2018 Market Volatility, Credit Card Debt, Bernie Madoff - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 235. I'd like to start by introducing my co-host, Brendan Mullooly. Say a few words.

Brendan Mullooly: A few words.

Tom Mullooly: Thank you very much.

Brendan Mullooly: You knew that was coming, right? You set me up for it.

Tom Mullooly: I'm Tom Mullooly. We are recording this the second week of December 2018. I don't know about you, but I am happy this year is coming to a close.

Brendan Mullooly: Why?

Tom Mullooly: I am getting really tired of this volatility in the market and all the drama that comes along with it.

Brendan Mullooly: That's interesting because I actually have some numbers from a post that Ben Carlson wrote recently referring to the volatility that you are tired of. Since 1950, the average entry year draw down on the S&P 500 is 13%.

Tom Mullooly: So, as we tell our clients, you should come to expect a 10% draw down on average about once a year.

Brendan Mullooly: Right. He broke it down further and looked at the percentage of years and then looked at each year in terms of where the max draw down was.

Tom Mullooly: So, at what point in the calendar year?

Brendan Mullooly: Yeah, it looked at the percentage of calendar years with a less than 5% draw down. 7%. The percentage of calendar years-

Tom Mullooly: So, wait a minute. I'm just going to hit the pause button. So, we have a year like 2017 where the market really didn't go anywhere.

Brendan Mullooly: Yeah, you're stealing my thunder.

Tom Mullooly: I'm sorry. I'm sorry, but that was the exception.

Brendan Mullooly: Yes.

Tom Mullooly: Not the rule.

Brendan Mullooly: Meaning I agree that it may feel worse this year because we have had probably super normal stock market volatility this year in 2018, but we did not have it last year. Last year was the first time in history that every month in the calendar was positive for the S&P 500. That is abnormal, but we all got used to it. Just to wrap up-

Tom Mullooly: I can get used to chocolate cake every day.

Brendan Mullooly: Sure. Right. That would be great. Just to wrap up these numbers from Ben to give people an idea, the percentage of calendar years with a less than 5% draw down, 7%. Between 5% and 10% draw down, 39%.

Tom Mullooly: I was going to say 90. I mean, you would think, we should get a 5% or 10% pullback every year, but only 39% of the years.

Brendan Mullooly: Right, because it's only between 5 and 10.

Tom Mullooly: Between 5 and 10.

Brendan Mullooly: Some of them turn into more.

Tom Mullooly: Okay, got it.

Brendan Mullooly: Between 10 and 15 is another 23%, so between those two. Between 5% and 15% is 70% of all years roughly. Then between 15% and 20% another 15% there, and 15% of all calendar years have a greater than 20% draw down. Now it's easy to look at these numbers and to say, "Sure yeah. 15% of all calendar years have a greater than 20% draw down."

Tom Mullooly: I like my odds.

Brendan Mullooly: I'm cool with that.

Tom Mullooly: I like my odds.

Brendan Mullooly: But then when it happens, it's a different story.

Tom Mullooly: I don't like my odds.

Brendan Mullooly: I'm not saying that anyone should be berated for having feelings in the heat of the moment, but to not put things in perspective and remember that even moves like that are within the completely normal realm of possibility, I think is setting yourself up with expectations that are unrealistic.

Tom Mullooly: I think there's something else that we almost have to staple what I'm about to say to this part of what you just said. I think it has to come along with all of these draw down conversations. Where's the Dow? 25000. So, 2% on an index like that is 500 points in either direction.

Brendan Mullooly: It feels crazy when you have down days especially, but up days too, in terms of the emotions that these moves invoke. When you see these giant point totals, it drives you nuts, or it can make you leap to conclusions that you do not need to, whether it's to the downside or the upside. To get excited by a 600 point up day or a 600 point down day, these are normal occurrences now based on where the Dow is when obviously ... We would prefer that people look in percentage terms, but that's not how the world works. Everybody looks at Dow points, and that's fine. I'm not going to shame people for doing that.

Tom Mullooly: I think what's also being overlooked are these intraday swings that are going on as well. We've had a couple of days even in the last two weeks where the market has been up or down triple digits and then swing the other way in the middle of the day.

