Why Stocks Go Up & Down - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 292 your trusty co-hosts are here, Brendan and Tom Mullooly. Brendan, welcome.

Brendan: Have some news. Did you know that Netflix shares are up today because this virus that's happening in China, very serious stuff. Hope it gets contained here, but did you know that people in China will be watching more Netflix stuff because they're sick?

Tom Mullooly: This is actually hilarious and I saw this online and retweeted this. Now tell them why, this is hilarious?

Brendan: Because Netflix is banned in China, but somebody, I don't know unless they were trolling really well-

Tom Mullooly: This is a real Twitter account. This is a real ...

Brendan: I know it's a real account. We don't know if the guy was joking or not because if it was, it was a very good troll and he got me, but people just more generally, people love to try to explain why is Netflix up today? Oh well, we've created this reason and it's because more people are going to binge watch TV shows as they recover from being sick with this virus. That is absolute nonsense, but as ridiculous as that one sounds, we come up with equally as ridiculous reasons for various other things that occur in the marketplace on a day to day basis and we just eat this stuff up and it's trash. We don't know why Netflix is up today?

Tom Mullooly: We don't really the reason why? On a more local level, we kind of do the same just to say that we don't just limit this kind of fantasizing to the stock market. We tell people because we believe it to be true, that the traffic down here in the summer is way worse on a Friday and it might not be. That might not actually be accurate. No one's there counting cars at the traffic light outside our office. It just seems that way. so Netflix has to be up because more people in China will be sitting at home getting through this virus.

Brendan: I mean the cop out answer, that's the true one is that Netflix is up today because there are more people trying to buy it then there are trying to sell it and so the price is going up.

Tom Mullooly: That is all.

Brendan: We don't know. We don't know why the millions of people trading these shares today are doing what they do and I really doubt that even a half of them have the same reason for doing what they do. People do things for all sorts of reasons. All the, and we're never going to know why.

Tom Mullooly: I think where the conversation kind of goes off the rails is when you try to explain, and I'm saying this as if I did it because I did early in my career, try to explain short covering to people stock is up on bad news because of short covering. Is it really? How do we know? No one posts a message anywhere that says, I'm selling my shares today because fill in the blank, or I'm buying this dock today because. We don't know. And so the answer you gave that there're more buyers and sellers is the only answer.

Brendan: It's the only. That's the only bit of truth that we have. Everything else is speculation to whatever degree you want to label it as such. Some stuff more ridiculous than others, but we don't need to know why. And we're not going to know why. So we should cut it out unless we want to just be entertained. But if we're looking for actionable stuff that matters, that's just nonsense.

Tom Mullooly: Which kind of leads into a very good article, actually a kind of a two part article that we both read from friend of the show, Ben Carlson.

Brendan: So Ben does a post each year where he updates a performance quilt. And for those who don't understand what we're talking about, he takes different asset classes and shows what they've returned over the years and puts each asset class in its own coloring so you can see it over time and see maybe a large cap stocks led the way in one year and emerging markets the next year. So you can see why it's called the quilt. When you got the visual, we'll have the link to Ben's in the show notes, but you can see that there's no pattern to this. Meaning that you look at all these things, large cap stocks, small cap stocks, mid cap stocks, rates, international stocks, bonds, tips, emerging markets, cash commodities. And every year they're in some jumbled up order that's hardly ever the same as the one before it.

Tom Mullooly: I believe that there are no two years where their performance is the same top to bottom.

Brendan: I don't think so. I don't see any that are exactly the same. You see a couple of years where maybe the leading group was the same for two years in a row. But I-

Tom Mullooly: Or the worst performer was the same a year or two.

Brendan: The problem is that, those years where the leadership is the same for a year or two, they tend to flip flop eventually. Meaning mean reversion kicks in after a certain period of time.

Tom Mullooly: well, here's a perfect example. I mean, just go back a couple of years, commodities last place four years in a row. So if you just presume that well, commodities are just a terrible place to have money the next year they were number two.

Brendan: Yeah. it's basically the general message of these things is that, you need to diversify in some sense. And that if you're, if you're looking at this and trying to say, well, last year small caps were great, so we're going to put, why didn't we just have all our money there? It's because next year odds are it's not going to be where you want to be and you're just looking at the rear view mirror. You're going to be perpetually wrong and you're probably going to be worse than somebody who has some static mix of these things and sits tight over time for the most part.

Tom Mullooly: The problem is we don't have the DeLorean with the flux capacitor, so we can't go back in time and put everything into the best performing asset class for the future.

