How Long Can Bull Markets Last? - Transcript

Tom Mullooly: Welcome back to the podcast. This is episode number 285. Your loyal co-hosts are here, Brendan Mullooly, and myself, Tom Mullooly. Welcome and thank you for tuning in. Plenty of things to talk about this week, post Thanksgiving. Thanksgiving was really late this year.

Brendan Mullooly: Yeah, it feels like we're already at Christmas, man.

Tom Mullooly: Yeah, it feels like we're a week away from Christmas.

Brendan Mullooly: We're going to get a couple weeks of it.

Tom Mullooly: But, today we're recording this, it's December 5th. I took down the ornaments today from the attic, so it's definitely starting to feel like Christmas.

Brendan Mullooly: Yep. I've had my tree up for over a week now.

Tom Mullooly: Yeah, it's cold enough too.

Brendan Mullooly: Yeah.

Tom Mullooly: The first piece that I'd like to introduce for discussion, this was published, we found it on CNBC, but it's probably going to pop up in a few other places too. Rand Paul has a new bill that he is proposing that would let Americans pay off student loan debt with 401(k) money or IRA savings.

Brendan Mullooly: Yeah, so this news came out just this morning, and obviously a lot of opinions swirling about on it. But the first reaction that I had was this is a step closer to something I think we've talked about before on the podcast. You think that a step that lawmakers should make is to allow student loan debt to be repaid tax free, kind of like how you make your 401(k) contributions or IRA. I mean, IRA is deductible. But, to pay that with pretax money, it would help. I don't think it's going to solve anything. It's not going to get people out of student loan debt, but it would be a nice bone to throw people who have large amounts of student loan debt. Agree?

Tom Mullooly: Disagree.

Brendan Mullooly: It's going to fix it?

Tom Mullooly: I think it's going to help a lot of people.

Brendan Mullooly: No, I didn't say it wasn't going to help people. I said that it's not going to solve the student loan problem.

Tom Mullooly: Well, right now-

Brendan Mullooly: It would be nice.

Tom Mullooly: ... right now we're not doing anything.

Brendan Mullooly: Right.

Tom Mullooly: So I think this will help. And I think it will help considerably. I think we're going to disagree a little more on this. I'm getting a little tired of hearing about the student loan crisis. Nobody's on fire, so it's not a crisis. The average student loan balance is $37,000.

Brendan Mullooly: Averages can be pretty misleading.

Tom Mullooly: Okay, but what do people spend on a new car? $37,000.

Brendan Mullooly: Might not be the same people we're talking about.

Tom Mullooly: It may not be, you're right. Now-

Brendan Mullooly: And look, the average person with $30,000 of debt or something certainly isn't on fire, but there are people out there with hundreds of thousands.

Tom Mullooly: Okay, I'm glad you brought that up.

Brendan Mullooly: They are on fire.

Tom Mullooly: Yeah, they are on fire. But you know what? They belong on fire. Here's why. We're talking about people that are going to law school, people that are going to go to med school or going to med school, and they are going to make a significant above average income for a very long period of time. It's not like they're an NFL running back and they've got a three or four year career. These people are going to be doctors and lawyers for long periods of time. $100,000 or $200,000 comes with the territory. That's the cost of going to an advanced education. Now, the other people who have $150,000, $200,000 of student loan and they have a bachelor's degree, almost every single story that we read is because they stopped making payments on their loans at some point and this loan has just continued to compound at 7% or 8% interest for a long period of time.

Brendan Mullooly: Those are the ones we hear about. I'm not sure that that's everybody, so I'm not willing to paint with such a broad brush. But I get your point.

Tom Mullooly: I think once people start making money, they should be permitted to pay their student loans back with pretax dollars. We've said this now on multiple podcasts and in videos as well, and we've written about it too.

Brendan Mullooly: Yeah, I agree. I just don't-

Tom Mullooly: I'm glad to see that Rand Paul is picking up my idea. Maybe he's listening to the podcast. Hi, Rand.