Brendan Mullooly: It could drive you nuts. You set your emotions based on whatever the gap up is. Gap up or gap down in the morning. Set your feelings for the day and then you check back at four o'clock and we're flat. We're the opposite of whatever we were in the morning, and that could drive you nuts or it could be completely irrelevant to you. If you've Rip Van Winkled this year and just woke up after going to sleep on January 1st, we're flat. It feels worse because we had gains for the year that are now gone. I get that. It makes perfect sense. We can't just forget that that happened in the past.

Tom Mullooly: I'm just wondering if we could find out how many years in the market, say in the last 50 years, where we had a gain and then had a 5% draw down or a 10% draw down or a 15% draw down. So, what started out maybe in the first part of the year was like a 12% gain and now it's a 3% loss, that's a 15% drop from the highs, but it only gets registered in the history books as a 3% drop.

Brendan Mullooly: I mean, that's all about perspective and how often you're checking it.

Tom Mullooly: I got an email today. I get them all the time, and you do too. Clients complaining that ... not complaining, but just they're stating that they're down 10% or 12%, but they're measuring from the high. I don't know how they can scientifically figure out today is the high. I'm logging in. I'm looking at my account and I'm locking it into my brain as this is my money, and it's not.

Brendan Mullooly: I mean, as long as it's invested, it's going to be subject to whatever's happening in the market. That means we're going to be, if we're looking every single day, coin flip. You're going to be happy some days and you're going to be unhappy others because you're going to be lower than you normally were. I don't have numbers or a source to cite for this, but I also saw recently, and I think that it was Michael Batnick who shared something that looked at how often the market is actually making new highs, which our opinions may also be skewed with recency in this regard. It's about 90% of the time the market is not making new highs, but we were spoiled last year with-

Tom Mullooly: New high.

Brendan Mullooly: Dozens and dozens of new highs.

Tom Mullooly: At least one every month.

Brendan Mullooly: Again, that was not the normal part. This is the normal part, where we move sideways for a calendar year. I think sideways markets, while they may not register for people who simply just do not check in. For people that do, can force just as bad behavior as a straight up draw down because when we're in a sideways phase, you have this whole spectrum of emotions where you get giddy after two up days in a row and then dejected after two down days in a row. If you act upon those emotions, you're just going to be in and out. I don't know. That's tough.

Tom Mullooly: Yeah it is tough.

Disclaimer: Tom Mullooly is an investment advisor representative with Mullooly Asset Management. All opinions expressed by Tom and his podcast guests are solely their own opinions and do not necessarily reflect the opinions of Mullooly Asset Management. This podcast is for informational purposes only and should not be relied upon as a basis for investment decisions. Clients of Mullooly Asset Management may maintain positions in securities discussed in this podcast.

Tom Mullooly: We both noted a story that we saw on CNBC about the average credit card balances around the 50 states.

Brendan Mullooly: Yeah, I'll share some numbers from that post. The average credit card debt in the US was about $8000. $8100. What this article did was it looked at the median household income in every state and then assumed that you were going to be really aggressive in paying down your credit card debt, and channel 15% of whatever that household income was towards the average credit card bill in the state, and it calculated based upon that, the average number of months needed to get rid of it at that rate, which I agree is pretty healthy to take 15% of your income and channel it towards one source like that. For almost all states, it was 10 plus months, and some stretching closer to the end of 20 months, in terms of how long it would take to pay off the credit card debt at that rate.

Tom Mullooly: It's not forever. I mean, it can be manageable. I think the first thing I was always told was, "When you're in a hole, stop digging." I think the problem for a lot of folks is they get conditioned on a monthly basis. That expense goes on my Visa card or that expense goes on a credit card, or when we have an emergency, it's going on a credit card because we don't have the savings or we don't pay for that out of cash. I think the gateway drug for all of this is points. Hey, I can put this all on my credit card and just pay the bill at the end of the month. I'm going to get points, so I can go on vacation and get more points.

