The Mallard Flyer

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Notices

Newark Office:
Paul and Pam will be in Orlando the week of November 7-14. The second half of the week Paul will be attending the Napfa conference. Ed will join Paul and will be out of the office Tuesday through Friday. Diana will be on vacation the following week.

Bill's Schedule / Hockessin Office:
Bill will be out of the office the week of October 19-23. The first half will be spent in Disneyworld with his family. The second half will be spent at a conference for fee-only comprehensive financial advisors.

Office Closings:
Both offices will be closed on Thanksgiving day, Christmas day, and New Year's day. Both offices will be lightly staffed on November 27th, and on December 24th.

Year in Review

Paul S. Baumbach

Now that we have had a bit over a year since the bailouts of FNMA and AIG, and the failure of Lehman Brothers, it seems appropriate to offer some reflections on my experiences. I started Mallard in 1996, and made it largely unscathed through the Asian Financial Crisis of 1997, the dot-com boom and bust, and September 11th. I was a personal investor in the 1987 market crash. In my studies, I had learned much about the Great Depression, the go-go years of the late 60s, and the crippling effect of inflation during the oil embargo of the 70s. None of that fully prepared me for the past year.

The research and books I've read over the years paint a sterile picture—investors do best when they act as robots, buying stocks when they have fallen and selling them when they have risen. Investor robots ride out bear markets, whether they are a 15% one-year drop, or a 30% drop over three years. Investor robots do not tune in to screaming people on CNBC, and do not heed the televised cries to SELL, SELL, SELL. Investor robots, however, also don't worry about losing their jobs.

I have no investor robots as clients. All of my clients are people, humans who have dreams and fears. Some of them have seen parents and others exhaust their life savings, forced to live their later years on Social Security and perhaps a modest pension. Unlike the investing robots in textbooks, my clients have both hearts and minds, and the past year has required that we address both.

Classic economic theory is based on the presence of 'rational investors' (aka investor robots) who always make rational decisions. Theory based on this premise has suffered very public failures (including the crash of 1987, the crash of Long Term Capital in 1998, and the dot-com boom and bust). To partially address this shortcoming, the subfield of behavioral finance has sprung up, studying how

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Mallard Announcements

Ed, Pam, and Paul each became CERTIFIED FINANCIAL PLANNERS™ in the past three months. Ed and Pam passed the two-day comprehensive test in March, and Paul and Susan passed the test in July (Susan requires more experience before she can become certified). Congratulations to all four!

Paul has been a guest on nationally-broadcast *Fox Business Network's* 2-3pm program monthly since August.

Paul's next Delaware Money School seminar is Tuesday, January 12th at 6:30pm at the Newark Library. The topic is How to Retire (and Stay Retired) in a Bad Market.

real people respond to financial situations. I have written several articles about this in the past, most recently in last October's article on Herd Mentality and the prior October's article on Caveman Investing.

Being Irrational is Rational—Being irrational gets a bad rap. In the context of financial decisions, being irrational really means that you consider not only the sterile financial outcomes, but also how you will feel. My friend Gary shared a story about a chicken and a pig, and their contributions to breakfast. The chicken that provides the eggs is invested in breakfast. The pig that provides the bacon, however, is committed. As a Fee-Only™ advisor, I am **invested** in my clients' futures, however it is the clients who are **committed**—while we report the results of our decisions, it is the clients who live the results. I believe that configuration can be very helpful; it enables me to regularly offer a rational perspective that we can jointly integrate with clients' perspectives, which are a combination of heart and mind.

Back to the Past—Bear markets and recessions all have reasons for stocks to fall, and this past one was no exception. The difference between a normal bear market and a terrible one is rarely obvious until you are deep into it. By late August 2008, US stocks had fallen 20%, a fairly typical bear market decline. In the next two months, however, stocks fell another 40%, as the financial system nearly froze up, and we entered the Great Recession. Even that wasn't enough, for despite a rebound in December, by early March we reached a level 10% lower than November's lows.

