MALLARD *Money Matters*

January 2015

NOTICES

Kevin will be attending the TD Ameritrade conference in San Diego from January 28-30.

Paul will be in Dover most Tuesday, Wednesday, and Thursday afternoons in January and March.

Pam and Paul will be in St John, USVI from February 6 - 21.

Diana will be on vacation from February 24 - March 3.

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Health Savings Account

Susan Lehnerd

Are you eligible to take advantage of a Health Savings Account (HSA)? Although HSAs were introduced in 2004, only 20% of eligible individuals have one. This savings vehicle is used for paying qualified medical expenses. However, it can be used to build a medical expense reserve fund.

To be eligible for an HSA, you must have a high deductible health insurance plan, usually with no other health coverage. For 2015, that means a minimum yearly deductible of $1,300 for individual coverage and $2,600 for family coverage. But be aware, not all high deductible plans are HSA eligible. You must also not be enrolled in Medicare or be anyone's dependent.

One reason to consider an HSA is its triple tax benefit. Contributions that you make to the account may be deducted from your gross income. If your employer makes contributions on your behalf, the contributions are exempt from income and employment taxes. The account grows tax free. And, any distributions from the HSA for qualified medical expenses are tax free. Another benefit is that there are no required distributions (like an IRA). In addition, contributions are not based on earned income, which means higher-income individuals are not restricted.

HSAs can be invested like other individual investment accounts, such as an IRA. They contain your money and are under your control. So, if you're able to contribute annually (up to $3,350 for individuals and up to $6,650 for families in 2015) to the HSA, and pay your medical expenses out-of-pocket, the account has the ability to grow, tax free. You can use the funds later for qualified medical expenses such as deductibles, co-payments for medical care and prescription drugs, long-term care insurance premiums, vision and dental. However, using the health savings account for non-medical expenses will result in a 20% penalty plus taxes on the withdrawals.

Check with your health insurance provider to see if you are eligible to contribute to an HSA, and whether or not your insurance plan is HSA eligible. Many banks and brokerage firms offer HSAs.

How Should Investors Approach Bitcoin?

Kevin Muto

If you were asked to name a currency that had a rough 2014, you might think of the Russian ruble, which finished the year down 44% versus the dollar. Depending on your definition of currency, however, you might point to Bitcoin (BTC), which suffered a decline of 59% for the year. Our question is: "How should a typical diversified investor approach Bitcoin, both now and in the future?" The inner workings and history of Bitcoin and other crypto-currencies are fascinating, but they are outside the scope of this article, so we will stick with the basics.

How Should Investors Approach Bitcoin? . . continued

Is Bitcoin a viable currency? A good currency is scarce, durable, portable, divisible, recognizable, fungible, and difficult to counterfeit. So far, so good; Bitcoin does all of these things as well or better than regular fiat currencies. However, when one buys something, the currency they use must be widely accepted, and this is what makes the future of Bitcoin as a currency uncertain.

The fact that BTC are held by only a tiny fraction of the world's population leaves the price exposed to large moves, both due to speculation and changes in demand for immediate use of the currency. On top of this, there are many who believe that the technology behind Bitcoin will be important, but the currency itself may not.

For comparison, TPC/IP is the underlying protocol that makes the internet possible, but the vast wealth that internet has created was the result of people *using* the technology to do things that were previously impossible. The creators of TCP/IP built tools that enabled the creation of an economy that could not be imagined at the time. This is why the best investing route today is likely the one venture capitalists are taking: funding the people who are familiar with the technology (aka "the block chain"), and who wish to build new things with it.

So, should an investor hold the currency itself as part of a diversified portfolio? Probably not. As an investor, treat it like a collectible. That is, strive for deep familiarity before speculating. But when it comes to new opportunities, keep an eye out for businesses that are making use of block chain technology, because there may come a day when consumers use it without even knowing.

Investing Fundamentals—It's the Little Things

Paul Baumbach

While much of the financial press focuses on how complicated investing and finances are, I would like to focus on some fundamentals and some basic investing themes. Ben Franklin has many famous quotes. Perhaps the best known is "**A penny saved is a penny earned.**" These seven words seem trivial, however their implications are substantial.

Note that there are two ways to earn money—you can work for it or you can have assets work for it. Those assets could be a rental property, or a portfolio of mutual funds, stocks, and bonds. Franklin notes that by saving money, you can work less (retire earlier) or need your assets to work less. You can save money by not spending it directly, by reducing your spending. When we work with a family on their retirement planning, two critical factors are their levels of retirement savings and of retirement spending. Spending $500 less per month during retirement, over your retirement years, can avoid the need for $200,000 of retirement savings.

In your working years, saving money serves two goals—it reduces your spending (which will likely reduce your expected level of retirement spending), and it boosts your retirement savings. This double benefit is a driver behind the strategy of 'paying yourself first,' taking payroll deductions for retirement savings so that you are not tempted to spend these savings dollars. Money in your checkbook/at your ATM is by design much easier to spend than those dollars locked inside your 401k account. Protect your retirement savings from yourself.

