"Living Off of the Interest" - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 311, 311. Thanks for tuning in. Joining me today is Brendan Mullooly and Tim Mullooly. Guys, interesting day in the market.

Brendan M: Yeah, I think we might have touched 7% down on the Dow today, this is Thursday. What do you think? Is it all the Robinhood traders taking their profits?

Tom Mullooly: Well, I think that's part of it. But before we even get into reasons why, I just want to... For perspective, I know that we were down 1,861 points on the Dow, and I think 190 points on the S&P. The S&P is back to where it was. Today is June 11. The S&P is back to where it was the day after Memorial Day, so just a little over two weeks ago.

Brendan M: It's alarming. I think with the way this year has been, a day like today in the market, in terms of the percentage move, would have been a big deal if we hadn't gone through a stretch earlier this year where we literally had 7, 8% moves. That was the norm for a two, three week stretch there. I think we got desensitized to market moves like these, so might be a bigger deal if we weren't coming from that. Also, we're coming off the best 50-day stretch for stocks recorded since, I think, coming out of the Great Depression.

Tim Mullooly: Yes.

Brendan M: So again, perspective in the sense that we went down about 35% and then rallied more than 40 to come back to where we were recently, at the highs of Monday.

Tim Mullooly: Yeah.

Brendan M: And yeah, so we've given back a little ground here. I don't think it's anything to lose your mind over though, right?

Tom Mullooly: Can we spend a minute just talking about this whole Robinhood phenomenon? When you roll in the idea that... I don't know how many hundreds of thousands of people have opened accounts in the last few weeks on Robinhood. They're sitting at home trading stocks now, and we've got Davey Day Trader, the guy from Barstool Sports, saying, "Warren Buffett's past his prime, I'm the new king."

Brendan M: The dude's business is in attention. He's just a cartoon character.

Tim Mullooly: Yes, he's creating content.

Brendan M: He's doing this on purpose. He knows it's a joke. Yeah, it's-

Tom Mullooly: He knows it's a joke, but there's a lot of people that tune into what he says, and they subscribe.

Brendan M: I said tongue in cheek, the Robinhood comment before, because these accounts are not loaded up with money. They're not moving the market, and anyone who suggests they are is out of their mind.

Tom Mullooly: I'm stunned that we're seeing that explanation though, given for why the market has been so frenzy the previous week.

Brendan M: Yeah. I think it's a funny anecdote to point out like, "Hey, my friend texted me and he's been trading stocks on Robinhood, and that's a sign of the top." People point out stuff like that all the time. We could probably tee up another 10 examples of people saying like, "Oh my God, look at this thing. This has to be a top." I don't condone the behavior of day traders on Robinhood. I wouldn't recommend doing it with any significant portion of your money, but I don't think they're out there driving the market or anything like that. That's ridiculous.

Tom Mullooly: They can't. Not with the size that they're swinging around.

Tim Mullooly: It was interesting today while the market was down, how quickly it went from poking fun at the Robinhood traders, like "This is the top, ha-ha." to, "Oh, we're back into the second drop. Here we go. More pain is coming today."

Tom Mullooly: Right, it's a second wave. Right.

Tim Mullooly: Nobody saw the first leg down coming and nobody saw the rally back up coming. But now there are people out there today saying, "Why today's market move is indicative of things to come in the future?" It's like, there are no credibility left to stand on for people making calls like that.

Brendan M: And just to point out an example, Druckenmiller, this week, was interviewed, and there was an article on CNBC. And he was basically saying how his comments from back in May about how the risk reward opportunity was maybe one of the worst he's seen in his career was obviously wrong here in the short term, that he had been humbled and that he underestimated the fed. And I don't think the lesson to take away from that is it's not the Davy Day trader lesson to take away, like "Drucks past his prime, he's washed up, he doesn't know what he's doing." This is one of the all-time greats who was wrong, first off admitted it, which I think-

Tim Mullooly: I was going to say, you don't see that very often.

Brendan M: Most of the time you don't see that. Druckenmiller tends to be better about that than most. But also, it doesn't matter to him. He's not out there betting his own livelihood. If he was wrong directionally, like he said he's returned 3% over the last couple of months since the market bottom versus over 40 for the S&P 500. That doesn't impact his life. He's going to be fine. Even if everything went wrong for him and he had a complete fall from grace and his investments were... He pretty much just had to close up shop, which isn't going to happen because he's a family office now anyway. But let's assume all of that. He will not be destitute, living out his remaining days in the poor house. Whereas people who try to play in these games like he did, making short term directional calls about the market, do have their livelihood on the line.

