Stocks Can Go Down, Too - Transcript

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Tim Mullooly: Welcome back to the Mullooly Asset Management podcast. This is episode number 324. This is Tim Mullooly, and Brendan is here with me today. Thanks for tuning in. Brendan, how are you doing?

Brendan M: I'm good. Some turbulence in the market since we last spoke though.

Tim Mullooly: Yeah, definitely. We touched on it a little bit last week, but there was another article in the Wall Street Journal and the headline made me just go, "Wow, this is a headline." The headline was, "Market volatility teaches new investors that stocks go down too." In a year like 2020, it's remarkable that we could even have a headline like that, considering everything that happened in the beginning of the year. Right?

Brendan M: Yeah. It's wild that we've forgotten that the way we got to this 50 plus percent run up in the S&P 500 and the Dow Jones is because directly preceding that, we had a 35% decline in both of them respectively. And it just seems we get super wrapped up in whatever the most current move is, but yeah, over the last several days, we had a five day stretch going back to last week and to the beginning of this week where we saw the NASDAQ drop 10% in five days, and the S&P 500 was off seven at that point too. Two of the tech darling stocks of the last month or so, Tesla was off 26%. Apple was down 14. So yeah, there were a lot of people who, I guess, are newer to investing just because the climate, things have just been going so well in the stock market, at least for the last several months since the end of March, roughly. And it's new for them to experience a quick 10% drop, although it's pretty normal market activity otherwise for folks who have been paying attention.

Tim Mullooly: So it's been pretty well documented in the media about how many people are starting to trade and get involved in the stock market over the last couple of months, because the market has been doing so well, like you're saying. All of these big name stocks have been really going up a lot and people, between the factor that there's no sports for people to bet on, and also that people are at home with more time on their hands, all of that perfect stormed into more and more people day trading their accounts. They always say that experience is the best teacher, but in this case, I really wish that there was another way for people to learn about the stock market, besides jumping in while stocks are hot and getting their face ripped off. You know what I mean?

Brendan M: Yeah. I mean, depending on how levered up people were, I mean, you read about individuals getting into different options, things like that too, in addition to individual stocks, things like that, or leveraged ETFs, products like that. Yeah, so a 10% drop in the NASDAQ might've been more painful for somebody, like I said, if you were all in on Tesla stock, you felt it more. Or if you were in some kind of three times NASDAQ product, yeah, you got your face ripped off and you have to learn. I just scratch my head-

Tim Mullooly: I wish there was higher hurdle to clear, because literally anybody can go and open a trading account if you have money to do that, especially with no commission costs anymore. The barrier to entry is very low. I feel like it sounds silly, but even just having people click through a course or something real quick before. It sounds silly. But-

Brendan M: If you just look at a market chart of this year. You don't have to like go back into the history books to see the last time there was volatility to the downside.

Tim Mullooly: Right. We went-

Brendan M: We're down 35% in six weeks.

Tim Mullooly: In six weeks. Yeah.

Brendan M: It's right there.

Tim Mullooly: What do you mean, stocks can go down? How short term memory are all these folks?

Brendan M: Right. So, it's just a wild year because we've had two polar opposite ends of the spectrum in terms of volatility. Volatility can be up, like it's mostly been since April, let's call it. And it can be down a lot too, like it was from the middle of February to the end of March. And that's just part of what comes with investing, but new lesson for some folks, hopefully not for clients of ours. This is something that we talk in terms of expectation setting and letting people know realistically what they should anticipate their investments doing. Hopefully not news to any of our clients, but it's wild.

Tim Mullooly: Yeah. I mean, especially with options too, they pointed out in the article about how there was a record, it said 28 million options contracts last month, and that was up significantly from the same month this time last year. Options are very complicated and you need to know what you're doing. And even sometimes when you know what you're doing, you can still end up losing a lot of money.

Brendan M: I'm not sure most folks need them.

Tim Mullooly: Yeah.

Brendan M: I don't think it's necessary to earn good long-term returns in the stock market. Unfortunately, you've been reading a lot about folks who are trading and doing options and using some of these options because it's a cheap way for them to get exposure to a stock that they want to own. But I mean, there's so much going on. And I think there was something else in the

Journal that we wanted to touch on just in terms of some of these new traders who are entering the market or have entered the market these last few months.

Something to note for folks who are trading stocks or whatever they're doing on their own, if you're doing this in a brokerage account and you haven't held the thing, the stock, the ETF, the mutual fund for longer than a year, you have to remember too, that you're not going to pay capital gains tax on that. You're actually going to just pay it as if it was ordinary income.

Tim Mullooly: Yeah. You're not going to get the lower long-term capital gains rate that you would if you held it for more than a year. But these people, if you're day trading, obviously, every couple of days you might be flipping in and out. And I think it's important for people to know if they've just opened their accounts, that every transaction that you have, every sale that you make has tax ramifications to it, whether you made money or you lost money.

Brendan M: You're going to get a tax form from the custodian come tax time next year and it's going to be like 20 pages long if you've been trading.

