MALLARD Money Matters

January 2016

NOTICES

Paul will be in legislative session, in Dover, Tuesday through Thursday from January 12-28, March 8-24, and April 12-21. On these days he typically is in the office each morning until 11 a.m. or noon.

Paul will be attending the TD Ameritrade investment conference February 3-6 in Orlando, Florida.

Ryan will be attending the Technology Tools For Today Conference February 10-12 in Fort Lauderdale, Florida.

Paul and Pam will be on vacation February 14-28 in St. John.

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Mallard is Expanding

Susan Lehnerd

Mallard Financial Partners will now be holding client meetings and receiving visitors in an adjacent suite. Our main entrance will therefore change. The new entrance will be identified by our Mallard sign, but will still be designated as Suite 3. We look forward to seeing you in the new space in the new year.

Recent Legislative Changes (at the Federal level)

Ed Mink & Susan Lehnerd

Social Security Filing Strategies

In November 2015, the Bipartisan Budget Act of 2015 became law. One key component of the legislation closed perceived 'loopholes' in the Social Security rules, putting a stop to Social Security filing strategies that have been primarily available to married individuals. While the unexpected changes did not become effective immediately, many individuals nearing retirement age may have to adjust their retirement planning.

The two filing strategies being eliminated for those born in 1954 or later are *File and Suspend* and *Restricted Application*. The File and Suspend strategy allowed one spouse, who reached Full Retirement Age (FRA), to file for Social Security benefits and then immediately suspend them. Using this strategy allowed the filing spouse's benefits to continue earning delayed retirement credits (8% a year from FRA to age 70). This opened the door for the other spouse to be eligible for a spousal benefit and to possibly file a Restricted Application for spousal benefits only. If the second spouse filed a Restricted Application, that spouse would also earn delayed retirement credits up to age 70. These two strategies greatly increased the couple's Social Security benefits.

For individuals who were age 65½ or older by October 30, 2015, the File and Suspend strategy remains available to them, provided the benefit is applied for before April 30, 2016. The opportunity to file a Restricted Application is still available to those individuals who were age 62 or older by the end of 2015. This benefit could be applied for at FRA, or later, if eligible. Given the small window of opportunity remaining to take advantage of these strategies, married individuals who qualify should not delay in weighing the potential benefits of implementing either of these strategies.

Although these filing opportunities will be lost, Social Security benefit strategy planning will continue to be an integral part of almost all retirement planning. Careful consideration as when to file: at age 62, at age 70, or sometime in between age 62 and 70 – will need to be taken. As always, working with a qualified financial planner to discuss this involved topic will help you maximize the benefits that are available to you.

Qualified Charitable Distributions

Just before the end of 2015, many tax provisions that had been renewed almost annually were permanently passed into law, as part of the federal budget. One of these provisions was Qualified Charitable Distributions (QCDs). The legislation also made QCDs retroactively available back to January 1, 2015. This means that an IRA distribution made directly to a qualifying charity by an IRA holder (age 70½ or older) in 2015 or after will serve to reduce the contributor's adjusted gross income, instead of being deductible as an itemized deduction. Often, this is a more beneficial treatment. Remember, however, that nothing of value can be received by the contributor from the charity in return for the donation when completing a QCD.

To explore issues surrounding the rising interest rates which began with last month's action by the Fed, the three members of our investment team have written up their thoughts.

Effects of Rising Interest Rates **Ryan Flurie**

On Dec 16th the Federal Reserve raised the Federal Funds Rate, which is the rate at which banks lend money to each other, from 0.00% to 0.25%. The initial reaction was a stock market rally (the Dow rising 218 points to 17,749). In the two days after the rate increase, the Dow fell 621 points to 17,128, but rallied back to finish 2015 at 17,425.

