How Interest Rates Impact Investments - Transcript

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Tim Mullooly: Welcome back to the Mullooly Asset Management podcast. This is episode number 325. Thanks for listening in. This is Tim Mullooly, and Brendan is here with me this week. Brendan, how's it going?

Brendan M: Pretty good. I think initially here, we'd like to talk about the concept of TINA, and we can explain what that means for people.

Tim Mullooly: TINA being the acronym, there is no alternative. And so there was an article that brought that idea into our heads that we wanted to talk about in the Wall Street Journal. The headline reads, "Should you buy stocks because interest rates are low?" And it's been well-documented over the last handful of months that interest rates are at a super low rate historically. So people have been making the case that your fixed income or your savings accounts at your bank are not yielding as much as they used to. So if you were looking for income or yield from those type of investments, are stocks the only alternative now? So should you buy stocks because you're not going to get anything else from fixed income or a cash account?

Brendan M: Yeah. And in general, the reason the Federal Reserve does what they do with interest rates, they do lower it to encourage people to borrow, to stimulate the economy and to invest in stocks to again stimulate the economy to some extent. And rates never really got high in recent memory. I mean, if you go back historically even 12, 18 months ago, something like an online savings account might've gotten up to two or two and a quarter percent at the peak, I think, like mine did.

Tim Mullooly: Yeah. That must have been the highest that I saw was something like two and a half percent.

Brendan M: Right. And compared to what people had seen, early 2000s and through the '90s, I mean, that's ... So yeah, I mean the very same online savings account that used to yield two and a quarter is now down to like half a percent or maybe even less these days. You get rates at that level and it starts to make people question, specifically with your savings, "Hey, I'm keeping this at the bank. It's getting half a percent now. Should I still keep that there?"

Tim Mullooly: Yeah. I think it's a very cut and dry binary decision making question to ask yourself, if the only reason that you had money in your online savings account was because it was getting two and a half percent, or the only reason that you have money in bonds is for the yield, then maybe, yeah, if you're just trying to like maximize your return-

Brendan M: I think if you were trying to maximize returns, you wouldn't have ever had money in those things to begin with because they're low return assets, even before rates got brought down to nothing.

Tim Mullooly: Yeah. That's a good point.

Brendan M: But to your point, there's no reason from a return perspective to have money in bonds or a savings account or anything like that. However, I don't think that those were the reasons that people had money in those things to begin with.

Tim Mullooly: Right.

Brendan M: So I think like a savings account at the bank, everybody needs to have, we talk about this all the time in our videos and podcasts, everybody needs to have some kind of safety net at the bank, and that's going to be situationally dependent on how much money they spend and also what their income is and how secure their income is in terms of employment, things like that. And just this year, I mean, we've seen a huge need to have a safety cushion like that like maybe we never have before.

Tim Mullooly: Yeah. I mean, we touched on it a little bit last week too, but it's kind of shocking how quickly people forgot if they had bonds or cash in their account as that safety net or a buffer, so to speak. It really helped them in February, March, April when the market was going down. But now that we've rallied so hard off the bottom, people flip the switch back from fear to greed and want to maximize every dollar. It's like, "Well, this money is just sitting in the bank, earning nothing. Should I put it in the market now and try and make the most of it while the market's going up?"

Brendan M: The idea that the money is in the bank earning nothing is the same, that same true statement is what made you comfortable and was your security blanket in March. You were thrilled to have money in the bank earning nothing in March. And it had nothing to do with the fact that maybe it was still earning close to 2% at that point in time. The 2% didn't matter. The point that mattered was that it was there when you needed it and it hadn't lost value like it would have if it were in stocks.

Tim Mullooly: Yeah. Naturally being financial planners and advisors here, it makes sense to us, but for people who don't necessarily have a larger context of their plan, they're just looking at this money, don't necessarily know what it's for or they have one investment account and one savings account and they don't have any general goals or planning done behind these dollars. I feel like that makes it easier, or those people are more likely to change up what they're doing and try and and shift money around. If they don't really have a plan, they're just flying by the seat of their pants.

Brendan M: Yeah. I think in general here, as it pertains to money in the bank, I'm not saying that everybody needs to keep all of their money in the bank. I think that through the financial planning process, you should be able to right size what you're keeping in the bank, so you're keeping enough there to make, one, you comfortable, and two, enough to support you if the unthinkable happened and you were in a very tough spot, whatever that scenario looks like. If you're satisfying those two things, there's an amount that can do that. And above and beyond that, you can take money and do something else with it that might maximize returns more, or to a larger extent than what you're getting on bank assets right now. But the things that we're talking about here are two opposite ends of the spectrum. We're talking about money at the bank and stocks, and that's not the decision that needs to be made here. It's how much do we need in the bank? And then above and beyond that, how much risk can we think about taking with money like that? It doesn't need to be all stocks.

Tim Mullooly: Yeah. Like most answers to financial planning or investing questions, it's not necessarily all one or all the other. I mean, we have people call in all the time and want to make wholesale all in, all out decisions with certain investments or different amounts of money or putting money in and out of accounts. And it's never as cut and dry or as binary as people make it out to be. And I also think that in a similar sense, low interest rates right now are easy to write about and easy to make headlines about.

