Ep. 222 - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 222. Wasn't there a route 222 that we used to take out to York, Pennsylvania?

Brendan: Yeah. Yeah, that runs through Lancaster, I think.

Tom Mullooly: Right. And I know that when I was growing up, I used to watch a TV show called Room 222, which was about Walt Whitman High School, a fake high school in Los Angeles.

Brendan: Okay.

Tom Mullooly: But that was 1970, '71, '72.

Brendan: Before my time.

Tom Mullooly: Well, a little before your time.

Brendan: Safe to say.

Tom Mullooly: Yeah. So, welcome to episode 222. Brendan has somewhat breaking news.

Brendan: Not breaking, but my indicator for whether or not a market event has reached the mainstream is to ask my girlfriend if she has heard anything. So, yesterday I asked her if she heard anything about Facebook, and she said yes. So, obviously-

Tom Mullooly: Breaking news.

Brendan: Yeah, everybody has heard at this point that Facebook went down 19% yesterday, off of-

Tom Mullooly: Wait a minute, wait a minute, wait a minute, Facebook goes down?

Brendan: Right, exactly, yeah. I thought we were just signing up for the game, sir.

Tom Mullooly: What's that all about?

Brendan: I don't know.

Tom Mullooly: So, I thought by buying some of these FANG stocks, Facebook, Amazon, Apple, Netflix, Google, these things only go up.

Brendan: That's what it seemed like for the last couple of years at least. But I think with all of these stocks, you can look back through their history and see that they've events like this, maybe not exactly of this magnitude, but like 10% drops, or bare markets that individual names have

experienced over the course of the years on their own, not alongside the market. Just off the top of my head I'm remembering, was it-

Tom Mullooly: Apple.

Brendan: ... 2013 where the market went up 30% and Apple-

Tom Mullooly: Went down.

Brendan: ... went down. This is kind of what you're signing up for when you try to pick stocks. And not only pick stocks, but pick big winners. So, you're trying to ride the wave of these big names, and if you think you're not signing up for this, I think you're kind of delusional.

Tom Mullooly: So Brendan, when we go online and we see, if you had invested $10,000 X number of years ago in pick a stock, today you'd be worth a billion dollars. You mean, these things don't go up in straight lines?

Brendan: No. And look, if you bought Facebook a couple years, you're probably still off very nicely on it, but it's never going to feel good to look and see a name that you own down 20% in a day. More or less, a day long bear market. That would be like ... It's like 1987 for Facebook yesterday, basically.

Tom Mullooly: Right.

Brendan: That's what we saw. So, people freak out over stuff like that. I guess, I mean there's going to be emotions attached to it, but if you thought that that wasn't within the realm of possibilities, I think that individual stocks are probably not for you. And I think that's most likely the case for almost all investors out there.

Can you really deal with what happened? If you're heading for the hills after yesterday, are you really cut out to pick stocks?

Tom Mullooly: You're on the wrong bus.

Brendan: Yeah.

Tom Mullooly: That's basically it. This bus is going to Cleveland, are you with us or not? So, I think we can say, friend of the show, Michael Batnick did a post about Disney same way.

Brendan: Yeah, and Michael has written about this before with, I think all of the FANG names, making almost this exact point, that you are signing up for the idea, or the hope of big upside. You want to see that wave continue that has drawn your attention to a name like this, but you are also signing up for excruciating downside moves. So, the whole invest $10,000 meme is ridiculous, because most people don't have the stomach to invest in an individual name and see it get cut in half, or down 20% in a day.

If you're going to sell based off of news like that, it's not for you to be picking companies like this. And that's not a knock on you. I don't think it's for many people. I just don't. But Michael wrote about Disney in his post, and some really great stats. So Disney, since 1970, is up 19,500%.

Tom Mullooly: That sounds like an eye popping number.

Brendan: Yeah. And the market ... Michael had perspective on what the market has done over that timeframe, and it's not ... It's beaten the market over that timeframe, but the market has also gone up a ton. So, this is a winner, but that makes it seem ridiculous. It's done very well.

