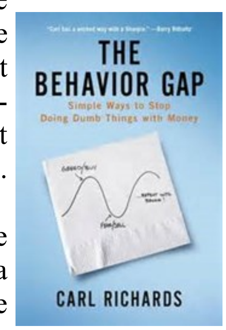
# MALLARD *Money Matters*

**July 2016**

## The Behavior Gap

**Susan Lehnerd**

I recently read a book by Carl Richards, *The Behavior Gap: Simple Ways to Stop Doing Dumb Things With Money*. In addition to being a financial planner, he contributes weekly to *The New York Times*. He likes making simple illustrations on napkins to make his point. A napkin! Which is a point in of itself – you don't need to overcomplicate things. Creating a visual can be a powerful way to provide a concrete image to an idea that otherwise represents a mental concept. Richards is quite good at this.




Richards defines the 'behavior gap' as the distance between what we should do and what we actually do. The goal of his book is to create a framework for making better decisions about money. I'd like to share some of his thoughts with you.

1) Have a Real Plan (not just one you're tossing around in your head) – Consider these three questions when developing a plan:
    a. Where are you today?
    b. Where do you want to be later?
    c. How will you <u>behave</u> in order to get there?

2) No Plan Will Cover Every Situation – It is important to have a plan, but don't make it so rigid that you can't seize opportunities as they come up. We all know stuff happens. It's the course corrections that become important, not the plan.

3) Ignore The Crowd – Base your decisions, investment or otherwise, on what you need to do to reach <u>your</u> goals.

4) Choose Your Life Goals, Then Your Financial Goals – You almost always need to choose your life goals before your financial goals. Once you've determined what will make you happy, you can then make financial goals to support those life goals.

5) Don't Follow Talking Heads – Being anxious about the market can lead to bad decisions. Focus on what you can do (or control). If your goal is to send your child to college, tracking the Dow isn't going to help reach that goal. You can't control the results of the market.

6) Stop Resisting Simple Solutions – Simple solutions are often resisted because a) they require a behavior change and b) old habits die hard. Yet, it can be the simple option that has the biggest impact on your financial success. But at the same time, it requires on-going discipline, patience and hard work.

7) Track Your Spending – Things that get measured are more likely to improve.

If you happen to be in Mallard's office, feel free to borrow a copy of *The Behavior Gap*. We're making it available. We believe it's a worthwhile read.

## NOTICES

Paul will be on vacation (Vermont) and at a government conference (Quebec City) from August 3– 11. He expects to be out of town August 23-25. Paul plans to attend the NAPFA National Financial Planning Conference in Arlington, Virginia October 12-15.

Pam will be on vacation July 28 - 30, at Lewes Beach, and August 3-13, in Vermont and Quebec City.

Ed will be on vacation August 1 - 5.

Alan will be on vacation July 11-14 and July 22-25.

