Informational Edges are Extinct - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 276. Today we're going to be featuring a short chat on Peter Brant and Leonardo DiCaprio. I am one of your co-hosts, Tom Mullooly. And alongside me is ...

Brendan M: Brendan Mullooly, and how could you not want to listen to the entirety of this podcast after that lead?

Tom Mullooly: That's right. And watch out for John Travolta.

They showed a picture of the same racket and tennis club in Midtown Manhattan where they actually shot the scene for Bud Fox to play with Gordon Gekko and just some of the other places that they showed. I was like, wow, you know what, I didn't realize. But this book actually provided a part of the story and this was a whole insider trading thing with a guy at the Wall Street Journal who was feeding tips to a broker. So what was going to be in the Heard on the Street Column tomorrow. It's pretty funny when you read those stories and then that actually showed up two years or three years later in a movie and it just makes you think about stuff. Even a movie like The Sting. You seen that?

Brendan M: Yeah, I watched that with you.

Tom Mullooly: Just the way the whole thing was set up.

Brendan M: Well it's like what Charlie Ellis says in terms of you don't have an informational edge anymore. And if you think you do, you're deluding yourself because he used to go to the library, I think, on the day that the company filings would be reported. And whoever could read it the fastest and run to a payphone could call the people on Wall Street to get ahead of other people. Just think about that. Let that sink in. That literally is not happening anymore. If you think that you have an edge, you're out of your mind.

Tom Mullooly: Along the same lines, I mean, even when I got into the business for the first four, five, six years, if you wanted to get a quote on a stock, you had to call a broker. That's what the broker of the day calls mostly were. What's AT&T doing? 25 and seven eighths, up a quarter.

Brendan M: Right, right. And you didn't get something down to the penny. You got something squishy so that, yeah, there could be a profit built in for whoever was going to do a transaction.

Tom Mullooly: Yeah. I mean it was-

Brendan M: That was the way the business was.

Tom Mullooly: Early in my career, I would tell people about stocks and they would say, send me a tear sheet. And S&P used to send these. Every brokerage office would have binders in a library room like this. And there was a page for every company. S&P did a two-pager, front and back, on the basic financial. So you would get a really slimmed down balance sheet. You know, some income numbers.

One of the classes that I took for my master's degree was doing stock analysis and that's what we used, were these tear sheets. But people would still call up, we would talk about a stock, "Oh we should look at a brown shoe and send me a tear sheet." And so I would actually have to go in, make a copy because I couldn't send it out. Make a copy and mail it to someone. That was like fast information.

Brendan M: Yeah. Just to wrap that into two things that we both read recently. I mean there was a post today, yesterday, from Nick Maggiulli and the title was something along the lines of how there are no secrets. But how everybody that talks about investing wants to know the secrets and that's why we get articles like five hot stock tips to play the trade war or whatever. So we're constantly duped by these things and a lot of us deep down, we know there are no secrets.

Tom Mullooly: There aren't. There's no information edge.

Brendan M: No. So the edges that are out there, Bob Seawright went over this in a post recently called Go for It. So he was talking about how coaches, this is just math, that coaches in the NFL should be going for it more on fourth down and that doing so would give them a quantifiable mathematical edge over their opponents. However, they don't because of career risks. They don't want to be fired because it's weird to go for it on fourth down in your own territory, let's say, unconventional. So they would rather fail conventionally, basically coach to delay losing as long as possible, instead of coaching to win.

Tom Mullooly: I think he talked about... One example he used was Rex Ryan with Buffalo.

Brendan M: And he talked about Cliff Kingsbury this year, I guess. So not last week, but week two, the Cardinals kicked field goals down. I think multiple touchdowns from inside the five-yard line. So they'd rather fail conventionally than potentially win unconventionally because you still get questioned if you do it unconventionally. But his point at the end of all of this, after sharing these numbers and a couple of stories, which were really good as usual, was that there are no investing counterparts for these ready-made competitive advantages. Meaning-

Tom Mullooly: Fourth in one. Go for it.

Brendan M: Go for it.

Tom Mullooly: And take the points.

Brendan M: And you will prosper because this is a quantifiable edge. They don't exist. Even though things like hedge funds and stock trading formulas and all these stories you read will tell you about how you could possibly have an edge if you'll most likely just pay somebody a higher fee. Normally they'll charge you for this possibility of having an edge when in reality the edges are time, patience, diversification, like these-

Tom Mullooly: Oh man. Boring.

