What's the Most Reliable Indicator? - Transcript

Tom Mullooly: Welcome back to the podcast. This is episode number 290. Your faithful hosts are here, Brendan Mullooly and myself, Tom Mullooly. Brendan, a couple of things we need to settle. Some things we've seen in the media in the last couple of days I think we need to discuss.

Brendan M: Yeah. What's your 2020 price target for the S&P 500?

Tom Mullooly: Did you want SPY or SPX?

Brendan M: Doesn't matter.

Tom Mullooly: I know it doesn't matter.

Brendan M: Get out of here. That's my response to that question.

Tom Mullooly: Yeah. And it's unfortunate because it seems like the last week of December and the first two weeks of January, every single year, what's your prediction going to be for the upcoming year?

Brendan M: Yeah, and important to remember that the reason you see this should be a signal because the places you see it, this is entertainment. Okay. So we, we all like to hear it because it's fun to hear what we think. You know, smart people are going to say about the future. We just need to take it with a grain of salt.

Tom Mullooly: They can't tell you what the future is going to bring.

Brendan M: No, and that's not a knock on them. That's the truth. Because literally nobody can do that. So if somebody is telling you that they can, they can tell you where the S&P is going in 2020, you might as well chuck a dart. That's, that's how much weight I would put into that.

Tom Mullooly: That's really it.

Brendan M: So this was all prompted because we saw an article on Bloomberg.

Tom Mullooly: Oh wait, wait, wait, wait, wait. The best ones are the ones where people say, well, I expect that we're going to have a 12% drop by summer, but then by fall everything will be recovered by the end of the year we'll be up smartly by 8 or 10%.

Brendan M: We're cautiously optimistic and constructive on the future of the market. Yes. I'm wearing a neck tie and bite me on television. All right. Enough, enough joking around. We saw an article in Bloomberg where they recapped some of the stuff that Jeffrey Gundlach said would happen in 2019. So whether it was the very beginning of last year or the end of 2018, a lot of these didn't age well.

Tom Mullooly: And Jeff Gundlach, for those who aren't familiar with the name, runs the biggest bond portfolio in the country.

Brendan M: Doubleline.

Tom Mullooly: Right.

Brendan M: Is Jeff Gundlach. This is not to say that we don't think Jeff is smart or that he is bad at his job or anything like that.

Tom Mullooly: Quite the opposite.

Brendan M: Right. So our point here is that this is one of the smarter guys in the fixed income space and his predictions about 2019 were pretty wrong in some regards and just to display how little, you know, you should put into these predictions. This is a smart guy. He was wrong. He'd probably be the first to tell you and I'm not sure that he positioned double line assets according to these random predictions he threw out on TV one day.

Tom Mullooly: I think that's really important to emphasize to the listeners is that this is not necessary. When these folks get on TV and they're interviewed and they're asked to make predictions, this doesn't mean that this is how their portfolio, their daytime job...

Brendan M: Yeah. I'd like to see the sidebar on the TV next to, you know, like they're interviewing them and then the column down the right hand side maybe would show you like what their actual.. What they fully own. Yeah, show me what you're doing, not what you're, what you're talking about here.

Tom Mullooly: He says he likes Apple, sold Apple yesterday.

Brendan M: Right? Yeah. I would imagine that there would be a lot of inconsistency there, but just to rifle through a couple of these things they asked him about emerging markets for 2019. He said they looked good, they underperformed, you know, the rest of the global stocks, U.S. and other developed nations abroad. Didn't like Europe, said it was a value trap, had its best year since 2013.

Tom Mullooly: Yeah.

Brendan M: Said the dollar would be down. It was basically flat.

Tom Mullooly: Right.

Brendan M: And even in his own backyard of credit he said that it was, you know, a bad time to be in stuff like junk bonds, high yield bonds, best year for those since 2016. And warned about, you know, potential downgrades in the investment grade, fixed income space and again, a fine place to be over the course of this year.

Tom Mullooly: Truth be told, there were some real stories over the summer about some corporate bonds that were at risk of being downgraded. I think he got that headline right, but...

Brendan M: But it didn't matter.

Tom Mullooly: It didn't. It's right. It didn't matter, you know.

Brendan M: Everybody's concerned about the triple B area of investment grade bonds because this is a ballooning space. It's the bottom of the investment grade tier in terms of, you know, ratings. And I've read a lot of intelligent commentary on why this is somewhat concerning, especially if you're using some kind of an index product and not an active manager who can select in this space what may or may not be a worthy of risk.

So yeah, I mean look at, it's not like any of this didn't have merit. A lot of the stuff that he said sounded really smart at the time because if you rewind the clock to the end of 2018-2019, like for instance, the warning about junk bonds probably seemed pretty smart because the market was down 20% and that's not necessarily the kind of fixed income you want to own when the market is down 20% because it's probably down 8 or 10 with it.

Tom Mullooly: Right. And on top of that, we still had a fed who was seriously making plans to continue to raise interest rates...

Brendan M: Or at least stand tight.

Tom Mullooly: Through 2019, right.

Brendan M: And they didn't, they did the opposite. They cut.