You can also save money by reducing your costs. Retirement savings programs vary widely in their costs, and their formats. Formats include managed account programs at brokerage firms, equity-linked annuities, and wrap accounts. No program is inherently good or bad, cheap or expensive. A program is expensive for you if the cost is high and the value it provides you is low. You may go to a specialist physician, out-of-network, and you may pay a lot out-of-pocket for their consultation. If, however, that consultation saves you months of wasted time and money and false-starts, then it could be a very good value.

While we are on the topic of pennies, there is an old British saying, warning you to not be "**penny-wise and pound foolish**," being thrifty with small amounts of money, but wasteful with large amounts (thanks, Wikipedia). Your retirement savings are often your largest asset, and thus there is a great cost to being foolish with your retirement savings.

For thirty years a firm named DALBAR has studied how investors have fared investing, comparing their results to the underlying investments, stocks, and bonds. In 2014 DALBAR reported that for the previous decade, investors using stock funds have underperformed the S&P 1½% annually (5.9% versus 7.4%), and bond fund investors by 4% annually (0.6% versus 4.6%), with even greater gaps over longer periods. What causes this persistent underperformance?

As I have described extensively over the years, investors inherently make bad decisions: following crowds, buying stocks when they are soaring and selling stocks when they are falling. It is these hardwired tendencies that cause investors to underperform markets. The impact of this underperformance, due to compounding, quickly qualifies this as a pound (dollar) problem, which quickly justifies a penny solution.

Albert Einstein stated "**Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it.**" Let's examine the 1½% annual underperformance over a decade of stock investors. You might think that the underperformance over a decade would have a 15% impact (ten times 1½%). However, $10,000 invested over a decade at 5.9% earns $7,740 while at 7.4% annually it would earn $10,420, for 35% greater earnings. There are CDs and annuities which pay simple interest. Simple interest means that it does not compound. A 3% simple interest fixed annuity over 5 years earns exactly 15%, while compound interest earns 16%. It is always better to pay simple interest, and it is always better to earn compound interest.

Charles Schwab offers some 2015 resolutions, including to *optimize your portfolio*. In this resolution they recommend that you "**Focus first and foremost on your overall investment mix**." This refers to being intentional about your level of stocks. If stock market declines make you very nervous, don't put 80% of your retirement savings in stocks. If you get frustrated when you only earn half of the market when markets are rising, then don't place only 20% of your savings in stocks. Know how much risk you seek, and build this into your portfolio. Schwab also suggests that you "**Monitor and rebalance your portfolio as needed.**" Rebalancing serves several purposes. When done regularly and without second-guessing, it permits you to avoid the crowds, and sell stocks when they are high and buy stocks when they are low. This is much more difficult than it sounds, but regular rebalancing during normal times makes it easier to rebalance during stressful times.

Rebalancing helps to ensure that you do not let your overall investment mix drift away from your targets. At Mallard we typically rebalance quarterly, but for individual investors, even annual rebalancing can be sufficient. I like more frequent rebalancing, as it enables us to regularly benefit from the highly fickle investment markets. Last summer bond prices fell sharply when investors suddenly realized that the Fed could remove its bond market stimulus (despite years of warnings of this eventuality). A similar drop in bond markets occurred in summer 2013. In both cases, the markets recovered within a month or two. Annual rebalancing does not permit taking advantage of these mid-year market moves.

I had heard that Vince Lombardi said "**Plan your play and play your plan**." This is critical advice for investors. Just as in a football game, there are almost limitless possible challenges that investors may face. It is critical that you have a game plan, how much you will save, how aggressive you will be with your retirement savings, how frequently you will rebalance, and how you will react to markets rises and declines. If you haven't already, make a 2015 resolution to write down your investment plan, and commit to following it.

Compliance Corner

Pam Baumbach

The Times are Changing

One part of being your financial advisor is making your life better, with fewer tasks and less paper. While we make every effort to do that, the direct contact between clients and custodians increased in 2014. TD Ameritrade began mailing clients a notice every time a transfer is made to or from a third party, even a monthly scheduled payment, and clients are contacted directly for verification when a check is requested to a third party. While this may be a hassle, it is the new normal.

The increase in direct contact is for two reasons:

1) There are increasing legal requirements on financial institutions. In some cases the cost in resources and hassle are outweighed by the potential fines of non-compliance

2) There are increasing incidents of cyber hacking, identity theft, and other fraudulent activities. In most cases, the financial institution (like your credit card company) reimburses you for some or all of your loss

Both measures are ultimately for your protection. Company policies reflect that it is no longer as easy as the good old days and increased verification and paperwork is here to stay. Thank you for your patience as the industry tries to keep up with the changing times.

News and Events

Delaware Money School Presentation:
March 9, 2015 - 6:30-8:30 p.m., “Social Security Benefits” at Newark Free Library, 750 Library Avenue, Newark, DE - presented by Ed Mink.

Working together, building your financial security

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