Brendan Mullooly: Maybe. I don't know. Okay, a couple things. I don't understand why the money has to come from a 401(k) or an IRA, because the specific thing here is that you could take money, and we're assuming that you sent it in pretax to your 401(k) or IRA, and then turn around and use it to pay down the loan. So, they're moving a step closer to what you're discussing, which is just straight up paying it with pretax dollars, but they're making it really convoluted and kind of stupid. Why should it have to go into the 401(k) first and then come out to pay the loans? Just let it happen.

Tom Mullooly: Well, it would be easier if they could just let it happen. We agree on that.

Brendan Mullooly: And I think it's instilling something bad, which is that it's okay to go into your 401(k) and do stuff like this.

Tom Mullooly: Okay, I can see that sinister aspect of it, because once you do that it's like well, I could do this for everything. Like, I should just-

Brendan Mullooly: It's a slippery slope.

Tom Mullooly: It is, you're right. However, if you take money out of a plan and it's not part of a loan, you're going to have penalties and you're going to have taxes. What they're allowing people to do is take, under this proposed bill, is take money out without any penalty-

Brendan Mullooly: Or tax.

Tom Mullooly: ... or tax, and it has to go-

Brendan Mullooly: Right, so why not just make it easier? Why does it have to go in there first?

Tom Mullooly: Because we don't have-

Brendan Mullooly: It doesn't make any sense.

Tom Mullooly: I don't think there is an infrastructure in place that will allow, that will calculate a way for people to say, "I made $50,000 this year and I paid student loans of $6,000 this year. That should be eliminated from my income."

Brendan Mullooly: I think it would be pretty easy because when you pay your student loans, you get a 1098E at the end of the year for education and it tells you how much you paid in interest. Why couldn't it just tell you exactly what you paid overall, and then you'd just make it a deduction right under the line for your IRA deduction on page one of the 1040?

Tom Mullooly: That would be great.

Brendan Mullooly: So what's so difficult about that?

Tom Mullooly: Yeah, I totally get-

Brendan Mullooly: That's my only thing. It's not you who made this issue. I'm just saying like why ... That's not very difficult. These companies who hold the student loans are mostly backed by the federal government anyway, and they're already sending out 1098Es, so why don't we just update their reporting to say, "Hey, instead of here's what you paid in interest this year, here's what you paid this year," and write it off of your tax return, deduction?

Tom Mullooly: Part of the, what I read in the story is that they're also allowing family members to take money out of their 401(k) to pay for someone else's student loans. So you may have a situation where a parent now says, "Hey, you know what? I can take five grand a year." I think the number is 5250.

Brendan Mullooly: I don't know where they make these numbers up.

Tom Mullooly: But take 5250 a year from a 401(k) without any kind of penalty to help junior with his student loan. It may not necessarily be the person who took on the debt. It may be their family members, their spouse or their child that they're trying to help out. In that case, I would say, "Hey, my wife should take money out of her 401(k) and I'll take money out of my 401(k) and then we can do this even faster." I think it's worth it. I actually do because how many times have we talked about with clients and in podcasts and some of the other videos that we've done here, where it's like, look, it's very important that you save money for retirement, but if you have this gigantic nut in front of you, how are you going to save for retirement when all of your free cashflow is going to pay this bill? Knock it out, get it done, and if you can get that done in two, three, four years, finish it, but then get on the wagon and start maxing out your contributions to a retirement plan. You've got some catching up to do.

I don't see anything wrong with this. I really like it.

Brendan Mullooly: I think it's okay. I think it could be improved upon. I think it's a little convoluted because I agree to your point that getting rid of some of that debt would be good for people, even if it's not their own. But no, I actually disagree with that because if they took out a parent loan to help their kid, and we're talking about now they can use their 401(k) money to pay that down because it's maybe 5% or 6% interest and you're not guaranteed to get any rate of return in your 401(k). So, use the money to pay down the parent loan because that is a drain on the parent's cashflow. But for the parent who already has parent loans to take money above and beyond what they're doing from their 401(k) to pay the student loans that the kids signed up for. I mean, I've heard you say to people before that you can, you can borrow for college, you can't borrow for retirement.

