Ep. 238: Understanding Gold, No Bond Apocalypse, Credit Card Points - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management Podcast. This is episode number 238. We are your hosts Tom Mullooly, and Brendan Mullooly.

Brendan: First podcast of the new year.

Tom Mullooly: Here we go.

Brendan: Yeah.

Tom Mullooly: So Brendan, you want to kick things off with something that we don't talk about a lot, very often, the yellow metal.

Brendan: So over the last couple weeks, maybe the last month or so, we've seen gold do decently compared to stocks. Which is not saying a whole lot because stocks have not been great. One of the worst Decembers in history and pretty bad end to the fourth quarter of the year.

An article on CNBC last week was talking about gold rises as sliding stocks boosts safe-haven demand. I kind of have a problem with gold being called a safe-haven asset because I think that implies negative correlation with the stock market, and that's not really what gold gives you. Just break down for a second correlation and what we're talking about.

Tom Mullooly: So correlation means it moves ... Two bodies move in sync together. So they're moving together. So if stocks and commodities were correlated they would both move up and move down together. If something is negatively correlated it means one side's moving up, it's like a seesaw. One side moving up, the other side moving down. So if stocks and commodities were negatively correlated, that means if stocks are going up, that means commodities are going down.

But we've seen over the years that gold can go up ...

Brendan: Gold is neither of those things.

Tom Mullooly: Yeah, gold can go up when stocks go up. Gold can go down ...

Brendan: When stocks go down.

Tom Mullooly: When stocks go down. Gold can do nothing for a long time.

Brendan: Or it could sky rocket like it did in the early 2000s. I think from when GLD the gold ETF launched through 2011 or 2012, it was destroying the S&P 500. But then, since then, we've seen a complete turn of the tables.

Tom Mullooly: There was a point where GLD was the largest exchange traded fund.

Brendan: Yep.

Tom Mullooly: That just blows my mind every time I think about that.

Brendan: Yeah.

Tom Mullooly: And I remember that.

Brendan: Right. But, so gold isn't correlated with stocks. It's not negatively correlated with stocks, it's just uncorrelated. And so to say that it’s a safe haven, like you alluded to, I think is maybe misleading. Like you need to really understand what uncorrelated means. So it's not going to always hold up when stocks go down. And I think that that's what safe haven implies. When in reality uncorrelated has its own value, and I think that if you put something that's uncorrelated into a portfolio, the idea is that it's going to follow its own drummer so to speak. Move to the beat of its own drum, and it's not going to do anything similar to the other stuff in your portfolio. And that can lower the volatility of a portfolio over all. But if you're going to sit there like most people do, and look at all the individual parts of the portfolio, I think sometimes uncorrelated assets are the ones that drive people the most insane.

Tom Mullooly: I'll agree with that because I have owned gold for clients early on in my career. And what typically happens is we get into a position like that and six months, a year, 18 months into a situation, we get a call from a client and they say, "Tell me again why we own this? Why did we buy this?" Or, "What are we doing?" And we wind up ripping it out of the portfolio. Usually right before it's about to make a move by the way.

Brendan: Yeah. I think another thing that makes gold difficult is that with stocks and bonds, there's some kind of underlying fundamental topic that you can discuss in terms of like owning a company or a group of companies with stocks. Like they have earnings, they have-

Tom Mullooly: There's going to be news at least every 90 days.

Brendan: Right, right. Like there are businesses that generate revenue and employ people, and there are a tangible thing. Like try telling me why gold does what it does. I don't know. Because there's like an ancient belief that this thing has value, or that it has held value over time. I'm just not sure.

Tom Mullooly: Well the other problem that you get into is that it's not just me and you that are trading gold. There's also nations that get involved with trading gold, and trading oil, and trading all kinds of different commodities. So there's so many moving parts when it comes to this. It’s hard to fundamentally analyze or put a value on something like gold.

Brendan: Right. And I think that if you're talking about countries, big corporations using things like commodities, they're often doing so in the future's market. And the intention of that originally was to ensure against, like if you're-

Tom Mullooly: Future delivery.

Brendan: Right. If you produce oil then you can head your exposure so that the price of oil doesn't destroy your business. It wasn't created so that people could gamble on the direction of assets over the short term. Which is what it has turned into.

Tom Mullooly: Right.

Brendan: And that's all you would be doing in terms of an asset like gold, which has no underlying utility whatsoever.

Tom Mullooly: So gold has had a pretty good month.

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Tom Mullooly: It kind of segues into the next bit that we want to talk about. You know when people are looking for things that are correlated or uncorrelated or negatively correlated with stocks, the topic of conversation usually turns to bonds. And you've come up with some interesting numbers for bonds.