Why is the Federal Reserve raising rates? It believes the economy is strong enough to start to unwind the government's support it had been receiving. Ms. Yellen has stated, *"I feel confident about the fundamentals driving the US economy, the health of US households, and domestic spending,"* and *"There are pressures on some sectors of the economy, particularly manufacturing, and the energy sector...but the underlying health of the U.S. economy I consider to be quite sound."* Another reason to raise interest rates is in preparation for a future recession. If we experience another recession with zero interest rates, the Federal Reserve would have nothing to stimulate the economy (through lower interest rates which produce incentives for consumers to spend and borrow). One analyst notes that, after the fire, you need the firetrucks to return to the station to be ready for the next one.

What does the rate increase mean for you? Savers will see a modest increase in savings rates. JP Morgan announced on December 29th that it would increase the deposit rates for certain accounts. We expect other banks to follow JP Morgan's lead and gradually increase their deposit rates as the Fed raises the Fed Rate throughout 2016. On the flip slide, borrowers will see rate increases within their revolving debt accounts (such as credit cards). We recommend consumers increase the monthly payments to department store cards and credit cards in order to pay off balances faster. Those consumers who took out a second mortgage should also keep an eye on how much they are paying, in comparison to current fixed rates on their savings (such as CDs).

How does the rate increase affect your bond portfolio? Holders of fixed income securities (bonds) will likely see prices decline as interest rates increase. We have prepared our clients' bond portfolios so that the effects of a rate increase should be minimal. To describe how we achieve this, let me explain effective duration, which is the approximate percentage change in the security price for a 1% change in rates. For example, the Fed Funds Rate was increased by 0.25% and a typical client's effective duration is 4.48. This means that the average impact of the recent rate increase will reduce a bond's (or bond fund's) price by 1.12% (0.25% x 4.48). For a bond or bond fund worth $100,000, this equates to a decline of $1,120. Another sector we are watching is floating rate bonds. However, due to a technical factor called 'Libor Floors,' we do not see this sector as a useful opportunity at this time.

How does the stock market perform in a rising interest rate environment? Historically, the stock market has performed well in a rising rate environment. In particular, the cyclical and financial sectors are most likely to benefit from rising rates. A further effect of raising interest rates is the increase in the value of the US dollar. A stronger dollar is great for those who travel abroad, as you get more for your money. However, the downside to a strong dollar is that it hurts companies who rely on exporting goods, and can thus hurt the share price for these companies' stocks.

Summary In conclusion, we expect the markets to be volatile over the next few months as the markets and individual investors continue to cope with volatility and position their portfolios for continued rate hikes. We feel that rising interest rates are not alarming, as rates are still historically low and higher rates can be a good event for your long term financial plan, as your savings will start to produce some interest income.

Rising Interest Rates—-Now What? **Kenny Beach**

For years the investment "experts", economists, and investors have been constantly focused on the Federal Reserve Bank and pondering when it will raise interest rates by cutting back on its purchase of Treasury bills. Well, now they've gone and done it, so what does it really mean to you as an individual investor or as a borrower? Take this as a signal from the Fed that the US economy, and to a lesser extent the world economy, is fairly healthy and growing stronger. Economically we are moving in the right direction. Higher interest rates generally will lead to higher income for investors. With short term rates only budging up 0.25% from zero, the income bump is not going to create a rush to purchase short term bonds or CDs. Even if rates reach 1% by the end of 2016, the extra return provided to investors will not generate the income most need to maintain their desired retirement lifestyle.

But economists are still talking about rising interest rates. Surely there is something I need to do! Not really. Hopefully you are already doing something every day, by owning a well-diversified portfolio of stocks and bonds with varying levels of risk, and you rebalance periodically. Allocate as much to a worldwide collection of stocks, from both developed and emerging countries, as you can tolerate. The balance will be devoted to a diversified collection of fixed and variable income securities (bonds), of high and low quality, and short and longer term maturities.

