



# MALLARD ADVISORS, LLC

# THE MALLARD FLYER

WILLIAM D. STARNES – MANAGING PARTNER –  
FINANCIAL PLANNING DIVISION

PAUL S. BAUMBACH – MANAGING PARTNER –  
INVESTMENT ADVISORY DIVISION

1041 VALLEY ROAD, HOCKESSIN, DE 19707  
(PH) 302-239-1654 - (FAX) 302-397-2675  
BILL@MALLARDADVISORS.COM

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

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## Notices

### Newark Office:

The Newark office will be closed on Tuesday May 18<sup>th</sup> for software training in Philadelphia. Paul will be in Chicago at the NAPFA National Conference the rest of that week. Paul will be in New Orleans from June 19<sup>th</sup> to 26<sup>th</sup> for a youth service trip with his church. Pam will be on vacation in Stowe, VT, the following week. Ed and his wife Patti will be vacationing in North Myrtle Beach from May 8<sup>th</sup> to 16<sup>th</sup>. The Newark office will be closed on May 31<sup>st</sup> and on July 5<sup>th</sup> for the holidays

### Bill's Schedule / Hockessin Office:

The Hockessin office will be closed on May 31<sup>st</sup> and on July 5<sup>th</sup> for the holidays.

### Next Newsletter:

The next newsletter is scheduled to be delivered in early July 2010.

## The Oracle of Omaha Looks Back

Paul S. Baumbach

Warren Buffett has led the Berkshire Hathaway company since 1965, and during that time the S&P 500 including dividends has grown 5,430%, while Berkshire's book value has grown 434,057%. In addition to successfully managing a conglomerate worth hundreds of billions of dollars, he annually puts pen to paper to share some of his wisdom in his annual letter to shareholders. In this letter Buffett was able to review the Great Recession and market crash. I put pen to paper to share the crème de la crème of his letter.

**Fight the Crowd**—Buffett is a value investor. He focuses on how much a company is worth, and on not paying too much for it. He doesn't speculate—buying a hot, overpriced company, relying on finding someone foolish enough to buy it in the future for a higher price. Highlighting his contrarian perspective, Buffett discusses “the chaos of the last two years. It's been an ideal period for investors.” If your investing approach required being able to find someone to buy your stocks during the last two years, then you weren't in heaven—you were in the other place.

In Mallard's January 2010 newsletter, I mentioned a scene from “It's a Wonderful Life” in which Mr. Potter is buying in the face of a run on the bank. Well, Warren Buffett ‘pulled a Potter’ during the crisis, spending \$15.5 billion dollars for investments in companies that fearful investors were avoiding like the plague. This is exactly how value investing is done. Few practice it better than Warren Buffett.

Having worked with Mallard clients through two very bad stock markets, I have learned that while it is quite difficult to ‘pull a Potter’ and buy a lot of stocks during the chaos, it is even

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## Mallard Announcements

### Money School Classes

Bill will be presenting one Delaware Money School class this quarter. It is titled **2010 Roth Conversions** and will held at the Lamborn Library (the first floor of Bill's building) on Tuesday, May 4th, at 6:00 pm.

Paul will also be presenting a class titled **Inflation: How to Fight It and Whether to Fight It** on June 9<sup>th</sup> from 6:30-8:30pm at the Newark Senior Center. If you would like to attend either of these classes, please call the respective office.

## The Oracle of Omaha ...continued

harder to convince someone else to ‘pull a Potter.’ This is one reason why I have created the Firewall Investing model, in which, rather than trying to ‘pull a Potter,’ I strive to have clients avoid the mistake that the vast majority of investors (and a disturbing number of professional advisors) make, by selling stocks during a bad market.