They're investing money that they're either consuming now or will be consuming soon, and it will be their paycheck replacement when they can't work any longer. That's irresponsible. So, he's playing a totally different game than people out there who are worried about short term market movements.

For those who are freaked out right now or were freaked out earlier this year or whatever the case may be, there's some good information, a good update. Ed Yardeni puts out great research, and he actually keeps a record, since 2009, so basically since the end of the financial crisis back then, of all the reasons that you could have panicked about socks, and there are a handful from every year along the way. I don't know if you guys want to pick out a random year since 2009, I can read off all of the things that you could have been worried about just to give you a taste of this.

Tim Mullooly: Let's do 2013 because you look back at what the market did that year, and 2013 was a really good year in the market. But what were people worried about then?

Brendan M: All right, so 2013, we had, in February, the fed was making comments about ending QE. In April, we had worries about a slowdown in China and commodities were plunging. In May, Bernanke made comments about ending monetary easing policy. I think that was also the taper tantrum.

Tom Mullooly: That's exactly what it was.

Brendan M: Right. So in August, fed speculation again about ending QE and weak retail sales. September, looming budget deadlines and debt ceilings. And then in December, more fed tapering fears. All on the way to a year where the market returned like 30%, if I'm not mistaken.

Tom Mullooly: That's right.

Brendan M: So, the best year in recent memory, aside from 2017, which was up nicely too. Those were the two best years that I can remember in recent history.

Tom Mullooly: Now there were times like the summer of 2011, where there was a lot going on. Yeah, it was pretty rocky that summer for markets, but it turned out okay.

Brendan M: Yeah. I mean the only things that... Two lines on here now would summarize the summer of 2011. We have Greek debt crisis, and then just in general, the Eurozone debt crisis. Skipped in there, I guess, would be the downgrading of US debt. But those are just two bullet points now that we chuckle about.

Tom Mullooly: They're just mile markers on the map.

Tim Mullooly: Michael Batnick wrote a post pretty much outlining that in a different chart form. And his point was that there's always a reason to sell, and we just listed off a handful. If you dug into those headlines and got freaked out and panicked, you could have sold along the way, and who knows if you'd gotten back in because there's always going to be another reason coming up that could scare you away from getting back in. Ultimately over that time, the market has returned nicely since then.

Brendan M: It's interesting to look back on that because there were plenty of opportunities to be scared out of your investments. And I think the important point that Michael makes, and I've heard some of our other friends from Twitter talk about is just the idea that the bearish newsletters or market pundits out there usually sound really intelligent. They usually are smart people who are buried in their work, and they come up for air to share it with us. And it sounds way smarter than somebody who says, yeah, that's true. But also, we should probably just hang in there because generally it's been the thing to do over time. Optimism sounds naive, whereas pessimism sounds intelligent. And so, you read these things and it's tough to ignore them sometimes, especially based on who they may be coming from.

Tom Mullooly: I know that Batnick’s piece showed that it's easy to come up with reasons to sell. It's very hard to find reasons to buy. And a lot of times, we wind up talking to folks about putting money away on a systematic basis. And I just think that makes so much sense that you're not going to try and say, "Hey, the market was down 7% on Thursday; I guess Friday, I should be pushing all my chips into the table," or "Maybe I should be taking money off the table." I think it's a lot harder to try and time or gauge whether it's the right time to be doing something or not. And just say, "I'm going to be on a systematic plan. If I've got too much risk in the market right now, I'm going to systematically de-risk over the next three months or over the next six months. Wherever the market is, that's where we're going to take a couple of chips off the table." In the reverse, we've got money going in, might be in your 401k, where the money goes in every two weeks. It goes in automatically.

Tim Mullooly: Yeah. And that's another Batnick piece that he wrote. It was about automating your contributions. And he gave a very basic example of if you sent money in consistently every two weeks, just to a basic 60/40 portfolio. As of last Friday, you would have been at an all-time high. That's a lot different for someone who might have tried to time when they put their contributions in, especially in a year like this. You don't know if you're catching it on the down slope or if you miss something on the way back up. But if you're sending money in along the way, it doesn't really matter what the market is doing. That was one of the quotes that I wrote down.

He said, automating frees you from the shackles of worrying about what the market does next because he said consistently making the right decision during difficult times is an impossible burden to bear.

Tom Mullooly: It is.

Tim Mullooly: And I think the word consistently there is very important too.