Tom Mullooly: There have also been periods of time where Disney laid an egg.

Brendan: Yes.

Tom Mullooly: I've seen it.

Brendan: So, Disney has lost, over that time frame, has lost 10% in a day over 11 times. It has had 13 bear markets over those 48 years, while the S&P has had four. So, not all of these were in conjunction with big market declines. You had to be willing to see just your stock getting chopped in half, or down 20% or more, while the market did nothing, or maybe it was down a couple percent or up. Like what we talked about with Apple before. Can you handle that?

And he also looked at the years that exist between new highs in a stock like Disney. And we're not just talking years, there were decade long stretches where this stock was below the highs from wherever it had drawn down from earlier.

Tom Mullooly: So, they don't give out awards like they do for baseball players when they come back from a serious injury. But I distinctly remember Disney being the comeback stock of the year in 1984, and 1989, and 1996. So, I've already seen this now a couple of times through my career, where this stock has been the comeback stock of the year because they didn't do anything for a year or two before that.

Brendan: And that's not a knock on Disney. Michael wrapped up his post by saying you could ... He rattled off five or six other huge name stocks that you could do this with over the years. So it's not to say Disney hasn't been a good investment, or that good stocks don't take decade long breaks between their peaks. They do, and it's fine.

But saying that you're okay with that, and then living through it in reality, are two very different things. And I think a lot of people just give lip service to the idea that they're long term, and that they're going to be there to recognize these big long term gains that these companies see. You see the nice smooth mountain chart that goes up and to the right, but I don't think many people are cut out for picking individual companies and having significant amounts of money tied up in them. I don't-

Tom Mullooly: As long as we're talking about the mountain range chart, understand that sometimes the mountain range gets smoothed out because you're looking at 20 years compressed into an image that's a half of a screen. Sure it's going to look smooth, it took out all the bumps, all the years where it was flat or down.

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Tom Mullooly: Hey, two other things somewhat related to that, two other articles that we picked off of MarketWatch, fate of the stock market for 2018 could rest on the next five days. It kind of sounds like the Mets plans to tear down, or rebuild, or to go for it. It all depends on the next couple of days. That's hocus pocus.

Brendan: Well, so what the article was talking about was some research from Bespoke Group. And so, since 1928, there have been 12 times where the S&P was positive in April, May, June, and July. And all of those years, it was positive for the rest of the year. So, let's break that down for a second. We're talking about a 12, 12 being our sample size here, and they obviously know this. It's interesting to look at data this way, and it reminds me of market seasonality.

My take on that is that the data is correct, they're not making it up, it is what it is. But what are you supposed to do about it?

Tom Mullooly: Yeah. Is this anything more than an interesting coincidence?

Brendan: Interesting, but not actionable.

Tom Mullooly: Right.

Brendan: When you look at a market anomaly, something like value stocks, or momentum stocks, you want to see two things, and you want to see it work across all countries and different types of investments. So, two things that you're looking for to explain things that exist like that are explanations for why they occur. There has to be a reason.

Some people are positive that things like value and momentum give you excess returns over time, or they have at least in the past, because you're taking on more risk than the market. Which is probably true in some sense. And then there's also the explanation of it being a behavioral thing.

Like, people throw the baby out with the bath water with value stocks, and over extrapolate to the downside, and momentum is almost the exact opposite of that.

So, there are these working explanations that probably both contribute alongside maybe other factors too, to these things being real, or at least the idea that they have been real in the past. But things like market seasonality or months being positive, what possible explanation, is there causation there, or is it just correlation?

Tom Mullooly: Yeah.

Brendan: I guess is my point.

Tom Mullooly: And we wrestle with this all the time, primarily because we get questions about this. Hey, we heard that sell in May and go away actually works. Well, sometimes it does.

Brendan: Right, until it doesn't.

