Casey Mullooly: Hello and welcome back to the Mullooly Asset Podcast. This is your host, Casey Mullooly and this is episode 367. This week we're going to talk about a Wall Street Journal article by one of our favorite writers here in the office, Jason Zweig, and we're just going to jump right into it. Hope you enjoy.

Tom Mullooly: You want to talk about that article that Jason Zweig put out today?

Casey Mullooly: We're going to talk about what everyone else is talking about. I don't want to say the word, but I'm going to. Inflation.

Tom Mullooly: I've heard for 35 years that gold is the best hedge for inflation.

Brendan Mullooly: It was at one time in the 70s and ever since then it hasn't been so, I mean, yeah, whatever you say.

Tom Mullooly: I've also heard recently that-

Brendan Mullooly: Peter Schiff told me.

Tom Mullooly: I've also heard that crypto is an inflation hedge and I mean all of these crypto assets have just cratered in the last few weeks.

Brendan Mullooly: Yeah.

Tom Mullooly: I think for a lot of people, the best hedge that they have for inflation may already be in their investment account.

Brendan Mullooly: Yeah. Stocks. Right. Definitely. Yeah.

Casey Mullooly: I think we wrote a blog post about that the other week.

Casey Mullooly: Funny how that happens. Head on over and check that out.

Tom Mullooly: We'll link to it in the show notes.

Casey Mullooly: We'll definitely link that up. But uh, Jason Zweig wrote about a specific area of the inflation narrative that's going on lately, and that is T.I.P.S. Or Treasury Inflation protection Securities. So these are bonds that quote unquote fight inflation. And over the first six months of 2021, they brought in 36 billion in new assets, which is a record amount for T.I.P.S related bond funds.

Tom Mullooly: I would say probably without even looking, the next closest period of time where these investments brought in so much money was in March-of the first quarter of 2009.

Casey Mullooly: Were these around in the seventies?

Tom Mullooly: No, they were created in-

Casey Mullooly: So that's why gold did so well.

Tom Mullooly: Right? No, they were created in-in the nineties. They didn't really go anywhere. The first couple of years they came out. I actually bought them for clients, but we didn't have any inflation. And so they didn't really go anywhere and they returned less in terms of coupon than a regular treasury would. So they were really not fantastic investments, but they were safe.

Brendan Mullooly: I think people probably have had that experience more or less every time they bought them since then, because inflation has never really been that high since their inception. Expectations for inflation, those come around quite often, but the actual results of it and, and therefore the bearing out of T.I.P.S being valuable because of inflation. I don't, I don't know that that whole, that whole thing has sounded good many times since the nineties, but has it ever actually been good as good as advertised?

Tom Mullooly: It kind of ties in with-with what I was saying that people thought with all of this money printing and quantitative easing that was going on after 2008, that we would have massive inflation, hyperinflation, right? [inaudible 00:03:32] And so T.I.P.S saw, at the time, comparatively speaking, a huge inflow of funds. Nothing like what we're seeing now, 36 billion going into these. And it's not just T.I.P.S. There's a couple of these different inflation protected securities that you can buy.

Brendan Mullooly: Right, so these funds are offering or claiming to offer 6, 7, 8% yields. The point of, of Jason Zweig's post is to point out that those aren't really what you're getting. Those yields aren't-aren't real. So how do these funds, how are these funds able to advertise those types of yields when they're not real?

Tom Mullooly: This is really messy. And we talked about doing this on a video and I thought it was going to be a little too complicated to cover in a four minute video. And so we've got, you know, a little extra time to talk about this on a podcast, but the actual cash flow yield that you get is nothing compared to what's advertised as the S.E.C yield. And the S.E.C yield was created, I'm foggy on a date, but it was about 15 or 20 years ago to help show potential investors in funds. What the-what the return ought to be on these investments. Because there was a situation in the late eighties and through the nineties where bond funds in particular were advertising double digit returns. And people thought that they were actually going to get 11% from a corporate bond fund or a treasury fund because they were showing that the investors were getting a five, six or 7% coupon, plus the appreciation. You know, as bond rates go down, the value of the bonds go up. And so they tried to put this S.E.C yield together to differentiate what you actually ought to be getting in terms of your returns. And what's happening with these T.I.P.S is a little different.

Casey Mullooly: Could you, could you elaborate a little bit on that for us?

Tom Mullooly: So the- the whole idea of what's happening with the T.I.P.S is you get a certain amount of cash flow. It's not very sexy, and it's pretty similar to what you're going to get on treasuries, but the principle resets based on the consumer price index, based on the rate of inflation. And so what they're seeing is a principle reset and that's getting added into the S.E.C yield. And so while these T.I.P.S or different ETFs that invest in these treasury inflation, protected securities are throwing off maybe 40 basis points, 50 basis points less than 1% in terms of your cashflow, they're advertised with an S.E.C yield of 6%, 8%. I think one of them is nine.

Brendan Mullooly: So they're following the rules for how, how you calculate the sec yield, but it's not a perfect measure. And so that's why when you look at bond funds, mutual funds, ETFs in particular, you're going to see several different ways that they report to you the yield that you should be getting. And so this is one of them. And the reason there are several of them is because none of them in particular is perfect, in my opinion at least. So I think like the, the takeaway for me was everybody knows where interest rates are. And if you're seeing either fixed income investments or stocks with dividends that are significantly higher than market rate, it should be fishy to you. And there's going to be a reason why that is the case. And it's either going to be some kind of weird discrepancy with the math like this, or the fact that you're just taking an inordinate amount of risk to obtain a higher yield. There's no, there's no magic, 8% yielding securities out there on the market today. It's just not, it's just not, it's not possible. It's not happening.

