The Fed Impact - Transcript

Brendan: There's a point where enough is enough, but finding that threshold ... Everybody's opinion isn't the same. So where someone thinks we have too many rules, somebody thinks we don't have enough and you got to find that balance of it, and that's really hard. And that's probably why not many people want those jobs of deciding the balance.

Tom: Yeah, thankless job.

Brendan: It's literally what the Fed does.

Tom: Yeah, it is.

Brendan: It's exactly what it does. And depending on somebody's opinion, they either did too much or didn't do enough or they started to soon or they waited too long. They can't be beholden to people's opinions of what they're doing, but they kind of have to be because I think that unintentionally, we have made their job that they prevent recessions, and I don't think that that's what the Fed was invented to do.

Tom: No, and how can you prevent something that happens in a normal business cycle?

Brendan: You can't, but people want them to, and then when they don't, it's like the end of the world.

Tom: They killed the party.

Brendan: Right. And I read an op-ed from the Wall Street Journal today that said they should have started hiking in like 2010. Can you imagine?

Tom: Oh my goodness.

Brendan: I wasn't in the business then but can you ... Let's rewind the clock. Can you imagine in 2010 if the Feds said that, what would have happened?

Tom: If I'm counting right, we had three more rounds of quantitative easing to go in 2010. They hadn't even started. Oh my goodness, no.

Brendan: That was like Druckenmiller and somebody else today and Wall Street Journal op-ed, just completely ludicrous. Monday morning quarterback stuff where it's obvious now in hindsight that they totally screwed up, but I don't know, I mean-

Tom: But did they really?

Brendan: We're here and markets are a lot higher and the economy has done a lot better since then. I don't know, I think that is the testament I guess can be just be survival. We're still here.

People thought at that point in time that that was within the realm of reason to question, like existence at all, like the entire financial system, right?

Tom: It's funny because this kind of reminds me of a tweet going around. I don't know if it was Morgan Housel or Jason Zweig, but someone said, "What do you think was the most amazing finance related story over the last 10 years?" People talked about how the internet has changed things, Bitcoin has changed things, quantitative easing, all of this stuff. My response was the Dow Jones went from 7,000 to 24,000 in 10 years. That's insane.

Brendan: It's great.

Tom: I think that's the biggest financial story, because 10 years ago everybody thought, like you just said, the world was ending.

Brendan: Well, I think it just goes to show that ... And at that point in time, that wasn't a ridiculous mindset to have. How could you refute that at the time? Obviously, sensationalism like we're not going to be eating canned goods in our underground bunkers, but people had lost a lot of faith in the system.

Tom: I think a lot of people were wondering if we would ever get back to 10,000 from the Dow.

Brendan: Well just as we can sit here now, we're not ridiculing, but just to use that word. You could ridicule people today for thinking that that wouldn't happen 10 years ago, but at the time, I think you were in the minority if you believed that things would get better. You would be ridiculed for that. And so I think that just goes to show that depending on what has happened over the last six months or a year, people let that determine what their narrative is, and just extrapolate from there. And so now-

Tom: We've met people-

Brendan: ... go 12 months ago, people wanted to do all sorts of ridiculous stuff a year ago in terms of-

Tom: I want to put money-

Brendan: ... "I want to own all of the thin stocks, all internet. I need to get more aggressive. I need to own Bitcoin. I need to own pot Stocks." And now 12 months later, we're talking about if this is it, and we're going into another recession, and I don't know. I mean, if we are, I just don't understand how that can be something that, again, to return to the point that the Fed is supposed to get rid of. If we never had recessions then what would growth even be? Would there be any reward for owning stocks if they never went down? Would they just be like a printing press where we went to collect our dollar bills to go spend over the next couple of months. We talk about equity risk and how there is a premium for owning stocks because there's risk involved, but then when the risk shows up, it's like this shocking event.

Tom: "I didn't know this thing could go down. I didn't know there was risk."

Brendan: Right. So the only way that you are rewarded for owning stocks over the long term is by bearing that risk. And risk in this case means that the prices are going to fluctuate, and it's not always going to be in the direction that we want. And when it's happening, it's going to feel scary, and people are going to have very plausible sounding narratives for why they're right, and this is the top, and you should get out now. And then also most of the time you should put your money into their gold bars or whatever the hell they're trying to sell you.

Tom: So Powell, we're recording this on a Monday. Powell, the Fed is meeting tomorrow, Wednesday. There'll be some kind of announcement, and there'll be a press conference. We don't know what he's going to say. We don't know what they're going to do. We don't know what they're going to decide. It's interesting to note though that most Fed meetings just as a matter of course, not all of them, but most of them when they take the vote, it's usually unanimous on whatever decision they have regarding rates. There were only a few times I think, once in Bernanke's tenure, and I think twice during Yellen's tenure where there was some kind of less than unanimous decision.