Brendan M: Yeah, I think sometimes the desire to time the entry or exit from the market is caused because people are playing with money that they shouldn't be. And so, I think to preface all of this, you need to have a plan place and understand why you're investing the money and for what and what the time horizon is. Because your returns will be impacted over the very short term based on the timing of your purchases or sales. That is a fact because we don't know what direction the market's going to take.

For instance, somebody who did something this year could have had, like you said, tremendously different outcomes based on just one or two months time in the market. But if you have a better idea of why you're putting your money to work in the first place, then you shouldn't be worried about short term timing like that because that is the sort of thing that, if you're investing for an appropriate time horizon, is not really going to matter all that much in the long run. It's not going to matter that you nailed the bottom or that you got out at exactly the top. If you have to do these things, again, systematically is the way to go, just because it's impossible to do those things consistently. And I think it's, quite frankly, a waste of time to try to talk about timing decisions. I think we should all just admit that we're not going to time it perfectly and come up with something that it's bearable in terms of the outcomes. It's managing risk. It's another way of managing risk is doing it that way.

Tom Mullooly: I agree with you, Brendan. And I think that if you do happen to get catch a short term bottom as you're putting money to work, you may feel good for a day or two or maybe even a week, but you're always going to be worrying. You're always going to be worried about the next move down in the markets. The alternative is to just misremember the facts and say, "Yeah, I got in pretty close to the bottom a year ago or wherever." Everybody's memory becomes foggy after a period of time.

Tim Mullooly: Yeah. I think Nick Maggiulli wrote a post. I don't have it in front of me, but I forget the exact number, but it was something like 95% of the time there's going to be a lower price than what you invested at. So even if you do hit the short term bottom, a year later or maybe a couple months later, there's probably going to be a lower price. And it's like, "Ah, see, I should have waited. There was a lower price."

Brendan M: But it doesn't seem like that in the moment. Because especially going onto the upside, we feel like all this euphoria... I remember each of the round numbers that we passed along the way from Dow, 20,000, all the way up to where we got earlier this year before the market took a dive again. I understand that back in the day it used to be a bigger deal when you hit a new round number on the Dow and they'd print hats and stuff, but we're acting as if you're never going to wear your Dow 20,000 hat again. And we did.

Tom Mullooly: We did.

Brendan M: We did, and we went through 20,000, we went so far through it that you thought, hey, maybe we will never see down below 20,000 again, but we did this year and nobody would have predicted it. Nobody did predict it, but it happened.

Tom Mullooly: It's easy to say, sitting here in June, do people really remember the Dow was down around 18,000?

Brendan M: Right.

Tom Mullooly: And not long ago, third week of March.

Brendan M: Right. Doing automated purchases saves you from getting too euphoric and saying, "Stocks are never going down again, I better put it all in now." And it saves you from being too despondent and saying, "Wow, I don't know when the heck this is going to end; maybe it is all going to zero." Because neither of those things are true. I feel confident about it, and there's an alternative. It's a boring alternative. It's like eating your vegetables, saying you're going to dollar cost average in, but it's the smart thing to do.

Tom Mullooly: So when I was growing up, I used to watch Beverly hillbillies, and the banker was his next door neighbor, Milton Drysdale. The story with him was that he had made a ton of money in stocks and he just lived off the dividends. Beverly Hillbillies were canceled 50 years ago, but we still talk to people today who say that that's exactly what they want to do, that they want to have a portfolio where they just live off the dividends.

Tim Mullooly: Yeah. And I don't think, especially in today's environment, the 10 year treasuries yielding 0.6%. It's not really feasible for most people, unless you have millions upon millions of dollars to live off of the dividends. There was an article from Christine Benz in Morningstar, and she was saying in the nineties, it was a little more feasible because there were rates for 10 year treasuries in between five and 8%. But with where things are today, you're either accepting less than 1% yield or you're chasing yield, and that causes you to increase risk by going into high yield stuff or the equity side of yield with dividend stocks and utilities. Just not really feasible for the everyday person.

Tom Mullooly: Yeah. Just as a yard stick, the last time that I saw... In my career, the last time I saw a one year CD paying 6% was 1994. So, it's over 25 years ago. And so people saying that they want to live off the dividends or live off the interest, it's extremely hard to do right now.

Brendan M: I think there's a misunderstanding because I think people tend to think that dividends and interest are safer because it's tangible, it's paid out, it's cash in hand. And to an extent that's true, but it depends on who's issuing it. And so, if you want interest in dividend... I would caution anybody for thinking any kind of stock dividend is safe or stable, no matter what company we're talking about. I'm sure you can light up the board with some examples of that in just a minute. But in terms of interest, the only interest that I would consider safe and secure is a CD or something from the US government. Even highly rated corporates are not ultra secure.

