MALLARD *Money Matters*

July 2017

Spend or Save

Susan Lehnerd

A year ago, in this newsletter, I shared a book by Carl Richards, *The Behavior Gap*. His column in *The New York Times* is *Sketch Guy*. I touted his ability to take a complex idea and simplify it in a basic sketch on a napkin. His sketches catch my attention, often prompting me to read further. One of his recent sketches resonated with me. It addresses a dilemma many of us have faced, and will continue to face throughout our lifetime – spend the money now or save it for later?

So often, we struggle with the decision of whether or not to spend money on something that we feel may be too extravagant. We are inundated with the advice to save – save for a rainy day, save for retirement, save for college… But what about the experiences we are missing out on? The experiences you can't put a price on? The memories you could create and have to cherish for a lifetime?

In his sketch, Richards put it simply using two words and a symbol: "Experiences > Money". Seeing this took me back several years ago to when I was debating whether or not to take my three children to the Grand Canyon. Adding up the costs of air fare, lodging and food really made me think twice. Why not stick with the annual beach trip? But then I thought back to my childhood experience of the cross-country trip my mother and grandfather took five children on, in a school bus yellow mini-van that my father had outfitted for camping needs.

I still look back on that trip (some 40 odd years later) with fond memories. The sights we saw, the historical landmarks we visited, the dude ranch where I experienced a trail ride are all invaluable experiences. And, yes, the Grand Canyon was one of our stops. I wanted to give my children that experience, because—how often do we take the time or make the effort to do something that has such a lasting impact on ourselves and others?

Now, I am not suggesting that we throw financial planning out the window and spend, spend, spend on experiences. I do, however, encourage you to not only look at the expense but to also consider the experiences and memories that could be gained. Don't get me wrong, if you don't have the money then there's no dilemma – you can't afford the experience (at least not at the moment). Create a plan to reach the goal. That's what I did when I committed to the Grand Canyon trip with my children. A trip that provided priceless memories for all of us, along with the satisfaction that it was money well spent.

NOTICES

Chris will be on vacation in California wine country, July 17-21.

Carol will be attending her son's wedding in Canada, July 12-17. She will be at an IACCP certification training class, August 14-18.

Diana will be on vacation in the Berkshires, Massachusetts, July 16-23.

Paul will be at a government conference in Connecticut, August 14-16. He will be on vacation in Oregon, August 21-25.

Joe will be out of the office July 24-August 3.

Pam will be on vacation in Oregon, August 19-26.

Ed will be out of the office September 18 and 19. He will be at a financial planning conference in Nashville, October 2-6.

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Investing Fundamental #1 – Asset Allocation

Paul Baumbach

At Mallard, we have many fundamental pillars in our investment approach. I will write briefly about each in the coming newsletters, starting with the most fundamental pillar, asset allocation. **Investopedia** defines asset allocation as *an investment strategy that aims to balance risk and reward by apportioning a portfolio's assets according to an individual's goals, risk tolerance and time horizon*. **Investopedia** goes on to note that the three primary asset classes are stocks, bonds, and cash. These three are similar to red, yellow, and blue, the three primary colors. At the highest level, you can create a portfolio of any desired level of risk/return with an appropriate combination of these three asset classes.

Further simplification is possible, for you can view cash as a VERY short-term bond, one without any risk of price loss (or gain). This creates a one-factor classification for portfolios—the percentage dedicated to stocks, with the rest dedicated to cash/bonds. We typically label portfolios by their stock level—a 70% portfolio has 70% in stocks and the rest (30%) in cash/bonds.

The reason that we focus on the asset allocation generally, and the stock level in particular, is that this is the portfolio feature that most affects its results. Whether your stocks are US or foreign, whether your stocks are large companies or small ones, your stocks will rise more and fall more than your bonds. Some bonds lost 8% during the entire year of 2008 in the most recent financial crisis. In contrast, the US stock markets fell 8% **in a single day** eight times. There were sixteen times when the US stock markets rose 8% or more in a single day.

There is a good reason for the dramatic difference in the volatility between stocks and bonds. Holders of stocks are **owners**, while holders of bonds are **loaners**. If you loan your brother $5,000 to start a landscaping business, you may agree that he will pay you quarterly interest of $100, and repay the $5,000 after five years. Alternatively, perhaps you could buy 10% of the business for your $5,000 check.

How would your investments fare if things go well or poorly? If the business goes very well, the most that you will get from your loan is the $400 a year and your $5,000 back in five years. But if the business goes well, your $5,000 ownership could rise sharply. If, however, the business goes poorly, your results would be markedly worse. Your ownership share could become 10% of nothing, for a complete $5,000 loss. If instead, you had loaned the $5,000, you may be able to get some back by selling some of the equipment, so that you received $100 for several quarters, and got $2,500 back from the equipment sales, avoiding a complete loss.