Brendan Mullooly: Yeah, the rationalization. I get if you do it responsibly, then it does seem like you are gaming the system, and you are, but the reason I think that they offer deals like that is because the vast majority of people are subsidizing the very few who can do it responsibly. If one person can rack up points and pay off the balance at the end of every month, then go on a free vacation every year because they have credit card points, that's great, but there are probably

20 more carrying a balance on the card at like 20% interest. So the card company doesn't care that Joe Schmo gets to go to Hawaii with his family with them footing the bill.

Tom Mullooly: Everyone else is paying for it.

Brendan Mullooly: Yeah. It's not great. I know you have strong feelings about when somebody pays down debt, how they should go about it. I was wondering if you wanted to chime in with some of that.

Tom Mullooly: I think this is important because we've seen this happen in our own practice where clients will come in. They receive a large influx of cash, inheritance, property sale, I hate to say it, distribution from a 401(k) before they're reaching retirement age. They're using this as a financial bailout. They take that lump sum of cash and they say, "I'm going to pay off my credit card. I'm going to pay off a car loan. I'm going to do this now. I'm going to put a new kitchen in my house. I'm going to do all of this stuff." Invariably, I have now after 30 years, I have pegged this down to somewhere between 24 and 30 months. Those people will be back in the same position they are today. They got this bailout. They didn't change their habits. Now they are sliding right back into the same problems again.

I think it would be much more beneficial, like when you start an exercise program or go on a diet, it's great to see very small changes at first and then larger changes as you go forward through the program. The whole idea is if you've got, I don't know, $20000 in credit card debt, if you were to take that and pay it down $800 a month over two years, you are going to see progress on a monthly basis. You're going to get something in the mail every 30 days that reminds you you're on the right track. You're doing the right thing. It's positive reinforcement. Then when you get closer to zero, it's like, dammit I want to be done with this thing, and you finish it off, and you're done. There's something that happens in our brain. I don't know the scientific term, but it triggers a feeling that says, "I'm never going to do that again."

It doesn't work for everybody, but the people who go through that usually, I hate to use the term, but learn their lesson. But that's kind of what happens. They're like, "I'm never going through that exercise again. I've learned that if I do get into trouble I can get out of it. That's a big hole that I got out of."

Brendan Mullooly: Yeah, not to wax philosophical here, but the process is almost more important than the outcome there, the getting rid of the debt. It's the lesson that you learn in doing that or the changes that it takes to make that happen. Then I agree that being able to look in hindsight and say that you did something, it gives you a sense of pride. That's right. It's well deserved when you make a change and you can celebrate your progress after a length of time. That in itself keeps you coming back for more. It's the incentive in itself to continue what you're doing and maybe even do more.

Tom Mullooly: Sure. It's interesting to see how people's perception of things change as they start making progress towards their goal, and they're paying down debt, and they're starting to actually gain a little velocity, a little momentum in paying down their debt. That can also work in the same way in reverse. Many times we get into these discussions with clients, like in the side door, because they'll say, "Well I want to pay this off because I have a really high rate of interest. I'm paying 14% on that credit card." Or, "I have this loan that I'm paying 8% on and I know I can refinance this at a lower rate."

Brendan Mullooly: Or like a balance transfer or something.

Tom Mullooly: Oh, brother.

Brendan Mullooly: I can get a teaser rate where if I transfer my credit card balance from this company to that company, I have no interest for the next 12 months, so it's like a kicking of the can ceremony.

Tom Mullooly: It really is.

Brendan Mullooly: People love that kind of stuff though. It's the tactics like that that will get people to click on articles or will capture peoples' interest because it seems like it's a shortcut.

Tom Mullooly: They think they're being smart.

Brendan Mullooly: Yeah. I don't want to say that it always isn't. Maybe somebody does do a balance transfer and takes those 12 months to come up with a genuine plan to pay it down, and then they didn't pay interest over this 12 months while they made the change. That's great, but I think most of the time it's being used as a mechanism to not pay attention.

Tom Mullooly: I think the other part of this ... I agree with everything you're saying, but the other part of this is people get hung up on the nominal rate that they're paying on the interest. The fact of the matter is if you're making minimum payments, your interest is already factored into that number. If you're paying more than the minimum, that interest is already factored into it.