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## Winning the Loser's Game

Paul Baumbach

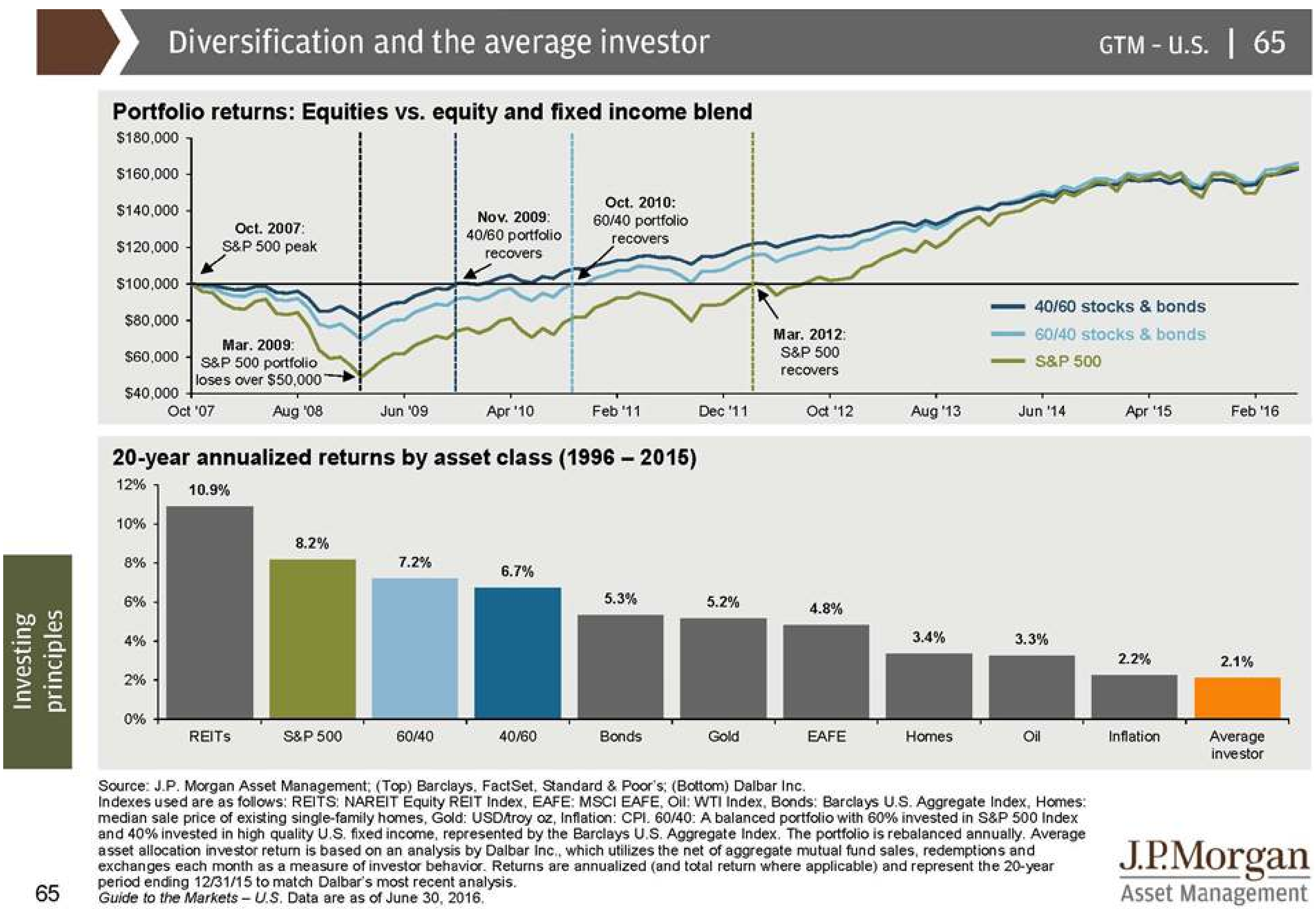
Charles Ellis wrote an article by this name in 1975, and has since written a book with this title. You can find the book at bookstores and on Amazon. The book was required reading when I pursued the CFA® designation in the mid-90s, and found it very readable and insightful.

While I haven't reread the book for many years, and I couldn't find it in my bookcase, I found that its core message was so eye-opening that it has been fundamental to Mallard's approach since our inception in 1996. It is a message that all investors should consider. I have written about this book in past newsletters, but not for over a decade.

Ellis uses tennis as an analogy for investing—he hooked me instantly. He notes that for most tennis players, tennis points are not won—they are lost, and thus the key to tennis is avoiding hitting losing shots. I have played tennis for well over forty years, and I know this to be quite true. One of the most effective styles of play is to be a 'backboard,' returning every shot but patiently waiting for your opponent to hit one out. In most cases they will, just wait. It isn't easy to play so patiently, and controlled, but it gives you high odds of winning the most points.

So, is investing also a loser's game? Ellis notes, as have others, including Burton Malkiel, author of *A Random Walk Down Wall Street*, that investing comes with costs, amongst them fees, commissions, bid/ask spreads, markups, taxes, and inflation. These costs result in investing not being a zero-sum game, with an equal number of winners and losers, but with more losers.

I have included an exhibit with two graphs, from two different time periods. The lower graph shows annualized returns from different investment approaches over the past twenty years.



Note that the S&P 500 index of large US stocks produced an 8.2% return, bonds have produced a 5.3% gain, and inflation has averaged 2.2%. With stocks averaging 8.2% and bonds at 5.3%, you would expect the typical investor to average somewhere between these two figures. Yet the graph shows that **the typical investor has averaged a 2.1% return—less than inflation**. How is this possible?

