Ep. 214: Buying vs. Renting, Kevin Durant, Annualizing Returns & more - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 214. 214, the Dallas episode.

Brendan: I don't get the reference here, so you're going to have to explain that one.

Tom Mullooly: I'm still getting flashbacks from my cold calling days at Lehman Brothers, so 214 is the area code for Dallas, Texas. So 213 was Los Angeles, 212 was New York City. 215, our next episode, will be Philadelphia.

Brendan: The things that stick with you.

Tom Mullooly: Yeah, so.

Brendan: it's like the Pythagorean Theorem.

Tom Mullooly: Something like that, right.

Brendan is here with me, and we are going to run through some of the headlines of the day. And put our own furious kind of spin on it. If you've caught some of these more recent episodes, we try and model this after PTI on ESPN, Pardon the Interruption. We hit a lot of headlines, and we move on to the next thing. So one of the things that I did right before we walked in here, was in my notes, I had scribbled down "Italy sparks global fear of fresh Euro crisis." And I scribbled out "Italy," and I wrote "Spain."

Brendan: Yeah, I mean it'll be another southern European country, soon after them right?

Tom Mullooly: I don't know who is going to be next. Portugal lived through that a few years ago. We've already done the Greece thing. Who's left?
Brendan: I don't know, but it just seems like everyone's worried that they're going to leave the E.U., like Brexit, like same thing.

Where are they going to go?

Brendan: But, like, Brexit, I don't know

Tom Mullooly: Are they going back to the Lira?

Brendan: I don't know. But I feel like it gets overblown in the short term, because even if they should decide to leave, I mean, how long is that going to take? Britain is still talking about that, right, like nothing's happening with that right now.

Tom Mullooly: It was two years ago!

Brendan: Right. And there was an initial reaction to that in terms of the market, too. And afterwards, international and US stock markets recovered just fine, actually within just like a week. It was a blip on the radar, like Brexit, it was a thing for maybe a week.

Tom Mullooly: It was like Cabbage Patch Kids. For investors that owned some of these global type of funds. I think you're going to find that some countries have a bigger impact than others. I think Italy and some of these big portfolios, these international funds…

Brendan: It depends on what you're looking at. But if it's like an all-world ex-US, it's probably in the realm of like 2%.

Tom Mullooly: Right.

Brendan: Which is I'm pretty sure what they contribute to the EU

Tom Mullooly: Global.

Brendan: Global GDP numbers too. So they don't contribute a lot.

Tom Mullooly: So basically what we're saying is that their economy can go to zero, and it's not going to have that much of an impact.

Brendan: Right, it would just be like spillover effects. Which is just uncertainty. Which investors apparently hate, but I just question. I really hate that phrase, because what do we ever get other than uncertainty.

Tom Mullooly: Right.

Brendan: There's literally never certainty. And maybe sometimes it's seemingly more or less certainty than others, and that's what scares people. I mean, you get paid to accept uncertainty in the market. If there were certainly, there would be no returns to be had.

Tom Mullooly: There would be no market. So we should re name this podcast "Embrace The Uncertainty."

Brendan: Yeah.

Tom Mullooly: Because that's what makes a market.

Brendan: Right. I think we all like inherently know that too, but nobody wants to know it. So the bingo word on Tuesday was contagion. Because everybody was talking about Italy, and obvious spillover effects. And we could sit here and speculate for days, my guess is as good as anybody else's. Maybe not even as good as anybody else's. I don't know.

Tom Mullooly: Same day this week, that we saw the headlines about Italy, we also saw headlines about oil prices. And I think the headline that I captured was "Political risks dwarf the dollar when it comes to oil."

Brendan: I chuckle when I read headlines like this, because you could easily reverse that, and it would be just as plausible, you know for oil prices, the dollar dwarfs political risks. Their point was that geo-politics seem to have more of an impact over the last six months or so oil prices than the dollar. And they were saying that the correlation you normally see between rising dollar and oil prices has not played out. I don't really

Tom Mullooly: Because for the last few we've seen a rising dollar, and rising oil prices, going together.

Brendan: Right. And so this makes me think, if at the beginning of the year, you had information that over the next six months, the dollar was going to rise. And then you made bets based on past correlations, you would have been wrong in this instance.

Tom Mullooly: Right.

Brendan: And I think the mistake isn't that this correlation is bunk, I mean it probably plays out over a longer period of time, I think it's a mistake to expect correlations to work over one day, week, month. I mean, we talk about these things, and most of the time, they're meant on a longer term basis than what we're analyzing here. But I think the mistake is trying to use a single variable to make binary in/out calls. Whether it's the dollar, or geo-politics, or a one-time signal, as if you're flipping the light switch on and off to be in or out of oil. I think that's a mistake.