Brendan Mullooly: Just to interrupt for a second with a stat from this article, somebody interviewed based on all those numbers we shared before, said that to people who are only paying the minimum on that average balance that they are literally going to be in debt for decades.

Tom Mullooly: Yes.

Brendan Mullooly: Just to quantify it. I'm sure that deep down that seems right to everybody and they probably know that. Not that that's an exact number, but hitting that minimum payment, you're not ... It's better than not doing anything, but man you're not really doing yourself a bunch of favors by doing that.

Tom Mullooly: You're only paying some of the interest and very little of the principle. If your credit card company says that you should pay a minimum of 3% of the balance, understand that, forget about compounding which will destroy you, but just using simple interest if you're paying 3%, it will take 33 years from this point forward to pay off just what you owe now. Forget about compounded interest going forward. People really don't understand this. The thing that I try to drive home with folks when we talk about these interest rates on debts and things like that. I'm like, "Don't worry about the interest rate. Don't worry about the rate. You're already paying. You're current on the loan, so there's no problem." The real problem, and I know we've said this in other podcasts and videos as well, the real problem begins when you stop paying on that loan because now it is compounding freely at 14%, 18%, 20%. Whatever the rate is. Now it's compounding and you are not doing anything to even alleviate some of the interest. That's when things really spin out of control.

If you're making small payments, at least you're staying current. You're not making much progress, but at least you're staying current. That's a real problem, and people get hung up on, I've got to get rid of that debt. So, they'll do this borrow from my 401(k) arbitrage which is just a load of hooey to, oh I'm paying myself to pay off some credit card, which is just a problem. You're not really getting rid of the debt. This goes right back to the last podcast or video that we did.

Brendan Mullooly: Yeah, I think a big thing here is there are a lot of I'll use the word optimal answers in terms of how you should pay off your debt. I know Dave Ramsey is a proponent of the debt snowball idea where you tackle the smallest dollar total debt that you have first and build from there because it gives you that mental victory that we were talking about before where you can completely get rid of one pile of debt that you have, and that gives you something to be proud of that's gone. Whereas the optimal answer would be, all right, well what is the highest interest rate and let's tackle that first. I think when you're trying to make behavioral changes like this, it may be a time to set aside what is optimal for what people are actually capable of doing.

It may be the same thing. It might not be a difference. But if there's a discrepancy between those two and you need to choose, I would just do whatever is easiest. Whatever the person is going to-

Tom Mullooly: The least path of resistance.

Brendan Mullooly: Yeah. If you can at least start by doing something along those lines, then you can maybe graduate to taking the habits that you gain, the experience you gain from that to do bigger and more beneficial things or more optimal things.

Tom Mullooly: Makes a lot of sense. Now I know a lot of people went into debt because Bernie Madoff ripped them off, and we are now 10 years this past week past that jaw dropping news. I remember sitting in my office seeing that come across the tape. I was like, "Are you kidding me? This guy was president of the Nasdaq."

Brendan Mullooly: Was it the kind of thing ... I guess, impossible to say in hindsight. If anybody knew, then maybe somebody would have called him out on it. But the kind of returns that that guy was promising to people and just saying ... Everybody assumed that their money was in the stock market. It wasn't that he was doing some exotic thing, like Rentech or something like that. He said he was investing in stocks and giving people guaranteed 10% returns a year, or whatever the number was. You feel bad for people who were tricked on that, but was there any vindication for people in the industry doing things the right way and not promising BS 10%

returns for people every year? Because that's ridiculous. It had to be infuriating to hear people even mention that anybody could do that because they can't.

Tom Mullooly: We lost business ... Not we. I mean me, early on in my career because people that I was prospecting to work with us as clients said, "We're with Bernie Madoff. You can't beat that." Yeah you look at this and of course hindsight has perfect 20-20 vision looking back in the mirror. I don't know. I think the most amazing thing now 10 years later is that Picard, the trustee who's been empowered to try and go collect this, is at the point where a lot of people are going to be made whole.

Brendan Mullooly: Yeah, they're getting back at least their original investment. I had seen that many have gotten back close to 70% of their original investment.

Tom Mullooly: That is pretty amazing.

