MALLARD *Money Matters*

July 2014

NOTICES

Congratulations to **Pam** for earning her IACCP© (Investment Advisor Certified Compliance Professional) designation.

Paul will be in Baltimore for a government conference August 3 - 6.

Chris will be attending the TD Ameritrade Technology Conference August 12 and MoneyGuidePro Conference August 13 -14.

Jacqie will be attending the TD Ameritrade Technology Conference August 12 - 13.

Chris will be on vacation July 3—11.

Diana will be on vacation July 9-18 and August 13-22.

Alan will be on vacation July 25—28.

Susan will be on vacation August 9—16.

Ed will be on vacation September 22 – October 3.

Kenny will be on a summer boating trip July thru September. He will be available by email.

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Increase Your Social Security Benefit

Ed Mink

For many of us, the income we receive from Social Security (or the income other people will receive based on our Social Security benefits) will be one of our greatest assets in retirement. Where else will you get a benefit that: (1) will last as long as you live, (2) adjusts for inflation, (3) will pay a survivor benefit to your spouse, and (4) provide a spousal benefit while you are collecting your retirement benefit. In addition, Social Security also provides disability benefits and certain benefits to dependents.

Many individuals want to start receiving Social Security benefits as soon as possible, at age 62, for fear Social Security will not be available later. A recent Social Security Board of Trustees report states that the Social Security trust fund is expected to be exhausted somewhere around the year 2035. However, that just means that at that point, the "stockpile" of funds collected earlier, when collections exceeded payouts, will be exhausted (assuming their predictions are correct, and no changes are made to correct the situation between now and then). It is a fairly well accepted fact that this shortfall is NOT our biggest area of financial concern (that might be Medicare/Medicaid), and will likely be rectified by a tweak here and there. Even if no changes are made, projected income at that time should equal about 75% of projected benefit payments. Because Social Security will still be a very big part of nearly everyone's retirement income picture, we need to make the most of it. The question is: "What steps can we take to accomplish that?" Here are some ways that could significantly increase your Social Security income for the rest of your life.

Claim later: Claiming Social Security at age 62 may be best for some people, but it is not the best strategy for ALL people! Let's look at the benefit of claiming later. If, for example, you are on pace to receive a benefit of $2,000/month at your full retirement age (FRA) of 66, your benefit would be reduced to about $1,500/month if you claim at age 62. If you wait until age 70, your initial benefit will be $2,640/month. Of course, these numbers would likely be affected by inflationary adjustments, so the actual differences could be greater. So, if a person waited until age 70 to start collecting Social Security benefits, instead of starting at age 62, they would receive an additional $1,140/month — or $13,680/year. If you live to age 80, you collect an extra $136,800 in benefits. If you live to age 90, you collect an extra $273,600 in benefits. And — it's really far more than that in actual dollars, with the COLAs added. However, by not starting to collect at age 62, you do give up $144,000 in benefits that you would have received between age 62 and age 70. So, you would need to live to almost age 81, just to break-even. That's why waiting to collect benefits is not best for everyone. If your health is such that your doctors do not expect you to live to age 70, for example, you should probably start receiving your Social Security benefits at age 62 (unless your earnings are high enough to significantly reduce your benefits).

Work longer. Social Security benefits are based on your 35 highest years of earnings. If you have worked for less than 35 years, each additional year of work will replace a $0 income year (up to a total of 35). In addition, if some of your 35 best years were years in which you worked part-time in the summer while you were going to school, a higher income year now can replace that lower income year. Social Security benefits may be temporarily reduced if you continue to work after you sign up for Social Security prior to your full retirement age--but the payouts will increase later. After you reach your full retirement age, your earned income will not reduce your Social Security benefit.

Increase Your Social Security Benefit . . . continued — Ed Mink

If married, make full use of all Social Security benefits. If you have decided to wait until age 70 to start collecting your own Social Security retirement benefits, you may still be eligible to collect either spousal benefits or survivor benefits before you reach that age (without affecting your own retirement benefits). When you reach your FRA, you have the option of specifying what Social Security benefit you are applying for — (1) your retirement benefit, based on your earnings history, or (2) your spousal benefit, based on your spouse's earnings history. In addition, separate from your retirement benefit, you could file for a **survivor** benefit at age 60 (or possibly earlier if disabled) without affecting your retirement benefit.

