the closing table.

Like fee-only advisors, because clients are working with transparent fees, conflict of interest is reduced. The broker is no longer working against you, but for you. The broker is now professional counsel rather than financial salesperson.

## TD Ameritrade Trade Confirmations Offered Quarterly

In the past many clients have requested less mail from TD Ameritrade. Now, TD Ameritrade offers clients the option of receiving their trade confirmations quarterly rather than after each trade is placed. Also, these confirmations can be sent via U.S. Mail or electronically.

If you would like to switch to quarterly trade confirmations and/or the format of delivery, please e-mail either Sherry (Financial Planning Division) or Diana (Wealth Management Division). Sherry's e-mail address is [sherry@mallardadvisors.com](mailto:sherry@mallardadvisors.com) and Diana's is [diana@mallardadvisors.com](mailto:diana@mallardadvisors.com). Of course you can always call too!