Tom Mullooly: That's right.

Brendan Mullooly: So yeah, maybe $5,000 a year is insignificant, but $5,000 a year over a five year period maybe to help-

Tom Mullooly: That's 25 grand.

Brendan Mullooly: ... junior year pay his theoretical loans, I don't know if that's such a great idea. It could be. It could not be.

Tom Mullooly: Now what I didn't see in the article was did it say that this money could be taken out to pay plus loans? Parent loans?

Brendan Mullooly: Not sure.

Tom Mullooly: I'm not sure either.

Brendan Mullooly: I really doubt they have that much detail yet. This seems very half-baked.

Tom Mullooly: That shouldn't be allowed. That shouldn't be allowed. Hey, the parents said, "Hey, I'm going to help you go to college and I'll take the loan and I'll make the payments on that." That's what you do with a parent loan. You shouldn't be able to get a bailout from your 401(k). I mean, I have a problem with that, but if you want to help someone in your family because they're really struggling. This may be someone who's 26 years old and it's like, "Hey, I know you may have trouble finding a job. You may have trouble getting started in your life, finding a place to live and getting a car and doing all this stuff. These student loans are a real problem. Here's help." I like it. Yeah, it would be simpler if they adopted the Mullooly Asset Management plan, just pay everything in pretax dollars.

Brendan Mullooly: So one thing they noted was that, and not very many employers are doing this, but some employers have started instead of a match for a 401(k), have started paying student loan debt, as opposed to like a 4% match. They'll do the same amount, but it'll go towards student loan payments, making that a pretax mechanism to do that.

Tom Mullooly: I like that.

Brendan Mullooly: That could be an instance here too where the 401(k) funnel makes sense because you could take money that is the employer match maybe, and you just use that to pay it. Like if you get matched every dollar up to like 4% in your 401(k), you put in your 4% to get a free 4% and then you take out the 4% extra, let's say, and use that to pay down student loans a little faster than you had been. There's some good in this. I don't disagree. And I think any, like you said at the onset, doing anything would be more helpful than what we're doing now. I'm just not sure that ... I think maybe they should expand it a bit because I don't think the idea of it having to come from a 401(k) or an IRA makes sense. Because you could see people then just using an IRA as a conduit.

Tom Mullooly: It's like a pass through account.

Brendan Mullooly: It's like why bother? That's such a waste of everybody's time and energy. It's like, "Oh I have to go open a IRA at Vanguard so I can then turn around and write a check from it the week later to pay my student loan."

Tom Mullooly: Take the money out.

Brendan Mullooly: That's ridiculous. I mean, you could also make the case that a lot of the people who would potentially use something like this don't even have 401(k)s or IRAs anyway because they're, like you said, just out of college and just getting started. So what 401(k) balance are they going to use to help with this? But one of the other things in there, the last thing, is that they're talking about getting rid of the phase out in income for the student loan interest deduction for taxes too.

Tom Mullooly: I think that's 57.

Brendan Mullooly: I think it's like $65,000, something like that. It's in that ballpark of 60, 65 if you're single, and then roughly double that if you're married filing jointly. To your point, I mean some people with some of the biggest student loan balances probably make more than that because they're coming out of school and getting a job as a lawyer or a doctor. And even the low rungs of those professions are starting off at pretty high earnings. Again, I mean it's nice that you get a deduction for your student loan interest, but that's not a reason to ... Sometimes people look at deductibility as a reason to or not do something as if deducting a few hundred dollars of interest that you paid makes it worthwhile.

Tom Mullooly: It's like item number 16 on the pros and cons. That's way down on the list.

Brendan Mullooly: That is nice, but-

Tom Mullooly: Not moving the needle.

Brendan Mullooly: ... look at the bigger picture. Yeah.

Tom Mullooly: I'm kind of surprised a lot of people come out of school with the debt levels that they have. I know, like you had referenced before, that the average, it's an average, is $37,000, but we've met some people who have $60,000, $70,000 and didn't go to law school, didn't go to med school. That's a big hole. It's a big hole to dig out of. I mean they really should forget about putting money away for retirement until they get that down to a more manageable number.

