MALLARD *Money Matters*

January 2014

Welcome to Mallard Financial Partners' first newsletter. As many may be aware, Mallard Advisors, Newark Office is now **Mallard Financial Partners**. We thank those who were directly impacted by our transition for their cooperation, and patience. If there are topics that you wish to see addressed, or that are on your mind, please share them with us at info@mallardfinancial.com. We would like you to help direct the information that we share with you. Be sure to visit our new website at www.mallardfinanial.com. In time, we will have a regular blog, and news articles. So, check in regularly.

Health Insurance Changes Facilitate Early Retirement

Ed Mink

When making plans to retire, you have many questions to answer and many scenarios to address. Do I have enough assets? What if we live longer than we expect? What if we need long-term care? Will health-care cost keep rising as they have in the past? Will the stock market continue to perform as it has in the past? Will Social Security be able to afford payments to all of the baby boomers? These are hard questions — and they need to be addressed. However, if you are considering early retirement, you face additional issues.

In the past, an additional issue had been a major challenge to early retirement: health insurance coverage. During our working careers, we often become accustomed to health care insurance coverage always being there — it was primarily just a question of who was paying for it. It was flexible in the sense that when we were added to an employer's group plan, we were automatically covered, and our previous medical conditions were covered too. However, the transition to individual coverage could be rough, if not impossible. Insurance companies would often exclude certain "pre-existing" conditions, either for some period of time or forever. In some cases, your prior medical history could make you simply uninsurable for individual health insurance. This effectively forced many individuals (who were otherwise ready to retire) to keep working until they were 65 and eligible for Medicare, to ensure that they maintained their health insurance.

Now, with the advent of the new health insurance rules as provided by the Affordable Care Act (known as ObamaCare in some circles), you can purchase health insurance independent of your employer, without exclusions for pre-existing conditions and without being subject to medical underwriting (the evaluation of your medical history to decide whether to offer a policy to you). Yes, you will pay more if you are a smoker. Yes, you will pay more if you are older. Yes, you will pay more if you want a smaller annual deductible and smaller copays. But, you can get quality, comprehensive health insurance — without exclusions. Sometimes you will get it for less cost than you were paying for the insurance provided by your employer!

Yes. The days of being held hostage in the workplace, just to maintain health insurance coverage, appear to be over. And — that's a good thing, especially if you would like to retire early.

NOTICES

Kenny and Kevin will be attending the annual TD Ameritrade conference in Orlando from January 29-31. Susan will be attending the 2014 T3 technology conference in Anaheim, CA , February 10-12.

Pam and Paul will be vacationing in St John from February 20-28.

Paul will be in legislative session—Tuesday to Thursday afternoons, the last three weeks in January, the last two weeks in March, and the first two weeks of April.

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Living with Investment Uncertainty

Paul Baumbach

Did you hear the one about the Buddhist monk who went to the hot dog vendor and asked, "Can you make me one with everything?"

Our lives are busy, chaotic at times. Investing is no less chaotic. There are many approaches to handling chaos. Two extreme approaches are 1) you can ignore it (adopt an ostrich approach), or 2) you can be like the monk, and become one with it. Let's find steps you can take in your investing to be more like the monk, and less like the ostrich. To keep this article shorter than <u>War and Peace</u>, I am going to focus on *mutual fund* investing in the face of chaos.

Investing does occasionally involve chaos. While chaos is disturbing, **having a plan can make chaos more tolerable**. Plans are not easy to create in the midst of chaos—they need to be created in advance, they need to be clear, and they need to be easily accessible when chaos strikes. This is equally as true for investment plans as for fire drill plans, and tornado evacuation plans.

More specifically, let's focus on your collection of mutual funds, your **portfolio**. Its success in any period of time is driven by its **allocation**—the proportion you have of stocks, bonds, and cash, and the types of stocks, and bonds. A 60/40 allocation typically describes a portfolio with 60% invested in stock funds, and 40% in bonds (plus a little cash). By their nature, stocks have more risk than bonds. Thus a portfolio with a higher stock allocation brings more uncertainty than a portfolio with a lower stock allocation.