Tom Mullooly: Yeah.

Brendan: Regardless of whether it's oil, the dollar, stocks, bonds or literally anything else. Like binary calls are a bad way to invest.

Tom Mullooly: As usual, the black box firms continue to search for the magic on/off switch when it comes to investing and they continue to be frustrated in finding one. Another headline that we picked up as "As global growth loses steam, US investors find there's no place like home." Now we can kind of tie those two stories together.

Brendan: So we've seen US markets outperform international markets this year, after two years of the opposite. With the change in price action, comes the change in narrative. So last year's story of synchronized global growth is now in question, because the stock prices don't confirm that narrative anymore. Or are showing signs of not confirming that narrative.

Again, we just talked about uncertainty pays.

Tom Mullooly: Right.

Brendan: And so, I look at an article like this, that was talking about GDP growth in the Euro zone as a concern, and geo-politics in emerging markets. Is there any correlation between GDP growth and stock prices moving forward?

Tom Mullooly: I don't think so. But we'd have to be really smart to know that when the economy's peaking, it's probably time to hit the exits.

Brendan: Right, and we can't know that beforehand.

Tom Mullooly: Right.

Brendan: I think, you know, to say that economic indicators are slowing, and that means stock prices have to follow, I think is a mistake. Because stock prices, at least over the short term, are more based on expectations being exceeded or not.

Tom Mullooly: We've been in a market where we've seen 2% GDP growth or less, for the last how many years? And stock market's done pretty well.

Brendan: It's done great.

Tom Mullooly: It's amazing to look at this, and the other take away that I have when I read a story like this, is wouldn't it be great if we knew that this year was the year to not be in international. Or better to be in small caps. But we don't.

Brendan: Right. So I think, along that same vein, you take these different areas of the market, that you are capable of being invested in, and you decide, you think of best case and worst case. And then determine what you want your exposure to be to those best and worst cases. To combine and make a portfolio.

Tom Mullooly: Right.

Brendan: You got to come up with something that you can live with, you probably want it skewed towards stocks, if you want growth, because that's where the growth is going to come from. And then you can decide which areas of the globe. There's different variables that impact all these different areas so you want to make sure you have some exposure to all of them, so you don't have to make these calls ahead of time with your crystal ball saying international this year, US the next year.

Because no one can do that over time consistently, if they could-

Tom Mullooly: But that's what everyone wants.

Brendan: Right, but you can't have that.

Tom Mullooly: So that kind of ties in with a post that our friend Michael Batnick, the article headline is "Never begin with the end in mind." And he talks about how we anchor ourselves after making an investment to say okay, we're going to buy this stock and we'll see how it does from January 1st, through whenever.

Brendan: I loved the way that he put, like as if, and we do this with things other than stocks too. And it's a funny way to just laugh at ourselves. As if the earth completing its revolution around the sun has any bearing on the stock market or anything else in our lives. Like why that, why do we have to measure based off of that?

Tom Mullooly: I know I've written in the weekly email many times, the market doesn't know what day it is. It doesn't know what time of year it is.

Brendan: The stock doesn't know that you own it. That's an adage, right? I forgot who said that.

Tom Mullooly: Yep.

Brendan: But you know, he was talking about anchoring to these things, and these different, maybe you're anchoring to the high water mark of an investment, or your initial purchase price, or what it's done since the beginning of this year. He suggested instead, which think is an interesting and useful way to look at a portfolio, is if you had to build it over today from scratch, would this thing still be in there? And why?

And I think if you had a good reason in the first place, for owning something, like if it's an ETF. I wanted exposure to this factor or this area of the market, or these countries, or whatever it is, this sector of the market. And if that thesis still remains, then great, you leave it. If you're only thesis was that the price was ripping up, and now it's not anymore. Well then you have your answer. And maybe you learn a little lesson through reflection too, that that shouldn't be the only reason that something gets into your portfolio. There has to be a better reason than that.

Tom Mullooly: There has to be.

So circling back to that story in the journal about global growth losing steam, it's hard to say at the beginning of the year, or really any point in time, international is going to do really well. Or small cap is going to do really well. Or bonds are going to do really well. We don't know. We just don't know from year to year. So it makes sense to have exposure to a lot of these areas.

Brendan: And in the right amounts, that's going to put together a portfolio that hopefully does something along the lines of what you imagined it doing.

Tom Mullooly: CNBC, in their infinite wisdom, looking for a stock market quote went to Kevin Durant of the Warriors. He actually came through with something actually really pretty good. The craziest thing Kevin Durant has learned about investing is that investing is a lot of work.