Brendan: It's like a dissenting opinion.

Tom: Right.

Brendan: Do we get that?

Tom: So I don't know what's going to happen, because at the last meeting it was unanimous that they were going to raise rates, and they were unanimous on the message. And are you telling me that the entire board is going to do a complete 180 in ... When was the last meeting? September?

Brendan: Right. And since then, what economic data has come out to suggest that they are totally wrong over a three month period. Aren't they considering economic data that stretches like rolling year plus period?

Tom: Yes.

Brendan: So what data points have been added to those time frames that now say, "We can't do this anymore." Aside from the stock market going down.

Tom: That has to have some kind of impact, but it shouldn't have the plunge protection team out there.

Brendan: Right, it shouldn't. And I get that my suggestion is overly naïve. I understand that they look at the stock market.

Tom: They do look at the stock market, but all the other economic data that's come out since the last meeting, if you could throw a blanket over it, more of the same. It's just more of the steady growth that we've seen nothing too alarming in either direction.

Brendan: A continuation of the steady growth that we've now seen for-

Tom: A long time.

Brendan: ... eight, nine years.

Tom: A long time.

Brendan: Yeah.

Tom: Yeah. I mean those first couple of years after 2008 weren't very good at all, but-

Brendan: Since at least 2011, 2012 we've seen improving economic data, and that obviously stretches over a long period. So there have been downside surprises in there too where the numbers didn't work out the way that we had expected, but for the most part improving economy continuing, going on eight, nine years now.

Tom: I don't want to sound like an old fuddy duddy but it's going to sure come out that way. I remember sitting in front of my Quotron machine in 1987, it was October 20th, the day after the crash, and seeing a headline come across the tape, "Greenspan says he'll do whatever it takes to support the markets. Keep the markets open."

Brendan: That was the same message they more or less sent in '08, '09 by doing quantitative easing. I mean that was not heard of at the time. It was new, right? That was a new thing that they instituted.

Tom: They had never used it. They had it in their back pocket, but-

Brendan: They basically saying like, "We're here. We're here to backstop all of you basically."

Tom: Right. I don't know what Powell can say. I mean, he really needs to thread the needle in the sense that we had Gundlach on TV today saying the Feds are in a tight spot because if they raise rates that's bad for the market, and if they don't raise rates they're saying something's wrong with the economy. Powell and the Fed need to think about how they're going to position their message, where they can kind of bring this in for a landing, and I certainly don't want to be in their shoes. But it's interesting that since Greenspan said that, now over 30 years ago, that there seems to be this implied put out there. The Fed put, the Greenspan put became the Bernanke put became the Yellen put and now maybe the Powell put, maybe.

Brendan: It's interesting though, I've heard that sentiment expressed, but it's not like we haven't had bear markets over the last 30 years now.

Tom: No.

Brendan: So there's been a Fed put so to speak, but it doesn't mean that they're going to prevent a bear market or a recession. We've had both of those things many times since that occurred.

Tom: In addition to trying to thread the needle and get in between what Gundlach said on CNBC. I don't know if that's a driver of the market, or if it's just noise, I don't know. But if you've also-

Brendan: Fear mongering, it sounds like.

Tom: Yeah.

Brendan: "No matter what, we're going down, don't worry."

Tom: You've also got this guy in the White House who is pointing the finger at his own Fed Chairman, who he selected saying, "I can't believe that they continue to raise rates, the economy's doing great." He has to also find a way to put out a response that's thoughtful, caring about the market and about the economy and about everybody in general, but yet not be a suck up for the president and create the illusion that the president really has a puppet in the Federal Reserve.

Brendan: Yeah, and I mean, we're speculating on all of this, as is Jeff Gundlach that we can predict the future. I mean, we're talking about the guy and the president, there were a lot of predictions about what would happen when he got elected that were totally wrong.

Tom: All wrong.

Brendan: And so yeah, we're recording this on Monday, like you just said, the message that many are believing now is that no matter, if the Fed hikes or if they don't hike, it's bad news for the markets. What if it isn't? I'm just saying. If we're so convinced of this, what if we're all wrong? Has that never occurred before, because I think it occurs a lot, and that includes you and I too. I'm not saying that we're smarter than everybody, but just, it's not easy to predict these things.

Tom: One of the things that we all tend to kick around when we're on the phone with clients are some of these statistics like the market's had a 10% pullback on average once every 12 months going back to the 1920s. So that's now 90 years of data that we have. A lot of those 10% pullbacks happened in the 1930s.

Brendan: Even since the 1950s the numbers don't change that much. You could chop off the Great Depression and you still have a 10% pullback about once every year.

