Do You Need More Exposure to Oil? - Transcript

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Tim Mullooly: Welcome back to the Mullooly Asset Management Podcast. This is episode number 304. This is Tim Mullooly and Brendan Mullooly is here with me today. Tom's out, but in Tom's absence, I wanted to mention that 304 is area code West Virginia.

Brendan M: That's a nice touch.

Tim Mullooly: Yeah, There are a couple of things that we wanted to touch on today. I feel like the most pressing and the thing that's been in the headlines the most is oil, and what's been going on in the oil markets. If you haven't seen it yet, we posted a new episode of the Mullooly Asset Show yesterday, where Tom talked about what exactly happened in the oil markets.

Brendan M: He wrote a good post this morning too on his blog, Jersey Shore Financial Advisor.

Tim Mullooly: We'll link to that.

Brendan M: Yeah, talking about the same. But this kind of price action in oil prompts questions all the time. Meaning people who don't have exposure to it or don't think they have exposure to it, wonder if it's a good time to get in because oil seems pretty beaten up. I mean and we're all going to need it at some point. We still do a lot of things, produce a lot of products that involve oil. And so does the price being beaten down make it a good opportunity, I guess is the view that we hear a lot.

Tim Mullooly: Right, from clients and friends and people just, they see the headlines that oil prices went negative on Monday. A lot of people didn't know that that was possible. And then, kind of like Tom talked about in the video, you have to explain the difference between the price of crude oil itself, versus the oil futures contracts, which is what people were actually trading on Monday afternoon. And then there's oil refineries and exploration companies that you could buy.

So if you, if you get a question like, "Is now a good time to buy oil?" There's a lot to it because people don't know that there are different routes that you could take to get some sort of oil or energy exposure.

Brendan M: Yeah, I think a lot of people forget that if you're doing a diversified kind of portfolio, you're exposed to different sectors underneath the hood.

Tim Mullooly: Right.

Brendan M: And so if you just own something like the S&P 500, you do have exposure to oil, and it's probably in the proportion that's a reflection of how well or not well it's done lately. And so just show people how different today is than prior decades, I saw some numbers. So in 2008, after we experienced the beginning of the 2000s, those first eight years of the decade, energy and commodities were in kind of a boom. And that was reflected in the S and P 500, because by 2008, about 20% of the S and P 500 was in energy stocks.

Tim Mullooly: Right.

Brendan M: Meaning that as from the late 90s through 2008, as the energy companies started to do well or as oil went up in price and these companies were making more money, you got exposure to that through your portfolio just by owning a diversified index.

Tim Mullooly: So people don't even realize that they already do in some capacity, own energy or oil companies.

Brendan M: Yeah. And so to even go back further, in the 80s, oil was like 30% of the S and P 500 back then. And if you looked at the top 10 stocks in the S and P 500 during the eighties, it was names like Exxon and Standard Oil, Slumber J, Shell, Mobile.

Tim Mullooly: Yeah.

Brendan M: So five or six of the top 10 biggest companies in the S and P 500 were oil. And so you were getting plenty of exposure to it then as these companies are being successful. But juxtapose that with today, 2.8% of the S and P 500 are energy companies.

Tim Mullooly: Right. And that that kind of reflects how that whole sector of oil and energy has performed in a sense over the last handful of years. It hasn't really been a good place to be.

Brendan M: Exactly. It's telling you its market cap weighted, meaning that the better performing companies over time become a larger and larger weight in the index. And so, it's on kind of a lag as that occurs. But it's basically telling you that this hasn't been a place that you've needed exposure to, to participate in what's been up until the last couple of months here, a very good market stretch over that period of time.

Tim Mullooly: Yeah. I also think, and this goes for other stocks in other sectors as well, but just the fact that the price of oil is beaten down and these oil futures contracts were trading at zero and then negative, that single variable alone doesn't necessarily mean that it's a good time to be investing. There are a lot of other things you need to consider what you're putting your money into. Why did the price of these contracts go to zeros, because there's no demand. Like Tom said in the video, there's nowhere to store it, and it's like in the very short term, we don't know when all of these things are going to go back to normal or what the new normal is going to be moving forward.

So there are other things to consider than just the price, when deciding if you want to put your money into it. And I also think that it leads itself back to a conversation that we have with people sometimes about interchanging the words investing and trading.

Brendan M: A quote on the topic, a paraphrase, it won't be exact, but Howard Marks has said that nobody has anything intelligent to say about the future price of oil.

Tim Mullooly: Right.

Brendan M: And one of the biggest reasons for that is because unlike a company, stocks are business and we can analyze them and take a look at what we think they may throw off in terms of earnings and profit revenue, numbers like that in the future. When we're talking about a commodity like oil or gold or something, it's even more feudal than trying to predict what a company's future earnings may be, because there's not a lot of analysis to do.

Tim Mullooly: Right.