Brendan: What brought my attention to this was a tweet that I saw from Cullen Roche over the last couple of days, and basically to just put my own spin on his tweet. I'm not quoting him directly, but he was like you know after all the fear mongering in 2018 over interest rates and what they were going to do to bonds, the Aggregate Bond Index finished flat. So it's up like one tenth of a percent.

Tom Mullooly: And the Fed raised interest rates four times this year, after three times last year.

Brendan: Mm-hmm.

Tom Mullooly: So we're-

Brendan: It just goes to show like if you rewind the clocks one year to January of 2018 and tell us then that the Fed is going to hike four times, and asked us for a prediction on what that would mean for the Aggregate Bond Index, I think most people will be wrong because the intuitive thing to say is like, "Oh, of course well, rates are going to go up and bond prices must go down." But there's obviously other factors feeding into that in the interim like the market falling out of bed in the fourth quarter.

Tom Mullooly: Yeah.

Brendan: That can impact these different bond funds. I mean hardly catastrophic if you're looking across a category. I looked at HYG, which is high-yield junk bonds down 2% on the year. TLT, which is the long-term treasury bonds down 1.6%, 7 to 10-year US Treasury bonds. IEF up 1%. Looking across credit quality and duration across the spectrum there, ranges from up 1% to down 2%. Again, feeding into the idea that we've discussed on here before that a bad year for bonds is like a bad afternoon in the stock market. And we've seen that be very true over the last month now with his stocks moving ...

Tom Mullooly: Violently.

Brendan: One plus percent multiple days in a row just over the last week or two here.

Tom Mullooly: I think it was nearly every day in December, stocks moved more than 1% at some point during the day.

Brendan: It seemed like it. And if it wasn't it was close, but just to say like you know, if you a fear mongered out of your bonds I mean ...

Tom Mullooly: It's a mistake.

Brendan: I'm not saying everybody should own bonds or that rising rates will never have an impact on returns of the aggregate index. I'm just saying that there was a lot of hand-wringing over stuff that ended up not mattering over the last year for bond prices and people who had a 60/40 allocation of the S&P 500 in the Aggregate Bond Index probably didn't make money last year, but I don't think they would have been better off not having the bond piece.

Tom Mullooly: It's pretty interesting how I think a lot of folks that own this in say 60/40 or 70/30 type of portfolios were probably scratching heads in April, May, June saying, "Why do we even have bonds ... "

Brendan: Yeah, of course.

Tom Mullooly: " ... in our portfolio. They're doing nothing. In fact, they're down a little bit. What's up with that?" And then by the end of the year, all these has got back to even-

Brendan: Completely reversed.

Tom Mullooly: Stocks have fallen apart.

Brendan: Why do we own any stocks after the fourth quarter or after that performance, right?

Tom Mullooly: Yeah.

Brendan: So yeah, the narrative totally changed. From January through August, bonds were cost and then they weren't. Let me know beforehand when that narrative is going to flip and then we can just be 100% and whatever is working, but if you can't do that then you're probably going to have to find some balance between the two of them.

Tom Mullooly: Right. There was an article that we both saw over the weekend in the Wall Street Journal about ...

Brendan: Credit card points.

Tom Mullooly: ... points.

Brendan: A hot topic. There are sites that are literally dedicated to just this topic.

Tom Mullooly: I will say that you have to use a lot more points to buy a plane ticket to Florida now.

Brendan: Yeah. And that's what this post was kind of talking about. It was honing in on rewards credit cards and how some of the big banks that give these rewards out are now backtracking on them, or at least second-guessing themselves in terms of ... You know the idea was always offer these rewards and it will lead to ancillary business. Like people will do other things with the bank because they had a card with them, maybe they'll work with the wealth management arm, or they'll get a mortgage through us, or all these different things.

Tom Mullooly: Kind of along the same lines from 30 or 35 years ago, when Sears decided it was a good idea to buy Coldwell Banker and Dean Witter and Allstate.

Brendan: Yeah.

Tom Mullooly: And not really.

Brendan: Yeah. I mean this hasn't been like a total dumpster fire for the banks, but some of these numbers were pretty crazy I thought. So the article said that as of the third quarter of 2018, rewards cost at big banks like Bank of America, Citigroup, JP Morgan, Wells Fargo were up 15% year-over-year. And JP Morgan card holders as of the third quarter had accrued 5.8 billion dollars in rewards, which was up 53% from 2016.

Tom Mullooly: That's an outrageous jump year-over-year.

