April 2013

Inside This Issue

MALLARD ADVISORS

Comprehensive Financial Planning & Wealth Management Solutions

The MALLARD FLYER

Notices

Newark Office:

Alan is on vacation in Texas 4/30 to 5/4, in Las Vegas from 5/10 to 5/12, and on his honeymoon in Maui from 5/28 to 6/4. Ed will be on vacation in Myrtle Beach from 4/29 to 5/2. Pam will be in St. John from 4/28-5/21, and Paul will be in St. John from 5/17-5/21.

Hockessin Office:

Bill and Sherry will both be out the week of June 24th on vacation. Christina will be out the week of April 29th in Disney World with her family.

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Wisdom from Warren

Paul S. Baumbach

Repeating my April 2012 article's first paragraph: *By tradition, I review Warren Buffett's annual letter to the shareholders of Berkshire Hathaway, which he has led since 1965. Berkshire is a 'conglomerate,' with holdings in most industries. In 40+ years, Buffett has not only accumulated vast investment wisdom, he has also honed his skill at passing it on.*

Investing wisdom. Buffett has led Berkshire for about half a century, and he has a knack for making investment ideas understandable. A major reason that I share his insight annually is that it often mirrors my perspective. Again this year, Buffett has written a very good summary of the prior year, including insight into the investing and economic environment, sharing some of Berkshire's "secret sauce," and how the company is able to so successfully manage a gigantic organization (over 200,000 employees) with headquarter's staff of 24.

As a warning to all, Buffett discusses a common failing of managers. "The usual cause of failure is that they start with the answer they want, and then work backwards to find a supporting rationale." This is a very common error, not only of managers, but also of investors. Buffett notes that in the 80s there was a case in which "I *wanted* the business to succeed and *wished* my way into a series of bad decisions… But wishing makes dreams come true only in Disney movies; it's poison in business." How many times have we as investors looked at an investment which has disappointed, and in reaction found ourselves wanting/wishing for its recovery rather than dispassionately analyzing the best approach: selling, holding, or increasing the position?

Putting benchmarks in perspective. Berkshire has increased its book value more than the S&P 500 stock index has returned in 39 of the 48 years led by Buffett. This means that the S&P 500 has outperformed Berkshire only 19% of the time. In 2012, Berkshire did well but not as well as the S&P. The S&P 500 also surged in the late 90s, with the dot-com craze. In 1999, Berkshire underperformed the S&P by 20%. In the following three years, as the S&P 500 fell each year, Berkshire cumulatively outperformed the S&P 500 by over 50%.

Continued on Page 2

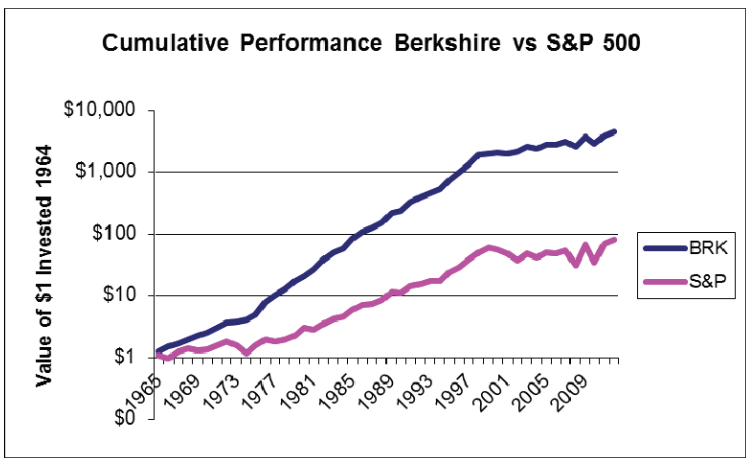
Mallard Announcements

Paul Offers a Free Money School Class
Paul will be offering a class through the Delaware Money School at 7pm on May 22nd at the Newark Library—"Around the World in Eighty Minutes," which covers the geo-political and economic landscape that today's investors are facing.

We Appreciate Your Referrals
We are very grateful that existing clients have long been a source of referrals. Because of this, we are able to focus most of our energies on client service. If you know anyone you think we could help and who would appreciate our comprehensive, fee-only services, we would be grateful and complimented if you were to mention Mallard Advisors.