Tom: Right. But the problem is that 10% pullback, it's not like the markets go to ... And this is what I want the listeners to walk away with, is that the markets don't go down exactly 10% and then stop or reverse, it doesn't work that way. A 10% pullback could be 14, it could be eight, it could be 10.5, it could be something in between. We don't know what it's going to be, but-

Brendan: It's interesting, just to stop you there. Since we've had this recent downturn that started in about the middle of September in the market, something that I like to do when I'm feeling nervous about whatever's happening that day is to just pull up a longer term chart of the market in terms of the price like S&P 500 or Dow or whatever. They're both doing roughly the same thing most of the time, but just to look at the price, like the mountain range chart that you could see on a longer horizon, and just to point to all the dates and points in time where we were also at this exact level, and to just wonder in my mind like what we were thinking about then. So like the prices we saw today we saw in March and February of this year. We saw them early December last year.

Tom: Totally different world.

Brendan: Totally different world, and price is the only difference there in terms of what direction we are coming from. Before it was on the upside and now it is on the downside that we're passing through these levels. But again, to just rope the Fed back in, if instead of considering the direction, they decided they were hiking last December, right?

Tom: Right.

Brendan: We have roughly the same economic data, maybe some differences. If you just gave them the S&P price, it's the same as last December when they decided to hike. So I mean, I'm not naïve, I get that what I'm saying can be refuted because it does matter what direction the market's going in but like man, let's try to put some things into perspective. Well, the world is not over.

Tom: The world is not over. It's hilarious, though, to look back at these same charts that you're referring to, and October 19th, 1987 was a day very early in my career. I was only about a year or so into production as a commission stockbroker. Now, that 22% drop in one day, I can't even find it on these mountain range charts.

Brendan: Another thing, and this is, I'm not sure the right word but very flip for somebody who wasn't there obviously to say, but wasn't that like 22% in a day correction more or less like round tripping the year?

Tom: Yes.

Brendan: Didn't it just take everybody back to where they were in like January of 1987?

Tom: Yes. In fact the market finished up that year.

Brendan: Right.

Tom: So yeah, it kind of wiped out all the gains between January and that day.

Brendan: I'm not trying to say I wouldn't be freaked out if we had basically a quarter of the market disappear in one day but like man. Again, like perspective that is easier to have in hindsight than it is in the moment. But if we can do some things like that little exercise that I just explained to try in the moment to put things in perspective and remain calm like, market plunges to prices not last seen since February of this year-

Tom: A few months ago.

Brendan: Where were you then?

Tom: Worrying about Bitcoin.

Brendan: Yeah. To kind of put some numbers on that, the Dow Jones went from 2200-something to 1700-something that day. In fact, the Friday before, on Friday, October 16, was the first time ever that the Dow Jones had dropped more than 100 points. It went down 106 points the Friday before. Moving on from that, I know in 1990, we had a recession, we had Saddam Hussein invading Kuwait, and we had just hit 3,000 on the Dow, and we went down to about 24, 2500.

We were down about 20%, and I felt like a lot of guys that I worked with, that we would never get through 3,000 again. 3,000 on the Dow. Do you think that sometimes it feels worse coming back through price levels that we saw a couple of months ago, because in the interim people have done probably dumb stuff?

Tom: Oh yeah.

Brendan: Like between February and September of this year, tweak the allocation maybe went more into stocks as things recovered, and especially into like the most high flying of names, like small caps were crushing it earlier this year, and now down much more than large caps are, right? Which makes total sense. They're small caps-

Tom: They're going to be volatile.

Brendan: ... they're riskier for a reason. But earlier this year, they were flying high, small caps, tech names, momentum stuff, all stuff that's been whacked over the last few weeks. Not to say that any of them are bad investments, or you shouldn't have money in, but to go in between the fact and buy more of what's working and get rid of stuff that isn't. I think some people do that, and then they get slapped on the wrist for it when the market eventually corrects.

Tom: I feel sometimes like perspective is the opposite of amnesia, or maybe I'm not saying this right, but when you've gone through ... I'm going to screw up the dates, but the first time that the Dow Jones went through 10,000, it was around '99 or the year 2000 when we went through 10,000 for the first time. In fact, they were throwing out hats from the balcony at the New York Stock Exchange when this happened. And we immediately pulled back from there, and it took a long time for the Dow to get back through 10,000. I think we went back to about 7,900. NASDAQ cratered at the same time, all the dotcoms imploded. You weren't thinking about, "We got to get back to 10,000." It was like, "Okay, last week was good, we were up. Let's make this week positive, and then let's make the next week positive."

All you could think about when you go through these big corrections is just build one good week on another good week. And actually, you can take it back even further. Give me one good day, build on a second good day. Give me three good days. All right, we had four good days this week, and then let's build another positive week. And then before you know it, all of a sudden it's like, "Hey, you remember we actually blew past that old high."