Increasing Social Security benefits for individuals who are married (or were married) adds a layer of complexity that can seem overwhelming because of all of the factors that can affect benefit decisions. What is the age difference of the spouses? Who is still working? Who has stopped working? Is anyone going to return to work? How is the health of each spouse? Who has the higher earnings history? How much higher is it? What about life expectancy? Will either spouse's lifestyle have an effect on longevity? So many options — so many variables — so many opportunities!

Investment Wisdom from the Other Half of Berkshire Hathaway — Paul Baumbach

In a column titled "Giving Yourself an Investing Makeover," Wall Street Journal columnist Jason Zweig profiles money manager Guy Spier. Mr. Spier has taken some notable steps to "purify the environment in which he makes investing decisions." These steps included moving to Zurich to avoid the "bad influences such as envy, greed and hyperactive trading" found in New York City. "Worried that knowing the prices of his holdings would make him want to trade them, he checks their market values once a week at most." Later, Zweig writes, "Nor does Mr. Spier publicly discuss the holdings in his portfolio—even in his letters to his own investors, where he writes instead about the lessons he has learned from the positions he has sold."

What started Mr. Spier's quest for "continually trying to counteract his own irrationality?" It was a lunch meeting with Berkshire-Hathaway CEO Warren Buffett, and discovering a lecture by Berkshire-Hathaway Vice-Chairman Charlie Munger. In 1995, Munger offered a presentation at Harvard University on the causes of investor irrationality. There is an audio of that presentation, titled, "The Psychology of Human Misjudgment." It runs over an hour, and can be found at **http://youtu.be/pqzcCfUglws.** The text of the presentation can be found at **http://buffettmungerwisdom.files.wordpress.com/2013/01/mungerspeechjune_95.pdf.** It is well worth your effort to hear and/or read the presentation.

The first cause Munger presents is "**the under-recognition of the power of reinforcement/incentives**." This is a critical weakness of (likely all) investors. If you buy a stock, any stock, and it rises in price fairly early, this reinforces the concept that the stock is great, and you are a great investor. It may be, and you may be, but this early reinforcement is incredibly powerful, and can cloud your judgment in the future. It can tempt you to not scrutinize that stock as well as you should in the future, and it can tempt you to doubt your future investment decisions as much as you should.

He describes "**incentive-cause bias**," a darker side of reinforcement/incentives. Most financial schemes occur due to a financial incentive to behave badly, to present information inaccurately, to act unethically. Investors must utilize 'constant vigilance' to shield themselves from this danger.

Munger next presents "a superpower in error-causing psychological tendency: **bias from consistency and commitment tendency**", and "the self-confirmation tendency of all conclusions, particularly expressed conclusions." He describes the human mind as having a shut-off device; once we have an idea, we often disregard contrary evidence, and this is more pronounced once we have publicly stated our initial idea. Once humans tell others of an idea they hold, they often will defend it to the death. This is the reason that Mr. Spier chooses to not mention current investments—doing so can tempt him to reject evidence that those investments are no longer suitable.

This 'evil superpower' is behind the guideline to "date your stocks, don't marry them." If you become committed to an investment, it is very easy to ignore evidence that can arise over time that you should reduce or eliminate that investment. This commitment is deeper when you have shared it with others.

Munger discusses the "bias from Pavlovian association, **misconstruing past correlation as a reliable basis for decision-making**." We are wired to find patterns, and to find comfort in finding such patterns, whether such patterns actually exist or not. In the times of the ancient Greeks, this could involve naming constellations (that's a bear, that's a hunter). Today this could include 'technical market analysis, which looks for patterns in stock price charts to forecast the direction of security prices. It feels great to believe that seeing a 'head - and -shoulders' pattern in a price chart indicates where the price will go in the future, but there is very rarely any true predictive power in such a discovery, not to mention that two technical analysts will disagree as to whether such a pattern exists.

Another mistake we make is a "bias from **over-influence by social proof**—that is, the conclusions of others, particularly under conditions of natural uncertainty and stress." Investing inherently involves markets, and markets inherently present social proof, the opinions of all other investors. This leads to booms and busts, including the dot-com boom of the late 1990s, and the market crash of late 2008/early 2009. We are most susceptible to this bias during times of stress, which only aggravates this type of mistake.

