The Mallard Message

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Autumn Plans

I will be attending a conference in New York City from October 8-11. The office will be closed November 25-26th in observance of Thanksgiving and on December 24th. I am not yet certain about the last week of December.

Whenever I am away from the office for more than one business day, I check my phone messages and return all urgent ones.

Frequently Asked Questions

1. Are you accepting new clients?
Yes. As my third year of business comes to a close, I am still growing. I have not yet reached my stated limit of thirty ongoing client relationships. I also accept one-time investment reviews, although I typically limit these projects to no more than two per quarter.

2. Why should I refer someone to Mallard?
If you trust in Mallard's ability to help people 'make their jobs optional', then you will be helping your friends by providing them with another option to consider. If you are a current client, then by referring people to Mallard you enable me to spend less time on growing my business, and more time on growing your investments. To encourage referrals, and to help reduce the stress of an initial meeting, I have an open offer to treat you and anyone you refer to lunch. Over lunch we can simply get to know each other. I am grateful to everyone who has referred friends in the past.

3. How is Mallard staffed?
I am the sole full-time employee of Mallard. In the past my wife Pam has provided administrative support. This fall, however, she will be devoting more time to her primary job. Therefore, I have arranged for a good friend, Margaret Badger, to provide this service. A local university business student, Valerie Lepore, will be volunteering at Mallard this fall. She will be helping with investment research.

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YEAR 2000

What is Mallard Doing?

One hundred days to go! In the past quarter I have been gathering information on my 'mission-critical' software. The information includes the status of the software's Year 2000 Compliance, and contact information in the case of problems. This search may yield updates that reduce the chances of problems in January.

Some people spend money on clothes, others on fast cars; my vice is spending on computer hardware. By the end of October, both of my office computers will be 1999 models, both from brand name manufacturers, both running Windows 98 Second Edition. In late December I will perform full backups on both computers prior to shutting them down. I am hopeful that my digital phone system and my laser printer/FAX machine have no problems despite each being three years old.

What Should You Be Doing?

If you have a computer or two at home, you should identify the critical activities. For me, this is email, bookkeeping, spreadsheets, and word processing. My son would argue that I should add games to the list. Just as I mentioned in the earlier article, it is advisable to obtain the Y2K compliance status and contact information for the providers of all of your critical applications. This information includes email addresses, websites and phone numbers.

Microsoft has a terrific free utility, called the Microsoft Year 2000 Product Analyzer. It scans your entire hard drive(s) and identifies all Microsoft products. It then determines the current software level for each such program, and reports on the compliance status of each. If there is an action recommended (such as loading a free software update), it directs you to the appropriate website address. As I use Microsoft Office so much, I found this tool to be especially helpful. You can obtain it at http://www.microsoft.com/technet/year2k/pca/pca.htm. I do not know whether a MAC-version of this tool is available.

If you would consider using a kerosene heater, find it and your kerosene tank, and buy your kerosene now. Also purchase your propane early if you are likely to cook on your grill. Remember to have your gas tank filled.

Do you have a phone list of your family and friends handy? Do you have the local police and fire department numbers handy in case the 911 service fails?

My local utility offered a hurricane-preparation list of items that seems to apply to Y2K preparations also. Do you have batteries, candles, matches, a battery powered radio, canned food, and a hand-operated can opener? If you use a cell phone, ensure that its battery and any backup batteries are fully charged. Determine now how to foperate your garage door if there is no electricity.

Greenspan Explains There is No Y2K Problem

The easiest way to eliminate a problem is to redefine it. The chairman of the Federal Reserve Bank, Alan Greenspan, spoke to the President's Council on Year-2000 Conversion earlier this month. He makes clear that there is no Y2K problem. Rather we should be concerned with disruptions around the CDC, the Century Date Change. Boy, am I relieved!

Actually, Greenspan's speech is very interesting. He points out that while we do rely increasingly on computers, we also find 'that failures and breakdowns in mechanical and electronic systems are a normal part of our everyday life'. That certainly rings true.

Greenspan considers broad, persistent breakdowns in our economy as a result of the CDC to be remote, 'even granting the uncertainties associates with our interconnections with less-prepared foreign countries'.

He expects that companies will work feverishly to solve all serious technical problems that surface. This is 'fostered by workers who can rise to a challenge and a market system that rewards extraordinary

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Diversity Training

I recently heard an audio tape of a presentation on portfolio diversification by a manager at UBS Brinson. He was speaking to investment advisors. He invited them to consider what they would do if in 1969 they were told, with absolute certainty, the average annual return and volatility of ten types of investments for the coming thirty-year period. These asset classes included US stocks, US bonds, foreign stocks, and foreign bonds.

He suspects that most would have recommended that clients load up on the top three categories, private markets, US stocks, and foreign stocks. He then fast forwards five years to review how the clients fared. Can you guess which three types of investments were the only ones that lost money during those five years, 1969 to 1974?

The risk of loss is reduced if you diversify properly. Proper diversification does not mean splitting your investments among four US stock funds. In the past 25 years, the average growth fund earned 13%, yet had losses in five of those years, including a 27% drop in 1974. By contrast, a balanced global portfolio earned a similar 12.4%, had only two down years, and fell only 14% in 1974.