Brendan Mullooly: I saw somebody trolling Hussman on Twitter, saying that returns from people over the last 10 years who lost all their money with Madoff have been better than the returns in Hussman's mutual funds, which is, you know everybody dunks on Hussman until the next market downturn when his funds magically go up a million percent. But even that at this point after such terrible returns, does it vindicate? I mean, if you're a broken clock, I don't think you deserve credit for being right twice a day. If you call for a crash every year, then I'd take your opinion and chuck it out the window.

This article with Madoff had this thing in it that I thought was hilarious. It sounded like it was out of a movie. The former CFO and office employees, I guess they testified that they had to create false documents for the FCC one time and they were basically just printing these things out as they were on their way to the office, and they put them into the refrigerator so that they wouldn't be hot. Then they threw them around the office like a football to make them look like they were worn. How ridiculous is that?

Tom Mullooly: Wow.

Brendan Mullooly: That sounds like something that was out of Wolf of Wall Street or something.

Tom Mullooly: Yeah, or Animal House. You know when they're stealing the biology test.

Brendan Mullooly: How crazy. Oh my gosh.

Tom Mullooly: That makes no sense.

Brendan Mullooly: I mean, it's not hilarious because a lot of people were really hurt by this, but oh my god.

Tom Mullooly: The extent that they really worked ... Just think about all of the effort that they had to put in to cook up this plan and then get all the statements and doctor everything up. I mean, there's an awful huge effort that they had to put in to get this to work. It almost worked completely. I mean, the guy was in his 60s. He probably could have walked away at that point. Now he's gone away for a long time.

Brendan Mullooly: That's what you get, I suppose.

Tom Mullooly: What can someone do to make sure that they're not getting sucked into another Madoff type of scenario?

Brendan Mullooly: Impossible to say because I don't think people are stupid. Plenty of very smart people were defrauded by Bernie Madoff.

Tom Mullooly: And people that didn't even know that they had money with Bernie Madoff-

Brendan Mullooly: Yeah. There were-

Tom Mullooly: Were involved in this.

Brendan Mullooly: Hedge funds. Hedge fund to funds. Feeder funds that had money with Bernie Madoff. So, people were hurt by the ripple effect here when they didn't even know that-

Tom Mullooly: They didn't even know they had money with him.

Brendan Mullooly: They could have seen the headline and been like, "Wow. Thank god I don't have money with that guy."

Tom Mullooly: Then find out that you did.

Brendan Mullooly: Guess what? I was personally affected as a Met fan because the last decade they haven't spent any money and used Madoff as a crutch to support that thesis.

Tom Mullooly: I read a couple of years ago that the owners of the Mets were involved in the clawback, so they actually ... Everyone 10 years ago learned what the term clawback actually means. The owners of the Mets were involved in the clawback, which they fought, but they also received money as a victim as well. So, they, I don't know exactly how it washed out.

Brendan Mullooly: I'm sure that that's how they would prefer it. They don't want anyone to know how much they gained or lost from all of this. But back to your point, I don't know. I think just broadly I would say if somebody is promising you returns from the stock market, I'll throw a blanket over that and say, "Run away from that person." That is not true. No matter how much you want to believe it, or how smart and smooth they sound saying it, that is not happening. If you get sucked into something like that-

Tom Mullooly: Run away.

Brendan Mullooly: I think that's a red flag that you're dealing with a fraud.

Tom Mullooly: It's hard to say what you're going to earn from year-to-year. There is no guarantee when it comes to this stuff. If anybody does say, "Hey we can smooth this out for you and get you an average X percent per year"-

Brendan Mullooly: Stock-like returns with bond-like volatility. Not happening. It sounds great. I mean, who wouldn't sign up for that, but the reason that you get stock market returns is because you deal with stock market volatility, not bond-like volatility.

Tom Mullooly: Well, we've certainly had plenty of volatility in the last couple of weeks. If you've got questions and you haven't been talking to an advisor or someone who's plugged into the market, feel free to get in touch with us. That's going to wrap up episode number 235. Brendan, thanks very much for joining us today.

Brendan Mullooly: Thank you.

Tom Mullooly: All right. We'll catch you next time. Thanks for tuning in.