Munger presents "bias from **liking distortion**, including the tendency to especially like oneself, one's own kind and one's own idea structures, and the tendency to be especially susceptible to being misled by someone liked." The converse is the "tendency not to learn appropriately from someone disliked."

How can you guard against putting undue faith in advice from another? Munger suggests compensating for liking distortion: "You can hire your advisor and then just apply a windage factor, like I used to do when I was a rifle shooter." We use a research tool from Zacks, which presents brokerage firm analysts' estimates of future earnings growth. The incentive bias inherent in the brokerage industry leads these estimates to typically be too positive, and therefore, we discount them a bit.

To me, the best example of the "bias from **over-influence by extra-vivid evidence**" is Jim Cramer. If humans were not susceptible to financial shock-jocks, Cramer's show would have no viewers.

Munger explains that, while these biases can be harmful to your investments, they become **critical when the biases combine**. He notes that when "three, four, five of these things work together and it turns human brains into mush. And maybe you think this doesn't happen in picking investments? If so, you're living in a different world than I am."

As investors, our psychological biases can hamper our investment approach, and these biases can be used by others to lead us to make poor financial decisions. Actually, "the tendencies are partly good and, indeed, probably much more good than bad, otherwise they wouldn't be there." We should accept that we are humans, and are subject to irrational financial decisions, and that we make worse financial decisions when we are under stress. However **there are ways to spread "wisdom and good conduct when one understands it and uses it constructively."**

First, recognize these biases, these types of 'human misjudgment.' Second, create and utilize formal systems. Investors should develop a written Investment Policy Statement to help avoid the temptation to deviate from our well-considered plans due to temptations, such as selling all stocks because others are doing so. Third, consider multiple future paths, different scenarios.

I have had clients come to me and say "I want to buy XYZ because it has done well and will continue to do so." My typical first response is, "What if you are wrong, and it begins to fall as soon as we buy it?" Considering possibilities that you view as unlikely, and which contradict the possibility you find much more likely, is an important planning tool. By going through such a 'portfolio fire drill,' you can improve the likelihood that you will make superior financial decisions, especially in stressful times when it is most important.

Charlie Munger was asked, "What one word accounts for your remarkable success?" He answered, "I was rational." In my two decades in the investment world, I agree that being rational is both incredibly important and difficult. Watching out for psychological biases can help you make more rational investment decisions. Hopefully, we don't need to follow Mr. Spiers' lead and move to Zurich to make better decisions. But we may have to turn off CNBC.

Compliance Corner

Pam Baumbach

Does Mallard Have Custody of Client Assets?

The answer is YES. So what does that mean? There is a difference between having a custodian (a company that holds the assets, produces statements, makes deposits and withdrawals) and having custody (“holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them”). We don’t have custody of client assets at TD Ameritrade, TIAA-CREF, or Vanguard where we use Advisor sign-ons and the custodian imparts notable restriction. We do have custody at any other institution where we use clients’ personal credentials, causing the custodian to conclude that we are the end-client. Depending on the website functionality, having the log-in credentials of the client can give us the ability to change beneficiaries, change mailing address, initiate loans or other actions. These actions could conceivably direct the funds out of the client’s possession. For this reason, we strive to minimize situations where we take custody. Typically, we use it only for current employer retirement plans, where we cannot roll the account to a custodian such as TD Ameritrade.

One of the consequences of having custody is that we are held to a higher standard of compliance for these accounts. We contract an independent accounting firm to perform a surprise exam annually. We also have additional safeguards in place to protect your access information.

Having custody of client assets comes with additional responsibility. The added reporting and procedural requirements are worth the security of client assets and enhanced ability to service our clients’ needs.

News and Events

Mallard will be offering a two-part Retirement Planning Class through the Delaware Money School:

August 18, 2014 - 6:30-8:30 p.m., “How Much to Withdraw from Retirement Savings, Part 1” at the Newark Free Library - presented by Paul Baumbach.

August 27, 2014 - 6:30-8:30 p.m., “Exactly How to Withdraw from Retirement Savings, Part 2” at the Newark Free Library - presented by Paul Baumbach.

Working together, building your financial security

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