On the tennis court, I have beaten 'better players,' and have been beaten by 'worse players.' Most often, this is due to the losing player trying to do too much, and the winning player being more steady. The big pros can win by being flashy—but most tennis players lose when they try being flashy. Before you play a match, if you know that your opponent will be tough to beat, it is best to develop a game plan, a plan that you stick to, but a plan that you are able to adjust a bit as conditions warrant.

Typical investors try too hard. They loaded up on stocks during the dot-com run-up, only to lose a whole lot in 2000-2002. They sold almost all of their stocks in 2008, and missed the very strong rebound which began in early 2009. Why did they sell in 2008? The upper graph, on the previous page, shows the 50% loss suffered by stocks from the October 2007 peak to the March 2009 low. It is very hard to be a patient investor, to 'keep the faith,' when half of your stock investment dollars evaporate, when the 'loser's game' hits you in the face so painfully.

This is the exact reason that investors should prepare the way that tennis players do, by making a plan. A written Investment Policy Statement (IPS) provides that plan, with guidelines to follow during normal times. Its greatest value, however, is during the difficult times, times like 1999 and like 2008. Your IPS may include some adjustments to make in trying times, adjustments such as Mallard's **Firewall Investing™** program, designed to limit further losses while enabling gains during subsequent recoveries, but your IPS should condone neither buying into a frenzy, nor selling into a panic. It is these overriding guidelines, when followed at stressful times, which can help you avoid being a typical investor, who loses at the 'loser's game'.

Last month, I was reading some recent issues of *Tennis*. The magazine spends most of its pages with reviews of the pros, which ones are expected to win the next major tournament, etc. I skip those articles, as being a distraction from my focus—improving my tennis game. I jump to the articles with tips for the recreational player: superior court positioning, improved communication with your doubles partner, helpful drills, etc. Professional tennis players can hit some astounding shots. When I try such shots, they go out or hit the net, and I lose the point.

Like *Tennis* magazine, the financial press is filled with astounding stories, about hedge fund managers and personalities such as George Soros, and the big bets they make, in the market, out of the market, etc. (Notice that the tennis press, and the financial press, spends no time detailing the story of the countless unsuccessful professionals.) Playing consistently works in tennis. The lower graph shows how the consistent 60/40 or 40/60 (stock/bond) investment approach has produced very attractive results over the past twenty years. Nothing flashy. The upper graph shows how much steadier the path was for such a balanced approach.

While the 2.1% average annual return for the typical investor over the past twenty years is depressing, I view it as encouraging. It shows how low the bar is for you, for you to win the loser's game. You don't need flash. If you adopt and maintain a very steady asset allocation (60/40, 40/60, or whatever), in good times and bad, you should be a winner.

## Compliance Corner — Pam Baumbach

### Proxy Voting

Most of Mallard's clients have delegated the responsibility for voting proxies to Mallard. With the magnitude of securities with proxy votes and the diversity of issues being voted on, Mallard decided that we will no longer set an all inclusive proxy voting policy and vote all the proxies produced by client portfolios. What does this mean?

Mallard has outsourced our proxy voting responsibilities. We utilize a service that applies the Proxy Paper™ Guidelines, An Overview of the Glass Lewis Approach to Proxy Voting. The advantages to using this service are many:

- An objective review of each issue
- Large resources in researching each issue
- Consistent application of guidelines
- Cost effective

At mallardfinancial.com under the Resource tab, you can find two documents. The first is the Proxy Paper™ Guidelines – United States. It outlines major changes since the previous year, methodology, and reasoning for many of the issues with a focus on US companies. The second is Proxy Paper™ Guidelines – Shareholder Initiatives. This covers research and methodology of shareholder initiated votes.

Copies of this and other documents are also available by contacting our office.

## News and Events

**Mallard's Quarterly Conference Call**
Friday, July 15 at 4 p.m. (East coast time).

**Delaware Money School presentations** will be presented by Ed Mink in October at the Newark Free Library:

Tuesday, October 4, 2016 @ 6:30pm
Social Security Benefits

Monday, October 17, 2016 @ 6:30pm
Pt 1 - How Much to Withdraw from Retirement Savings

Monday, October 24, 2016 @ 6:30pm
Pt 2 - How to withdraw Retirement Savings

*Working together, building your financial security*

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