Investment results are most commonly described in terms of **percentages**, rather than dollars. This enables comparisons amongst investors, regardless of how much each investor has in terms of dollars. If your $4,000 IRA earned 13% in 2013, and the Rothschilds' $4 billion portfolio earned 12%, you can say that you earned more than the Rothschilds. Not too shabby! One final note on investment results—when describing results of over one year, investment results should be annualized, to ensure fair comparisons.

Back to allocation—the reason you should focus on the allocation is that this is a key factor that you, the investor, can control. The allocation to stocks in your portfolio is similar to the speed you drive a hotrod in a video game—it is a factor you control to determine how quickly you will reach your goal, if you don't crash first. We work hard with our clients to identify a suitable long-term stock allocation target level, neither so high that the pain in bad years is so great that you are tempted to sell your stocks, nor so low that your low returns prevent you from reaching your investing goals (such as retiring without worry at age 65).

Notice how I slipped in the phrase '**long-term stock allocation target**?' I firmly believe that stock allocations should be set nearly in stone, for long periods of time. The reason is that our human nature works against us—we are wired to buy and sell stocks at the wrong time, to make bad 'in the moment' investment decisions. In early 2000, after stocks had risen in price sharply for five years, and were trading at insanely expensive levels, investors were increasing their stock allocation, chasing yesterday's winners. In early 2009, after stocks had fallen 30% or more, investors were decreasing their stock allocations (sometimes to zero), selling yesterday's losers. As car drivers we primarily focus on the front windshield, however as investors, we primarily focus on the rear view mirror. <u>This makes most investors poor judges of when to increase or decrease their stock allocations</u>. **A set, long-term stock allocation target is designed to protect yourself against yourself, to you-proof your portfolio**.

There are good reasons to adjust your stock allocation target, but that is a good topic for a future article.

Once you have determined what your stock allocation will be, what kind of stock funds will you use, and in what proportion? **There are four primary dials for a stock portfolio.** The first is your balance of US stocks to non-US stocks. While the world's stock markets are balanced about 50/50, most US investors have closer to a 70/30 US/foreign balance, and we currently use a 58/42 balance. The second dial is limited to your foreign stocks. You can identify what proportion of your foreign stocks comes from developed, versus emerging, markets. Emerging markets typically bring higher highs, but lower lows (greater risk). A third stock dial is the proportion of large to mid-sized, to small companies. The last stock dial focuses on whether you prefer value stocks or growth stocks. These four dials enable you to get your stock exposure 'just right' for you.

At Mallard we developed a regular, disciplined method of setting these dials. If you invest on your own, however, this doesn't have to be terribly complex. You can select broad, low cost funds to provide dependable (for a stock fund) exposure to the markets you desire. There are 'total world stock index' mutual funds which provide a single mutual fund to give you exposure to US and foreign stocks, developed plus emerging markets, large, mid-sized, and small caps. If you wish to customize your stock exposure, you can use the total world stock index as your base, and then add specialized (emerging markets stock, small-cap US stock, growth stock) funds to reach your desired allocation.

Bond allocation comes with its own dials. We segregate bonds into two broad categories—quality and opportunity—and use a dial to identify how much to place in each side. This is a very critical bond dial, for quality bonds returns are driven by interest rates, while opportunity bond returns are driven primarily by another factor, economic growth. The primary dial within your quality bonds is duration/maturity—whether to focus on short-term, intermediate-term, or long-term bonds, and where to set that dial. Maturity dial adjustments involve the classic investment trade-off—longer-term bonds typically provide higher yields, but also larger losses when interest rates rise.