Don't be afraid. There is little to fear from rising rates. The Fed's zero interest rate policy was a grand experiment dating back to 2008, the likes of which the US has never seen before. Zero interest rates were an elixir for what many economists diagnosed as a very sick, collapsing economy. Rising rates are a step in the right direction, by moving closer to allowing the bond market work with less artificial demand for short term bonds. We don't yet know what harmful effects zero interest rates have caused by the misallocation of capital. We do know the 'patient has largely recovered' and the zero interest rate elixir is no longer needed.

Another common fear is that rising rates will put the brakes on an already slow growth economy. It typically takes a year or so before a change in interest rates impacts the economy. During this period of what is predicted to be gently rising rates, the Fed will keep a watchful eye on economic indicators to avoid bad outcomes. At the pace that unemployment is falling, by creating more new jobs than new workers, the Fed has some concern that inflation could become a problem sooner rather than later. One year from, now unemployment could be nearing 4%, low enough that labor prices could rise meaningfully, and energy and commodity prices could reverse course in 2016 and move upwards. As unlikely as it seems today, the word 'inflation' could creep back into our vocabulary.

Let's trust that the Fed's commitment to raise rates, based on economic conditions, and not mechanically as in the past, will result in continued steady growth, and not be disruptive to the economy and to investors.

Surviving Rising Rates **Paul Baumbach**

Several years ago I made a presentation to financial advisors at a conference on the topic of investing with rising interest rates. I found that the best investments during times of rising interest rate were, simply, stocks. The reason is simple—when interest rates rise, companies pass their higher costs onto their customers. Bonds, however, typically pay a fixed rate of interest, and when other bonds' rates rise, investors drive down the prices of older bonds, resulting in losses.

There are two ways that 'this time is different.' First, the increase is expected to be long, slow, and steady. As long as the Fed acts in the way that is expected, there should be no sharp corrections, no sharp bond losses. Our fingers are crossed. The second difference is that we are starting at a VERY low level, essentially zero. Past rate rises have begun at higher levels. We really don't have history to show us what rising rates will bring. I expect that the rise of the Fed overnight rate to 1% or perhaps even 2% will have little (negative) impact. In the past, a 2% Fed rate was considered VERY supportive to economic growth, so I don't see the first 2% rise to be 'harmful' to the US economy.

A key for investors to remember is that the Fed drove overnight rates low to help a disabled economy, and is beginning the process to let rates return to normal levels, as our economy returns to normal. Thus rising rates in this instance are evidence of a stabilized, healthy US economy. This, in turn, is beneficial to opportunity bonds, such as high-yield bonds, and also to US companies. Investors can decide to be excited about, rather than fearful of, rising interest rates. It is your choice.

Compliance Corner — Pam Baumbach

CFA, CFP, AAMS, RP, ChFC, CPA, CDFA

- Alphabet Soup

At Mallard, we pride ourselves on the competency of our staff and their accomplishments as reflected by their professional financial designations. But what do all the letters mean and how do they compare? The website for our federal governing agency, FINRA, (http://www.finra.org/investors/professional-designations) can help with this. You can type in a designation or browse the alphabetical list of 193 designations to get information on (and some hyperlinks to) requirements, issuing organizations, disciplinary actions and more. The website has a tool that can compare up to three designations.

The presence of a designation does not ensure a quality professional. Understanding what the designation requires, and the standing of the designee will increase your skills in selecting and evaluating the professionals with which you work. This is just one more tool for you in navigating the ever changing and complicated environment of financial professionals.

News and Events

The following Delaware Money School events are being held at the Newark Free Library, 750 Library Avenue, Newark:

Around the World in 80 Minutes
Paul Baumbach
Monday, January 11, 2016, 6:30p.m. - 8:30p.m.

Social Security Benefits
Ed Mink
Monday, February 8, 2016, 6:30p.m. - 8:30p.m.

Register by going to www.dfli.org <http://www.dfli.org> (Sign Up as a Student if not already one). Log In, then go to Class Schedule, Date, and find our course. Walk-ins are also welcome.

Working together, building your financial security

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