Ep. 217 - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management Podcast. This is episode 217. I am Tom Mullooly, and I'm here with-

Tim Mullooly: It's Tim Mullooly this week, not Brendan. Brendan's out, so I'll be filling in.

Tom Mullooly: Episode 217 takes us through Central Illinois.

Tim Mullooly: Right.

Tom Mullooly: 217 is the area code for places like Springfield, not the one from The Simpsons, Springfield, Champaign-Urbana, and that middle part of Illinois as you're driving from Chicago to St. Louis.

Tim Mullooly: Is that near Aurora, where Wayne's World takes place?

Tom Mullooly: Party on, Wayne.

Tim Mullooly: Right. Yeah, I've been following along with the area codes while I was editing all of these podcasts over the last couple weeks, so learning them slowly as we go along.

Tom Mullooly: Our next episode, we'll be going to northern Minnesota with episode 218.

Tim Mullooly: Good to know.

Tom Mullooly: 219, we'll be back into northwest Indiana, not far from Chicago, near Gary, Indiana and some of the other towns in the northwest corner of Indiana. But I'll have to look and see, 220 is the area code for Bangladesh or some place outside the United States.

Tim Mullooly: Interesting.

Tom Mullooly: We've had some changes announced in some indices, a couple of names that most people will recognize.

Tim Mullooly: Right, yeah. It was recently announced that GE was going to be removed from the Dow. For people that have been in the market for a long time, that might seem like heresy. Oh my God, GE's coming out of the Dow. What's happening?

Tom Mullooly: It's only been in the Dow for 111 years.

Tim Mullooly: Right. You look at it recently, and it's just gone down. I think, what, it's at $12 or $13 now?

Tom Mullooly: Right. Isn't it interesting that these companies get dropped from the Dow Jones and the S&P when their stock is down? There's a pretty good ... I guess we can call it an internet mean, but one of these things that happens with the stock market, where companies that get bounced from the Dow Jones tend to have a better year after they're dropped from the Dow than the company actually going in. When Apple went into the Dow, it was terrible. It went in ... 2013, I think Apple was down 25% or 30%.

Tim Mullooly: The first thing that came to my mind has nothing to do with stocks, but Matt Harvey came to mind.

Tom Mullooly: Sure.

Tim Mullooly: Once he gets out of the spotlight and goes to Cincinnati, everyone thought he would perform better. Turns out he hasn't, but the same thing, when you get put in the spotlight of New York, like people thought Giancarlo Stanton was slumping, you can't handle the pressure. These stocks can't handle the pressure or something of being in the Dow. Not really the case, but ...

Tom Mullooly: They said the same thing about Jay Bruce when he was traded from the Reds to the Mets a couple of years ago. He came in, and August and September, he was terrible. Last year, he was terrific. He had 27 home runs when they traded him at the trading deadline.
Yeah, GE is moving out of the Dow. I just think it's hilarious that we tell our clients all the time that we want to be buying low and selling high. Yet, all of these indices are selling at the bottom. It makes absolutely no sense to me.
But being around the market since the mid '80s, I've seen almost a complete turnover in the Dow Jones. I'm going to have to go back and go through the list and see who's still there. I think IBM is still there. Coca Cola's still there. 3M is still there. I'm trying to think of some of the other ones, because I know just while I've been in the business ... Boeing has been there all along. United Healthcare was added. Goldman Sachs was added. Home Depot was added, Apple. McDonald's was added. Cisco was added. I'm having a hard time coming up with-

Tim Mullooly: The originals.

Tom Mullooly: The originals that are still there after 30 something years. Would be an interesting walk down memory lane, but here's the thing. Without giving it away, what's the couple of names you would think of that would be ... okay, so what's a growing stock that's going to replace GE in the Dow Jones?

Tim Mullooly: I would think of huge stocks off the top of my mind, like Amazon, Netflix, some of these other technology stocks, Facebook.

Tom Mullooly: Sure.

Tim Mullooly: Naturally, those are the first that just pop in my head.

Tom Mullooly: Of course, it's a layup then that Walgreens-

Tim Mullooly: Of course.

Tom Mullooly: Gets selected to move into the Dow Jones. Walgreens, great stock through the '80s and '90s and this new century. Their symbol for a long time was WAG, a great, great story, just growing like a weed early on. Now the symbol is WBA, because recently they merged with a company in the UK, Boots. Now it's called Walgreen's Boots Alliance, WBA, like the ... I was going to say WNBA, but World Boxing Association.

Tim Mullooly: Or bowling, something.