Brendan M: These core tenants. Right, exactly. So they don't feel like advantages. They feel like the opposite of advantages. They feel like punishment. It's like, what do you mean, I have to be more patient and diversify? That guy said he put all his money into one stock and now he's retired.

Tom Mullooly: Right.

Brendan M: These stories are far and few between. And to suggest that we have informational edges, just to wrap around this entire thing that we've begun discussing, to suggest that there's informational edges out there, it's ludicrous. And I think that it's dangerous for people to operate under the assumption that they have some kind of an edge.

Tom Mullooly: I think a lot of people waste time.

Brendan M: It is a time waste.

Tom Mullooly: Looking for the-

Brendan M: Holy Grail.

Tom Mullooly: Yeah and it's just not out there. If you can prevent yourself from making unforced errors, you're going to be better off. Again, back to a Charlie Ellis-

Brendan M: Winning the Loser's Game.

Tom Mullooly: So, we've gone full circle. We started talking about... What was the name of that? Oh, there's a book called Trading Secrets. It came out in 1985, still on the shelf here at Mullooly Asset Management, where we talked about-

Brendan M: This is a story by the way, right?

Tom Mullooly: This is real.

Brendan M: This is real. So this really happened.

Tom Mullooly: Yeah, Peter Brant I think did time.

Brendan M: Okay.

Tom Mullooly: He was a broker at Kidder, Peabody. A guy named R. Foster Winans was a reporter at the Wall Street Journal and he had access to the Heard on the Street Column. And so he was, they made a deal. They knew each other and made a deal where the reporter was filtering information to Peter Brant, the broker, and they were making a lot of money.

Brendan M: So, but it's interesting that so things like this and then you had brought up the movie Wall Street and how it had potentially borrowed some ideas or concepts or just locations in general from this book. And a lot of the way that our industry is portrayed in popular media, movies, TV, whatever, it does suggest that there are... Most of it revolves around somebody having some kind of an edge because of information that they get. Insider trading or a hot tip that makes them rich overnight. But the point that I would make is that that's entertainment. But I think that it sends off the wrong-

Tom Mullooly: The wrong message.

Brendan M: Ideas to people, yes. Yeah. So people get the idea that that is how we're here obtaining secret trading information for our clients when in reality-

Tom Mullooly: Welcome to the casino.

Brendan M: Yeah. That's not what we're doing. Unfortunately, we have a much more boring job, which is talking to people about what Bob Seawright said, which is time, patience, diversification-

Tom Mullooly: Those unforced errors. That's where Charlie Ellis got looped into this also.

Brendan M: Yeah, so he talked about it in the concept of tennis.

Tom Mullooly: Right.

Brendan M: Meaning that-

Tom Mullooly: The book was called Playing the Loser's Game.

Brendan M: Winning the Loser's Game.

Tom Mullooly: Sorry, yeah.

Brendan M: He talks about tennis and how in professional tennis you have to beat your opponent on a skill basis. But for the other 99% of people playing the sport, amateur tennis, all you have to do to win is not lose basically. So as you said, not making unforced errors. If you just play and can stay in the game longer than your opponent, you'll win. It's not a matter of having more skill than them, really. It's just consistency, I think, is the name of the game.

And that's the case for the average investor who just needs to make sure their money's working for them to have a good retirement. I mean, you need to be consistent with these, unfortunately, kind of boring core tenants and you'll be better off than most.

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Tom Mullooly: It's funny. We'll put the titles of these books in the show notes and we'll certainly link to Bob Seawright's post, but you got to meet him at Wealth/Stack.

Brendan M: Yeah. I had met Bob a couple of years ago-

Tom Mullooly: You met him before.

Brendan M: In New York City. One of the nicest guys I've had the opportunity to meet in the industry. Has some great stories. We were talking, had a conversation with him and Tim and Ben Johnson from Morningstar, and we were talking about top sports games that we've ever been to. And man, you got to talk to Bob to hear his list. He's been at some doozies. Just one, for example, game six of the 86th World Series. He was there. So some really terrific stories in terms of the profession as well as a sports moments. So cool to hang out with Bob.

Tom Mullooly: We're in a business where we talk about numbers a lot and there used to be a commercial put out by a very large insurance company that talked about... They would go around asking people with little Post-it Notes, "What's your number?" We both read an interesting article about that.