Brendan: He's in Silicon Valley now, with the Warriors. So he has like a small venture capital firm, and he invests in some companies. I think Acorns was one of them, and he was just saying that seeing the process that goes into VC, and I think this applies to any kind of investing, is that it's a lot of work, and you need to do your homework. Or you're going to lose your shirt. It's an important lesson to just zoom out and take a cross fields. When you don't know a lot about somebody else's job, regardless of what industry or line of work they're in, almost always, you would be surprised to see how much work goes on behind the scenes.

How does the pizza shop that you go to every couple of weeks for dinner. Like what goes on behind the scenes there, all the prep and stuff earlier in the day before they're making pizzas and dinners for you. Or what's going on, even at dry cleaners, or a lawyer, or a doctor. We have these perceptions of how people operate in business, and there's probably so much more that goes into it.

Tom Mullooly: Yeah.

Brendan: So just having an appreciation for other people and their work, I think

Tom Mullooly: I think that's really the big take away.

Brendan: The purest outlook to have, is try to learn these things about people.

Tom Mullooly: Instead of just saying, you know, when you look at the bill, I got charged $1,100 for that? He didn't do anything, I could have just picked up my own screwdriver and done that.

Brendan: Right.

Tom Mullooly: That was actually a pretty good takeaway.

So another story that we both talked about was, "Even with mortgage rates up, buying instead of renting makes sense for many." We've gotten so many calls over the years, when people have been looking to refinance. And it's hilarious sometimes to hear these calls. Going back when rates were even lower, they'd be like, "I can get 3.5% from one guy, but this other mortgage guy said that-

Brendan: If I move my bank accounts over.

Tom Mullooly: If I move my bank account, I can get three and a quarter, and I just laugh because historically, if your mortgage is 5% or less, you're doing great.

Brendan: A lot of the urgency that people seem to have about the interest rate they're getting on their house is manufactured by the people who are selling them the mortgage. And I understand that's their job, and that's what they're incentivized to do. They need to sell mortgages and make them happen. So that's their work. But people freak out, because they get scared and think that rates going up is going to mean this incredible burden to them.

And I think Michael Batnick and Ben Carlson were talking the other week about how obviously, people pay attention to the rate they're getting on their mortgage, but if you find your dream home, you're not going to buy it if you can afford it, because interest rates are like 25 basis points higher than they were a couple months ago?

Tom Mullooly: You're just going to buy it.

Brendan: You're going to buy the house.

Tom Mullooly: Right.

Brendan: A house is so much more important than the interest rate you're getting on your mortgage. And I understand that over time, a difference in interest rate over a 30 year mortgage could add up, but I don't think that's what people are making decisions based off of when they're deciding whether to buy a home or not.

Tom Mullooly: Buying a home is a purely emotional decision. Once you get past the price.

Brendan: And if you can afford it, to buy a house, I'm hoping that you're doing your homework to make sure this is reasonable and obviously you have to be qualified for a loan and stuff too, but if you can afford it, there's literally no way that it's going to become unaffordable because of like a small change in interest rates. And if it does, than you weren't ready to buy the house anyway.

Even if it's like 1%, if you were going to get 3% on your mortgage and you got four, and that made it unaffordable for you, then you're cutting it too close anyway, and I'm surprised you would even get qualified.

Tom Mullooly: I think you have to sit down with pencil and paper. Which is something I'm surprised people don't do anymore. But sit down with paper and pencil and just figure out, if my interest rate on my mortgage is, pick a number. 4.5%, my payment is going to be this. If my interest rate is 5%, my monthly payment is going to be that. And you don't even need to do the math anymore. You can type that actual quote that I just said into Google, and it will tell you what the number is. And there's hundreds of mortgage calculators available online.

I think you'd be surprised, when you actually look at the number over 20 or 30 year lifespan of a mortgage, you may be talking about $75 a month.

Brendan: Right. And you could use, excel has some really good amortization tables too. They're premade so you just pop in the home value and a couple other variable, like the interest rate you're going to get. And it can show you right there, the difference. You want to do your homework, and make that decision based on other factors. I think a secondary factor might be your interest rate, but I don't think that's going to force you into buying or not buying.

Tom Mullooly: So when we talk about rates, we invariably wind up talking about bonds. There was a tweet in the last week or so, that came out, and somebody on twitter wrote "The annualized," I always, the hair on the back of my neck stands up when I see that word annualized. Because we're five months into a year. "the annualized total return on the 10 year treasury note is now negative 10%. The worst since the 12.6% decline in 1931."

You know what? I think reading that, without any other information, I would feel really stupid if I had money in bonds.

