Why You Don't Have an Informational Edge Investing Today - Transcript

Tim Mullooly: Welcome back to the Mullooly Asset Management podcast. This is episode number 255. This is Tim Mullooly and Brendan’s here with me today. We've got a good handful of articles that we wanted to cover in today's episode.

Brendan: We're going to start off talking about James Harden. Go figure. I don't think most people would expect to lead off an investment financial planning related podcast with basketball, James Harden, but our friend Drew Dickson tied in James Harden to a quick post that he did last week about edges and whether or not any of us have them.

Tim Mullooly: Right. Full disclosure, I'm not a big NBA guy, but I know the narrative about James Harden and his traveling antics and how he takes like three or four steps and jumps back and takes a shot and the refs don't call it.

Brendan: Yeah, not a basketball guy.

Tim Mullooly: I know the premise.

Brendan: His thing is like the step back jumper.

Tim Mullooly: Right, yeah.

Brendan: That's what he's known for. Other people in the league are doing this now too. It's become pretty prevalent. Take, it seems like two quick steps back. I don't know if anybody out there saw the video that was floating around the internet a couple of weeks ago where it was him like doing a step back and then somebody photoshopped it on like him traveling across the world basically, which is pretty funny.

Tim Mullooly: Yeah, but the point that Drew was making in the article was that everyone kind of sees that as a leg up for Harden like, hey, this guy can take ... The refs aren't calling it when he takes all these extra steps, but now other people are starting to do it as well and not having it be called traveling. The advantage is-

Brendan: Right. The definition of traveling has been changed over the course of the years.

Tim Mullooly: Right.

Brendan: Drew was like watching this game with his brother and both of them had played basketball in high school and were like average by their own accounts. Drew was like, "Man, like can you only imagine if we were able to take extra steps like all these guys in the NBA now?"

Tim Mullooly: Right.

Brendan: His brother was kind of like, "Yeah, but like everybody else would have been able to take the extra steps too."

Tim Mullooly: Right.

Brendan: The point was it wouldn't have made them any better because the playing field was leveled.

Tim Mullooly: Right. The comparison, the tie that he made to investing and alpha, which is trying to find some sort of edge or out-performance in the market is that if everybody has the same advantage then it's not really an advantage anymore because it's just a level playing field. You're all operating under the same rules.

Brendan: Right. He specifically was talking about like somehow having like better information than somebody.

Tim Mullooly: Right.

Brendan: He rattled off a couple of things, like do you meet with company management? Do you build your own earnings models? Do you pull credit card history, satellite images and other big data in real time? So does everyone else.

Tim Mullooly: Right.

Brendan: Everybody is out there doing this, operating with the same information, so you either have the same info as everybody else and you should recognize that, that it's not an edge and that's not where, if you are going to outperform, that's not where it's going to come from, just having better information.

Tim Mullooly: Right.

Brendan: You probably don't, or you actually have insider information, which is probably, I think even more unlikely. Where could you obtain better results than others? You could behave better than them. You could have a longer term mindset than them.

Tim Mullooly: Lower cost investments than other people.

Brendan: Right.

Tim Mullooly: Yeah, I mean in today's world with all this public information flying around 24/7 at the speed of light, everyone has essentially the same information. Even if you do have a slight edge in some sense, the word that Drew used in the post was if you think you have a sustainable information edge. It's like, yes, you might currently have an edge over someone else, but is that sustainable?

Brendan: How quickly is that going to be disseminated across the marketplace?

Tim Mullooly: Right. Exactly. Yeah.

Brendan: Well, especially I think an important one ... It's easy to get sucked in when you see headlines about the markets or a company or ... If you're reading this kind of information in like a press release or like you're listening to the earnings call, like it's too late. The information's out there. There's no way to take something that you just read on like MarketWatch and like go trade your account and profit off of it.

Tim Mullooly: Right.

Brendan: That may have been how the world worked at some point where you could like stay ahead of the news and trade and profit based upon that decades ago perhaps, but especially after Regulation FD, which spoke to a lot of this insider information that may have existed more prevalently in the past, it's just not out ... The opportunity isn't out there. To think that you can trade based off of what you're reading on a Bloomberg terminal or your computer on a day to day basis is not realistic.

Tim Mullooly: Yeah, it's probably not as significant as you as you think it is. Unfortunately for some people out there and unfortunately for James Harden, the advantage seems to be nonexistent anymore.

Brendan: Yeah. If everybody can do something then it's no longer an advantage.

Tim Mullooly: Yup. He'll just have to start taking four steps as opposed to three, find a different way to travel or break the rules.

Brendan: Yeah. We'll see them where the game goes from here, but I think every sport has these kinds of things. That's, I think, why it's also really difficult to compare players from different eras.