Brendan M: And it was from HumbleDollar, right?

Tom Mullooly: That's Jonathan Clement's-

Brendan M: Jonathon Clement's site. And Jonathan was on with Tim on Living With Money.

Tom Mullooly: It's one of the first episodes in Living With Money.

Brendan M: It was a while ago at this point, but I'd put it up on probably the Rushmore in terms of my favorites. It was a great episode. We talk about this idea a lot and so did the article. So people, whether it's from this commercial or because the idea is just captivating in general, often come to us and they have this number in mind in terms of what they need to accumulate to retire. It's not that it's a terrible... It's not the worst thing in the world I guess is what I'm getting at, but-

Tom Mullooly: So what you're saying is we've had situations where people have come in and said, "I need to get to $2 million."

Brendan M: I need X before I will be comfortable. And I'm just not sure that that's a healthy way to approach it. Certainly not the best way because it's very linear to think that, "Okay, so if I get X," $2 million, whatever it might be, "I'm going to be good to take Y every year in perpetuity forever."

And you know what I've written about before. I hit a post and it was called Financial Planning is a Compass and Not a Map. This idea that you need to update your financial plan over time and that the amounts that you're drawing from your investments are probably going to differ based upon your situation. And to suggest that, in a linear fashion, a 30-year retirement is just going to play out nice and cleanly with the same average annual return and withdrawal and inflation is going to be constant throughout. These variables are going to be changing.

And so it's a little misleading to think that this one nice round number is going to solve all the problems and that everything's going to be okay then. And I think it's just dangerous because it may not be that. You might get to that number and it might just be the hedonic treadmill. You get there and you're not happy. And it's just, "Wait a second, I thought I was going to be happy when I got to $2 million" or whatever it is.

Tom Mullooly: I better keep working until I get to 2.5.

Brendan M: Yeah. So I think it's healthier to think about why you have that belief in place and what you think... What kind of security or comfort you think that it's going to provide to you and then really think about whether getting to that number is the way to achieve the underlying purpose or the feelings that drive that number in the first place. But people love the number thing.

Tom Mullooly: When I hear people talk about a very specific number, $2 million or whatever it is, I guess the doctor evil side of me says, "What are you going to do on the second day of your retirement when the market goes down and you have $1,997,000? Then what? Are you going to flip out? Are you going to go work somewhere and what are you going to do? Have you really thought about..." I mean, getting back to the practical side of things, "Have you really thought about what inflation might do to these numbers in 10 years? In 12 years?"

I mean we were just talking about this yesterday, about another situation where someone needed to get a fixed amount of money and I'm like, "Hey, look, if you have 1% inflation over the next 20 years, your costs have now gone up by... It's now 120% of what you needed back when you started. If you're not factoring in some kind of way to keep that pile escalating, you're going to fall behind."

Brendan M: I think it's a lot more important to come to grips with what you're going to need in retirement in terms of an income and to be open to the idea that if you need a certain amount per month, that that's the amount per month that you need now. And maybe you can project that into the immediate future five or 10 years out. But even at five or 10 years out, that number is probably going to have changed by the time you reach it and so-

Tom Mullooly: Your life is going to change. And so you don't know what your expenses are going to be.

Brendan M: Right. I think a good way to remind yourself of that is to think if you're trying to project something 10 years out... It's not that you shouldn't because you have to do some kind of projection and assumption to do financial planning but to just have a little humility in it. Just think about where you were 10 years ago today.

Try to think about, to the day, where you were at 10 years ago. How different things were and if you could have predicted where you are today based on where you were then. And to just say, "All right, we're making these assumptions, but they're squishy and they don't need to be super exact. We just need to put something down that's reasonable. And so let's be humble about this and not over-exaggerate our returns or don't even say inflation's not going to exist. Let's be conservative in these because holy crap, I can't predict where I'm going to be in 10 years."

Tom Mullooly: You're putting a lot of pressure on your portfolio and thus on yourself by doing that. It's hard to tell where people are going to be 10 years from now.

There's a really cool meme that's going around now on social media. I've seen it on Facebook and on Twitter where they take these celebrities and they have them pose side by side. So they basically photoshopped a picture from 10 years ago to a picture today. So Leonardo DiCaprio looks like the little kid that he was on in Growing Pains. Do you even remember that? Honestly, he's like a seven-year-old kid and now he's a lot bigger and a little wider than he was. He doesn't have the little bowl haircut. So yeah, some of these things don't age well.