Tom Mullooly: Here's the thing that really kind of bothers me and I'm not picking on Gundlach at all. It just amazes me that these folks that are invited on to the radio shows that we listen to and the TV shows that a lot of people tune into. I think a lot of people just, it gets lost in the sauce. They'll introduce someone and they'll say, this person is the, you know, investment manager for the largest bond fund in the world. And then they start asking him questions about, what do you think about gold? What do you think about oil? What do you think about the stock market? Wait a minute, this guy, his whole world is bonds. Why are you asking him about gold, oil, stock market?

Brendan M: Because their business is entertainment.

Tom Mullooly: I think that's an important point.

Brendan M: Right.

Tom Mullooly: That a lot of people overlook because it happened more 20 years ago. Less now. But people see some of these recognizable names on TV and they pick up the phone and they call us, Hey, so-and-so just said this is going to happen. And I'm like, do you realize like this guy doesn't even, you know, the guy that was interviewed doesn't buy and sell stocks. He doesn't manage a portfolio. He's an economist. Or this guy works in the bond market, but yet he's asked about stocks. What's up?

Brendan M: I mean look, even if they were asking him about something in his lane, so to speak, I mean they did in this example, I would still not put much weight on that because again, like the credit example with Gundlach. I don't know necessarily how he was positioned in his Doubleline funds. Was he actually bearish on junk bonds to start the year? Was he, you know, in quality cause he was afraid of junk. How was he positioned?

Tom Mullooly: And we don't know.

Brendan M: I would rather see that than anything else. But even that doesn't speak to what you or I or any individual should be doing with their money. I mean that's, you don't need to have, just to bring this full circle since we started with the price target joke, you don't need to have a 2020 S&P 500 price target to, you know, effectively allocate your money for retirement or whatever your goals might be. You don't need to have an opinion on where the S&P finishes this year to do that.

And I think that people forget that. You don't need to have a take on that. You do if you want to be a TV guest and that's why they go on and they sound really great and they have these opinions and they say these things because you don't get invited back if you say, Hey, I don't know, even though that's probably their most honest answer.

Tom Mullooly: Yeah.

Brendan M: They tell you, thank you for the interview. We will never be calling you again if you tell him you don't know where the market's going, even though they all know they're not, they don't. None of them know where the market's going.

Tom Mullooly: They're encouraged to make a statement. It's the sizzle that sells.

Brendan M: Yeah.

Tom Mullooly: Along the same lines, there was an article in the wall street journal that you passed along to us about, actually this was about the manufacturing sector and talking about the different indicators that are used. ISM versus Markit, and they found that there's really no single, reliable indicator out there for the manufacturing sector. We're getting all kinds of different reads.

Brendan M: I would expand that to say that there's no single reliable indicator of anything.

Tom Mullooly: Right.

Brendan M: Ever. But yeah. This one was about the ISM, which is one of the older measures of the manufacturing sector versus a newer one, which is from IHS Markit. Both of these, importantly, I think, they get quoted all the time. ISM people want to see...

Tom Mullooly: People hang on that number.

Brendan M: Yes.

Tom Mullooly: They trade off of it.

Brendan M: I think it's important to remember, first and foremost, that this and the corresponding one from Markit are surveys.

Tom Mullooly: Right.

Brendan M: These are people's opinions. I again, I'm not necessarily sure that they're doing what they say they do in surveys cause people lie in surveys all the time.

Tom Mullooly: Yeah.

Brendan M: So it's a sentiment gauge. It's a survey data. And right now these two pieces of information are telling different stories in terms of the manufacturing sector. One is that, you know, a low since the beginning of the recovery back in 2009 and the other one, it looks very optimistic and they've been a little bit criss-crossed over the last several years too. And they pointed to periods of time where you can now in hindsight, shocker, in hindsight, you can go back and say, wow, you know what ISM was the one to follow here.

I think they were a little bit earlier in actually, you know, predicting, if you want to even call it that, the recession in '08-'09, but it would have led you astray over the last several years when you, if you followed IHS Markit, you probably would have been positioned better to participate in some of these better years where we kind of shrugged off light manufacturing data. So which one is right? I don't really know.

Tom Mullooly: And you're right in the sense that you can expand this in so many different ways. I mean, just look at real estate. Just look at non-commercial, personal real estate. People hang on what's the new construction permits number? Is that up or down? What about existing home sales? That's an indicator of people's, you know, feelings about the economy. They both tell different stories and you're right, from time to time, one will be a better indicator than the other. The problem is we don't know until it's already passed.

Brendan M: Yes. And so the point of this article in the journal was just to say, look, we know way less than we think we do in the moment. It's only in hindsight that we can point back and say, ah, ISM nailed this one. It may not be as helpful as you think right here and now in terms of giving you real time updates on, you know, how to react to what is purportedly going on in the economy since this is survey data. You know, if somebody is feeling happy that day, they give you a better answer than they did last month.

Tom Mullooly: Well, I think also another example of this would be, you know, the payroll numbers. So a day or two before the government statistics come out, ADP provides their own survey. That's exactly what it is. It's a survey. Think you're going to be hiring more people soon?