Brendan M: What are you analyzing about oil? You're basically making a guess about supply and demand in the future, which I think is-

Tim Mullooly: I mean, as we saw, even if you made a guess about oil, no one could see what was going to happen now. So all of their predictions about oil were wrong unless for some reason they could predict that a pandemic was going to wipe out the globe and the economy for two or three quarters.

Brendan M: Like Saudi Arabia and Russia would do what they did with the oil markets lately. It's even tougher to predict than the earnings in the future of a business. But another great question, like you alluded to, like investing or trading, do you need more exposure in your portfolio to energy, to oil, than you already have by just owning different index funds and having shares in these different businesses that rely upon oil and whatever the case may be in a different capacity.

I don't know that you necessarily do if you're the average investor. If you're just the average investor, the way that you're going to get that exposure to oil is not necessarily ... If you're a professional and you want to go in and actually trade these futures contracts because you think you have some kind of an edge, that's great. But by and large, I mean what we're hearing from people are that they want to go out and buy some of these weird exchange traded products, USO or leveraged products that are tied to the price of oil.

And these products are not designed for long-term investing. And I don't know necessarily that people are doing their homework before they think about putting their money into here, because these are meant to be used-

Tim Mullooly: By professional traders.

Brendan M: Or on a day to day basis. And I know like our friend Josh Brown recently said on one of his videos, he was like, "Okay, so you're using these daily products, these exchange traded products on the price of oil. You have a view on an oil that expires in 24 hours, you have a daily view on the price of oil."

Tim Mullooly: Right.

Brendan M: "Are you high?" Is what he said.

Tim Mullooly: Right.

Brendan M: "Are you joking?"

Tim Mullooly: Yeah. It doesn't really make a lot of sense when you think about it that way, but I also, I guess kind of get where some people are coming from in the sense that, I mean in Tom's post today, he finished it up by linking to a story from the New York Post. And the headline was saying out, "Here's how to invest in oil if you want to take a big risk."

And like Tom said in his post, "If you're taking investment advice from the New York Post, you have bigger issues." But at the same time, a lot of people read the New York Post and they see something like that and it's like, "Oh, I need to invest in oil." And they get confused. And that's why people start using the wrong terminology or having a wrong mindset about how they want to get into oil or make money on oil. It's like, you're not investing. You need to understand what these products are, how they're traded on a daily basis and understand how risky it is.

Brendan M: Yeah, a lot of these products, I mean, if you're buying and selling leveraged products tied to the price of oil, I mean, as Tom noted, that's not investing, that's, that's just gambling. That's trading, it's gambling and if you're going to do it because it's fun and it scratches an itch, at least acknowledge that and do it with something that is responsible, like something that you would take to Atlantic City or Las Vegas and not your retirement dollars.

Tim Mullooly: Right.

Brendan M: And just try to understand that that should oil be on the precipice right now of a huge run where it becomes something that you do need exposure to, that in many cases, if you're investing through diversified index funds, things of that nature, you're going to get the exposure to that.

Tim Mullooly: It'll reflect that.

Brendan M: As those companies succeed, they're going to become bigger weights in these different portfolios, and you are going to participate in that by just being a more patient long-term investor. And that that is investing because you're doing that over the long-term and letting market dynamics guide you to that decision. You don't have to be a hero and get in at the bottom tick of oil. You don't get a prize if you guess right. I'll tell you that much.

Tim Mullooly: I think it also, kind of going back to what you were saying about being responsible and just using the amount of money that you might take to Las Vegas or something like that, I think you have to just think about like risk reward. Like, let's say you take 1% of your investible assets to put essentially to gamble into oil, even if that investment or that trade goes up 300%, is it really going to move the needle that much for you in a sense of making you rich overnight?

Brendan M: I can retire 10 years early.

Tim Mullooly: Right, exactly. Even if it goes up 1000% that's only 1% of your portfolio. And then if you take the opposite approach and you put in a substantial amount of your investible assets, what happens if that gets smacked in the face and you lose all of that money? The risk reward there, is it worth it?

Brendan M: You got to think of the probabilities. What's probable here? What's likely? And I think a lot of times when people are looking at doing stuff like this, it really is when you boil it down, whether they've considered it or not, it is just scratching kind of a gambling itch. And look, I understand that. It's just that's not what we do here. We're helping people responsibly invest so that they have money when they need it and they're older and they can't work anymore and they need to be supported. So we're happy to discuss this sort of thing with people, but it's not a part of what we do and it's not going to be.

Tim Mullooly: So another thing that I wanted to bring up, was actually a topic that Josh Brown also has been kicking around for the last week or two. He wrote a post on it, I think last week and then kind of followed up again this morning. It was about credit cards, and Josh was worried that more economic stress could be put on the system and people's own personal finances through credit card debt.

And he followed up today by saying that two companies, Discover, which is a relatively big credit card company, and Synchrony, are actually starting to tinker with the credit limits that are available to customers, because they're getting worried that people aren't going to be able to pay back their balances. So they don't want to extend too much credit to them. And Discover's actually easing the process of on boarding new clients and giving out new lines of credit. So what are your thoughts on this whole credit card situation?