Brendan: I'm also leery of big numbers like that, like the 5.8 billion because it sounds like a ton, but then let's put that into the perspective of JP Morgan and what they generate in revenue over a year. But still, a lot of money owed to the people for using credit cards is linked to these different big banks.
And so the article went on to share some different anecdotes about how people have been like "gaming the system" or winning in these and the level of detail that people have to pay attention to in order to use these kind of cards to get rewards, it was kind of astounding to me. Like I think that if people paid half as much attention to their cash flows or the fees of their investment portfolio as they do to reward points that their earning on credit cards, then man, I think people would be a lot better off in terms of their overall financial situation.

Tom Mullooly: Well, we both heard the refrain that people will spend weeks and weeks researching where they're going to go on vacation next year, but they won't spend a fraction of the time planning their retirement.

Brendan: It's totally true. And I get that vacation or the new TV that you want to buy or whatever has like a more immediate payoff and so it's more fun to research. And it's the same thing with this kind of stuff because you're basically researching ways to obtain free money or travel in many instances with these rewards "free." As long as long as you're using these things and paying off the balance at the end of the month to, which the bank is not counting on, you can be one of the success stories that this article ended up being about.

Tom Mullooly: I think what bothers me above and beyond all of this are the TV commercials where you're asked like, "What kind of car do you have? What's in your wallet?" Or you know, "You're using a card that doesn't give you points?" Like, "You must be an idiot." And they just portray these actors as having this glamorous life. And really what you're doing is becoming a slave to paying off that debt.

Brendan: Right.

Tom Mullooly: Well, quite the opposite.

Brendan: Yeah. And I think for what? Maybe four or five success stories here about how people are gaming the system and taking free vacations every year. There's probably at least two or three times that in terms of just like horror stories where somebody opened up a rewards card and put their in a big purchase on there, and maybe did go on a free trip, but then forgot to pay off this thing, and now they're paying interest. So the fact that the banks are trying to walk back some of the rewards tells me that they're not as profitable as they thought they would be, but I'm sure that there are still people carrying balances month-to-month on these credit cards that offer rewards, and that is where the bank is making their profit.

Tom Mullooly: I just think that that whole business has to be a big churn. I don't understand enough of their credit card business to even sound remotely like I know what I'm talking about, but there's got to be a fixed amount or ... That's a bad phrase to use, but there has to be a limit to the amount of credit that's out there and it just gets churned. Meaning, "Hey, we have a Bank of America card last year and now we're going for this Capital One deal, and then we're going to get something from TD Bank and next year we're going to do this deal with Chase." And we're just moving from one to the other day. They're not really growing the business.

It seems to me like there's some service businesses, I think of Payroll as an example. There's not a whole lot of growth. It's just swiping business from somebody else, and that's where the growth comes from. So I wonder if these banks and credit card companies created these reward systems and basically one-upping itself on offering greater rewards to steal some of the asset side of the business.

Brendan: That's definitely happening and that's a ... The article touched on a little bit of that too, in the sense that some of these banks want to walk back some of the offers, but they have seen real life examples of when they take the offer away. People really do leave people because people are paying attention in this kind of stuff, which again back to my point, it's like man if you're paying that close attention to what different credit cards are offering and the rewards and what their point system translates to in terms of plane tickets or whatever. I mean ...

Tom Mullooly: We just hope your maxing out your 401(k). For goodness sakes.

Brendan: Yeah, or like ... I don't know.

Tom Mullooly: Yeah.

Brendan: Really you should be fully optimized in terms of other financial decisions you need to make too. I hope you're spending as much time on those things, but-

Tom Mullooly: I said this to Brendan before we turned on the microphones, but when I was a kid growing up, occasionally I'd go food shopping for my parents or with my mom and everybody paid in cash. Occasionally, they were someone who paid by check, but if you ever, ever, ever saw someone paying with some kind of credit card, this was in the 1970s, the whispers are out in the parking lot were, "What's wrong with the Smiths? What's wrong with them? They had to put their groceries on a credit card. Holy cow!"

Brendan: Yeah. Amazing how that's totally changed because-

Tom Mullooly: Now, people go to parties and they brag about, "Oh, I paid my groceries with my American Express card and I got points."

Brendan: Yeah, and that's again like you would see these commercials where like the group of friends is out to eat and then the one of them pays for their whatever because they want to get all the points. So the banks have definitely encouraged this environment, where points are sought-after and people will hop around from card to card to obtain them.