Brendan Mullooly: Right, so we see numbers like that and then we see the corresponding articles that are like millennials have nothing saved for retirement.

Tom Mullooly: No kidding.

Brendan Mullooly: If only we could do something about this crisis. Crisis might be a bit alarmist, but using averages is also a bit misleading.

Tom Mullooly: It is.

Brendan Mullooly: So yeah, there are some people out there really struggling. I don't think this thing from Rand Paul is perfect, but a step in the right direction in a sense of doing something, right, like you said. So maybe this is something that gets kicked around by lawmakers and morphs into something that helps. It's not, like I said, I think my point at the beginning was like, look, we're not solving anything with this, but it might help.

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Tom Mullooly: We need to talk about what Ben Carlson wrote.

Brendan Mullooly: And we hear this a lot, which is why I like this post so much from Ben. It's, you know you hear that we've had a good year in the market or a good run, however you want to measure it. I mean, since 2009 we've had several blips along the way, like the end of last year, or 2011 where we were basically on the cusp of bear markets by how everybody tends to measure them. The market's been on such a good run, how could it possibly continue? Meaning that most people subscribe to the idea that markets experience mean reversion, meaning that periods of good returns are followed by periods of bad returns, which is generally correct.

However, we don't know when the mean reversion is going to happen. So there's no schedule. There's no predetermined amount of time under which good returns can last for and then they have to turn, like a piece of fruit that goes rotten or something. We don't know for sure. And so people get pulled in by this narrative that since things have been good, they will have to be bad, and shouldn't they do something to anticipate that bad? But what happens when you anticipate the bad too soon?

Tom Mullooly: And you're wrong.

Brendan Mullooly: Because the market continues going up longer than you thought was possible.

Tom Mullooly: I know many of our client experts have told us that we're overdue for a bad spell in the market.

Brendan Mullooly: I don't know. Overdue. Based on what? Because there's nothing to suggest that there's any specific period of time that things can be good for. They can be good for a long amount of time. So what Ben Carlson wrote about was this idea generally, and then he had some numbers just to maybe articulate this point that things can continue for longer than you expect and you just kind of have to take a stance in such a way so that you're not totally exposed if things do mean revert, but also so that you're not full of regret if you miss out on what he showed, like another decade of returns possibly.

In the 1980s, the S&P 500 was up nearly 400% when you included dividends. And this also included the crash of 1987, the single worst day in stock market history. So that's about 17% a year annualized, what the S&P 500 did over that 10 year period. And so Ben's question was how many people at the end of that decade would have said that the next decade was going to be even better?

Tom Mullooly: Very few.

Brendan Mullooly: Right, but it was.

Tom Mullooly: Can I share a story from the fall of 1989 without hijacking the conversation too much?

Brendan Mullooly: Sure.

Tom Mullooly: 1987 we had, of course, October 1987 the market was down 22% in one day, and the market had been slowly building its way back through 1988, and 1989 it was actually approaching the old highs before the crash in '87. It took about two years to get back. And in October of 1989, it was a Friday afternoon. We were in the middle of all these leveraged buyouts. That was all the news. United Airlines was going through a leveraged buyout and the buyer of the airline was Donald Trump. And about three o'clock in the afternoon on a Friday, he said he couldn't put together the financing. The stock market had a mini crash again. And everybody that you talk to, brokers and clients alike, all thought, here we go again. The market's going to completely fall out of bed just like it did two years ago. And there's no way, no way the Dow could ever get above 3000. And here we are today.

Brendan Mullooly: Look at us now.

Tom Mullooly: Nine times higher.

Brendan Mullooly: To the point that you just made, we did go above 3000 obviously. We know the answer now and I'm sure the fears at the time were very real. It's probably how people felt in 2011 when the market was down 20%. We were talking about double dip recession. Here we go again. Except-
Tom Mullooly: US debt got downgraded that year. Yep, same thing.