Tim Mullooly: Yeah, the article in the Wall Street Journal that outlined the tax notes that people need to know if they're day trading had a quote from someone who was day trading, didn't realize that there were tax ramifications to what they were doing, and they got something from the custodian the next year. I think the person said it was like 16 or 17 pages long.

Brendan M: Yeah. Your tax preparer is going to hate your guts, or you're going to be really mad at yourself when you're trying to do TurboTax or whatever you do.

Tim Mullooly: Imagine. I can't even imagine people who do their own taxes.

Brendan M: It might be reason enough to hire somebody else to do it if you've gotten this thing and now you can't. It's complicated you're a tax return to the point where it's no longer within your hands.

Yeah. I just think if you've had a good time thus far doing trades in the environment of the last four or five months, that's great. Just remember that net out of your returns are these taxes that are going to be due next year if you're not already making quarterly estimated payments as a result, because there's no way to withhold tax from brokerage accounts, as you can do when you're taking like an IRA distribution, let's say.

Tim Mullooly: Right, yeah. One other interesting note from the first article that I thought was how they noted that with the options contracts, it was a lot more calls than it was puts for people, which means, I think the quote was that the investors, it seems like investors are more worried about missing out on gains than they are about hedging against losses.

Brendan M: That captures just the overall market sentiment and feelings. It's more FOMO than - You just get the feeling-

Tim Mullooly: ... actual fear at this point. Fear of missing out as opposed to fear of losing money.

Brendan M: Fear of losing money.

Tim Mullooly: Yeah. It hits a lot of people and I get it, but it feels like everybody else out there is getting rich, wildly rich in the stock market and I'm not, so I need to participate. It's not the case. I know it might feel that way though, for some people.

Brendan M: Yeah. I mean, and you can do it in a more methodical, organized way. You don't have to get your exposure by doing crazy calls on-

Tim Mullooly: Right, out of the money call options.

Brendan M: ... on Tesla. You can invest in the market in a more prudent way than that and a more sensible way with money that you can afford to have in the market. All of these different boxes you want to check and then have a strategy that isn't going to give you a bunch of extra ordinary income to pay tax on this year. You can do it in a brokerage account in a tax managed way. It's all possible to do. You can participate so you can have that feeling, but just execute on the idea a little differently. But again, that's up to the individual. If they'd rather trade in their Robin Hood account, then power to them. They should at least just have this information though, like, okay, one, the market can go down as the first article alluded to.

Tim Mullooly: Yes.

Brendan M: And two, there are tax ramifications to trading in a brokerage account that I should probably be aware of.

Tim Mullooly: Yeah. One thing that you mentioned in there was invest with money that you can afford to invest with or trade with. At the end of the first article, they talked about a guy who said that he saw Tesla going up and up and up and essentially bought in at the top and has now lost $20,000 in Tesla. And one of the last quotes in the article was him saying that, "We were planning on getting married." Yikes. So, moral of the story-

Brendan M: Yeah. Don't put money in the market that you need for something like a wedding or literally anything that you would need to do in the next 12 months. We harp on this all the time, but have a margin of safety. Do not have money at risk that you're going to spend in the short term. And I consider the short term to be the next year or two, maybe three, depending on what kind of goal we're talking about here. So, be sensible about this sort of stuff.

Tim Mullooly: Yep, absolutely. So the other article that we wanted to talk about was from our friend, of course, Christine Benz at Morningstar making her weekly appearance on the podcast.

Brendan M: Yeah. A lot of good stats about 401(k)s in there.

Tim Mullooly: I picked out a handful of stats that she included in the article and just the implications, or what those stats mean or what they say to me, at least. The first one being that just generally, 56% of all workers are participating in a workplace retirement plan of any kind. So that's 401(k)s, 403(b)s, anything like that. And that was from 2019. So that was a stat from last year. While it's good to see a majority of people participating in those plans, I think the opposite stat there says more to me. It means 44% of people are not participating in those plans. So how are those people saving for retirement? Because if they're just using an IRA, the limitations for what they can put in there are significantly less. It'd be great to see that number go up.

Brendan M: You're at a disadvantage if your employer doesn't offer a workplace retirement plan. Disadvantaged in the sense that you can't put stuff away on a tax deferred basis, to the extent that others can. You can still save and there are options available to you, like you said, IRA, Roth IRA up to the limit. And then after tax from there, I mean, there may be some other options to discuss and people who are self-employed have a whole other host of options to dig through in terms of what they can do. But yeah, it's great to see that that many people have access to a plan, but I can't say-

Tim Mullooly: I certainly hope the number goes up.

Brendan M: You hope it goes up, but it's not cheap, especially for small businesses to offer these sort of plans.

Tim Mullooly: That was another point that we saw later down in the article, I think. We'll touch on that now then. One of the stats was 1.42% was the total cost per plan average per participant. So it costs a participant 1.42% to participate in their 401(k) if the plan has less than $1 million in assets, versus 0.26% for plans that have more than a billion dollars in assets. So to your point, those smaller 401(k) plans are pretty expensive for the participants and also for the employers to run as well.