Owning stock means that you own the future earnings of the company, not just for the next three months, but potentially for the next three decades. As such, one big news story could sharply change how investors value that share of stock, up or down. As the loan example showed, the range of outcomes is much smaller for a loan than ownership, and, therefore, news will typically have a muted impact on bonds, compared with stocks.

This is the reason that we place a **primary, fundamental, focus on asset allocation**, and clients' exposure to stocks. We feel that stocks provide higher returns, over time, than cash and bonds, however we work to identify the stock level best suited for each client. We sometimes note that we want each client to have as high a stock level that they can handle, not now, but at the depth of a market crash. Since we don't know when markets are going to crash, we want to be prepared at all times, by building portfolios with a low enough level of stocks that the client won't feel compelled to sell stocks (at their lowest prices). Only once we get this right can we move onto the next steps.

Oil Change Rebalancing

Joe Daigle

In January, I penned my first article with Mallard and I discussed some introductory concepts of Asset Allocation. I conveyed how it entails investing in a broad base of diversified investment types so that the overall portfolio maintains stability by owning assets that grow and shrink differently in different environments; taming the largest swings in value. I also discussed the importance for an investor to be aligned with an appropriate 'risk profile' to personalize their allocation to meet risk and liquidity needs.

Now, I want to discuss an important and advanced concept of Asset Allocation: Rebalancing. Most investors have heard of rebalancing, and understand it to be making whatever sales and purchases are required to get the portfolio back to the original mix of asset classes. This is true, but it doesn't convey the economic benefit of regular rebalances.

I like to relate portfolio rebalances to getting an oil change for your car. You want your car to work for you everyday. You don't need a major overhaul and repairs all that often, but in the course of regularly operating your car, you want to get the oil changed to keep the machine finely tuned and working as best as it can for you. Rebalancing your portfolio should feel similar; it's a chore you should do, and if you do it regularly you will keep your portfolio humming along in tip top shape.

After you implement your initial asset allocation for your portfolio, time passes and parts of your portfolio will grow faster than others; often stocks grow faster than bonds. If the stock portion of your portfolio is allowed to become and remain significantly larger than the bond portion, your portfolio will end up with greater risk than you initially chose. The elegant solution is to sell some from the expensive sector and add to the proportionally cheaper sector until you achieve the appropriate balance. This works out quite well, however it doesn't answer the question when exactly to rebalance, and by how much.

There are two primary conventions for triggering an appropriate time to rebalance. The first is after a certain amount of time has passed, and the second is when an asset class is out of balance by a certain percentage. Research shows that neither convention is consistently superior, when applied to historic short-run periods. We believe in a blended, more nuanced, long-run approach of first evaluating portfolio composition quarterly, and then only initiating a transaction if an asset class has crossed a defined threshold of being out of balance.

Again I think about this like an oil change; you don't want to buy an oil change weekly because you'll pay the mechanic much more than the value you get from clean oil, but you also want to check your car enough to not run on low or dirty oil. Likewise we evaluate regularly, but don't want to recommend rebalancing trades until there's economic value to do so. In this way we avoid frivolous transactions, while catching the opportunity to sell an expensive asset class to buy a cheaper asset class and keep the portfolio's risk profile in check simultaneously.

Many investors have heard of websites offering a questionnaire to find out what their asset mix should be; I've even done this a few times. This is sort of like considering the right type of vehicle for your needs. After you have the vehicle, you need to take care of it, that's what rebalancing is for a portfolio. It's where we look under the hood, change the oil, and keep things running smoothly.

Compliance Corner

Pam Baumbach

Please join us in welcoming Carol Boncelet as our new Compliance Officer, assisting our Chief Compliance Officer, Pam. Carol comes to us with broad experience in the private and non-profit sectors. She has owned a retail business in Newark and has worked for large and small organizations, most recently fund-raising for local non-profits. She has an MPA degree and a BS in Engineering.

Carol's first priority is to review and update Mallard's Compliance Policy and Procedures Manuals. She will be part of our Compliance Committee and will work to ensure Mallard's culture of compliance. Carol is currently pursuing her IACCP certification.

The Investment Advisor Certified Compliance Professional® (IACCP®) is a professional designation requiring 20 courses, a comprehensive test and 2 years experience.

The certification process provides an individual with a solid understanding of regulations and rules that investment advisors must comply with.

News and Events

A **Delaware Money School** presentation will be made by Ed Mink at the Newark Free Library:

Social Security Benefits

Monday, September 25, 2017 - 6:30pm to 8:30pm

Working together, building your financial security

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