Except that wasn't a good time to be getting defensive either. It was a terrible time to be getting defensive. So following the 17% annualized returns in the 1980s of over 400%, or up nearly 400%, the S&P 500 then went on during the '90s to go up 425%, or about 18% annualized.

Tom Mullooly: Pretty much the same kind of returns.

Brendan Mullooly: Right. And so, this isn't unique to US stocks. Another great example was that during the 1970s, Japanese stocks did basically the same thing that the US market did in the '80s. They were up nearly 400%, about 17% a year, and then in the '80s Japanese stocks were up almost 1200%, or 29% a year. And obviously they'd done, in both cases here, eventually the mean reversion came. But if you were calling for mean reversion in 1991, were you right? You had to wait until 2000 to be correct.

Tom Mullooly: You had to wait nine years to be right.

Brendan Mullooly: Right. So even if you sat in cash that whole time, the market then, subsequently it didn't fall far enough for you to be vindicated. You still missed out on returns. And the same thing goes for people with Japan. Obviously returns have been pretty anemic since that two decade stretch. But where were you right if you were bearish on Japan after the big run in the '70s? No, you were absolutely wrong.

Tom Mullooly: You were totally wrong for another 10 years.

Brendan Mullooly: You know, the same thing happened in the US market where the '80s and the '90s were great, and then the 2000s, the first decade of this century, was lousy from 2000 to 2010. Not much to show for your efforts of investing in at least large cap US stocks. And so just to the main point that yes, mean reversion is one of the biggest forces that we deal with when it comes to investing, but anybody who suggests they know when this stuff is going to happen is out of their mind. They don't know. They don't know and they're only guessing.

Tom Mullooly: And a lot of times we've come to the conclusion that it's really just a, in many cases, a projection of their own worries. Okay. I feel like I've had, like my luck is starting to run out and I've done pretty well and they approach it like they would a slot machine. And I just don't think I'm going to be that lucky going forward, so I want to cash in my chips. And that's a terrible approach to take, but we hear it a lot.

Brendan Mullooly: You need to look at it from a probabilistic standpoint in the sense that markets generally rise over time and they're not a zero sum game, like sitting at a slot machine. The more time you spend on a slot machine, the greater your odds of walking out of their broke are, but the longer your money is in the stock market, the greater chance you have of having more than when you started. And so trying to jump out and jump back in, first off, it's really, really hard and I don't think anybody has shown a proven ability to reliably do that time and time again.

Tom Mullooly: Because it's really a two decision event. You have to decide when it's the right time to get out and you have to decide when it's the right time to get back in.

Brendan Mullooly: Right. And I think that inherently people who maybe do get out, maybe their hunch is correct and their luck is turning and they get out, then they get addicted to sitting in cash and they're always waiting for the market. Well, I'll buy when the dust clears or when things are lower, except all that causes them to do is miss the bottom and then they end up buying back in around or higher than where they sold out in the first place. And it's just, to think that you're going to do that dozens of times throughout your investing lifetime and get it right on all of them, nonsense. I think you're just going to erode your returns and cause yourself a lot of unnecessary stress.

Tom Mullooly: Okay. I'm again going to sound like I'm older than I actually am, but a story to relay. In the late '80s, I cold called this guy who, he had told me in previous calls the kind of different positions that he had, the different stocks that he had, the different things that he had in the market. So I knew that this guy had money and he followed the markets on a regular basis. And at the time, the market was around 2000, the Dow. And he's like, "I'm not doing anything until the market gets back to 1600." Now, we had to go through a crash to get to those kind of levels, but I did call him when we got back near 1600 and of course his response was, "There's no way I'm getting it back into this market. Are you crazy?"

Brendan Mullooly: That's exactly how it's going to work though. Everyone thinks that they'll be the person, if they're sitting on cash, who's going to jump in when everybody else is panicking, but you're probably going to be panicking too, or you're at least going to be scared enough to say, "Yeah, I'm going to wait to see if this thing falls further. I'm not going to put money to work here." Buying when stuff is down is way, way harder than it sounds.

Tom Mullooly: Thanks for listening to episode 285, and we will catch up with you on the next podcast.