Tim Mullooly: Right.

Brendan: The game's just like so different, not just basketball, I think every sport.

Tim Mullooly: Yeah. The players are different. We hear about how athletes are getting bigger and stronger as time goes on. The rules changed. Things get a little more lenient. Styles of play are different.

Brendan: Yeah. I think that also you could ...

Tim Mullooly: Apples to oranges.

Brendan: Great investors, you could say the same thing.

Tim Mullooly: Right.

Brendan: It's like trying to compare Kobe to Wilt Chamberlain to, I don't know, name it, but like across decades, can we really sit around and compare Jim Simons from RenTec to like Peter Lynch to Warren Buffett? They all operated under very different circumstances. Really tough to say like who's the best. I think that's why those debates will continue forever because there's no correct answer and so everybody can be right in their own mind, based upon whatever they think.

Tim Mullooly: Right. Yeah, but definitely it was a quick article from Drew, but it had a pretty good point to hammer home there.

DISCLAIMER: Tom Mullooly is an investment advisor representative with Mullooly Asset Management. All opinions expressed by Tom and his podcast guests are solely their own opinions and do not necessarily reflect the opinions of Mullooly Asset Management. This podcast is for informational purposes only and should not be relied upon as a basis for investment decisions. Clients of Mullooly Asset Management may maintain positions in securities discussed in this podcast.

Tim Mullooly: I think the next article that we wanted to touch on was from Barry Ritholtz. It was about selfie deaths. The title-

Brendan: Yeah, we just led with two articles that I just like ... We're talking about people dying taking selfies and James Harden today on the Mullooly Asset Management podcast.

Tim Mullooly: Go figure.

Brendan: Sorry about that.

Tim Mullooly: No, no, two unusual topics to start off, but they have pretty good points when you dive deeper into the articles.

Brendan: Yeah, we swear there's a point to this.

Tim Mullooly: The title of the article, Selfie Deaths Are Like Stock Market Crashes, again, from Barry Ritholtz. He started out by saying over the last 6 years, 259 people have died from selfie related deaths, usually climbing out onto some unsafe place and falling from a great height or something happens, but he was talking about how these selfie related deaths are kind of bizarre instances, same thing with like shark attacks. People are terrified of getting attacked by a shark when the odds of that happening are so slim.

Brendan: Right. We're really focused on these low probability events that are vivid because they're gruesome, like a shark attack or somebody falling from a really high place. These things are really unlikely and we spend a disproportionate amount of time worrying about things like that, as opposed to like two other examples, like if you're at a beach, probably way more important to focus on something like getting skin cancer, which kills many people each and every year, or as opposed to like a selfie death, to worry about something like heart disease, the number killer of people here in America.

Tim Mullooly: Right.

Brendan: We don't worry about these things that we are all at very high risk for, that that we can control, and we get sucked into exciting, I don't know if exciting is the right word, but vivid and gruesome stories about people dying from things like taking a selfie or being attacked by a shark when the probability of that occurring is incredibly low.

Tim Mullooly: Like you said, people won't go in the ocean because they're afraid of getting bitten by a shark, but they'll sit on their towel or in a beach chair wearing no sunscreen for eight hours a day.

Brendan: Right.

Tim Mullooly: What's more likely to be the cause of your death? Tying this in Barry's point, how selfie deaths, shark attacks are like stock market crashes, investors fear these huge one time catastrophic events like a 1987 crash. Things like that, that don't happen very often, are kind of similar to-

Brendan: I mean you can rattle off the major ones from the last 20 or 30 years and everyone will remember them because they occur so infrequently.

Tim Mullooly: Right.

Brendan: Like the other examples, we do spend the majority of our time as investors worrying about these one-time events, things that occur very infrequently, when it would probably be more useful to focus on things like fees and behavior, which can, instead of being a dramatic one off event, can just like slowly erode your money over time by paying high fees or by behaving poorly and jumping in and out of the markets at the wrong time. That can dramatically impact how much wealth you will have at the end of your accumulation phase. You have absolute control over the amount of fees that you pay and how much credence you give to a behavior and how well you behave.

Tim Mullooly: Right.

Brendan: You don't have a lot of control over when the market's going to crash or when a shark's going to happen to be in your vicinity when you step into the ocean.

Tim Mullooly: Right. Along the same lines of fearing these big crashes, Barry says, we're also enticed by these hot, crazy, exciting things that come along. People have fear of missing out on like the next big thing. I think one of the lines that he said, he was like, people want ... We want Amazon. We want Bitcoin instead of diversification and low cost investing. We want to take part and be a part of these fads and crazes like Bitcoin a couple years ago, but people don't really give any ... It's not sexy. It's not exciting to be like, wow, look how diversified I am, or it's so exciting to have this low cost fund in my portfolio, when in reality those are the things that really kind of get you to where you want to go over time.