Wisdom from Warren...continued

In the four calendar years since the 2008 market meltdown, the S&P 500 has gained 15% or more three times, including in 2012. In all three of those years, the S&P outperformed Berkshire, by approximately 10% cumulatively. However, in 2008, as the market fell 37%, Berkshire's book value lost less than 10%. He notes that "We do better when the wind is in our face." Buffett (and Mallard) utilizes a contrarian approach, which spreads risk, and refuses to load up on the 'flavor of the day.' We believe that this steady, disciplined, contrarian approach taken by Warren Buffett over the past fifty years is the best approach for **all** long-term investors. Taking a contrarian approach means looking for opportunities where others see danger. The benefit is that others' fear can lead to bargains, and as Buffett notes, "It's hard to go wrong when you're buying dollar bills for 80¢ or less." Amen!



Teamwork is essential, and this can help you with your continuity plans. Warren is 82 years of age, and Berkshire's Vice-Chairman Charlie Munger is 89. For many years, they have been fielding questions regarding continuity—what will Berkshire look like when they retire? Their large business includes many best-in-class (and best-in-world) managers. In addition, they have brought in 'new investment managers' Todd Combs (age 42) and Ted Weschler (age 51) in the past few years. Each outperformed the S&P in 2012. At Mallard's Newark office, we have built a great team where the total is far greater than the sum of the parts. Just as with businesses, it is critical for families to have continuity plans, such as a power of attorney, a will, and in some cases a trust.

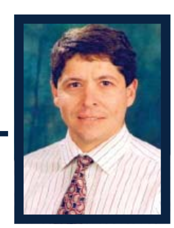
The long-term future is bright, always was, and always will be. He spends four paragraphs on this topic. "American business will do fine over time. And stocks will do well just as certainly, since their fate is tied to business performance. Periodic setbacks will occur, yes, **but investors and managers are in a game that is heavily stacked in their favor.**" Then he notes, "since the basic game is so favorable, Charlie and I believe it's a terrible mistake to try to dance in and out of it based upon the turn of tarot cards, the predictions of 'experts,' or the ebb and flow of business activity. **The risk of being out of the game are huge compared to the risks of being in it.**"

Buffett notes that "*every* tomorrow has been uncertain. America's destiny, however, has always been clear: ever-increasing abundance." Also, "Charlie and I love investing large sums in worthwhile projects, **whatever the pundits are saying**. We instead heed the words from Gary Allan's new country song, '*Every Storm Runs Out of Rain*.'"

In this year's letter, Buffett shares that he expects the U.S. economy to chug along. He expects to "set still another record for capital expenditures in 2013. Opportunities abound in America." He notes, "We are benefitting from a resurgence of U.S. oil production." This is particularly helping two of Berkshire's companies, one which is a railroad and the other which includes a major tank car manufacturer/leaser. He has seen the housing industry strengthen, as their manufactured house producer/financer see sales rise over 13% in 2012. It appears that the housing storm has indeed run out of rain. As they say, April showers…

Summer reading list. If you haven't had enough already, in this year's letter, Buffett recommends several books: Carol Loomis' *Tap Dancing to Work: Warren Buffett on Practically Everything*, William Thorndike's *The Outsiders*, Jack Bogle's *The Clash of the Cultures*, and Laura Rittenhouse's *Investing Between the Lines*. Let me know if you read any of these, and how well you liked it.

Buffett's letter this year didn't disappoint. It provides excellent guidance to today's, and tomorrow's investors.



