# MALLARD Money Matters

July 2015

## NOTICES

Paul will be at a government conference in Wilmington August 17-19 and at a leadership program in Knoxville from August 28 to September 2. He will be attending the NAPFA national financial planning conference in Indianapolis October 20-23.

Ed will be on vacation September 14-18. He will also be on vacation October 5-7 and 12-16.

Diana will be on vacation July 22-24.

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## Mallard Financial Staff Changes

Paul Baumbach

Ryan Flurie joined Mallard this May as an Investment Specialist. Ryan earned his CERTIFIED FINANCIAL PLANNING™ certification in 2014 and earned a Bachelor of Arts in Finance and a Bachelor of Science in Biology with a Chemistry Minor in 2002 from The University of Pittsburgh. Most recently Ryan has worked as a financial advisor in New Castle for the past four years.

Ryan lives in West Grove, Pennsylvania with his wife, Jessica, and their three children. In his personal time, Ryan enjoys coaching his children's baseball games, and spending time with his family at the beach.

Kevin Muto left Mallard this Spring, due to his move to Boston. Kevin joined Mallard in 2009 as an undergraduate at University of Delaware, and had a major impact at Mallard during his tenure, as he served in many roles, ending as an Analyst. He led efforts to replace our website, had been the lead on all of our technology, and had been instrumental in improving and executing many of our investment analysis processes. Everyone at Mallard wishes Kevin the very best in his career in Boston.

## Identity Theft

Ed Mink

Identity theft happens every day, but we like to think that it will ***not*** happen to us. We hear and read about various practices and safeguards -- and try to practice them religiously, most of the time.

Some recommendations are: (1) don't carry your Social Security card in your wallet or write your Social Security number on your checks, (2) protect your PIN, (3) watch out for "shoulder surfers," (4) collect mail promptly, (5) pay attention to your billing cycles, and (6) keep your receipts. Some additional "digital" recommendations are: (1) choose good passwords and PINs, (2) protect your computer, (3) be alert to phishing scams, (4) be careful with anything containing your information, (5) be careful when shopping online, and (6) never answer unsolicited emails.

***With all of that due diligence, nothing happens to you … until it does.*** Then what? Recommendations include:

1. Contact credit providers to cancel your lines of credit.

2. Contact the police and file a report.

3. Contact one of the three credit agencies to explain what happened.

***But what if someone filed a false federal income tax return using your name, address, and social security number?*** Now what? First of all, if that happens, your first indication will probably arrive in the form of a letter from the IRS. If the "thief" files a tax return using your information before you do, you may receive a letter from the IRS asking why your tax return information is so different than in prior years -- or telling you that the IRS has already received a tax return for you for that year, *so it has rejected the* *one that you filed!* If you are expecting a refund, it means that you will not receive it very soon.

***In either case, immediate action should be taken***, beginning with contacting the IRS at the phone number in the correspondence that you received about your tax return. You will be directed to an IRS specialist who will work with you to address the problem. Start a file that will include dates, times, names, and information for future use, if needed.

This tax return scam started around 2008. In 2013, the IRS called tax return fraud its number 1 fraud -- and the problem has gotten worse since then. In 2014, the IRS said that it had tripled in the past three years. Thieves who obtain enough personal information to file a tax return (i.e., name, address, and Social Security number) file a return using fake Form W-2 information.

***Most tax return fraud occurs early in the tax season.*** Thieves prefer to file their return before you file yours! That way, unless the IRS thinks that their return is suspect, the refund will be paid by the IRS to the fraudster before you even file your legitimate return, and the IRS determines that a problem has occurred.

So, what can be done to take preventative measures?

For one thing, ***file your income tax returns as early as possible --*** even if you run the risk of needing to amend it at a later date.

The second thing is that, instead of planning for a sizeable refund, pay just enough in estimated tax payments and withholding throughout the year to avoid a penalty; — ***ideally, owe some with your tax return, instead of collecting a refund***. Many people like to get a tax refund every year (even though that is the equivalent of an interest-free loan to the IRS), but how long would you like to wait for your refund if this happens to you? What if you needed it? The IRS will certainly be sympathetic to your plight, but is not likely to speed your refund on its way just because you say that you need it. The resolution time for cases such as this is usually over ten months!

The IRS is very interested in stopping this income tax refund fraud and has recently met with leaders from tax preparation and software firms, state tax officials, and others. They have identified new steps for validating taxpayer identities when tax returns are filed. Time will tell if the measures are effective. Until the problem is resolved or greatly diminished, taking the steps identified above may be helpful.

## Portfolio Rebalancing

Ryan Flurie

What is portfolio rebalancing and why do we do it? Portfolio rebalancing is a risk reduction tool used by portfolio mangers to return current portfolio asset allocation to the targeted allocation model specified in the Investment Policy Statement (IPS). Rebalancing helps ensure that we are buying low and selling high. This is not only done at the Stock vs Bond level but also on the capitalization (Large vs Small), Investment Style (Growth vs Value), and the world region (US vs Non-US). Currently, Mallard rebalances client portfolios every quarter when the portfolio stock allocation deviates from the IPS targeted allocation model.