Brendan: Yeah. And I think that kind of speaks to how bottoms occur. And it's easy in hindsight to say when they were, but you don't know them in the moment, because I would imagine that some of the worst things that happened, some of the worst parts of a bear market are when you're building those days, and it's kind of like building a house of cards, because you'll build one day, and then it's like, all right, we had two days in a row that were good and then you get crushed on the third day. And then you build up a solid week and then you get slammed again, and then like two weeks. But eventually, like you described, this bottoming process occurs. But I think people instead look in hindsight and say, "Oh, there was the bottom and there was the top," and like, "I should have sold here and bought there." And it's like, "Holy crap."

Tom: It doesn't work that way.

Brendan: Even if you nailed the call to get out of the market somewhere along the way, to say that you were going to get back in somewhere in that gut wrenching bottoming process that takes months to occur, and then seemingly in hindsight it's like, "Wow, I guess we bottomed." It's not like, "Oh, we bottomed."

So to say that you're going to get back in is like ... I think people always make that case for why you shouldn't try to time the market, but I don't think it can be overstated enough. You're not going to get back in.

Tom: You won't. You won't do it, you just won't. When I was a rookie in the business, there were plenty of guys around me that went through '74, 1975 where the market, there was no news. It was just inflation, Watergate. There was just a lot of bad stuff going on. The economy was in a malaise. And I remember this one guy telling me ... It was the weirdest thing because the market at this point was a lot lower than it is now, but he was like, "The market would go down six points on Monday, and then the next day it would do nothing, and then the next day it would go down 11 points, and then the day after that it will go down eight, and then it would do nothing on Friday."

He goes, "That's what it was for two years, where it was just a grind down. Never went up. Some days it was flat, most days it was down, and it was just a slow grind all the way to the bottom until it had chewed up and churned out everybody in the business. Everybody that was investing in the market. It's just the way it was."

Brendan: Seemed like a brutal decade in hindsight, worse maybe even than experiencing some of the crashes in the early 2000s because of the duration that they occurred over, and without any kind of light at the end of the tunnel. Even if it was like a fake out. You could look at whatever occurred between 2002 and 2007, 2008 as basically a fake out, because you round tripped on the S&P when you went from 2000 to 2010. Maybe there were some of those during the '70s, but it seems like a period of time where bonds didn't work, stocks didn't work. Like what did you do? Gold, I guess. That's where a lot of gold bugs came from, right?

Tom: Gold did really well.

Brendan: You're shaped by whatever works when you're in your formative years of investing. So that's I think a lot of gold bugs are of that age, are they not?

Tom: Well, that makes a lot of sense. It's unfortunate, but it's-

Brendan: It's not unfortunate, if that's what they want to invest in then good for them. I don't believe in it, but that's terrific.

Tom: So we've got a Fed meeting this week. We're all kind of curious to see what has to happen, but like you were saying before we turned the mic on, I don't think that the market is going to become "good or worse," based on what one guy says.

Brendan: It might seem that way. And it's easy a lot of times to just point to one thing that occurs on a specific day and use it as a narrative to explain the entire world as if that could even begin to explain why millions of people decided to buy or sell shares on any given day. But I mean, I understand the need for explanations but man, I'm not sure that anybody can explain why the market does what it does on any given day.

Tom: People forget something, again, right before we turn the mic on, for every time that someone is in a panic and needs to sell, someone's standing on the other side of that transaction.

Brendan: Right, and people aren't always even selling because they're in a panic. There was a lot of selling today in the market on Monday, today. To assume that everybody who sold shares today is panicking I think is maybe not the case. Somebody might be selling shares because they're going to buy a house or something, or they needed money because they had an unforeseen expense, or they just decided that today is the day and they're going to do it. It doesn't mean that they were watching the market or listening to anybody talking head speak, or that they were parsing the Fed minutes or something. Somebody might have just been like, "Hey, my kid needs his tuition payment, I got to sell my shares today."

Tom: But there's someone else on the other side of that transaction.

Brendan: Yeah, there always is. But to assume what the motives on either side are is futile.

Tom: It's a stretch.

Brendan: Yeah. I get that it stinks to say that we don't know why the people did what they did, and that it doesn't give us any answers or clarity or comfort but that's the truth. I mean when the market goes down, you're not selling to nobody. Your shares don't just vanished into thin air, somebody else is buying them from you, and we don't know what their motives are, but it's interesting to at least wonder what those motives might be. What do they know that you don't? Why do they want to buy your shares?

Tom: Well, we'll see what this week will bring as we head into the end of the year. That's going to wrap up episode number 23-

Brendan: 236.

Tom: ... 236. So we will catch up with you on the next episode, and thanks for listening.