Tom Mullooly: Well, that's kind of the same thing, you know, you'll be watching a baseball game and they'll say, "The Dodgers, when they're ahead in the eighth inning, they're 89-0, until today.

Brendan: Yeah.

Tom Mullooly: Until it doesn't matter.

Brendan: It's not something I would hang my hat on. I don't have any problem reading research like this, because I think it's interesting, but to say that it's-

Tom Mullooly: It's interesting, but it's nothing more.

Brendan: ... to say that it's something you should adjust your portfolio or make investment decisions based off of, I think is insane.

Tom Mullooly: Holy moly, that's a bad plan.

Brendan: Yeah.

Tom Mullooly: So, along the same lines, another article that we saw in MarketWatch, how to predict the next stock market downturn. For real?
They talked about relying on the VIX, and they also talked about the inverted yield curve as an indicator. I don't know about you, but I am so tired of hearing about the inverted yield curve, and the 2-10 spread. Because I don't know if this is really an accurate indicator. I don't know how many indicators are really-

Brendan: Do we know if any indicators are accurate indicators?

Tom Mullooly: No. It's a confluence of a lot of different things all happening at the same time. Even with the charts that we use and our own indicators, one indicator going off doesn't mean that there's a problem. When you start to see multiple indicators going off, or going in the same

direction together, you might want to pay attention, but it doesn't necessarily mean that something's going on.

Brendan: Even that is a maybe.

Tom Mullooly: Right.

Brendan: So, yeah, I think more generally, I don't like articles that purport to have the answers to the test. As if you could read a MarketWatch article and obtain the answer to how to get upside without downside.

Tom Mullooly: Right.

Brendan: Because that's basically what every indicator out there is explicitly telling you that they have, whether they say it outright or now, is that we have the answers to the test so that you can time the market and not have to deal with the negative impact of being invested in stocks.

Tom Mullooly: So, we can find an article like that, usually a couple every week on different websites. And we'd be happy to tell you what websites if you reach out to us. But we should make them subscribe to our newsletter. I'm just kidding.

Brendan: But the thirst for these stories about this indicator has now, you know, the last X number of bare markets or recessions or whatever it may be, whether it's economic based on charts, or fundamentals, I don't know, but people crave this stuff despite probably understanding at some level that it's ridiculous. And that if somebody could do that, then investing would be like super ... There would be no risk to investing then, and why would we earn money if we could just jump in and out of stocks every time they were going to take a dive? That's not how it works.

Tom Mullooly: I just want to revisit this 2-10 spread business. This just baffles me that we're even having this conversation today. Brendan's been in the meetings with clients when I've said this, so he's already smirking because he knows what's coming. The numbers on fixed income investments have been so small the last few years, you need a microscope to see them.

When we've had an inverted yield curve, or the 2-10 spread goes to zero, or a negative number, in the past it's been when interest rates are five and six percent or higher. We're dealing with numbers that are in the twos, there's no precedent for this. So, to just throw a blanket over it and say, "You know, when we see the 2-10 spread go to zero or go negative, that's a clear sign that there's going to be a recession." Really, is that true?

Brendan: I think any data that purports to foresee recessions is ridiculous, because you can't by ... The definition of a recession, you cannot know that you're in it until at least-

Tom Mullooly: Six months later.

Brendan: ... six months after it has already begun. So, to say any kind of group of economic indicators are going to tell us ... If we knew we were going to go into a recession, then wouldn't we do something about it?

Tom Mullooly: So, we've talked about Facebook, I think it's only fair that we talk about Twitter. So, Twitter down today. They are continuing to purge the fake accounts that are on Twitter. Twitter's actually doing something good for the long term health of their business, stock selling off.

Brendan: Right. Like, you could have the answers to the test and it wouldn't matter.

Tom Mullooly: Right.

Brendan: You could have the GDP numbers that came out this morning, and you probably would have gotten the direct ... The market's flat today because it's Friday. You know what I mean? You could have had the numbers, but you don't know how everybody's going to react to them.