Some criticisms are that it creates too many transactions on the monthly statement, incurs unnecessary tax consequences, and involves selling the winners and buying the losers. During Mallard's June 2015 Investment Committee meeting, we addressed these concerns and have decided to make the following change: implement a trading minimum threshold of 25 basis points (0.25%) of the total portfolio value. By instituting this minimum trading value, we are reducing the small transactions that do not significantly move the portfolio allocation. For example, any rebalancing trades would have to be equal to or greater than $1,250 for us to execute the trade on a portfolio valued at $500,000.

Mallard keeps our clients' tax costs in mind with every rebalance. This is accomplished through tax-loss harvesting in the taxable accounts. An additional benefit of the minimum trading value is the reduction of transactions that may increase current income taxes. To further reduce the tax implications of rebalancing, Mallard will not reinvest capital gain distributions for portfolios that hold municipal bonds, but instead the capital gains distributions will be used at the next

## Portfolio Rebalancing . . . continued

quarterly portfolio rebalance.

In regards to the selling winners and buying losers concern, rebalancing reduces the risk associated with an over-weight asset class, sector, and/or geographic region. Past performance is not an indicator on how an investment will perform in the future. This is highly important in a volatile market where one asset class will trend up but due to an economic indicator or global crisis, such as a job report or an event such as the Greece default, the previously trending high performers can turn lower. For example, during the 1990's Dot-com era, those investors who regularly rebalanced their portfolios reduced the internet/technology sector risk exposure and saved themselves from the substantial losses of the ensuing 2000-2002 bubble burst. Rebalancing allows us to capture any gains in a moment in time, and return the portfolio back to the targeted allocation that is in the IPS. Maintaining the targeted portfolio allocation is imperative to the long term investment plan to meet your financial goals.

## The R Word—What Kind of Relationship Do You Seek? Part I of II

Paul Baumbach

Let me warn you—this is the first of two articles, and the second one won't be out until October.

Financial advisors often like to compare themselves with doctors. Who wouldn't like to be compared with a doctor? One typical example is when fee-only advisors ask, "If you wouldn't go to a doctor who is employed by a drug company, why would you go to a broker who is employed by a brokerage firm or fund family?" When reading a book recently, I encountered an interesting parallel between advisors and doctors, at least in my mind.

The book is <u>Being Mortal: Medicine and What Matters in the End</u>, by Atul Gawande. Several members of the medical community recommended the book to me, as part of my learning about end-of-life issues. I found the book to be excellent and at times it brought tears to my eyes, as Dr. Gawande described incredibly touching experiences with patients and family members approaching the end of their lives. The parallel I saw did not, however, deal with end of life; it dealt with relationships.

Gawande shared his view of three models of the doctor-patient relationship. The first is the traditional doctor-patient relationship, a bit patriarchal, the **Doctor Knows Best** approach. Here the doctor reads your chart, examines you, orders tests and reviews them, shares his diagnosis, and the steps for you to take. You follow the advice.

The second turns this around. I call this the WebMD approach, or more generally the **Equal Partners** approach. Your doctor reads your chart, examines you, orders tests and reviews them, and then you sit down together and discuss the diagnosis and treatment. You typically have several WebMD printouts, perhaps with both Western and Eastern medicine approaches, and in partnership you and your doctor identify your next steps, almost as peers.

The third approach is quite intriguing, and I'll call it a **Professionally-Driven Collaboration**. Here the doctor reads your chart, examines you, orders tests and reviews them. You then sit down together. You may share some of your research and insights. But critically, the doctor asks you many probing questions, about quality of life, your goals and your priorities. With this information, the doctor identifies the course of treatment that is best suited for your medical situation, your goals, and for your priorities.

There is no right or wrong model—all three are 100% valid. The key is to identify what kind of relationship you desire with your doctor, to find a doctor who can work within that model, and to request this of your doctor. I expect that most doctors are quite comfortable working within two if not all three of these models, but they would appreciate knowing what you are seeking. By the way, in most matters I seek a Doctor Knows Best relationship with my doctor, however with my knee replacement several years ago, I sought a Professionally-Driven Collaboration relationship.

Give some thought to whether this set of three approaches makes sense to you and your relationship to your doctor(s). Then give thought to what relationship you want with your financial advisor, and we'll explore that in my October column.

### Compliance and Employees

As we say good-bye to Kevin Muto, who is continuing his professional journey in Boston, we welcome Ryan Flurie to our Investment team. What exactly does that mean from a compliance standpoint? All new employees must agree in writing to comply with Mallard's Privacy Policy, to adhere to Mallard's Compliance Manual and to submit personal trading records quarterly.

Before any employee can authorize a trade within the parameters of the client-adviser relationship, they must be registered with the state. Registration is accomplished by filing a Form U-4 (Uniform Application for Securities Industry Registration or Transfer). An investment adviser cannot submit their Form U-4 until they have demonstrated competency in securities knowledge. Competency is defined as completing a Series 65 exam or holding a professional financial designation (CFP®, CFA, ChFC, CIC, or PFS). The Form U-4 includes registration history, employment history for the last 10 years and other business activities.

Registered advisers are listed on the FINRA website. You can lookup any adviser/broker at www.finra.org/brokercheck.

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*Working together, building your financial security*