**The Proper Role of Cash**—It is hard to accept that Warren Buffett, from September 2008 through February 2009, truly felt that times were ideal. I know that I didn’t. But then Buffett hordes cash. He notes that, “We pay a steep price to maintain our premier financial strength. The \$20 billion-plus of cash equivalent assets that we customarily hold is earning a pittance at present. But we sleep well.” Note that Buffett customarily maintains a solid cash cushion—cash isn’t something that he runs to when stocks fall (quite the opposite—he puts cash to work buying stocks when they fall). Instead he maintains enough cash to handle normal times, enough cash to carry his enterprise through rough times, and also enough cash to serve as ‘dry powder,’ to be able to act on exceptional opportunities that invariably arise during tumultuous times. As his cash is called to serve all three of these functions, he readily accepts the occasionally miniscule earnings that cash provides, for earnings power is the last function of cash within an investment portfolio.

**Reaching for Opportunities**—Stocks weren’t the only area with good value opportunities in the past two years. Buffett found that at one point corporate and municipal bonds were “ridiculously cheap relative to US Treasuries. We backed this view with some purchases, but I should have done far more. Big opportunities come infrequently. When it’s raining gold, reach for a bucket, not a thimble.” We also identified a “ridiculously cheap” investment during the chaos—high yield (aka junk) bonds. We bought a bit for many clients, but, like Buffett, we failed to reach for that bucket.

As with most of what Buffett discusses, this strategy is easier said than done. Investments get cheap for real reasons. Municipal bonds became cheap due to serious

concerns about whether municipalities could meet their financial obligations as tax revenues were plummeting. Junk bond yields were climbing due to concerns about whether financially weak companies could meet their obligations “when the financial system went into cardiac arrest.” It is exceptionally difficult to reject the consensus views, and reject them with a bucket when a thimble feels so much better.

**Who’s to Blame?**—Buffett has rarely minced words when pointing out what he feels are the problems with corporate America. In this year’s letter, he lays the blame for the financial crisis squarely on corporate leaders’ laps. He laments that it is the shareholders, not the CEOs and board members, who have “borne the burden” from the financial industry meltdown, and yet the shareholders deserve little if any of the blame.

“A board of directors of a huge financial institution is derelict if it does not insist that its CEO bear full responsibility for risk control. If he’s incapable of handling that job, he should look for other employment. And if he fails at it – with the government thereupon required to step in with funds or guarantees – the financial consequences for him and his board should be severe.” Later, “they should pay a heavy price – one that is not reimbursable by the companies they’ve damaged nor by insurance. CEOs and, in many cases, directors have long benefitted from oversized financial carrots; some meaningful sticks now need to be part of their employment picture as well.” Investors should take the time to become informed about the financial industry reform being considered in Congress. Pay particular attention to these sticks. Ignoring this development can be hazardous to your financial health.

Investors should also take the time to learn from Warren Buffett’s experiences. His is a sterling example of being fearful when others are greedy, and being greedy when others are fearful. This lesson, well learned, can lead to a very financially healthy life.

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*Paul Baumbach is the managing partner of Mallard Advisors’ Investment Advisory Division.*



You can't simultaneously ACT rich and BECOME rich. If you are NOT financially independent already, then stop acting like you are...and start living in a manner that is congruent with your means. If you want to be rich, you need to stop acting rich. These are the straightforward statements of Thomas Stanley from his recent book titled "Stop Acting Rich and Start Living Like a Real Millionaire". His research demonstrates that millionaires are not who you think they are and they don't spend their money the way you think they do.

### Who Are Real Millionaires?

What occupations result in the most millionaires? Attorneys? Doctors? Not quite. In fact, it is these two groups that have the most trouble converting their income into wealth. Why? Because with their high occupational status comes an *expectation* of a certain standard of living. This standard of living includes the purchase of expensive high prestige items. The result is a lifestyle that does not result in enough savings to build wealth. Income is not wealth. Doctors and attorneys may have a high income, but generally don't convert this income into wealth as efficiently as others. Specifically, only one in four high income doctors have an investment portfolio valued at over \$1million. So, who does?

The most financially independent occupational groups are teachers, engineers and business owners. In my own experience evaluating the financial security of clients, I can certainly confirm his findings. I am always intrigued by the fact that teachers are generally financially independent. How can this be? They live beneath their means (as a result of a lifetime of modest income) and retire with attractive inflation-adjusted pensions. There is no peer pressure for teachers and engineers to buy expensive suits, or drive prestigious automobiles. In fact, the opposite may be true.