Brendan M: Well just, for instance, 10 years ago you probably had no idea that I was going to be here at this business.

Tom Mullooly: No.

Brendan M: But think about where we are today. And so things have changed over that 10 year period, just as an example from our personal lives and our business here. So things change. You need to adapt to them. And so, just be humble about what kind of assumptions you're baking into your financial plan. And to suggest that some magical round number can account for all these different variables you're going to have to adjust to over time is insane. So don't lock yourself up in that cell of "I'm not going to be happy until I have $2.5 million" because that's not a recipe for leading a happy life.

Tom Mullooly: No, it's not.

Brendan M: I think that that's ultimately what all of our work boils down to is we want our clients to feel comfortable that they have enough so that they can lead happy lives.

Tom Mullooly: They don't have to worry. Yeah.

Brendan M: Right. It doesn't matter. If you accumulate all the money in the world, but you're never happy with it, you're constantly scared or feel that it's not enough. I mean, that's no way to lead a happy life, I don't think.

Tom Mullooly: The last thing I'll say about that meme is don't look at John Travolta. He has not aged well. Well, they have the picture from Welcome Back Kotter. I mean that was before

Saturday Night Fever and now they have this picture... Now I'm sure his hair is different because he's probably starring in some kind of movie or something like that, but holy cow he did not age well.

Brendan M: Well to be fair, maybe it's just humanizing. Because we look up to these people and at the end of the day, they're just humans too. They get older, they look different. That's the way it is.

Last post I wanted to bring up is from Christine Benz.

Tom Mullooly: Wow. She's going in the podcast hall of fame here at Mullooly as Rushmore.

Brendan M: Yeah, of guests on Living With Money and probably on our Rushmore here too in terms of number of mentions. Christine, I think, writes something almost every week that we bring up, but so great in the personal finance and retiree space.

Tom Mullooly: You can find her on the Morningstar website.

Brendan M: Yeah, she's a terrific follow on Twitter too. Always sharing stuff.

So I actually found this, an article that she did recently. But I found that because she tweeted something over the weekend about her feelings on it... Because the article was looking at right now, would it be better to have money in cash, like CDs or an online savings bank, something really short term, or a bond fund?

And Christine said... We'll get to pros and cons in a second. But what caught my eye was she had this tweet that said, "I'm having trouble getting excited about bonds or bond funds at the moment over cash. But I've also felt this way dozens of times over the last decade, let's call it, and I've been wrong on every single one of them."

And I have literally been hearing since I came to work at Mullooly Asset Management that now is the time to get out of bonds because there's no way you could possibly make money in them anymore. And I could go pull up the returns over any rolling periods since 2012 when I started here. And you would have been better off having your money in bonds.

Tom Mullooly: Having some exposure to bonds.

Brendan M: Versus CDs or putting it in a bank account, especially a checking account.

Right. So what Christine said, and I think that this makes sense too, is that decision of really short-term stuff, so cash, CDs, online savings bank versus bonds, should primarily be driven by what the need for the money is, right? And so if you need the money in the next one to two years, you're probably better off just having it in cash or CDs or an online savings bank.

But once you venture out past the immediate year or two, if the money really is going to be there for any longer than that, you're probably going to want to have it in something that takes a little bit more risk, because you're going to take a little more risk and odds are you're going to get a little bit higher return for that. Again, we're talking bond returns, so nothing sexy here.

Tom Mullooly: We're not talking about going into some high-risk stuff.

Brendan M: No, but Christine was looking over, I think the last decade, intermediate-term bonds or even just government treasuries. Something that really is, on the risk spectrum still very low risk, earned another percent or two above CDs or T-bills or something like that because you're taking on duration risk because you're going to own a little more long term of an instrument when you own intermediate-term bonds.

Tom Mullooly: It's amazing to see how interest rates... I mean everyone, honestly for the length of your career, has been saying this is where interest rates start to move higher and people are going to get clobbered in bonds. And I'm not trying to get into any kind of market timing discussion, but they have turned out to be solid citizens in an investment portfolio.