Maybe you consider those safe, but those sorts of things, the type of interest that you're going to get in today's world is .5% to maybe 2%, depending on what we're talking about.

Tom Mullooly: Right.

Brendan M: So, if you're getting that sort of stuff, then as Tim alluded, to the base of money that you have to have to just live off of that interest and never touch the principle, you need to have vast sums of money or you need to spend absolutely nothing. So, if your situation lies in between, which is most of the people who we come across, then it's just not feasible. Yeah, Tim also touched on the idea of dividends. And I think no matter what we're talking about, you can find companies out there that are high yielding, just like you can find high yielding bonds. But I would caution anybody for believing that the interest or dividend payments on those things are rock solid or something that they should bank their livelihood on in retirement.

Tim Mullooly: Right. I think that's the important part too, what you just said at the end. Banking your retirement income on that. As an investment strategy in general, it's not that bad of an idea. But if you need that money to live on, that's your livelihood, you need that. I wouldn't bank it on something risky like that.

Tom Mullooly: We see people come in the office, and they'll show us their statements from their broker, and they're loaded up in a high yield bonds, they're loaded up in energy, master limited partnerships, MLPs-

Brendan M: Bank stocks, utilities.

Tom Mullooly: They don't even know they're getting K1s with some of these investments. They're overloaded in sectors, like you just mentioned, banks, utilities, that if the market goes against you, the dividend isn't going to matter.

Brendan M: Yeah, it's nice that you have a 4 or 5% dividend on that thing. It doesn't really matter too much when it goes down 20%, when the market goes down 30. Sure, it might go down a little bit less, but it's not going to save you in terms of your income because then your incomes based on a lower base of money.

Tim Mullooly: Yeah, right.

Tom Mullooly: I'm not going to keep you up all night with horror stories, but just a couple. In the eighties, we had tons and tons of clients who had thousands and thousands and thousands of shares of Long Island Lighting. And when their Shoreham nuclear power plant wasn't going to get the necessary approvals, they eliminated the dividend. They did not start cutting the dividend. It was just gone. It was there Monday and gone on Tuesday.

Brendan M: Right, and then what happens to your principal when that occurs?

Tom Mullooly: Stock went from 18 to two.

Brendan M: It's not like you just lose your income there. You also lose a significant chunk of your principal. So, the idea that you can have a portfolio where you never touch the principal, it's just not going to happen because there are going to be some... And it all depends on what you're counting as your principal anyway, okay? So, we talk to people all the time who build up savings in their 401k, and then maybe they're approaching retirement and they want help with planning and maybe we roll it to an IRA. And people then are maybe considering, "Hey, I rolled over $1 million, and so my principal is $1 million." But in reality, some of that money is money that was contributed every two weeks from a paycheck over the course of a career, and then some of its earnings anyway. It all depends on where we're drawing the line from. Is it every year, is that your new principal line? Because the market went up 30% last year, but it was mostly making up ground that we lost at the end of 2018. So, what's the principle there? It's tough to say.

So, the article from Christine Benz was talking about an approach, which is basically what we do here, where we're just considering non-market sources of income in retirement. We're really talking about cashflow. So, non-market sources of income in retirement, like social security or a pension. And then we're looking at what the gap is between that and what people need and trying to come up with a portfolio that can reasonably throw off what they're going to need it to. And most of the time, it's not just going to come from dividends and interest, unfortunately.

Tim Mullooly: It probably won't.

Brendan M: I think if you are realistic and say, "Hey, if I can put two years or three years or four years of that gap between my pension and social security income and what I'm actually going to need, if I can sock away that much money, then I can let the market do whatever it's going to do for the next two, three, four years, and we're going to work out okay." It just doesn't work like clockwork in the sense where we put together a portfolio that between interest dividends and then market action, it throws off 4%, and we're going to withdraw the 4%, so that you're at the same point you were when you began the year, and the next year, we just do it again. That would be wonderful. I wish we could do it that way. It'd be a lot less nerve-wracking for everybody involved. But we know how the market works. We're going to make 20% one year, and then the market's going to do what did that earlier this year, and it's going to give back some ground. You're going to have results all over the map, and that's just what happens.

Tom Mullooly: Okay, that's going to wrap up episode 311. Thanks again for tuning in, and we will catch up with you on the next podcast.