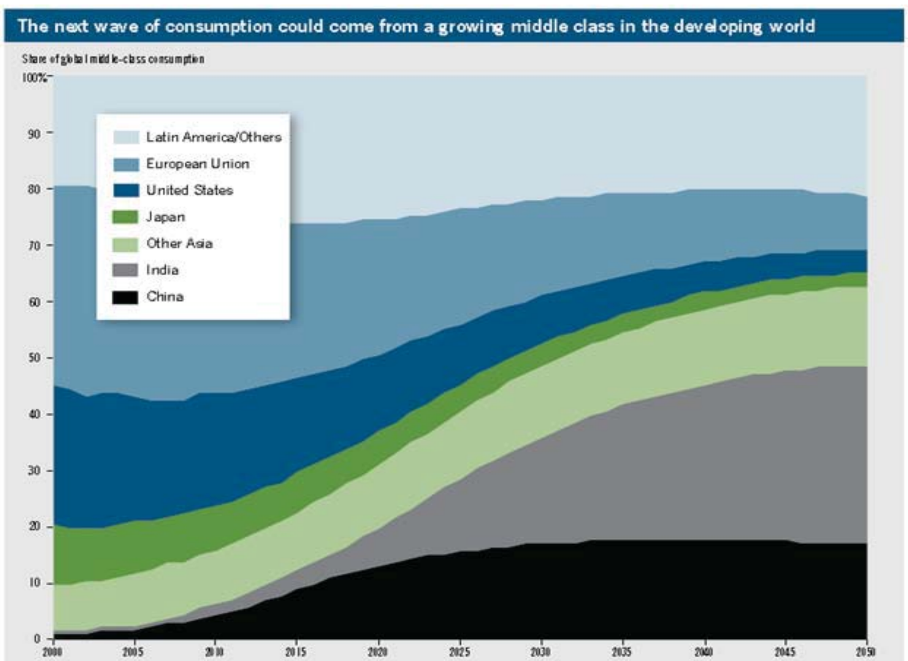
Paul Baumbach is the managing partner of Mallard Advisors' Newark office.

Betting on Abundance

William D. Starnes

In my last newsletter article, I spoke about faith in the future and mentioned two books: ***Abundance: The Future is Better Than You Think***, by Diamandis & Kotler; and ***The Rational Optimist: How Prosperity Evolves*** by Matt Ridley. Both speak about long-term historical progress in technology, energy, trade, and how this progress will continue, resulting in great strides in standards of living for most of the world. Coincidently, in Paul's article, Warren Buffett notes that "every tomorrow has been uncertain. America's destiny, however, has always been clear: ever-increasing ***abundance***."

In developing countries around the world, the current generation is doing things their parents never dreamed of. Now, a low income teenager with a smartphone has access to more information and computing power than Bill Clinton did when he was president! According to Peter Diamandis (author of *Abundance*), laptops will compute at the speed of the human brain in only 10 years, and at the rate of the human race in 40 years.



Sources: *The New Global Middle Class: A Cross-Over from West to East*, 2010, Homi Kharas and Geoffrey Gertz; *The Emerging Middle Class in Developing Countries*, 2010, Homi Kharas.

The current generation is using cell phones, has access to cleaner water, washing machines, and is traveling further from their homes. These improvements in standards of living represent a transformation that will most certainly impact the global economy, and companies all around the world. So, we will see a very strong and steady emergence of a "consumer class".

The McKinsey Global Institute estimates that in 2025, there will be about 4.2 billion people in the "consumer class" - defined as those with disposable income. This is about <u>twice the amount of consumers in 2010</u>. They also state that China's economy is changing at ten times the speed of the British Industrial Revolution. The result is that by 2025, more people will be middle class than poor.

The Institute has also recently released an iPad app titled ***Urban World*** which provides a better sense (visually) of how economic growth will move as this expansion of the consumer class takes place. Of course, no one knows exactly the extent of these changes, but the direction is obvious.

Naturally, China and India will be adding most of these consumers, but so will Africa and Latin America. This consumption growth of the emerging markets will be important as the U.S. decreases in its share of consumption (see the chart at left).

This growing consumer class will greatly increase the demand for a variety of consumer products ranging from household necessities to smartphones and health care related products.

Across all industries, **<u>the pace of innovation</u>** lends itself to smaller, more nimble companies as larger companies can quickly be knocked down. Just think about the impact the MP3 player has had on the music industry, or how the digital camera has killed Kodak.

However, rather than trying to bet on any one company, sector, or country, I would simply maintain a low-cost globally diversified portfolio with a healthy dose of exposure to emerging markets equities (including smaller-cap emerging markets).

Bill Starnes is the managing partner of Mallard Advisors' Hockessin office.

Big Future—A College Planning Resource

William D. Starnes

As my own children grow older and closer to college age, I am thinking and reading more about college planning. Therefore, I would like to share with you a popular, quick, and easy resource for anyone interested in getting financial statistics on any college or university. I would also encourage you to pass this along to your children or grandchildren who are approaching the time of college related decision making.

www.BigFuture.org

Big Future is the college search website run by ***The College Board***. You can find some useful and high level information on this site such as size, graduation rates, application deadlines and costs. This website has tools for both parents and students.