Brendan M: Yeah, I think so. We had a stretch from early 2017 through the end of last year where the Fed was hiking, because that was the thing that everybody was afraid of. It's like, okay, quantitative easing is ending and eventually the Fed's going to start raising rates, and they did. And you know, high quality short- to intermediate-term bonds, obviously it didn't do terrific during that stretch. But nobody had their retirement blown up because they owned the aggregate bond index over that year and a half, two-year stretch.

You brought the words out. So I'll say it. I think that when you say you're going to hold really short-term stuff versus taking on more duration or credit risk, what you're implicitly saying is that I can time the bond market. I got this. And I don't believe you. I think that you should spread out your risks because we don't know what path interest rates are going to take. I mean, God, if there's anything that's unpredictable out there, it's interest rates, but people love to explain why they can predict interest rates.

I saw something from Cullen Roche on Twitter a couple of weeks ago and he was kind of dunking on Jeff Gundlach, because remember a year, a year and a half ago when the 10-year treasury broke above some support line on a chart. And he said maybe it was the 3% thing and he was like, "It's going to six now because it broke above that." And Cullen was like, you can't do technical analysis on an interest rate chart. That's not how it works because we can go in and change what's going on with interest rates, manually.

It's not just a market supply and demand thing. It is somewhat because people can buy and sell to affect what's going on with interest rates on different ends of the spectrum. But at the end of the day, we can also step in and do what we want with it. And now the Fed has done that and they've backed off again, which has been exacerbating more by people buying during that stretch.

Tom Mullooly: Interesting field. It never really changes. Very interesting how we've had similar conversations with clients over the last five or 10 years like Christine mentioned in her post where a lot of folks would think, including us, that "Gee, I don't know if this is really a good time for bonds" and sometimes you have to kind of hold your nose and just say, "Look, we know historically this is the kind of performance that we should be expecting with an asset allocation with this kind of mix, 70/30, 60/40, whatever the number is right now. It doesn't look attractive, but"-

Brendan M: Sometimes what you're being paid for is that feeling of I don't know. The more 'I don't know' you feel the more potential there is for you to be compensated for that 'I don't know.'

Tom Mullooly: Can we just talk for a minute more about real rates of return and nominal rates of return, because I think this is something that a lot of people still today... If we get a retired client, they'll say, "Wow, I remember when I was getting fill-in-the-blank teen rate at the bank. I was getting 14% on a CD." But what they fail to mention or fail to realize was that at that time inflation was running at 10% and no one knew how much higher or hotter inflation was going to run. And now interest rates are a lot less.

Brendan M: Yeah and I think that it's always important to talk about things in terms of real returns. That was another aspect that Christine had brought up. That if you're looking for returns after inflation, neither bonds or cash are really going to knock your socks off. But cash is certainly not going to do on an inflation-adjusted basis, it's probably going to be a negative return.

Tom Mullooly: It almost always is.

Brendan M: And bonds, you at least have a chance of pacing or maybe being a little bit ahead of inflation. Historically, you have been, in terms of real returns.

Tom Mullooly: I think you see the low rates now. It's a reflection that there's very little inflation in the system.

Brendan M: It doesn't mean that's going to be the case moving into the future and that doesn't mean you should project that that will be the case forever. But I think that you own different components of your portfolio to account for different risks.

And so in our opinion, you hold things like a mixture of short-term bonds or cash and intermediate-term bonds to help with the volatility of the market, not for real returns, inflation protection. You own the stock side of your portfolio to help beat inflation.

You have these things in conjunction. And to think of them myopically like, "Oh, the bond piece isn't going to keep up with inflation. So why bother? What's the point?" Well, okay, but can you stomach the volatility of being 100% in stocks? Maybe, maybe not. On the other hand, if you're really worried about volatility and you're going to be 100% in safe stuff, that's cool, but what's that going to mean for your future spending when you've been in bonds and short-term stuff and you haven't really seen a lot of growth? Does it mean lower spending in the future? Is that okay?

And it's a trade-off. It's not like a yes or no to either of those questions. It's like to what degree are we comfortable with these things? And we balance it and then we have this whole of stocks and bonds and short-term cash that make up the portfolio. We get really fixated on the individual parts of it when they're there to support one another. And strengths and weaknesses offset.

Tom Mullooly: Good stuff. All right, we'll link to all of this in the show notes. Once again, thanks again for listening to episode 276 and we will catch up with you on the next episode.