Tom Mullooly: There you go. Okay, so Walgreens is in there. The first thought when I heard of Walgreens is why didn't they think about CVS?

Tim Mullooly: Or how did they land on Walgreens was something that crossed my mind as well. We were talking before about how the Dow is price weighted. GE was $13, one of the cheapest stocks in the Dow. Walgreens coming in is going to be the eighth from the bottom in terms of price. How much of an effect is it really going to have on the index itself?

Tom Mullooly: It may not have much at all. I don't think the Dow is even going to have a wiggle when GE gets dropped. What Tim is referring to is, unlike other indices, the Dow Jones is a price-weighted average. What that means is the highest priced names in the index really swing the boat around from side to side. Highest priced stock in the Dow, Boeing, $330 something a share, United Healthcare, $250 something a share, Goldman Sachs, $220 or around there. Even Home Depot is $200 a share.

Tim Mullooly: When those stocks move up and down, you feel it a lot more than when GE at $13 moves around.

Tom Mullooly: Absolutely. Let's take a look at some of these companies. Remember, it's the Dow Jones Industrial Average, but I don't really put McDonald's in there as an industrial stock. I don't put Pfizer in there as an industrial stock.

Tim Mullooly: There aren't many real industrial names left in the index.

Tom Mullooly: If you think about it, some of the companies that were in there, these were steel companies, oil companies, railroads. You don't see them anymore. You look at these names and say, okay, now we're going to have Walgreens moving in. Walgreens, most people know them as a drug store, like CVS, but both of those companies are now getting into pharmacy management. If you have someone who needs to get a prescription sent to them on a regular basis, they handle all of that stuff. They'll take over the pharmacy benefit management for some huge companies. It's a big revenue stream. It's not an industrial company whatsoever, and yet it's replacing an industrial company.

Tim Mullooly: May be the time to change the name or something of the index.

Tom Mullooly: Dow Jones-

Tim Mullooly: Dow Jones average. Just take out the word industrial.

Tom Mullooly: This is the thing, and Tim, you were alluding to this. When the market is up or down a couple of hundred points, we get some calls from folks.

Tim Mullooly: Right. People ... and just realizing this about the Dow Jones makes me scratch my head when people call in and say, "I saw the market was up 300 or 400 points today." Well, the Dow Jones was up 300 or 400 points today. Those, as we were just talking about, are only 30 companies out of hundreds of companies out there that are publicly traded.
It just makes me wonder what the infatuation with the Dow Jones itself is and why people use that as the yardstick and that as the measurement for, "The market was up this many points today. I bet I made a lot of money." They go check their accounts, and they didn't. Then they're like, "What's wrong? We must be doing something wrong."

Tom Mullooly: We must be doing something wrong. What I explain to clients a lot of times is yes, that's right. We don't own those 30 stocks, and we don't own them in the same proportion either.

You and I both listen to Animal Spirits podcast from our friends over at Ritholtz. They responded to a letter or a comment that they received. Someone had ... their father had several thousand shares of GE. The letter was written maybe six or eight months ago. What do we do with this stock? It's a gigantic portion of my parents' net worth. Some of the comments that they received were people were saying, "You're going to be getting thousands of dollars every quarter in a dividend."

Then they cut the dividend. Then the stock continued to drop. When that message was posted online, I think it was a Reddit thread, the stock, GE, was trading in the 30s. The stock's $12 or $13 now. What do you do? Jump out a window?

Tim Mullooly: Yeah, I don't know. Even before they cut the dividend, if your stock is going down that much, the dividend's not really going to make that much difference.

Tom Mullooly: It's not going to help you out.

Tim Mullooly: No, you're not even going to break even on the losses there.

Tom Mullooly: We've seen a couple of articles recently about the uneven recovery in stocks. This was something that you and I both talked about we saw in the Wall Street Journal recently. There was an article in particular that talked about how technology stocks have powered most of the recovery in the market. I know you had said, Tim, that it's going to be interesting to watch people chase these tech names more and more.

Tim Mullooly: Yeah, people are always looking at the news and seeing what's doing well and say, "Ooh, I want that," or "Ooh, I want this stock." If technology stocks are the ones that are going up, obviously, people are going to want to get in line and file and get on board with these technology stocks.

It's interesting to hear people call in and ask, "Can we own this tech stock or this tech stock?" It's this, you already do. You own it in these ETFs, or in these indexed funds, or large cap whatever. You already own it. You hear them go, "Oh, okay."

Tom Mullooly: That's nice. It's like it's not real to them. If they can't see-

Tim Mullooly: They don't have the stock certificate in their hand, so to speak.