Final point, that kind of is important too. This idea of hopping from card to card based on annual offers or to avoid the annual fee associated with some of these cards because if somebody ... Like if you're doing that, that's great and everything. If you're doing it responsibly and beating the system, terrific, but just something to keep in mind is that if you're going to be applying for something like a mortgage or anything that requires a credit check, if you're closing lines of credit and changing companies, there are going to be ramifications in the short-term on your credit score because you're opening tons of lines-

Tom Mullooly: If you have so many inquiries on your credit accounts, that's a problem.

Brendan: Right. At least to my knowledge, that could have a negative impact on what's going on in terms of your credit score. So something you keep in mind if you're going to buy a house over the next couple of months, and you're trying to avoid some annual fee on a credit card, it may be better just to bite the bullet and pay your $300 or whatever the heck they're going to charge you because if it ends up costing you in terms of the interest rate you get on your mortgage, I think that's going to be more expensive over the long-term.

Tom Mullooly: Just one last thing on credit cards. My very first credit card, I know I mentioned this in the previous podcast. My very first credit card was a Sears credit card, and the reason why I wanted a Sears card was because I was going to CW Post, and there was a Sears in Hicksville on Route 110, and they had gas pumps in front of their store. So I knew that I could get gas for my 1979 Chevy Chevette and I could get to work in Syosset and get back to class at CW post for school. But Sears, here we go, stocks trading like it's gone for good and you know Sears and Kmart are now ... Actually Kmart bought Sears, but they kept the Sears name when repackaged it as Sears Holding. I guess that was 2002 or 2003.

So for the last 15 or so years it's been a Sears and Kmart. And we mentioned earlier in this podcast about how Sears bought and then later spun-off Coldwell Banker, Allstate Insurance and Dean Witter, which became Morgan Stanley. A lot of value carved out of Sears. They also had Kmart, and I think a lot of people overlooking ... It's easy to remember stocks and stocks and Dean Witter and all that stuff, but Kmart also owned ... It's not the Barnes & Noble. I think it was Borders Books.

Brendan: Okay.

Tom Mullooly: And they own the Sports Authority, which they carved out. And there was another company, pretty good size, that they carved out. All of these companies, these were the aggregators in the '70s and '80s and everybody ... I know this was a previous podcast topic, everybody talks about how Amazon put Kmart and Sears out of business. They didn't. Sears and Kmart just refused to innovate and continue to make changes to bed. There's going to be a lot written, a lot of angst spilled over the over 2019 about how retailers and Sears in particular have gone down the drain.

Brendan: A lot of a lot of financial engineering from guys upstairs at companies, like those too, as opposed to like you said growth, but at a certain point you got these giant companies. Like what are they supposed to do to grow? But I guess in hindsight, it probably could have been getting on the internet.

Tom Mullooly: It's funny because Sears really was the Amazon of its day in the sense that they first started with the catalog business. And then I forgot the guy’s name, he convinced Sears and Roebuck that he wanted to open up like an outlet for these stores, to build the stores so they could sell all the merchandise that they had and I mean that thing just exploded.

So they were pioneers in the sense that they started a catalog when really there was nothing else out there. And then they started the stores, which no one had done, and they institutionalize the business. So they really were doing Amazon type work, but I think they kind of lost their way. Too bad.

Brendan: Yeah. I mean how long can you keep up that kind of a trajectory?

Tom Mullooly: Good question.

Brendan: Right? Because every decade has these companies that were the new thing, innovating, and then eventually they have to reach some kind of an endgame because I mean you can look at the biggest companies from every decade and they're not the same in many cases. Even if a company spends a couple of them, they tend to fall off the map at some point.

Tom Mullooly: Well, again one more story before we turn off the mics. I'm reading James Clear ...

Brendan: Atomic Habits.

Tom Mullooly: Atomic Habits. And there's a chapter where he talks about this guy Patterson who had a store and he found out that his employees were stealing from him, so he actually found someone who built the cash register. This is in the 1870s, and he bought two for his store and his profits were realized immediately. People stop stealing from him. And he actually shifted his business model, bought the patent for these cash registers, and he started a company called National Cash Register.

So when I got started in the business I didn't know that it was called National Cash Register. I just knew the stock as NCR. That was this huge company. And then NCR was eventually bought out in 1990 or '91 by IBM. And so it's interesting to see how these companies get peeled off, merged into other companies, get spun out again. There's actually a lot of interesting family trees or ...

Brendan: Company trees.

Tom Mullooly: Company trees, I guess we should call it, just showing like where these companies all morphed from. Interesting stuff, but not for anymore in episode 238.

Brendan: Yeah. I think that's enough for the first episode of the New Year. Don't want to burden people with too much here.

Tom Mullooly: Good way to start. Thanks for listening, and we'll catch you on the next one.