MALLARD Money Matters

April 2015

NOTICES

Diana, Jacqie, Mike and Chris will be attending a Redtail seminar May 12.

Paul will be in Dover for most of the day, Tuesday to Thursday (at least for the full afternoon), for April 21 -May 14, and June 9-25. The legislature is out of session from July through December, and this is not an election year.

Pam will be on vacation in St. John May 1– 29. Paul will join her May 15 - 29.

Other employee vacations:

Kevin: April 6 - May 5

Ed: April 19 - 26

Chris: April 23 - 27

Diana: May 13 - 15

Alan: June 22 - 26

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Life Insurance

Susan Lehnerd

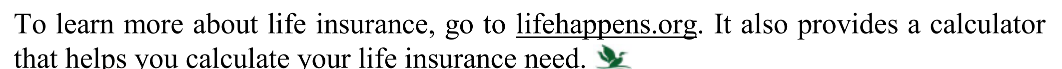
Life insurance – Do you need it? Do you have enough coverage? How much is enough? All good questions, with the initial answer being 'it depends.' It depends on your circumstances. Are you married? Do you have children? Are you still working? Start by asking this key question: "Do any individuals depend on me financially?" If they were to lose you, would they be able to continue on financially without having to make drastic changes?

Reasons to consider coverage-

1) Single person – You're providing financial support to a loved one, or carrying significant debt that you don't want to pass on to family members.
2) Married – You want to replace lost income, cover funeral costs, or pay-off outstanding loan balances (including credit card and mortgage).
3) Married with children – You want to replace lost income, cover funeral costs, payoff outstanding loan balances, cover child care costs if your surviving spouse works or would have to work, or cover future educational expenses, such as college tuition.
4) Stay at home parent – You want to cover the cost for services lost, such as childcare, cleaning, cooking, and other household activities.
5) Single parent – You want to provide for the future needs of your surviving child (ren).
6) Retired – If you have a large estate, life insurance could help provide liquidity to pay estate taxes.
7) Small-Business Owner – You want to protect your business from loss of a key employee.

The amount of insurance needed can be determined by first figuring the expenses that will need to be covered. There are the immediate expenses, such as – funeral costs, medical expenses, mortgage, and estate settlement costs. Ongoing expenses also need to be determined – the cost of living, from food to insurance, and future expenses of tuition and retirement. Next, determine the resources available to cover these expenses. These resources include your spouse's earnings, savings, investments and existing life insurance coverage. Subtracting resources from expenses gives you an estimate for your life insurance need.

As if it isn't enough determining whether or not you need insurance and how much, you need to consider what type of insurance. Two key types of insurance are term and permanent. Again, the 'better' type depends on your need. Term insurance is typically used for short-term needs, like ensuring that tuition is covered and is typically purchased at a relatively younger age (it becomes more expensive with age). Policies can be purchased for a set amount of time – 10, 15, or 20 years. The premiums are typically less expensive than premiums for permanent policies. Permanent insurance, on the other hand, provides life-long protection. These policies build cash value over time, but they initially have high premiums.



To learn more about life insurance, go to lifehappens.org. It also provides a calculator that helps you calculate your life insurance need.

The Warren Buffett Twist On Risk

Kenny Beach

Each year in Berkshire Hathaway's annual report to shareholders, Warren shares his wisdom by means of an open letter to shareholders. The recently released 2014 letter can be found at http://www.berkshirehathaway.com/letters/letters.html. Having managed Berkshire Hathaway for 50 years, Warren spends much of this year's letter covering the unique business practices utilized to ensure the business units thrive and continually grow earnings, which ultimately becomes reflected in the Berkshire Hathaway stock price. I will share with you this report's primary investment lesson in Warren's own words which I hope you will find useful.

"The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been far safer to invest in a diversified collection of American businesses than to invest in securities – Treasuries, for example – whose values have been tied to American currency. That was also true in the preceding half-century, a period including the Great Depression and two world wars. Investors should heed this history. To one degree or another it is almost certain to be repeated during the next century."

This is not what we are used to hearing. When Warren refers to a collection of American businesses he means stocks. Securities tied to American currency is his reference to Treasuries and other short term bonds which offer slim rewards.

"Stock prices will always be far more volatile than cash-equivalent holdings. Over the long term, however, currency-denominated instruments are riskier investments – far riskier investments – than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is far from synonymous with risk. Popular formulas that equate the two terms lead students, investors and CEOs astray."

Currency denominated instruments again refers to Treasuries and other short term bonds. In this paragraph Buffett introduces the time period qualifier that stocks, even though more volatile, are less risky when held over the **long term**. If you have friends or relatives with very, very long time horizons for their retirement fund please share this information with them. Starting early with a high allocation to stocks can make the difference between retiring comfortably at age 60 or remaining in the workforce for many more years. What if a portion of your portfolio is not long term? Keep reading.

"It is true, of course, that owning equities for a day or a week or a year is far riskier (in both nominal and purchasing-power terms) than leaving funds in cash-equivalents. That is relevant to certain investors – say, investment banks – whose viability can be threatened by declines in asset prices and which might be forced to sell securities during depressed markets. Additionally, any party that might have meaningful near-term needs for funds should keep appropriate sums in Treasuries or insured bank deposits."

Aha. Volatile stocks are not appropriate for all time horizons. Shorter term investments are better for short term needs.

"For the great majority of investors, however, who can – and should – invest with a multi-decade horizon, quotational declines are unimportant. Their focus should remain fixed on attaining significant gains in purchasing power over their investing lifetime. For them, a diversified equity portfolio, bought over time, will prove far less risky than dollar-based securities."

