



MALLARD ALERT

PAUL S. BAUMBACH — MANAGING PARTNER —
INVESTMENT ADVISORY DIVISION

273 EAST MAIN STREET, NEWARK, DE 19711
(PH) 302-737-4546 - (FAX) 302-397-2675
PAUL@MALLARDADVISORS.COM

What to Do—October 23, 2008

Paul S. Baumbach

As I began writing this, the US stock markets are beginning to open, much lower. The Dow has already fallen almost 2,000 points lower (21%) than it stood when I wrote my last Market Alert on September 19th. So what can I say today?

Mutual fund manager Ron Baron in late 2002 said: “Investing is funny. When a store puts on a 40-50% sale, people flock to buy the discounted merchandise. When the investment markets put on a 40-50% sale, people compete with each other to sell.”

Warren Buffett last week wrote an op-ed in the New York Times, titled Buy American. I am. He writes: “Let me be clear on one point: I can’t predict the short-term movements of the stock market. I haven’t the faintest idea as to whether stocks will be higher or lower a month — or a year — from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.”

Conference Call Announcement
Thursday, October 30, 2008
8am and 5pm
Dial-in number:
toll free 888-617-3400
Passcode: 391648

An advisor wrote to their clients: “If only we had a crystal ball in our arsenal, we would have sold every portfolio to cash or Treasuries early last October (and you probably would have fired us for doing so during such a great market with a strong outlook). Truthfully, THAT was the time to go to cash. Not since. Not now.

Going to Cash is Guessing. You did not hire us to ‘guess’ with your investment portfolio. We have always maintained that if you want to ‘guess’ with your money, go to Las Vegas. You’ll have much more fun losing everything and probably have a nice last meal to boot.

Waiting out a bear market in cash sounds like a great idea, but without the crystal ball, is among the worst possible investment advice.”

This morning US stock markets are down 40% year-to-date, and foreign markets are down 50%. Normally stable bonds have failed to provide gains to lessen the pain. Broad taxable bonds are down about 2% while municipal bonds are down about 3% year-to-date. The current level of pessimism and prices was likely last seen in 1974, during the worst of the oil embargo.

What are WE Doing? We are communicating a great deal with clients, in writing, in person, by email, on the phone. We are reading a great deal. We are making recommendations for our clients.

This month we are sending quarterly reports to half of our clients (the other half received their reports last month). This month we are generally including two sets of recommendations. The first set contains ‘upgrades’, replacing stocks and funds that have been disappointing and replacing them with (hopefully)

Market Crisis—Why not surrender?

superior investments. The second set identifies a few changes which would boost their allocation to stocks by 3-5%, for clients who accept our view that we have a once-in-a-generation opportunity to purchase stocks at incredibly low prices. We won't make this second set of changes without our client's explicit approval.

What should YOU do? Last month I wrote about the three steps to take if you (like most investors) are very nervous. The second step is to do nothing. I would like to amend that.

We build client portfolios with cash and bonds. We do that for several reasons, including to smooth the results. I would like to emphasize two additional reasons to have bonds in your portfolio.

You hold bonds and cash to permit you to meet your cash needs during weak stock markets, without selling stocks. While you may be already retired, or close to retirement, this doesn't mean that you are spending your entire portfolio this year and next. You are likely withdrawing no more than 5% of your portfolio a year. If you had 25% in bonds at the start of the year, this means that you could wait five years for the stock market to recover before you would be forced to sell a single share of stock or stock mutual fund. Your bonds and cash permit you to ride out awful markets.

A limited number of investors, including myself, see cash and bonds as 'dry powder', a place to store money safely, so that we can bring it out to take advantage of today's incredible bargains.

We have introduced a new program for smaller investors with IRAs and with retirement plans from past employers. I used myself as the first guinea pig, moving all of my IRA money into this new program. I initially set my allocation to 70% in stocks, and 30% in bonds/cash, based on my personal risk tolerance. During this market crisis, I boosted the stock allocation up to 80%, and next week I will shift it to 100% in stocks. I am 46 years old, and I do not plan to pull the first dollar out of this account for twenty or so years. I would like to avoid any regret years from now that I did not take adequate advantage of the low current stock mar-

ket values available today.

I do not mean to imply that I feel that conditions are rosey. Pam and I have postponed home projects and vacation plans, reducing our spending where we can. I expect the US economy to continue to weaken for at least six months. I do accept the possibility/risk that it will take more than a year for the economy to begin to recover. The impact of the tremendous steps already taken by the US and foreign governments, and those not yet introduced but which will come, will definitely take time to see concrete benefits. What I reject is the belief that globally, we will not eventually work our way through this.

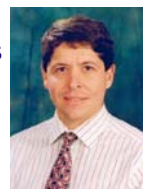
It will take time, but I have time. You do, too.

Consider your retirement, when you withdraw money regularly. At what point will you reach the half-way point, spending the 'middle' dollar of your retirement savings? If I live to 85, I may spend my middle dollar thirty-years from now. I want that dollar to benefit from today's extremely cheap stock prices. If you are 65, that middle dollar likely has at least ten years. This doesn't address the likelihood of passing wealth onto our children and grandchildren, in which case that middle dollar will be hard at work for even longer.

We invest our clients' retirement savings very deliberately. We set a long-term target for stocks, and for bonds/cash. The bonds/cash is ready, willing, and able to meet your cash needs, while we all await the recovery of the stock markets.

I have quoted Yogi Berra before: "Plan your play and play your plan." In wrenching times like today, it is even more critical that you review your plans. Let your plans reassure you that you are prepared to weather this terrible storm.

Warren Buffett has invested billions of dollars in stocks earlier this fall (at higher prices). I'm not going to sell my stock funds while Buffett buys. Are you?



Paul Baumbach is the managing partner of Mallard Advisors' Investment Advisory Division