Brendan: If you had the DeLorean and you could pull out Biffs a sports Almanac, then sure you could be in the best one every year and your performance would be great, but you don't have that knowledge beforehand. It's impossible, so don't bother.

Tom Mullooly: That's a real problem and I think this time of year, we're recording this in late January, usually around this time of year, we get into discussions with a few clients about what you just mentioned. Why didn't we have more in this asset class or why didn't we have it all in that asset class? Can you imagine if we're wrong, if we were to do something like that, how do you explain that to a client and still be a fiduciary?

Brendan: Also? Not even just explain that to a client. How do you keep somebody's financial plan intact? They're going to need this money. This isn't just us playing around trying to, shoot the lights out. This is money that people are going to reasonably need to draw on in the future. And so by diversifying we're automatically forfeiting the ability to be number one in terms of performance because we will undoubtedly own some things that aren't number one, we'll probably own number one, but not enough of it and will own too much of the stuff that isn't number one. But we're also not going to be dead last or getting our faces ripped off because we made an all in bet on something and it didn't work or backfired.

Tom Mullooly: We're going to link to Ben's posts in the show notes, but he did raise a couple of points. So, if we go back 10 years to 2010, 2011 this was supposed to be the time where people got destroyed in bonds. I think a very large firm that is now owned by bank of America called it the great rotation out of bonds and into stocks. Didn't really work out that way. No, I mean you've, you've averaged 3.6% over the last 10 years in the aggregate bond index and if you are using that as the ballast of your portfolio in the sense that it was there to provide some stability when stocks weren't doing so hot. That's pretty good. Good way to lower risk and, and still collect some interest on that too.

I think another interesting point is that if you rewind 10 years to 2010 sure we were out of the worst of the financial crisis. But by no means were people feeling great about the market. I mean this is a time in history where we were talking about a double dip recession and the market was still, pretty volatile and every time it went down people were scarred by the then more recent crash and they thought it was the next one coming to over the last 10 years. These, these annualized returns that that people have seen across every asset class has been pretty good. Large cap stocks compounded at 13% annualized over a decade. A small caps at 13% mid-caps at 12 1/2 percent rate at 12% I mean, and you even made 3.6% annualized in bonds as we said. So a diversified portfolio did really well. And I bet at that point in time saying that having a diversified portfolio, would've been labeled as a heresy?

Brendan: And even if you go back to 2008 if you had the misfortune of investing right before the market hit the skids, meaning putting a lump sum of money, all of your money, you took it from a bank account and put it into the market in the regular Lehman, right in the fall of 2008 Ben had those numbers. What were they?

Tom Mullooly: So if you had put money into the S and P 500 the day before Lehman filed for bankruptcy, right before things started getting messy, you'd still be up nearly 230% from there.

And that included another 45% fall from the time Lehman declared bankruptcy to the bottom in March of 2009 about six months later. So if you put $1 million into the market right before all this happened, it got cut to 500,000 a little bit less got cut in half, but you've still doubled your money since then if you just didn't freak out. Easier said than done for sure. But I don't think many people would have believed that at the time either.

Brendan: No chance.

Tom Mullooly: So some of the other things that I noticed is that, for all of the trashing that emerging markets take, they still are a viable asset and there were times in the previous decade where that was the number one or two asset class for several years. And so it's going to go through waves where it's in and out of favor. Same thing with rates. Rates had terrible years in 2007 and 2008 but otherwise they've actually been an okay place to play.

Brendan: I thought the interesting thing was going back, like you said, so the last 10 years, the story has been us stocks have been way better than international stocks for sure. We don't know when, when the tides will turn because just the decade before that from 2000 to 2010 international stocks crushed it.

Tom Mullooly: And the S&P 500 was one of the poorest performing classes at the same time. So if you did what we just said, not to, if you just at the end of the early two thousands decades in 2010 you said, I've had enough. My international stocks did really well. My U S socks have been crummy and they just went through this 50% draw down. I'm going to sell them all. I'm going to, I'm going to put it into international stocks. You've lagged. If you're doing the same now, meaning you're saying, why have I bothered owning international stocks? They've, they've lagged behind now for 10 years. I'm going all in on us. I think we're probably going to have a point in time. I don't know when, but I think you will be sorry in hindsight for making that choice.

Brendan: It's, that sounds great today?

Tom Mullooly: It does. It's that all in all out approach that just slaughters people. You may be right. Broken clock is right. Two times a day. You may catch lightning in a bottle. The worst thing that ever happened to me early in my career was I had a profitable options trade in 1986 and I was hooked and then I lost 30 grand trading in my own account.