Brendan M: Yeah. So again, you are at an advantage if your employer offers a plan versus not at all. So you've got a leg up there, but then your tables turn. You're at a disadvantage if you're at a smaller employer, on average, we're saying, versus somebody who works at a Fortune 500 company, because we've seen 401(k) plans from the smallest mom and pop businesses to some of the biggest companies in this country. And yeah, the costs are usually just what you alluded to, in the sense that, the bigger the plan they have economies of scale, they can get their costs lowered because they're bringing more assets to whoever the plan provider is.

Tim Mullooly: Right.

Brendan M: Unfortunately, that's how it works. It's all something to consider. So I would say all else equal, it's better to have a plan. So if it's offered to you, then you have the ability to put 19,500 into a plan versus six grand for an IRA on a tax deferred basis, I mean, I say you do that in most cases, assuming you have the ability to. Yeah.

Tim Mullooly: Assuming you can, yep. So another stat that I thought was interesting was how she said 7% was the average salary deferral amount in Vanguard retirement plans in 2019. So that means, people are deferring 7% of their salary into their accounts, whether or not that maxes out for them. I think for a lot of people deferring money into their 401(k) or their 403(b) checks the box in terms of retirement savings. And if that's their only means of savings, 7% is a kind of low savings rate. So that's the takeaway that I have from it. Hopefully if you're putting 7% away, that's great, but I think there should be more on top of that if you have the ability to.

Brendan M: There's no one size fits all answer, unfortunately. And so, yeah. I mean, because 7% for somebody might mean they're maxing out and for somebody else, it might be nowhere close. So there's different answers for both of those people. Obviously the person who's not maxing out, maybe there's a reason they're doing 7% into there. Maybe they have some more shorter, intermediate term goals and they're doing more savings on top of that, but it's going into a brokerage account or a Roth IRA in addition to their 401(k) kind of thing, and that could make perfect sense based on their situation.

Tim Mullooly: Yeah. See, I would rather have them do that than one of the last stats that I pulled was that 78% of all plans have loans outstanding.

Brendan M: Yeah, right.

Tim Mullooly: So I would rather someone contribute a little less and have more money if they needed in the short term, than pile money into this plan, max it out and then have to take loans and pay it back with interest over a handful of years.

Brendan M: Absolutely, yeah. I mean, I'd rather see somebody put 1% into their 401(k) versus 7% with a bunch of consumer debt on their balance sheet or something like that.

Tim Mullooly: Yeah.

Brendan M: So likewise, like I said, 7% could also mean somebody is maxing out based on their salary. And if that's the case, then I would say that person needs to be focusing on above and beyond that 7%, if they're checking that box, maxing out their 19,500, or more if they're over age 50. What else can they do from there? Because a healthier savings rate, depending on their goals, might be close to double that, maybe even more. It depends, but don't just assume that maxing out or doing X percent is-

Tim Mullooly: Your job is done.

Brendan M: Yeah. It's not right just because somebody else is doing it or somebody recommended it to you initially. I mean, these are the things you need to revisit as your income changes as, as your life situation changes, goals change. So yeah, unfortunately there's no magic number, like if you do 10% into your 401(k), you'll be-

Tim Mullooly: You'll be good.

Brendan M: Yeah. You'll be golden. You're set.

Tim Mullooly: Yeah. So they did say that of 401(k) savers at Vanguard, only 12% of them maxed out. There are people taking advantage of these accounts, but 88% of people are not maxing it out to the max benefit that they can put away every year. Again, like you were just saying, that could be a good or a bad thing. It depends on how much money they're making. They might not have the ability to put that much money away into the account.

Brendan M: Yeah. You don't want to just do it for the sake of doing it. You need to do it because it's right for your situation and it makes sense.

Tim Mullooly: Yeah. Getting to the number of investment choices in the plans. The average number was 28 investment choices, and that was from 2017 across all 401(k) plans.

Brendan M: 401(k), like menus, we've seen tons of these things. They're just an enigma to me because some of them are really good and balanced in terms of like they'll give you two or three options for each asset class. They'll have US large cap, they'll have a couple of mid cap or small and mid-cap funds or small cap separate, they'll have some international funds, some bond funds. And then usually a slew of target data options. There just seems to be no rhyme or reason to some plans that I see, like they'll have some random sector fund or they'll have 10 large cap growth funds and like one small cap option. And it stinks because if that's going to be, which I believe it is, one of the easiest ways to save because it's doing it through salary deferral, and the place where you can save the most on a tax deferred basis, which it is for most folks, again, you want to use it, but then you get there and the investment options leave a little bit to be desired. So you just have to make do with what you can.

Tim Mullooly: Well, that seems like a good place to wrap up episode 324 of the Mullooly Asset podcast. A lot to think about if you're just getting started with day trading stocks or investing in your 401(k) at work. That's going to do it for me and Brendan. Thanks for tuning in, and we'll catch you next week.