If you already have a few schools in mind, you can research and compare them on this site. To get started, type the name of a school in the search box in the upper right corner of the main page. Click on the college and location (if applicable) that you would like. For example, I typed in 'Villanova University.' On the left hand side of the page there is a 'Paying' tab. If I click on that, I get the screen shot below.

	On-Campus	Off-Campus	At Home
Tuition and fees	$42,890	$42,890	$42,890
Room and board	$11,370	$11,370	--
Books and supplies	$950	$950	$950
Estimated personal expenses	$900	900	$900
Transportation expenses	$600	$600	$600
Estimated Total	**$56,710**	**$56,710**	**$45,340**

This table shows the "sticker price" of all costs. Remember, these sticker prices are generally higher than the actual out-of-pocket costs. Why? Marketing. Parents tend to equate sticker price with quality. However, most schools will discount the sticker price, in order to attract desired students. If I click on the 'Financial Aid by the Numbers' tab, I see that the average non need-based aid (aid available to those who don't qualify for need-based financial aid) is $13,622 and the average indebtedness (how much student loan debt they have to pay back) a student from Villanova has at graduation is about $35,297.

This site also features the ability to filter through all 3,979 of the colleges in its database. For example you can filter by the type of school, size, public/private, majors and so much more. I encourage you, or your family members that have children close to college age, to check out this free website.

Passing On Tangible Personal Property

An estate attorney recently commented that they have earned a tremendous amount of fees solely as a result of family infighting over tangible personal property. While this type of property generally has relatively little value, it contains strong emotional value.

As a result, during a highly emotional time (the death of a loved one), division of family possessions can get ugly and even destroy family relationships.

As long as the personal belongings are unresolved, the real estate will also be unable to be liquidated. How do you get rid of the house when it is filled with furnishings and belongings?

<u>What can you do to minimize the emotional and financial costs?</u>

Almost every will references a separate list (or memorandum) of tangible personal property. Complete it! Naturally, this is most important prior to the death of the second parent.

While children may not like the selections that parents have made, they will almost always go along with it. However, when children have to divvy up the personal belongings among themselves, a lot of historical family dysfunction comes out.

Investment Outlook and Review

U.S. stocks posted an astonishing 10.6% gain in the first quarter of 2013. A 10.6% gain in one quarter!

U.S. stocks beat both developed international stocks—which overcame ongoing issues in Europe to return 3.8%—and emerging-markets' stocks, which lost 3.5%. Meanwhile, the broad bond-market benchmark, Vanguard Total Bond Market, was nearly flat.

Supported by an accommodative Federal Reserve, U.S. economic fundamentals have continued to grudgingly improve. Unemployment is slowly falling, home prices have been rising, and corporate earnings and profitability are near record highs. Fed actions have also continued to support—and drive—strong U.S. stock market gains. The *American Institute for Economic Research* recently reported that "business-cycle conditions paint a picture of a steady recovery that is likely to continue."

Total Return as of 3/31/2012

	March	4th Qtr	YTD	Last 12 Months
PORTFOLIOS**				
60% Equity	1.8%	5.1%	5.1%	9.3%
40% Equity	1.3%	3.4%	3.4%	7.5%
STOCKS				
Larger-Cap	3.7%	10.6%	10.6%	13.8%
Smaller-Cap	4.7%	12.8%	12.8%	18.0%
International - Developed Mkt:	0.8%	2.9%	2.9%	8.5%
International - Emerging Mkts	-1.5%	-2.7%	-2.7%	1.4%
Real Estate	2.9%	8.0%	8.0%	14.7%
Inflation Hedges*	1.0%	2.6%	2.6%	0.4%
BONDS				
Investment Grade Bonds	0.1%	-0.1%	-0.1%	3.7%
Emerging Local Market Bonds	-3.3%	-0.2%	-0.2%	6.9%

Each asset class is represented by a relevant Vanguard Index fund except for Inflation Hedges where the Morningstar Category average for* *"Natural Resources"*** *is used, and for Emerging Local Market Bonds where* ***PIMCO Emerging Local Bond*** *is used.*

***Each portfolio is represented by a Vanguard Lifestrategy Index fund.*

Looking ahead, significant uncertainty surrounds fiscal and monetary policy in terms of what policies will be adopted and their ultimate economic and financial market impacts. More broadly, still-high global debt levels pose economic difficulties.

