The Mallard Message

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Mallard Asset Management Corp **(302) 737-4546**

Frequently Asked Questions

1. **How is your business going?** I officially opened my doors on January 1st, 1997. Since then, Mallard has grown to more than a dozen clients, with more than $4.5 million in assets. This represents approximately 40% of my ultimate target. Since I bill my clients after the work is performed, 1997 represents a year's expenses, but only nine months of income. For this reason Mallard will miss the breakeven point in 1997, should turn a profit in 1998, and hopefully will 'replace' my pre-Mallard income by 1999. Just as each of you has a long-term horizon for your investments, I have a long-term horizon for my business.

2. **Will you be changing your fees?** Yes and no. I am not changing the fees I charge to existing clients. However I am raising the fee schedule for new clients from the current 0.60-0.90% to 0.70-1.00% annually, based on assets under management. I am offering a 5% discount on 1998 fees for clients who sign up in 1998 (a similar incentive program for 1997 expires this month).

3. **What holidays and vacations are you planning?** I plan to take several days off during the next two weeks: December 24-26, 30, and January 1-2. I plan to check my messages at least every other day during this time period. I am likely to take February 12-13 off, as my son has a school ski trip on the 12th. I may take a few days off when my son's school has its Spring Vacation. I will likely attend the national NAPFA conference in May, and I am involved in planning a NAPFA regional conference in Philadelphia in November. Whenever I am away from the office for more than one day, I check in to get my phone messages at least every day-and-a-half.

4. **How can I find out more about Mallard?**— My fee structure, along with many pages of detailed background information on Mallard Asset Management Corp is available in my recently <u>updated Form ADV Part II</u>, which is available free of charge to anyone who requests it. I hear that in some cases reading it has provided relief from insomnia ☹ !

International Investing—A Waste of Time?

This month in the Wall Street Journal's INTRINSIC VALUE column by Roger Lowenstein was an article

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entitled "'97 Moral: Drop Global-Investing Bunk". He raises several interesting points: assessing the 1997 losses suffered by many international markets, questioning investing in areas with which you are unfamiliar, deeply scoffing at investing in an index of countries in which you are unfamiliar, and expressing confidence that the US stock markets offer sufficient diversification opportunity.

This reminded me of another article which recounted that, up until the early 1990s, Ibbotson & Associates (a research firm which tracks investment returns for many, many decades) pointed out that international stocks offered superior returns to domestic stocks for **every five-year period** since before the Great Depression. The article went on to point out that this winning streak has since been broken, even before the recent Asian currency crises.

How does this affect me, a confirmed 'global investing advocate'? I am unshaken, and actually encouraged. The Ibbotson data shows that, eventually, that which appears to be too good to be true is. Investors who in 1990 felt that international investing was the holy grail (larger returns with no additional risk), have suffered this decade. I suspect that investors who believe that US-only investing is similarly magical will be licking their wounds over the next decade.

Alan Greenspan in his December 2nd speech to the Economic Club of New York discussed the 'home bias', or the degree that portfolios remain substantially local. He quotes foreign investments at 10% in the US and Japan, 15% in Germany, and 33% in Great Britain. He further notes that while home bias is declining, 'we are still far from full globalization'.

Jean-Marie Eveillard, the manager of several SoGen mutual funds was recently asked by Investment News about American investors: '*American investors are more or less disgusted with global markets. It's a paradox, really, the opposite of 1993, when global markets did so well and we (SoGen International) were flooded with money and had to close the fund for 15 months. Now investors are making the opposite mistake by staying away, when there are some excellent buying opportunities.*' He goes on to identify several foreign stocks that he feels are good values.

In summary, I continue to believe that portfolios should be globally balanced. International stocks have far underperformed US stocks in 1997, and should continue to produce more volatile returns than US stocks. Yet I believe that when measured in years, instead of months, globally balanced portfolios will offer higher returns with lower overall risk than US-only portfolios.

Successful Investment Management

Nine months ago I briefly mentioned the book Investment Policy: How to Win the Loser's Game, by Charles Ellis. In this article, I will examine Ellis' views of worthwhile and worthless investment endeavors. The book's subtitle refers to the observation that there are two types of tennis games. Professionals win points, and amateurs lose points. In professional tennis, 80% of points are won, while in amateur tennis, 80% are lost.

He points out that investing is similar to amateur tennis, as it is a game in which most participants are losers. As the market is made up of all investors, then by definition, the average investor can not beat the market. When you add transaction fees (and investment advisory fees), both individual and institutional investors have entered a loser's game.