This supports global diversification. Yet from 1994 through 1998, the average US growth fund has earned an average annual return of 18%, while the globally balanced approach has earned only 13%. This has prompted many investors to question diversification, and to simply place most of their portfolios into an S&P 500 index fund, or large US company growth fund. While this makes sense initially, I liken it to driving your car by looking through the rear window.

This approach was great for the past five years. What will the next five years bring? Four years ago, small-cap US stocks had outperformed large-cap US stocks 21.7% to 17.2% for the trailing 5 years. A rear-view investor would have loaded up on small-caps in late 1995, just as the large stocks began their winning streak.

This week the US stock markets are reeling from fears of the declining US dollar, a widening trade gap, and the potential impact on US inflation and interest rates. I do not suggest that these fears are completely justified, however I do suggest that these fears were largely absent six months ago. Should US inflation and interest rates rise over the next five years, would you expect the S&P 500 to lead the way? I don't.

More importantly, should another fear arise in six months, a fear we are not fully considering at this time, how will this affect the strategy of placing all of your eggs in the S&P 500 basket? It may not be all it's cracked up to be.

Three Month Activity

In this section I review the significant investment actions I have taken over the three months ending September 15th.

MUTUAL FUNDS

I continued to add intermediate-term bond funds to clients' portfolios, along with some stock index funds and foreign stock and a closed-end small-cap fund. I began using three Japanese stock funds and continued using several of the Vanguard Variable Annuity investment options.

Several of the purchases were funded with the sale of shares of shorter-term bond funds. One closed-end fund liquidated and the other converted to open-end status; both actions eliminated the discount, boosting returns. Rather than wait until December, I have been gradually realizing losses in a limited number of both closed-end and open-end funds.

BONDS

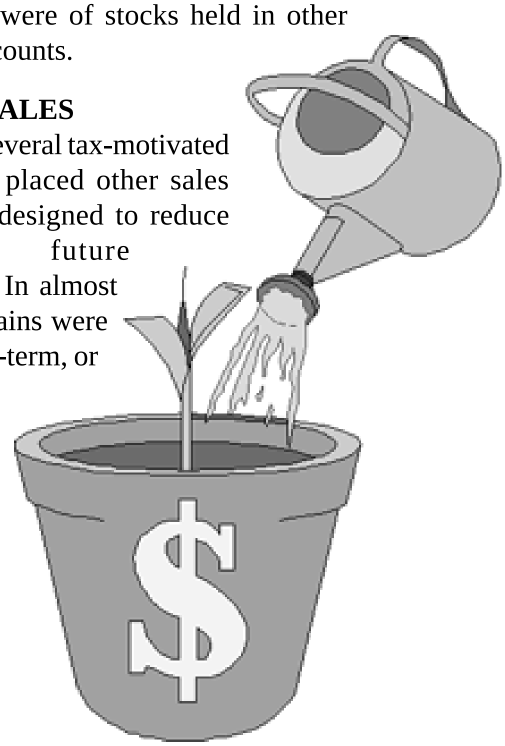
I purchased $240,000 of individual bonds, primarily municipal, while $40,000 of bonds were called. I primarily purchase individual bonds in taxable accounts where a substantial sum can be devoted to bonds. When held to maturity, this approach can produce lower costs than bond mutual funds.

STOCK PURCHASES

I purchased six US and two foreign stocks. Several purchases were of stocks held in other clients' accounts.

STOCK SALES

I made several tax-motivated sales, and placed other sales that were designed to reduce expected future volatility. In almost all cases gains were either long-term, or within tax-sheltered accounts.



Recent Conference

In early August I attended my first DataLYNX conference, in Denver. DataLYNX is a brokerage firm of sorts, and I wanted to learn more about them, to see whether they offer better value than Waterhouse and Vanguard Brokerage. I also attended sessions on the Global Economy, Focused Investing (such as the Janus Twenty fund), Asia's Road Map to Recovery, and two technology talks.

The tech talks were given by Robert Cringely, the author of *Accidental Empires, How the Boys of Silicon Valley Make Their Millions, Battle Foreign Competition, and Still Can't Get a Date*. I recommend his website: http://www.pbs.org/cringely/. It mentions that "Nerds 2.0.1: A Brief History of the Internet" airs nationally on PBS on Wednesday, November 25, 8:00 p.m. ET.

I especially enjoyed the opportunity to meet several mutual fund managers and representatives face-to-face. We discussed the use of a commodity-linked mutual fund in place of a natural resource fund, how Asian markets appear to a fund manager who travels there extensively, socially responsible investing choices, and the use of leveraged bull and bear market funds.

Greenspan
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efforts.' He notes that 'the overwhelming majority of us [financial institutions] are not only prepared but have contingency plans to deal with breakdowns.'

Less we become complacent, Greenspan warns of the impact of 'unwarranted fears of serious disruptions'. He points out that this should replace 'technical concerns as our major challenge.' He recommends that 'the safest thing for consumers to do with money around year-end is to leave it where it is. ... Prudent consumers nonetheless should always have up-to-date copies of their financial records just in case of a "normal" computer glitch.' He points out that 'Those people who do cash out a significant part of their deposits only increase the risk that they will become victims of crime or fraud.'

He concluded that at the Fed they believe that the CDC computer problems 'and the response to the CDC will not be a major event for our nation', and that 'the Century Date Change will hopefully replicate the saga of "the dog that did not bark".' My fingers are crossed.

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