We continue to find emerging-markets stocks attractive, both relative to U.S. stocks and in absolute terms.

Most parts of the bond market offer paltry longer-term return potential particularly given our expectation for rising rates over the next five-years. We continue to favor flexible, diversified, and actively managed bond funds.

Inflation seems poised to accelerate. With the money supply ballooning, everyday prices rising faster than CPI, and the bond market showing signs of expected increase in inflation, there is obvious upward pressure on prices that will likely accelerate into the future. However, there are no signs of runaway inflation.

What Now for U.S. Stocks?

With U.S. stocks hitting new highs, we are naturally getting two questions from clients:

1. With stocks up so much, shouldn't we reduce our exposure (to lock in gains, given all of the big picture risks)?
2. With stocks up so much, shouldn't we increase our exposure (since the economy must be much better than people expected)?

There are two facts that must be considered prior to answering these questions. First, expected returns are lower after the market has climbed. This supports reducing equity exposure. However, the second fact is that no one knows how long the rise will continue. Even if this were to continue as a period of "irrational exuberance", **the market can remain irrational much longer than most investors can remain disciplined**. Because there is an unusually wide range of possible outcomes for economic fundamentals and hence the market, it is even riskier than ever to attempt to outguess the market.

A wise man once said, running inside a moving bus won't get you to your destination any quicker.

So, what do you do? Accept that you can't consistently time your equity exposure. Rebalance. Dollar-Cost-Average (new money into the market). Diversify.

Investment Outlook & Review ~ continued

Uncertainty with Government Policy
A major contributor to the uncertainty we face in today's environment surrounds government policy, both fiscal and monetary, specifically what policies will be adopted as well as their ultimate economic and financial market impacts.

With respect to **fiscal policy**, in the first quarter, the markets digested the sequester's spending cuts without much drama. But the sequester's impact (estimated at around a 0.6% hit to GDP growth in 2013) is small potatoes compared to the debt and fiscal policy challenges that still confront the nation. Although we would agree that there is not an immediate federal budget deficit crisis, and that there is a real risk of snuffing out what remains a weak economic recovery with too much near-term fiscal austerity, there is clearly a debt/deficit crisis. This calls for a strong and credible longer-term fiscal policy response, and the sooner the better. We won't hold our breath. It may yet take a crisis to create the political will necessary to implement meaningful structural fiscal changes.

The NAHB-Wells Fargo Housing Market Index is a monthly survey based on the reponses of NAHB members. Respondents rate: present market conditions for new home sales, expected market conditions for new home sales in six months, and traffic of prospective new home buyers. Data as of 28 February 2013. Source: National Association of Home Builders.

On the **monetary policy** side, there is more clarity. The leadership of the Federal Reserve continue to be very vocal in stating that the Fed is not close to starting to unwind their stimulative policies, which involve purchasing $85 billion per month of Treasury bonds and mortgage-backed securities (i.e., quantitative easing) and holding the federal funds' policy rate near zero percent. But there is significant uncertainty as to the medium- to longer-term ramifications and unintended consequences of these policies.

Housing. The housing market is strengthening, although mortgage lending to households remains tight, and household wealth is growing, driven by stock market and housing price gains—a key goal of the Fed.

Update on Bond Markets. The big-picture bottom-line is that the fixed-income marketplace, particularly the highest quality parts, continues to offer paltry longer-term returns given our expectation for rising interest rates. Most areas of fixed-income are trading at historically elevated prices, and yield levels are at or near historic lows.

What this means in terms of our fixed-income positioning is that our balanced portfolios remain underweight to core investment-grade bond funds. In their place we have large allocations to flexible, global, and inflation-protected bond funds that we expect to outperform the core bond index (and core bond funds).

Concluding Comments
Investing is a marathon, not a sprint. The key is to maintain discipline. It is easier to see the longer-term with far greater confidence, and invest accordingly, but realizing this demands the discipline to ignore inevitable shorter term gyrations that are impossible to predict with consistency. Succumbing to the temptation to jump into "what's working" based on a recent run of outperformance is a path to disappointment and subpar long-term investment results.

As always, we will continue to work our hardest to make the best investment decisions we can on your behalf.