How did clients react? Fear, concern, anger, paralysis, acceptance, you name it. Some of the greatest concerns came from clients who are approaching retirement, who have jobs that could be lost in a weak economy, and who are concerned whether they could retire 'on time.' While an investing robot wouldn't worry about such trivial matters, clients do.

Individual investors weren't the only people struggling. The Fed and Treasury (and their global counterparts) were also in uncharted territories. Adding to the stress, the past year has seen heated conflicts between schools of political thought, and schools of economic thought. This in many ways made matters worse—when things are bad, most of us seek a single authoritative voice (think Walter Cronkite) to share the clear path to recovery. Unfortunately, the fact that we were in uncharted territories meant that all I could do is offer my best, untested advice.

What did I do differently over the past year? Initially my battle plan called for boosting communication, which included the regular newsletter, three Market Alerts (including one the weekend before my knee surgery in November), and ten conference calls rather than the normal four calls. Starting this January, I began providing to clients the opening comments for the conference calls. Also I sharply increased the number of our client meetings, which sometimes involved 'talking clients off the ledge.' It was at these meetings that I recognized that the 'stick to the plan' mantra simply didn't fit clients' needs.

During the winter I developed the **Firewall Investing** concept, which I presented in the March conference call, and in the April newsletter article. This approach addresses the need for a deliberate series of steps for an investor to follow when stock markets are terrible, steps that help address the investor's concerns over job loss, further stock losses, and the impact of continued weak stock prices on an approaching retirement date. Does Firewall Investing resolve all of clients' concerns? Not even close, however it does a nice job of showing clients specifically how we plan for their portfolios to survive sharp stock losses.

What would I have done differently over the past year, other than selling all client stocks in October 2007 and repurchasing them all in March 2009**?** Obviously, this is a very tough question. I wish that I had been more effective in fully reserving (into cash and bonds) money that we **knew** would be withdrawn in the next year or two. I wish that I would have developed and integrated the Firewall Investing concept a few years ago, so that each client would have more clearly known (in both their mind and their heart) that their retirement portfolio was prepared for both the best of times and the worst of times, and everything in between.

Every storm that we weather prepares us to weather the next one better. Let me close with a quote from Greek philosopher Epictetus: "*The greater the difficulty the more glory in surmounting it. Skillful pilots gain their reputation from storms and tempests.*"

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

Piecing Together an Education

William D. Starnes

Paying for college is a partnership! It is not a test of endurance. It is not an obligation. It should not take precedence to saving for retirement. It should not result in your own personal bankruptcy. Paying for college is a partnership shared by those vested in its benefits! I will never forget a joint meeting with a single mother and her son. This mother was willing to sacrifice her retirement savings to pay for her son's college. There is no arguing with a mother looking out for her "cub" (as my wife will say)! However, I turned to her son (who was adrift and doing poorly) and I asked him if he would be going to college if he knew that he had to pay for any of it. The answer came swift…NO!

Everyone must be committed to the value of an education, committed to the fact that it is a partnership, and understand that it should not jeopardize one's financial security. Because the cost of college is a more immediate problem than retirement, and it involves those precious "cubs", many parents fund college at the expense of their own retirement. This leads to disastrous consequences. Your retirement plan must be in place and in process of being executed PRIOR to committing to paying for college costs. It is indeed rare to find a family that has fully funded their retirement, living the lifestyle they desire, and saving the full cost of college in advance. Therefore, planning must be done!

Ave Annual Full Cost of College	
Four Year - Private	$37,390
Four Year - Public (out of state)	$29,139
Four Year - Public (in state)	$18,326

Planning is all about creating an image for the future and the path to get there. If you are planning on remodeling your kitchen, you envision the completed project, estimate the costs, and continue to revise the project until the end result is in synch with the amount that you can afford to spend. Then you begin to work on the list of things you have to do to get to that completed project in the future. You plan even though you can't estimate every cost in a remodeling project due to delays or unforeseen circumstances. You also can't nail down the many uncertainties related to the final out of pocket cost of college. However, for those who try to put some numbers down, or try to visualize the end result keeping it in synch with what is reasonable, they will make much better decisions than those who don't. In this article, we will go though a fictional (yet realistic) visualization of one family's plan to ensure that their son's college gets paid for.