Tom Mullooly: Or they don't see AMZN in their monthly statement, something's wrong. We should be doing something else. You explain to them you own this, and in this ETF, and this ETF is 10% of your account or 20% of your account. You own it already. We're only going to get now more overlap. In fact, there may be situations where you already have built in overlap, because you have a technology fund, an internet fund, and a growth fund. They all have the same positions.

Tim Mullooly: Right. Yeah, it's hard for people to understand that. It's also hard for people to understand, think about how happy and enthusiastic you are about wanting this stock while it's going up. Think about how much you're going to not want it when it's going down-

Tom Mullooly: That's right.

Tim Mullooly: ... because some of these huge tech stocks, as we've talked about and people have written about, have had huge drawdowns along the way. That's one of the hardest parts about owning individual stocks. It's great on the way up, but-

Tom Mullooly: Murder on the way down.

Tim Mullooly: Right. Owning it within the ETFs that they already have is most likely the most appropriate way for them to get exposure to those stocks, even if it's not as entertaining I guess as seeing the ticker symbol in your account.

Tom Mullooly: The other thing that ... I don't want to be talking down in any way, but it seems like we get a lot of emails and calls from people who say, "When this market goes down, dot, dot, dot, I want to get defensive. I want to get out. I want to change it up. I want to do things."

Very interesting, I was listening to Barry Ritholtz' interview Ed Yardeni the economist and market strategist. He raised an interesting point. He said, "We may not have one recession where everything stops working altogether. We may be going through a period where we have rolling recessions." That's important.

What he highlighted was from mid-2014 through the middle of 2016, we saw energy stocks get crushed. When you look at what oil did in that time period, it went from over 100 to the 30s. We saw a lot of energy companies and commodity-related companies get destroyed in that year-and-a-half, two-year period.

Tim Mullooly: The same thing happened with biotech in 2016.

Tom Mullooly: Correct. We saw the air come out of the tires in a big way in that entire group. Then we've seen how the retailers and commercial real estate companies in the REITs that are tied to them also have some really tough times. Some of these investments are down a large percentage. We're starting to see some of these areas get hit one by one.

It reminds me of what happened in 1994 when the Fed ... it seemed to be a big surprise, February of 1994, the Fed started raising interest rates, and they raised them throughout the year. The market never really took a big whack, but we saw one sector after another get knocked down 20% or more and then recover. 1994 was a flat year in the market. Every sector had their time taken out back and getting shot.

Tim Mullooly: It makes me wish that we didn't use the term the market.

Tom Mullooly: This ties in with what you were just talking about, watching the Dow go up 200 or 300 points. Wow, we probably made some money today.

Tim Mullooly: Right. It's like the market was flat, or the market is up 20%, but you don't log into your account and just see the words, the market and plus 20%. You own different funds that might cover broad range of areas of the market, but you don't just own the market. If you don't own the funds that are going up, or you own the funds like biotech in 2016, or oil and energy in 2014, that were going down, your reality is going to be much different than what is going on in "market, the market."

Tom Mullooly: Sure, or international stocks last year.

Tim Mullooly: Right.

Tom Mullooly: Small cap this year. They all take turns. They all take turns doing this. Even something like the S&P 500, which most people refer to as the market nowadays, that's 500 of the largest companies now. That's a large cap index.

Tim Mullooly: Right, so if you own mid cap stocks or small cap stocks that-

Tom Mullooly: You're going to have a different yardstick.

Tim Mullooly: Right. That doesn't apply to you. It's just important to understand what you own, I guess, is the moral of the story there.

Tom Mullooly: I mentioned just a few moments ago about how in 1994, the Fed was raising rates. We saw what that did to the market. You pointed something out to me that you saw on CNBC that you really disliked. Do you want to share it?

Tim Mullooly: Yeah, and full disclosure, it turned out to be a don't judge a book by its cover type of thing, but the headline was How to Play Rising Interest Rates Based Off Your Age. I saw that headline, and I just cringed, because that's such a click bait-y headline. Their job is to get people to click on these articles, so I get it.

But when you actually dug into the article, it just broke down based on where you were in your career, earlier in your career, in the middle, and towards retirement, how you might want to consider things that are tied to interest rates. But just the headline ... and anytime I see the word play in terms of investing or something, it just makes me shake my head.

Tom Mullooly: What's the hurricane play?

Tim Mullooly: Right. It's like a how can I get rich quick off of this. I don't know.