Brendan Mullooly: It may feel like you found the-the secret bonds that still [crosstalk 00:07:53] can I just get a safe 8%? Yeah. I deserve a safe 8%. Where can I, where can I get that

Casey Mullooly: Safe 8. Get out of here with that.

Tom Mullooly: And, In many cases, the actual-when you measure the dollars that you get, your cashflow, it's negative, it's a negative return.

Casey Mullooly: It also speaks, I know we've kind of highlighted this before, but we're not owning bonds to collect 7- 6, 7, 8% or owning bonds as a buffer to our stock sleeve of the allocation.

Tom Mullooly: As I said to someone on the phone the other day, it's the reason why we own bonds. It's because it's bowling with bumpers.

Casey Mullooly: Alright. I like that. Some alliteration in there too.

Tom Mullooly: Thank you.

Brendan Mullooly: Yeah, but bonds are not the inflation hedge of your portfolio. And so I would just say like, we, like when things fulfill their role and it would be great to have a portfolio, like a piece of the portfolio that did it all, but that's not how it works. So stocks are there to hedge against inflation and to, and to make sure you get the growth you need for your plan to work, bonds are there to preserve principal and make sure that the account's not so volatile that you can't handle it and to fund cash flows that are coming up in the next few years. And that's why they married together, like peanut butter and jelly. Like they're, they're just great, great components of the portfolio there. And I think it's worth keeping that in mind, because if, obviously we could have something that did both of those, that'd be perfect. And we would invest in that all the time. But short of that, you need to pair things up appropriately.

Tom Mullooly: You mean like structured notes.

Brendan Mullooly: Oh, Jesus. Yeah. If some, if somebody is promising, it, it kind of reminds me of how we talk about like variable annuities. In many cases, it's like, okay, you have insurance and you have investments and they can both serve a role for a financial plan. People need to insure risks that they're not capable of otherwise bearing on their own. Great by insurance for that investments are investments. You invest for a reason. So do that and do not combine those two things. And so yeah, when you try to combine inflation, hedge and safety, I think you get the worst of both worlds, meaning like high fees and complexity and just garbage.

Casey Mullooly: Yeah. Very well said.

Tom Mullooly: I think when we, when we're talking about-again, I don't want to hijack the, the idea behind the podcast, but you know, when we're talking about things like annuities and structured notes and crazy stuff like that, if they were that great, why are they offering it to you?

Brendan Mullooly: And why are they paying somebody 5% to sell it to you

Tom Mullooly: In some cases, 9% to sell it to you. So it can't be that good.

Casey Mullooly: Yeah. You got to be on the lookout and it's, it's another, I'm Really beating the drum on what we say all the time here, but you got to know what you own. And you got to look under the hood and do your homework and ask questions and really pick apart these- these different types of securities, because they're not always as advertised. So you definitely got to be careful there. It's interesting though, because the S.E.C yield, I was going to make a joke while you were talking about that and say that, so that means that the S.E.C- it's stamped with the S.E.C's approval, right? Well, the S.E.C approved it, so that means it must be real.

Tom Mullooly: Wow.

Casey Mullooly: It's confusing though. And people probably think that people Look at it and they say, well, this has got to be the gospel, right?

Tom Mullooly: Because the S.E.C has basically said, this is how you calculate the returns, but it's extremely misleading to, to look at that. And so I was just about to ask the both of you, who do you think is buying these funds? Are these folks that are buying these investments, are they just people on own who are finding this and thought they've discovered a pot of gold or are these financial advisors who are luring people into this kind of stuff.

Tom Mullooly: Now I'm not saying that these things are bad. They're not, but-

Brendan Mullooly: they have a role.

Tom Mullooly: Yeah. But they're misleading in terms of when they cite return yields that are six, seven, 8%. That's just wrong. I'm sure there are some people

Brendan Mullooly: Buying it because of that. But I think, I think for the most part, people are buying tips because they think inflation is going to be high and they want to preserve their principal. And, and I, yeah, it's anybody's guess as to whether that will play out well for them or not, but I know how it's turned out for the last 30 plus years for people who have done that. So, I mean, maybe it'll be different this time.

Tom Mullooly: I think people in general tend to lose their minds when we start talking about inflation because they it's, it's invisible. They can't see it. The only place that they do see it is at the grocery store or at the gas pump, or when they're trying to buy a house and they see this-

Casey Mullooly: Or a used car.

Tom Mullooly: Right. So they see this price appreciation for no good reason. But you know, the point that we try to drive home with people is if you are investing in companies. Companies that can, yeah, they've got to pay their employees more money, of course, but they can also raise their prices to keep up with the cost of their materials and still maintain a healthy profit margin. That may be the single best hedge against inflation that you could fine

Brendan Mullooly: Agreed.

Tom Mullooly: But I think people forget that they're like we got to have crypto, we got to have gold.

Casey Mullooly: Stocks. Stocks are the way to go.

Casey Mullooly: And that's going to do it for episode 360 7 of the Mullooly asset podcast. We hope you got some good takeaways from this one. And we'll see you for 360 8.