Brendan M: I think it makes sense because these companies have to run a business. And I think they are probably right to be concerned about people potentially carrying balances over and not paying in as timely a fashion as they used to, because people are feeling it. And I think that if you think of the hierarchy of what people are going to use their money to pay if they're out of work and they just got a stimulus check and they've got to pay some of the bills. I mean you're going to pay things like your mortgage and your utilities, you're going to pay for your phone in your car and food. And if you're carrying a balance on your credit card, I don't know, I mean maybe like if push comes to shove and you can pick something, that's probably going to be it.

Tim Mullooly: Yeah.

Brendan M: But I did have a funny quote that I wanted to share. I don't know who to attribute it to, but I've heard it a million times. And so, "It's important to remember that a bank is a place that lends you an umbrella during fair weather and then asks for it back when it begins to rain."

Tim Mullooly: Yeah. I think that that's really important, because when you're thinking about your personal finances and we always talk about the importance of having a safety net and emergency funds and cash in savings. It's important not to really take lines of credit into like, "Oh well if I have to go through my emergency fund and then I run out of that, I can always just put up to 5 or $6,000 in the short term on credit cards." Except when bad things like this happen and then your credit line gets cut down from $6,000 to $1,000 and you can't put as much on your card as you thought. Then what do you do? So banking on a certain line of credit always being there, is a not a good plan.

Brendan M: I just think that you should be thinking about it appropriately in the sense that, if you need money, unless it's some kind of a personal crisis, if it's a more widespread one, like what's going on now, where the economy is in rough shape, I mean whether it's the same as today's standards or more typical recessionary period, something like that, other people might need money too.

And so then it becomes a more systemic risk, in the sense that these companies have to worry about whether or not they're going to be getting made whole on the money they lent out to their customers. So they may have to do what we're seeing here, pair back the credit lines that they're offering to people. And unfortunately, that comes as a real kick in the nuts because it's at the worst possible time.

Tim Mullooly: Right.

Brendan M: So just remember that. And if you're going to rely on things like lines of credit or credit card that are not fully within your control, meaning that they've been extended to you on terms that can be changed by a bank or wherever else, just remember that in the hierarchy of things, and if this is at the top of your list saying, "Okay, I don't have much of a safety net, but I could always use this line of credit that I have." Just remember that if you read the fine print, it usually says that they can change the terms, and it's at their discretion and not yours. And so unfortunately, it all comes to a head at the same time.

Tim Mullooly: Real quick, the last thing that I wanted to bring up was an article from MarketWatch. There's plenty in the article that they talked about, but there was one point in particular that I wanted to touch on. The headline was how it said 84% of Americans say they need another stimulus check. And I know a lot of Americans haven't gotten their first round of stimulus check. But the one point that I wanted to talk about was how it said that they listed a lot of different percentages and stats from people who say that this downturn has really hit their bottom line and they're struggling on a month to month basis. And they said that it's really hit people across all wealth brackets. So meaning obviously, people that don't earn a lot of money are struggling, but people that do earn a lot of money are also struggling.

And I think the point that I wanted to just I guess remind people of is that, the amount of money that you bring in is only half of the equation when you're talking about financial security. And there are some people out there who think that just because you earn a lot of money means that you're financially well off or you're financially secure. And we're finding out now that, that's not the case. It doesn't matter how much money you earn, it matters how much you have in the bank.

And if that high earning paycheck stops and in a month or six weeks you're kind of struggling for cash to pay bills, I mean, it's tough.

Brendan M: It's tough, because not everybody even got a stimulus check. And so the point you're making kind of rings true from that perspective. They had to put some kind of limitations on this, I suppose. And so if you make more than certain thresholds, you didn't even get one of these stimulus checks. And to your point, your adjusted gross income, which this was based off of, may or may not be a reflection of your cashflow or-

Tim Mullooly: How well equipped you are to handle something like this.

Brendan M: Yeah, you could be in a rough situation even though your AGI excluded you from something like a stimulus check. And to your point, yeah, I mean, you've got the income side of things, but what are expenses like too? And if they're running pretty equal with each other, and by nature of that, you don't have too much saved away, then you could be net worse off than somebody who makes three quarters of what you do but, but lives on less. So yeah, you've got to you got to factor in all parts of that equation.

Tim Mullooly: Yeah. So I think just reminding people that savings rate is super important. Obviously right now isn't the best time to harp on that, you have to do what you have to do to make ends meet if you're in a tough situation right now. And less and less people are in a situation to actually increase their savings right now. But I think just something to consider that, if you make it through out to the other side after this whole crisis passes, I think re-examining how much you're putting away each month would better prepare you for something in the future.

Brendan M: Agreed.

Tim Mullooly: So that's going to wrap up this episode of the Mullooly Asset Management Podcast. This was episode number 304. Hopefully Tom will be back with us on 305, because I don't know what area code that is. But thanks for tuning in and we'll catch you next week.