College is expensive. The average cost of a four year public, out of state, tuition is about $30,000/year. This is the total cost, and therefore includes tuition, room, board, fees, etc. It is this number you must recognize, and not simply the cost of tuition alone. However, this also won't likely be your gross annual cost since the gross cost may get reduced. First, the school itself may not charge you the full sticker price. Why? Many schools have empty seats to fill and may be willing to discount their costs in order to fill these seats. Many schools also want to attract diverse students, or to compete with other colleges for desirable students. Second, you may obtain some free money (you never know)!

However, since you don't know what the actual net annual cost will be, you must make some reasonable assumptions based upon your child, and where you may encourage them to attend (in-state, out-of-state, private, public, community college, etc). There are many plans that can be created to cover the cost of college that will vary based upon your family values and your ability to pay. Let's go through one such example for a couple that has one child and are having some difficulty finding a way to cover the cost of college for their son.

Let's assume they want to plan for a cost of a $25,000/year school for their son for four years. First, they need to decide how much of the costs they will bear personally versus others. Paying for college is a partnership. Some of these partners may include their children, parents, the government, or even a service organization such as the Coast Guard.

Let's assume in our example, that these parents think it is logical to have their son finance one year of the full cost of college through his own future student loans. After all, that is what they did! Perhaps they just want their son to "have some

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skin in the game". So, their son would start his career with a student loan of about $25,000 (in today's dollars) – about the cost of a new car. In fact, the average student loan debt in 2007-2008 year was $24,651. While some would never consider the thought of having their son finance a portion of the college costs, they should keep in mind that they can always elect to pay off the loan for their son anyway. In our example, these parents have some **flexibility** that others would not have. They can pay it off if they want and can afford to. However, there is no obligation, if they can't.

Second, these parents may expect their child to earn some money for college prior to, or doing, the school years. These earnings could be used directly to go towards the cost of college. It is certainly possible for a college student to earn about $22,000 over a four year period. In fact, for this article I looked at my own Social Security earning statement to see how much I made during my college years and it amounted to $27,500 (converted to today's dollars). These earnings were also almost exclusively summer employment.

$25,000 in Savings Needed (in today's dollars)

Years Till College	5 Years	10 Years	15 Years
Rate of Return	5%	7%	8%
Annual Savings Needed	$3,000	$1,875	$1,250
Monthly Savings Needed	$250	$156	$105

Assuming now that their son will finance one year of college, and also cover one year worth of college costs through employment income, this leave two years left for which these parents will be directly responsible. Most parents have employment income and can cover a portion of college expenses out of this income. Typically, college occurs during one's peak earning years; or perhaps a spouse returns to the workforce at this time. This creates some additional available income. Furthermore, many parents are already paying for private school out of their current income. This private school tuition (typically about ½ the cost of annual college costs) will simply convert to tuition payments. For the sake of simplicity (creative license!), I will assume that the parents in our example have additional available (after tax) income of $6,250/year. If so, then over four years ($6,250 * 4 = $25,000), they will have the ability to pay for the equivalent of one years' total tuition cost.

Now, they have one year left to cover. Since they are planning to pay these costs without debt, they will forgo considering taking home mortgage debt or other loans. They will have to save for it. How much will they have to save each year in order to pay for that remaining year of college? Depending on how many years they have to save and the rate of return of the saved dollars, it would be similar to one of the amounts shown in the table to the left. Obviously, this is only for one child. These results assume that the savings amounts increase with inflation each year and that the cost of college rises 1.5% more than inflation each year. You will see a higher assumed return with additional years until college due to the ability to take on more risk in the desire for a higher return.

I would guess that most clients would be able to work this type of saving amount into their budget. If not, then they should reduce their lifestyle to free up the savable dollars.

So, paying for college is possible, especially when everyone is committed to the value of an education, committed to the fact that it is a partnership, and understand that college savings should not jeopardize a retirement savings plan. Obviously there are an infinite number of ways an image for a college plan can be visualized. Regardless of how, once done, the path will be clearer, less frightening, and much more likely to be achieved, than with no plan at all.

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