You will have a much better chance of becoming wealthy if you don't emulate the consumption habits of those with high occupational status and in-

stead do what real millionaires do.

### Real Millionaires Consumption

So, what are the consumption habits of real millionaires?

Automobiles: The median purchase price for a car among millionaires was \$31,367. Real millionaires don't drive BMW's, they drive Toyota's. Why would an engineer who is far more interested in function, reliability, and quality, than style and prestige, buy a Mercedes? They wouldn't.

Homes: 90% of millionaires live in homes valued at less than \$1 million dollars.

### Possessions & Happiness

In fact, spending like you are rich (when you are not), or having more or bigger things does NOT lead to an increase in long-term happiness with life. In fact it is those who have *stretched* themselves into house payments and car payments who are the most unhappy – financially speaking.

According to Stanley, if we want true financial independence and financial happiness, we should focus our efforts in the following three areas ?

1. Be skeptical of high consumption
2. Choose your friends wisely
3. Be true to who you are

Doing these things will help to avoid traps, and build wealth so that it can be used in a way that brings lasting financial happiness.

### Be Skeptical of High Consumption

Be very skeptical of what consumption really buys. Most readers have probably been pretty excited by a new car purchase. However, how long after the purchase did it take for that new car smell and excitement to fade? In my family, with three boys, the new car

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smell lasts only two weeks. While there is that short-term happiness rush, those feelings fade quickly. We should not be jeopardizing our financial futures for the **fleeting euphoric rush** of a new purchase that we can't afford anyway.

If you are not living in poverty, then the odds that having more income will make you happier are close to zero. Studies have shown that members of the Forbes 400 are no happier than the Amish (with their rural lifestyle), or the Maasai (who herd livestock in the plains of Kenya). How could this be? **Answer:** When everyone you know is about as poor as you, there is less likelihood of envy. That brings me to the second area Stanley suggests we focus on.

### Choose Your Friends Wisely

It is sad, but true.....studies show if you want to be happy (financially speaking), then surround yourself with others who earn less than you. It is not how much money we have, but it is our *relative* wealth and income compared to our peers that impact our happiness.

There is a reason the Ten Commandments end with "Thou shalt not covet". Always wanting more in order to keep up with those who have more makes people very unhappy because they end up spending more than they should on things they can't afford. It is the selection of a neighborhood that ensures we don't make our peer group one that we struggle to emulate.

**For Example:** Imagine two situations in which you earn the same amount of income and buy the same cost home: In the first situation, you buy the most expensive house in a middle class neighborhood; in the second situation, you buy the least expensive house in an affluent neighborhood.

Where will you likely be happier? It will be the middle class neighborhood where your neighbors will not be constantly outspending you. It is where your

"relative" wealth and income will be higher than your peers. In fact, you will also become wealthier quicker as you won't be wasting the dollars you should be *saving* on expensive status symbols in order to keep up with the more affluent JONES. Instead, you will be converting your income into wealth through saving.

The larger house in a more affluent neighborhood is an illusion of happiness and wealth anyway. In general, the one thing a big house tells you about the person living in it is the size of their mortgage.

The true cost of living in homes and neighborhoods which extend you beyond your financial limits are unseen and devastating.

So, one of the most important things we can do is: **Buy an easily affordable home**. Nearly three out

of four of those living in expensive homes are not really wealthy. How can this be? Access to credit does not equal wealth.

### Be True to Yourself

Finally, living beneath your means is also honest. You are being true to yourself and who you are. How do you know if you are living beyond your means? If you have more than one dollar of REVOLVING credit card debt, you are living beyond your means. If you do, stop using them. Credit cards only make it easy for us to spend money on things we don't need and can't afford.

Each of us (including myself) should ask ourselves, "Wouldn't I be wealthier and happier if I stopped acting rich". Of course we would. What a sense of relief to dispel the illusions of income versus wealth. Never forget: it is nearly impossible to act rich and become rich at the same time.

**"Know first who you are; then adorn yourself accordingly."  
- Euripides**

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*Bill Starnes is the managing partner of Mallard Advisors' Financial Planning Division.*