Confronted with this observation, I see three paths. You can identify an approach that you believe will let you consistently beat the market. You can become frustrated and quit (and place your money in CD's from your bank). You can examine whether playing the loser's game is actually rewarding enough!

But I'm Different!—I have severe doubts of those who believe that 'they are different', and that they can consistently beat the market. Mark Hulbert has tracked investment advisory newsletters for 15 years. He has found that following advice from the newsletters each calendar quarter generates a range of results, 80% of which do not beat the market. Furthermore, of the 20% of market letters that beat the market in a given quarter, 80% of them fail to beat it the next quarter. 'Professor Barr Rosenberg estimates that it would require 70 years of observations to show conclusively that even 2% of incremental annual return resulted from superior investment management *skill* rather than chance.'

Winning While Losing—Ellis writes 'In investment management, the real opportunity to achieve superior results is not in scrambling to outperform the markets, but in establishing *and adhering to* appropriate investment policies over the long term'.

As many of you know, running is one of my hobbies. Fortunately for my ego, long ago I recognized that winning races is not my goal. Yet I continue to enter races with goals in mind. Those goals include

- doing the best I can (despite the observation that this 'best' seems to slip over time ☺)

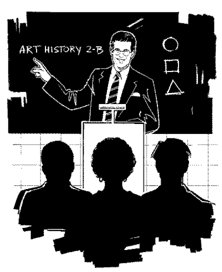
- using the race as added incentive to maintain my physical fitness

In other words, my goals describe how I can ‘win’ without winning.

The Investment Policy Statements I develop jointly with my clients spell out the investment policies which are unique to each situation, and which are most often quite unrelated to ‘beating the market’. Thus, we chart out how we can win the loser’s game.

Conferences

The 1997 NAPFA Northeast Mid-Atlantic Regional Conference was held in Alexandria, Virginia in October. In addition to networking with other financial professionals, I attended sessions on Estate Planning, Retirement Distributions (including discussion of the Roth IRA), Bonds, Risk Tolerance, Tax Relief Act of 1997, Stocks, Decision Making Under Conditions of Uncertainty, Money Psychology Tips, the Changing SEC and State Regulatory Environments, and What Works on Wall Street. WHEW!



There was a very interesting lunch-time session given by Louise Yamada of Smith Barney. She reported on her views of ‘Old Tech’ sectors such as Paper & Forest, Specialty Printing, and Publishing, along with ‘New Tech’ sectors, such as Aerospace/Defense, Electronics—Semiconductors, Communication Equipment Manufacturers. One of her most interesting points is that the raw materials for tomorrow’s ‘manufacturing processes’, sand, air, and light, are not being tracked by commodity indices. She noted that a gallon of spring water now costs more than a gallon of gas, and that it takes 150 gallons of ultrapure water to rinse a single computer chip during the manufacturing process.

Three Month Activity

Over the past three months, I have managed many purchases and sales. I also produced portfolio reports for many clients. I suspect that it would be informative to survey the activity and results.

Portfolio Returns—I produced more than a dozen reports for the 3rd calendar quarter. The returns ranged from –0.1% to +7.7%. As many portfolios came under my management during the 3rd quarter, there were significant cash flows that impeded the management. In each report, I reviewed the factors that appeared to explain the return.

Mutual Funds—I have begun using CGM Realty as an alternative real estate mutual fund to Cohen & Steers Realty. I continue to use several low-expense Vanguard mutual funds, and Warburg-Pincus International Equity to gradually shift clients’ portfolios towards our targeted allocations. I recommended the elimination of some Schwab-only mutual funds, and asset allocation funds for one client, in anticipation of moving the portfolio to Waterhouse Securities.

Bonds—I purchased a municipal bond for one client to replace the principal which was repaid from a municipal bond Unit Investment Trust. To reduce the volatility of another client’s portfolio, I reduced the risk of the bonds by selling the long-term zero-coupon bonds, and retaining the shorter-term ones.

Stocks—Stocks purchased in the past three months include Cityscape, Hearst-Argyle TV, Hewlett Packard, Matsushita, Seagate, Xilinx, Eastman Kodak, Korea Electric, and Sony. Only the last three have risen since their purchase.

Tax Losses—I have contacted several clients about the opportunity to realize some taxable losses now, and benefit from them in April on their tax returns. Loss positions were closed in Atmel, Boston Scientific, Cityscape, Cypress Semiconductor, First Philippine Fund, Seagate, a Singapore investment, and the Vanguard gold fund.

Other Stock Sales—Enron, Exxon, GE, ICN Pharmaceutical, Lucent, and Pfizer were sold in various portfolios to 1) seal in gains, 2) reduce concentration in individual positions/industries, and/or 3) raise funds for other purposes.