Brendan: Yeah, I mean, if you don't know any better to not annualize five month performance numbers. Like juxtapose that with something equally as foolish, in a two week stretch, from the end of January to the middle of February this year, the market went down 10%.

Tom Mullooly: Annualize that.

Brendan: So yeah, we're going to annualize that two week negative 10% performance. What does that mean?

Tom Mullooly: I think we're down, we owed the stock market money. We're going to be down more than 100. And this is, I'm going to get a little off topic here. But we get into these periods where the market sells off, and it goes down 3% a day for a couple of days. And you know, when the clients start calling, I understand their worries and their fears. I get it. But you have to inject a little bit of levity, and you remind them, look, at this pace, the market will be at 0, by July 14.

Brendan: Right.

Tom Mullooly: Bastille Day.

Brendan: And you don't get that perspective when you're tuned into the media. Because they're going to sensationalize what's going on, so you get to sensationalize it in the other direction. And I think that, when people are annualizing five month performance, it's very fair to juxtapose that with annualized two week performance on the S&P. Is that going to be terrifying too?

Tom Mullooly: You want to sit them down, take their car keys away.

Brendan: Batnick tweeted that chart out over the weekend and said flagrant foul. And I completely agree.

Tom Mullooly: Yeah.

Brendan: You can't do that. Come on.

Tom Mullooly: It's just wrong.

Brendan: I mean you can do it, I just think it's a scare tactic.

Tom Mullooly: Yeah.

Disney shares, this is something that we saw on CNBC. Disney shares dip after franchise low debut for Star Wars prequel.

Brendan: I don't know what they did wrong in terms of marketing this movie, but I went to see it over the weekend, and it was really good. Solo.

Tom Mullooly: I think it's a great opportunity to plant another branch in that tree of Star Wars movies, it's another opportunity for marketing and merchandising. What's wrong with it?

Brendan: I mean, we obviously knew they were going to crank one of these out a year when they bought the rights to the franchise. So yeah, there may be some kind of lethargy, in terms of, like, another Star Wars. I'm not in a rush to see it, or something.

Tom Mullooly: It's only been out for forty years.

Brendan: The movie itself, I thought was entertaining. I thought it was good. I liked it better than the Last Jedi. Which is the one that came out last year. That's just my personal opinion. But also, I understand that this Star Wars franchise is a big cog in the wheel of Disney in terms of earnings, but it's still just a piece of what they're doing. And maybe the stock dipped on the news that not as many people went to see it over the weekend, as they thought, you know, were going to.

Tom Mullooly: Maybe they stayed home and watched ESPN.

Brendan: But like yeah, like long term, is that going to be an impact on them? I'm not sure. If this is the start of a secular trend of Star Wars movies tanking, because people are just tired of them, then, maybe. But this could also just be an aberration. Or because it was like, an offshoot, people didn't care as much. Yeah, I don't know.

Tom Mullooly: Don't know. I can tell you that in May of 1977, Star Wars came out, the original movie. And I remember that was the thing to do that weekend. Was to go stand on line, at Park East Theater in Garden City Park, and all the other places where it played. The film industry totally panned it. You should go back and read some of the reviews. Siskel and Ebert, and all of the film critics came out and said "This is a kiddy show. This will never go anywhere." It's hilarious, to go back 40 years later, after the Star Wars Saga

Brendan: Saga. Saga's it.

Tom Mullooly: Has come close to generating five billion dollars in revenues.

Brendan: Just jumping back to something you said there. You said stand on line, and I never knew that was a regional thing. Because I've always said it that way too. I guess that's, I saw over the weekend that's a New York City kind of thing.

Tom Mullooly: Stand on line.

Brendan: Right, but no one else in the country says that. Apparently it's just standing in line.

Tom Mullooly: Apparently other people say stand in line.

Brendan: Yeah, and I get, that makes more sense when you think of the words themselves, but I've always said stand on line, and I've never questioned it, until I saw something on twitter this weekend, and it just made me think of that, because you were saying it that way too.

That's where I got it from.

Tom Mullooly: That must be it, that's got to be the source. So thanks for listening to the Dallas episode. Before we turned the mics on, I was asking Brendan if he knew who shot JR, and he didn't even know what I was talking about.

Brendan: JR Smith?

Tom Mullooly: Yeah. No, the guy from I Dream of Jeanie.

Brendan: Okay.

Tom Mullooly: So, we'll try to get a picture of Larry Hagman up there.

Brendan: Sounds good.

Tom Mullooly: Thanks for listening, we'll catch you on the next episode, which will be episode 215, the Philadelphia Story.