Brendan M: Right? So the big one...

Tom Mullooly: Wait a minute. What's the line from a Groundhog day? I think it'll be an early spring. I'm predicting March 21st.

Brendan M: Right.

Tom Mullooly: I love that movie.

Brendan M: I was going to say another example of this is, that's been trotted out in recent years as just a display of like political bias, was the small business optimism index, which is by party affiliation just shows whose ever party was in office. They got like way more optimistic. Basically overnight, as if the economy transformed because you know the baton was passed between Democrat, Republican back to...

Tom Mullooly: That's not true?

Brendan M: No it's not.

Tom Mullooly: Oh, okay.

Brendan M: And we don't need to go on that trail. We've beaten the drum on that on this podcast very often. I think that's an obvious bias that needs to be left at the door when investing.

Tom Mullooly: Hey, there was another very interesting article that we both saw on Morningstar recently. David Blanchett wrote about this.

Brendan M: Yeah. It was called, When Retirement Expectations Meet Reality. And the...
Tom Mullooly: This was really good and we'll link to it in the show notes so people can take a look at it.

Brendan M: Yeah. It took a really in depth look at when advisors and clients want to mutually, you know, assume what the expected retirement date is and the ramifications that can have on how things really play out. Just at a high level, I thought that the point they concluded with was that you should plan for an early retirement and then if you can hit those numbers, if you can hit all the things that need to happen to, you know, let's throw a number on it, retire at 61.

Tom Mullooly: Right.

Brendan M: And you get there and you don't want to retire, well then it's probably your decision and it feels better at that point to say, nah you know what, I'll keep working. Or maybe you've hit all the goals and you're like yeah, let's do it. All of that is okay. What is not a great idea is assuming, Oh, I'm going to work till 70.

Tom Mullooly: That's when problems start.

Brendan M: Yeah, because so what they showed is that people who plan on working longer end up being negatively surprised in the sense that they might reach their early 60's and due to a litany of potential outcomes. Just don't end up working that long.

Tom Mullooly: Sure.

Brendan M: And then you're short and the amount that you could be short, if you were banking on, let's say working all through your 60's and you get to 61 and you're downsized or something like that occurs, you can be dramatically short. You've just cut the amount of savings that you were going to have, you're going to have eight or nine more years of savings. You're going to have more time for your money to compound before you started looking at it. You may end up claiming social security earlier and you're going to have a longer expected retirement. You're going to have a thirty year retirement instead of a twenty year retirement. And all of those negatively impact the probability of everything working out.

Tom Mullooly: Right.

Brendan M: All of them negatively impact it. I'll throw another log on the fire. So we know many cases of people who had to leave work to take care of a sick family member.

Tom Mullooly: Yeah.

Brendan M: So in addition to no longer working, now you've got medical expenses, right, stuff that, you know, maybe wasn't baked into the degree that, you know, it was something unpredictable. So I think the overarching narrative for me was to just be generous with your assumptions in a sense that you want to give yourself wiggle room for things to go wrong. You want to project, you know, conservatively. And that can mean different things. You project for low returns, you project for an earlier retirement and then when you, you know, can work longer and you want to great, you're going to be fine or you get higher returns. Terrific. That is great news. But the reverse, not great news.

Tom Mullooly: Yeah. It was very interesting. I'm kind of backtracking over what you said, but the folks that intended to retire before age 61, a lot of them went on to work longer, more years, really because they wanted to and they could. And the people, you know, what they mentioned in the article was that the people who plan to retire at 61, usually retired at 61. But this other group that we've been talking about, that say I'm going to retire at 65 or I'm going to retire, I'm never going to retire or whatever. They actually came up with... It's not an exact mathematical formula, but basically it was something like if you figure, Hey, I'm 62 I've got eight more years. The reality was in most cases that turned out to be for four years.

Brendan M: Right.

Tom Mullooly: And so you didn't make it until you were 70 because as some of the reasons Brendan mentioned, you got squeezed out of a job, you had an illness, something happened. And so instead of working till 70 from age 62 you worked a couple more years until 65 or 66.

Brendan M: And I just think the quality of life too, like if you plan to retire earlier and then you reached that point and you hit your goals and you can retire but you choose not to. The mindset that you're going to take to work and then bring home is going to be so relaxed.

Tom Mullooly: Totally different.

Brendan M: Because it ultimately doesn't matter. At that point you're doing it for the love of it or because you want to keep busy. It's not, I have to have this job for another four or five years. The stress of that is much greater than knowing, Hey, you know what? If something happens it happens and I'm going to be fine. I don't need to work for another seven or eight years to make sure I'll be okay.

Tom Mullooly: We'll definitely link to that in the show notes and that's going to wrap up episode 290. Brendan, we're almost at 300.

Brendan M: Pretty good.

Tom Mullooly: It's amazing. We'll have to think of something special for... Oh, we'll get party hat so everybody can see us.

Brendan M: Yeah.

Tom Mullooly: Oh, it's a podcast. All right, well thanks for listening to episode 290 and we will catch up with you on the next episode.