Bond Types—A second dial within your quality bonds, and to some extent within your opportunity bonds, whether to use corporate bonds, US government bonds, or municipal bonds. This decision is typically driven by your tax bracket (high-income investors typically use municipal bonds in their taxable accounts, while other investors, and all investors in their retirement accounts, typically use corporate bonds). US government bonds are most often used by investors who prefer their higher level of safety, and who are willing to accept a lower level of interest payments in return for this safety.

Opportunity Bonds—These are the higher-risk bonds. The best known type of opportunity bonds are junk bonds, also known as high-yield bonds. Another type are foreign bonds, and a subtype of those are emerging market bonds. A third type are bank-loan funds, also known as floating-rate bond funds. These opportunity funds generally have one thing in common—they do better when the economy is growing, and they do worse when the economy is shrinking.

This sounds complicated! In Mallard's early years, I would direct 80% of client bond money to quality bonds, 10% to a good junk bond fund, and 10% to a good foreign bond fund. We now are much more precise in weights to each opportunity bond subsector, and we review these dials regularly. Another simplifying alternative for do-it-yourselfers is to use what is called a multi-sector bond fund, sometimes labeled as a Strategic Income fund, and sometimes called an unconstrained bond fund, to obtain your opportunity bond exposure. These funds are go-anywhere bond funds which typically have at least 50% of their holdings in opportunity bonds.

Target Date funds Off-Target? I am not a big fan of the widespread use of 'target date' mutual funds, and funds with 'conservative allocation' or 'growth strategy.' The reason is that there is no precision to these labels. One firm's Retirement 2020 fund could have twice the stocks of another firm's, and the same can be the case for two firm's Moderate Allocation fund. With these types of funds you need to look beyond the window sticker—you need to look under the hood.

WYSIWYG—This stands for What You See Is What You Get. The Fidelity fund family offers a series of funds with the stock allocation amount in the fund name—Fidelity Asset Manager 20%, Fidelity Asset Manager 40%, etc. I like this WYSIWYG approach more than the target date, and the growth/conservative/moderate allocation approach, as being much clearer.

By taking the time to plan your investment portfolio, you will be better prepared for the next chaotic episode of the markets. You will better know the proportion of your portfolio that is in bonds, largely protected from falling stock prices, so that you can sleep better at night. This knowledge can give you the confidence that your portfolio won't 'go to zero.' Financial planner Ken Robinson has made a rap video about how, properly planned, portfolios won't go to zero, at https://www.youtube.com/watch?v=C3GtxtWSZxE. Perhaps Ken's next video will be as a Buddhist monk!

News and Events

Mallard welcomes Liz Salt. Liz joined Mallard in December. She serves as support for the Investments Division, and to the Office Manager, as well as assisting with the day to day activities of Mallard. Liz lives in Newark with her husband and young son, Will. She enjoys creating art and spending time with her family.

Mallard will be offering the following Delaware Money School classes:

January 13, 2014 - Ed Mink - Traditional & Roth IRAs - Newark Library - 6:30pm

February 10, 2014 - Paul Baumbach - Around the World in 80 Minutes - Newark Library - 6:30pm

March 3, 2014 - Ed Mink - Traditional & Roth IRAs - Newark Library - 6:30pm

Compliance Corner

Pam Baumbach is Mallard's chief compliance officer. She and all of the Mallard staff aspire to have a culture of compliance, by safeguarding our clients' assets with our policies & procedures, as well as by leveraging our resources. We are constantly developing policies and procedures. They are continually adjusted as we improve each task. We review transactions daily, and accounts are verified and reconciled regularly, which allows us to always be aware of the state of our clients' assets.

Above all, we leverage our most valuable resource, our employees. We strive to create a working environment that encourages our employees to share experiences, bounce ideas around, and solicit input. By working together, we each get better, and we are able to do our best.

We really embrace our fee-only status, and our belief that the fiduciary role is paramount to our responsibility to our clients. This differentiates us from the brokerage firms, and more importantly, it is the only way we would consider working.

Working together, building your financial security

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