Tom Mullooly: Let's stay with that theme for a second. How can we play the internet sales tax news? Today right before we walked in to record this, the Supreme Court announced that states are now permitted or will be permitted to charge sales tax on internet transactions. Immediately, Amazon, even though it's a $1,500 stock or something like that, the stock went down $15 or $16. In normal times, that would seem like a lot. Now it's really nothing.

Tim Mullooly: I also don't understand ... maybe my initial reaction to that news is backwards, but I feel like that would be okay news for Amazon, not bad news, because they're massive. They can afford to pay those taxes. It's going to hurt so many other small websites out there that haven't had to pay these sales tax.

Tom Mullooly: Absolutely right. Amazon, a lot of people have been noticing over the last few months, even over the last year, Amazon has been charging sales tax for most jurisdictions. Their model is already set up. This is not news for them, and they're going to continue to do great. This is actually really good news.
What it's going to drive away and really hurt are the smaller businesses. I think about all these stay-at-home folks that sell on Etsy. You're in New York. You have an Etsy website. You sell, I don't know, knit caps or something like that. Someone in Colorado buys your knit cap. You have to now pay and file ... collect the sales tax in Colorado, file a tax return for your business in Colorado.

This became now a logistical nightmare for many small, online realtors. It'll probably make some of these smaller online retailers think about whether they want to continue doing this. That's only going to strengthen a Walmart, and an Amazon, and these other companies that are doing big business online.

Yeah, what's the angle with the internet sales tax decision? Seems like Amazon's-

Tim Mullooly: More good news.

Tom Mullooly: Yeah, Amazon's going to continue to get more and more good news.

Tim Mullooly: Yeah, I guess sometimes in the market though, even good news can be taken as bad news, I guess, because what we just talked about all sounded like good news for Amazon, and like you said, the stock went down. Who knows, I guess.

Tom Mullooly: Well, I think some of that is the knee-jerk reaction. Now they have to charge sales tax without even looking that ... no, Amazon's already been doing it. Sell the stock, because it's ... for most tech-related stocks, it seems sell the headline, read the news later.

There was another story. Tim, you may not have seen this, but the Supreme Court is going to hear a case challenging the government's ability to charge securities fraud. Did you see that?

Tim Mullooly: I did.

Tom Mullooly: It was in the Journal the other day.

Tim Mullooly: I did see that. Yeah, that was about some broker is arguing that he can't be punished for the misleading statements that he disseminated but never wrote. His point is that whoever was in charge of the firm, the firm itself wrote the misleading statements, and he simply just forwarded it or passed it on in an email to clients.

Tom Mullooly: Well, that's interesting, because most of the stuff that the firm ... most FINRA firms, when they give information to the sales force, somewhere on that sheet of paper, or email, or whatever, it says for internal use only.

Tim Mullooly: Right. Yeah, and the article went on to say that the firm and whoever was in charge of the firm agreed to shut down the firm, be barred from the industry, and pay millions of dollars in fines. The firm obviously is okay with accepting guilt here, but this broker apparently is not.

Tom Mullooly: It's going all the way to the Supreme Court.

Tim Mullooly: Right, The big takeaway from this is that if they rule in favor of this broker, then it hinders the SEC's ability to charge individuals with fraud.

Tom Mullooly: We split the hairs one more time. It just doesn't make sense. Not to turn this into a commercial for our firm, but it just lends more weight to the story of work with people who are going to be a fiduciary. They understand that there's a legal obligation with the advice that they're giving to clients.
I think you and I both saw something about the party ending soon. I think we better call Uber and get our ride home. What's that all about?

Tim Mullooly: The world was supposed to end back in 2012 too.

Tom Mullooly: I keep forgetting that.

Tim Mullooly: Lucky us, we're still here. But the article says, "The party may end soon. Economist predicts a recession by 2020." You know what, guys? We've got about a year and a half left. Let's enjoy it.

Tom Mullooly: Since the market is a discounting mechanism, and it tends to look forward by six to 12 months-

Tim Mullooly: It's pretty much over.

Tom Mullooly: What inning are we in?

Tim Mullooly: Yeah, right. Wait, what's the play here? What's the recession play? Yeah, there's no real accountability I guess for these guys to make these claims, so again, another click bait-y headline. You just need to keep that in mind when you're reading these things. There's no downside for them to make these calls. I think Brendan has said it on a previous podcast. If they're wrong, they're just one of the hundreds of guys who made a wrong call, but if they're right-

Tom Mullooly: They're going to say, "Hey, look."

Tim Mullooly: It's a career changer for them. I was right.

Tom Mullooly: Yeah, back in 2018, this guy called it.

That's going to wrap up episode 217. We appreciate you listening, and we look forward to you when we visit northern Minnesota in episode 218.