And I think it's kind of the same when you're getting earnings numbers for the second quarter from Facebook or whatever. You could look at those numbers and interpret them differently than the person sitting next to you, and the person sitting next to them on the other side. And that's kind of what makes a market.
So, we can all believe what we want about the direction a stock or an industry is headed, but if more people disagree with us than agree with us, then we're wrong, at least in the short term. I don't know. We're always looking for the answers to the test, but realistically, it's impossible to have them because so much of what we see on a day to day basis is based off of the opinions of people, and that's it.

Tom Mullooly: Hey, one thing that I think we do need to touch on today, there's ... Wells Fargo has been in the doghouse now for a long time, for some of their business practices. Some of the whistle blowers now on the wealth management side are producing correspondence that said that employees of the firm were paid extra compensation, or given some kind of incentive to push certain products.

I can't believe that we're talking about this in 2018. I thought all this stuff ... I mean, it’s naïve to hear, or to say, but I thought all this stuff went away over the last 10 or 15 years, but it still goes on. So, lofty sales goals were at the heart of the scandal at Wells Fargo retail bank. Incentives also appear to be at the root of issues under investigation within its wealth management business.

Four advisors in Arizona sent a letter to the Justice Department and the SCC, detailing what they said were long standing problems with the banks dealing with wealth management customers. In January, two advisors sent a formal complaint to the SCC alleging similar problems. They cited goals for product sales that lead employees to push customers into products that generated more fees, or to move client assets between different products of platforms to generate more revenue and bigger bonuses.

Brendan: Right. So we don't need a fiduciary rule, right?

Tom Mullooly: Apparently not.

Brendan: People are going to do what they're paid to do. So, when you put somebody in a position where they're paid to sell a specific product, or push some kind of ideology in terms of how they believe you should invest, that's what they're going to do. It's between losing their job, or doing it and maybe not feeling great about it.

I don't even know, do people ... A lot of people will probably trust their employer in this sense. Maybe not at Wells Fargo after all the stuff that's come out over the years, but when you work for a company and they tell you what your job is, you're going to do your job. I don't know, maybe it's a surprise to some of these people that Wells Fargo has been telling them to do the wrong stuff now.

And this isn't unique to them, I don't think.

Tom Mullooly: I was just going to go there. I don't think Wells Fargo is the only player. They're not the only one in the industry that does this. I worked for a firm that had a different fee schedule if you sold proprietary products. That was, however, 25 years ago.

Brendan: I'm sure it probably still exists today though. It's not like that firm, which will remain nameless, is conflict-free now today. They're doing the same stuff still. That's basically the crux of the fiduciary rule being struck down, is that firms don't want to get rid of practices like this where they incentivize to sell products that they earn more profit on.

Tom Mullooly: They're very profitable.

Brendan: Right. That's why we don't have a fiduciary rule, because people want to continue doing stuff like this.

Tom Mullooly: I think it would be fairer if we could have everybody disclose everything in black and white, easy to read, in some kind of way to show people this suggestion, this recommendation over her, is going to cost this much per year. This suggestion over here, which might be better, is going to cost a little more. It's going to be over here. This is what it's going to cost.

I don't think there's anything wrong with it, if you can justify a good reason for owning it, I don't see anything wrong with it. However, if it becomes a practice where everybody's getting strawberry because we're paid more for strawberry, well then, I think they ought to disclose that too but-

Brendan: I just think the person on the other end receiving the advice to do stuff like this, should be aware of why they're being told that over other options. And if they decide, because our business is very personal in nature, if they like the person who is selling them proprietary products because that's the firm the work for, and they still choose to do it after that, then that's

great. We shouldn't get rid of their choice to do business that way if they want to, but it should have to be transparent, and I'm not sure that it is.

Tom Mullooly: All right, that's going to wrap up episode number 222. Thanks for listening to the Mullooly Asset Management podcast, and we will catch up with you on the next episode.