Brendan: You may get lucky the first time and have a string of losses after that. We want to sidestep that whole approach and just say, look, we can't tell you from year to year which one of these asset classes is going to be number one. So we want to take a little different approach instead of the all in all out. Let's pick next year's winner.

Tom Mullooly: Something else that we both picked up bond story in the wall street journal today about online brokers going from zero to hero. The Story actually it just talks a lot about the fourth quarter after TD Ameritrade and a lot of other firms came out to say that trading commissions on stocks and ETFs were just being eradicated. No more, no cost. TD Ameritrade, saw total trades jumped 13% over the the prior year in in the fourth quarter of 2019. we are talking about an increase of thousands and thousands of trades per day happening millions of trades per month that we're now coming into the system.

Brendan: So I think fair point in the article was that they were saying individual retail investors are not a huge part of trading volume anymore or you know, just the market overall. This isn't just mom and pop being silly with their money. I think this is everybody saying there's no more trading commissions and you know we're, we're going to take advantage of it, which seems to make sense on the surface. I mean you take away the barrier to something and people will take advantage.

Tom Mullooly: What I don't understand though is previously, I mean before these announcements in October, the trades were like $7.

Brendan: Right. You would think that wouldn't matter?

Tom Mullooly: Right.

Brendan: But if you want to make a trade in $7 is holding you back from doing it, then how much conviction do you really have that what you're doing is correct?

Tom Mullooly: I don't get it at all.

Brendan: No.

Tom Mullooly: And for a while, TD Ameritrade and Schwab had a lists of exchange traded funds that you could buy or sell without any commission. We're not in the business of actively trading. Things happen where you have to make a quick turnaround. So anything's possible. But I just can't understand folks going in individual investors or institutional investors going in and doing these rapid fire trades.

Brendan: So don't know for sure if you know correlation is causation here, but it certainly seems to be the case. Some of the more interesting things in the article I thought were just some of these stats that I think bear mentioning, even though you know, some people may have heard these before, but through the 60s turnover on stocks, they had the average annual holding period was, it was about six years. Six years. Not to be Debbie downer here, but six years isn't even the long term in the stock market. No. It feels a really long time because you got to live day to day. That's what 18000, 19000 days... That's a lot of days to live through. That's not the long term in the stock market. It's not and I think what held that number back when you see six years now looking back to the 60s a lot of that was because the stock certificates were held in a safe deposit box.

Tom Mullooly: Even when I got started in the business in the, in the 80s we were mailing certificates out to clients. So for them, the folks that wanted the actual certificates for them to sell it, they had to bring in the shares. We had to book it into their account. It had to go back to the transfer agent. That would take weeks for them to say this thing is clear to trade in your client's account. And we would just, I mean we would shake our heads in the 80s and be like don't take certificates. You know, you want to sell this stock, you want to get this ballpark price, we're not going to be able to do that. This process takes too long.

Brendan: Did they mention in the article where... How the average holding period now? So they said that in the 80s the average annual holding period was about two years.

Tom Mullooly: So from six years down to two years.

Brendan: And in 2018 it was around nine months. Wow. Again, you're having these numbers, we're talking about averages. So they're skewed by institutions and hedge funds that are trading millions of shares a day for sure. We're skewing the numbers there, but allowing these, these barriers come down, meaning cost and just the manner in which we can do trades like that. You can click a button and do this online now where it used to be a whole drawn out process. That's all good for investors. You just got to make sure that to reap the benefits of these gains in the sense of costs coming down, barriers coming down. You need to continue to act as if they haven't come down. Because if you're, if you're constantly trading, there's, there's not going to be a benefit.

Tom Mullooly: You're probably doing something wrong. I don't know much more we can say about that now in the sense that if you give something, I think the headline was if you give something away for free, people are going to want more of it. So if you make trading free, people are going to want to trade more. Now it's important to note that stocks and ETFs are commissioned free at most of these places, including TD Ameritrade, but things like mutual funds, you're still paying some kind of, if you decide you want to buy or sell a fund where there's a transaction fee, you're going to have a transaction fee and it's not commissioned free everywhere. The big brokerage firms, as far as I know, are still charging commissions. They're, they're trying to move more and more of their clients into the wrap fee business. That eliminates the commissions, smooths out the revenue stream.

That's going to wrap up episode number 292 thanks again for tuning in and we will catch you on the next episode.