Brendan: Yeah. To put a bow on all of that, I think that we spend too much time worrying about what's possible and not enough time worrying about what is probable.

Tim Mullooly: Right.

Brendan: These are low probability events like hitting the jackpot in some obscure asset class or a 20% down day like 1987 or a shark attack, when we could be worrying about what is probable and what can I do about those kinds of risks?

Tim Mullooly: Right. One of the articles we wanted to talk about was from Morningstar about their fee ... They recently just put out a study about fees.

Brendan: Yeah, so they do a fee study each year. They've done it since 2000 and they look at the asset weighted average fee of mutual funds and ETFs. The reason they do asset weighted is to kind of show ... Asset weighted just means like where the dollars are.

Tim Mullooly: Right.

Brendan: They want to take into account fund fees, but they want to also take into account which funds are people investing in more than others.

Tim Mullooly: Right.

Brendan: They don't want to give too much weight to crummy funds that have high fees or whatever the case might be, but every year since 2000 this number has dropped.

Tim Mullooly: Right.

Brendan: That trend continued in 2018. In the year 2000, the average mutual fund and ETF, the average asset weighted fee was 93 basis points and it's down to ...

Tim Mullooly: It was 48.

Brendan: 48 basis points in 2018.

Tim Mullooly: A 6% decline from last year alone.

Brendan: Yeah, and they put that into dollar terms, so a five and a half billion dollars estimated in savings from fund fees being cut, just between 2018 and 2017, so in one year. Obviously that's the culmination of a lot of different people getting one or two basis points sliced off of their funds.

Tim Mullooly: Right.

Brendan: It's not like ... You read that number and you're like, wow, everyone's rich now because of this.

Tim Mullooly: We saved so much money.

Brendan: Collectively we saved an estimated five and a half billion.

Tim Mullooly: Right.

Brendan: We all saw that in the degree to which we have exposure to these kind of funds.

Tim Mullooly: Yeah. They outlined a couple of reasons or factors that played into the fees continuing to drop. Some of the top reasons they said was just investor awareness that we've seen over the last couple of years. Investors, even people just coming in our door, they're more worried about fees and low fees, which is good, obviously.

Brendan: I don't think the message has ... Obviously with the numbers and what you said, we've heard more people talking about this, but we still see ... To say the average expense ratio is down to somewhere like 48 basis points or how they're measuring it here, we still see people come in with portfolios that are costing them like well over 1% in mutual funds and they have no idea. It's just enlightening to share that kind of information with them.

Tim Mullooly: The snowball is-

Brendan: You can have this exact portfolio for like 1% less than what you're currently paying and there would be no ill effects to do that. There's no reason to continue paying these high fees.

Tim Mullooly: Right. Yeah, so I think the snowball is rolling in terms of spreading awareness.

Brendan: They even broke it down to ... I'm not willing to say that everybody should be all passive all the time, but fund fees are even dropping ... They split it up. Passive funds in this study are down to 15 basis points on average, where active ones are down to 67. I mean, 67, it depends, if you want active management for a portion of your portfolio, it should be in this neighborhood. Just to give yourself a good barometer of what you're ... If you have an active fund and you like what they're doing but they cost double that still, then it's like, all right, well are they clearing this hurdle because there are probably cheaper alternatives out there even if you want to stay in an active fund? I mean, like you said, the snowball's rolling and they even looked at like the cheapest 20% of all of these funds took in like over $600 billion last year. The other 80% had net outflows of like 475 billion, something like that, very close to those numbers.

Tim Mullooly: Right.

Brendan: Just to show that people are becoming more aware and that most of the new money coming into the cheaper funds are basically, it's just like hemorrhaging from the more expensive ones, whether this is individual investors waking up to this idea that costs matter or people working with advisors who are sharing that message with them, but

Tim Mullooly: Or a little bit of both.

Brendan: Yeah, probably both.

Tim Mullooly: Then I think on top of that, between those two factors, the fund families and the fund providers themselves are seeing this awareness growing and they're responding by cutting their fees.

Brendan: Right.

Tim Mullooly: It's just causing, like we've been saying, snowball

Brendan: Vanguard lowered fees again last week. Vanguard lowered fees on their ETFs, which were already microscopic.

Tim Mullooly: Right.

Brendan: A basis point here or there on about a dozen of their ETF products last week, as if they needed to.

Tim Mullooly: Right. Well, we're going to stop there for this episode, episode number 255 of the Mullooly Asset podcast. Thanks for tuning in and we'll catch you on the next one.