If you have a long term time horizon, stocks are appropriate and less risky than short term investments. Believe this. If this is hard to understand, ask your advisor to show you the returns of stocks over long periods of time compared to other asset classes. Over long time periods you will see that spending power grows much faster with stocks, despite the volatility, than with the less volatile investments. If price volatility makes you uneasy, perhaps you should not be paying so much attention to security prices or even your portfolio's value.

"If the investor, instead, fears price volatility, erroneously viewing it as a measure of risk, he may, ironically, end up doing some very risky things. Recall, if you will, the pundits who six years ago bemoaned falling stock prices and advised investing in "safe" Treasury bills or bank certificates of deposit. People who heeded this sermon are now earning a pittance on sums they had previously expected would finance a pleasant retirement. (The S&P 500 was then below

700; now it is about 2,100.) If not for their fear of meaningless price volatility, these investors could have assured themselves of a good income for life by simply buying a very low-cost index fund whose dividends would trend upward over the years and whose principal would grow as well (with many ups and downs, to be sure).”

As a Mallard client, you likely were not overcome with fear and you avoided the mistake of running to safety during the financial meltdown. Although Warren declares volatility is not risk, he does recognize it can surely compel investors to make risky decisions. Some investors may easily avoid risky behaviors by recognizing these price swings are normal and do not portend the end of our economy. Others may need the help of a financial advisor to avoid these risky behaviors.

“Investors, of course, can, by their own behavior, make stock ownership highly risky. And many do. ***Active trading, attempts to “time” market movements, inadequate diversification, the payment of high and unnecessary fees to managers and advisors, and the use of borrowed money can destroy the decent returns that a life-long owner of equities would otherwise enjoy.*** *Indeed, borrowed money has no place in the investor’s tool kit: Anything can happen anytime in markets. And no advisor, economist, or TV commentator – and definitely not Charlie nor I – can tell you when chaos will occur. Market forecasters will fill your ear but will never fill your wallet.”*

Here Warren cites the investor behavior that can lead to risky behavior and poor returns. As easy as it sounds, it is not always so easy to avoid risky behavior. Mallard is often presented with the question, “Is now a good time to invest…?” When asked Warren always provides the same answer. “I don’t know if now is a good time or not but I do know the American economy will be much stronger twenty years from now than it is today.” With a long term time horizon the answer to the timing question is easy. **Now is a good time to invest.** It is easy to become non-diversified when you fall in love with your winning stocks. It is important to re-balance your portfolio on a regular basis by trimming your winners and buying more of those investments that may be a better value or priced lower. This is an effective risk reduction strategy that should be followed.

So what do you do now? Think about the timing of your future financial needs. Long term needs should be met with funds that are invested for the long term. Is the long term portion of your portfolio allocated to longer term investments? Make certain that your stock and bond allocation is appropriate for your long and short term needs. According to Warren the long term portion should be in stocks if you want to structure it in the least risky manner. You need to discipline yourself to know that short term volatility is not hurtful to your long term investments. In fact short term dips in the market create opportunities to buy stocks at lower prices, easily captured through regular rebalancing.

In closing the paragraph below indicates Warren’s continuing faith in the US economy above all others.

“Our subsidiaries spent a record $15 billion on plant and equipment during 2014, well over twice their depreciation charges. About 90% of that money was spent in the United States. Though we will always invest abroad as well, the mother lode of opportunities runs through America. The treasures that have been uncovered up to now are dwarfed by those still untapped. Through dumb luck, Charlie (Munger) and I were born in the United States, and we are forever grateful for the staggering advantages this accident of birth has given us.”

Warren’s lesson is very clear but should come with a warning. The lowest risk strategy for long term investors is to own a diversified portfolio of stocks, bought through time with minimal transaction costs. He also gives his blessing to low cost index funds as an appropriate vehicle for long term investors. If you are at the stage in your investing life where you are strictly in saving mode for your long term financial security, this is good sound advice - stocks are the way to go. But, if you are drawing down financial assets due to short term needs then Warren’s “lower risk, stock strategy” is only appropriate for the long term portion of your portfolio. Short term needs can be more appropriately funded with lower volatility investments such as bonds.

Buffett sets the bar extremely high for investors—I have met very few people who can tolerate the volatility that comes with an allocation of 100% stocks, even for their long term money. We can, however, aspire to be ‘more like Buffett.’ That means committing to investing your long term money with the greatest allocation to stocks that you can stomach, in the worst of times. This also means resisting the temptation to act on the fear which naturally accompanies investing in stocks. This won’t bring you the fame of Warren Buffett, but it should bring very satisfying results.

2014 Compliance in Review

While compliance is always on my mind, March is an even busier month than usual. Our Annual ADV update, due March 31st, was filed on March 20th. The ADV Part 2 is available on our website www.mallardfinancial.com under Resources. You can request a copy by calling our office (302-737-4546) or emailing me at pam@mallardfinancial.com.

Additionally, my Annual Compliance Review to the board was presented in March. Many things have been accomplished in the compliance area in 2014, including the following:

- Hosted three Compliance Cafés (single topic seminars for employees)
- Led the Annual Employee Compliance seminar (overview of most topics in our ADV)
- Underwent an Annual Custody Review – an independent accounting firm examined our compliance with custody requirements per the Advisors Act of 1940
- Migrated all client Vanguard accounts to enable Advisor access (which safeguards clients)
- Began monitoring of Investment Committee meetings
- Conducted testing of client Investment Policy Statements (IPSs)
- Obtained the IACCP® designation (Investment Advisor Certified Compliance Professional), which consisted of education, testing and experience components

While 2014 was a busy year for compliance, 2015 promises to bring even more improvements to our compliance program.

Working together, building your financial security

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