And it's easy for people to fixate on that one thing that a lot of people are doing, but Michael Batnick had just a real quick post today titled, Where Are They Going. And he outlined how in August the S&P 500 hit an all time high, but there was also at the same time, a record amount of money leaving as well. He said there's $50 billion coming out of the market. And it wasn't just people moving from active to passive funds. He said 70% of the money came from passively managed funds. And at the same time, he said $77 billion went into taxable bond funds during the month of August, which was a record.

So I think it's easy for a lot of people to focus on what they see in the news and the headlines about how low interest rates are making people make all these investment decisions, but at the same time, looking at what Michael wrote, there are still people going about their business, sticking to the plan and not just completely abandoning these bond funds or fixed income, just because they have low interest rates. That's not the only factor going into these things decisions.

Brendan M: Right. And I think that's sensible because, and we just talked about money that's at the bank, but people who have diversified, balanced allocations probably have some money in bonds too, which their yields have come down in conjunction with bank account type assets. And it still makes sense for people who had bonds to continue having them because the reason you had bonds was never to stay ahead of inflation or to earn maximal returns. It was to balance a risk on the stock side of your portfolio, and again, you were thrilled to have that piece of the portfolio earlier this year when the volatility was to the downside. And now we've had several months in a row where from the bottom in March, we've gone up 50% plus on things like the S&P 500 or the Dow. So, maybe those stats that you just shared were people rebalancing their accounts.

Tim Mullooly: Right, because their stocks went up that they had to reign it back in and-

Brendan M: Exactly.

Tim Mullooly: ... increase that fixed income exposure.

Brendan M: If they were 50-50 stocks-bonds before a 50% move in stocks, then maybe they had to sell 5% of stocks because it got to 55-45, and they put some money back into bonds because that's as much risk as they need to get to where they're hoping to be one day.

Tim Mullooly: Yeah. I think one point that they made in the Wall Street Journal article as well was that these low rates might seem to be just a way for people to justify investment decisions that they had already made. Whether they see the market going up and they want to jump in. It's like, "Well, it's low rates. That's why I want to take my money out of the bank and put it into the market."

Brendan M: It can justify the fear of missing out.

Tim Mullooly: Right.

Brendan M: You see stocks running away, especially some well known individual names. And it's just like, "All right. Well, I want to do this. That money's not earning anything anyway. So I might as well dive in head first." Yeah, fair point.

Tim Mullooly: When they were going to do it regardless.

Brendan M: Yeah. It has nothing to do with rates, but after the fact, you can justify it. Point it out and be like, "Well, I wasn't earning anything on that money anyway. So I might as well have piled it in."

Tim Mullooly: Yeah, exactly. Ben Carlson had a post earlier this week, I think that can tie into this as well. He was talking about how there are a lot of investing experts that are experts on an earlier version of the world. And he was talking about how people get stuck using the last games playbook, or you're fighting the previous war. So he used the example of how, when the 2008 financial crisis happened, investors, people were using the pre-2008 playbook. They weren't necessarily taking into account what was actually happening right now. And the same thing kind of happened in 2020. People were looking back to what happened in 2008, like, "Oh, what should we do now?" But it's a completely different situation.

Brendan M: Yeah. We never get the answers to the test, so to speak. So if you learn too specifically from prior corrections, I think there are general points that you can grasp by having lived through stuff. But if you're learning too specifically, it's not going to be useful. Like the lesson from the 2008, or from 2000 rather, was not that technology stocks are bad forever. It was just that when you pile into-

Tim Mullooly: Over-allocating.

Brendan M: ... excessive chasing performance like that, eventually mean reversion comes home and you bear the repercussions of it. It wasn't don't ever invest in technology stocks. In fact, that was a pretty good place to have money for 20 years after that. It just mattered when you made that decision and to what degree. You don't want to have your entire portfolio in technology stocks, but it wasn't to avoid them entirely.

Tim Mullooly: Yeah. And I think even with this low interest rate environment, I mean, we know what has happened, we have market history of when rates were low in the past, but there are a lot of other factors of what's going on in the economy and in the market and what different companies were operating at that time. Like we didn't have certain technology companies or, you know what I mean? Businesses come and go. The economy is completely different than it was a couple of decades ago. So just because interest rates are low now, it's not a 100% guarantee that what happened last time is going to happen this time with the markets or the economy.

Brendan M: We've seen people trying to use history as a guide, and maybe too specifically. People have been saying, rates have been generally low, like we alluded to earlier in the podcast, they've been generally low since 2010, '11, '12. I mean, ever since the 2008 crisis, rates have been generally low. Yes, they went up and down during that period, but not to the extent that they had in the past. And so people back in 2012, I remember saying, "Bond yields have nowhere to go, but up. Don't own bonds. They're a bad investment. You're getting no yield and you're going to get killed when the rates go up." I mean, rates did go up over that time period for a stretch of time. Now they've come down again. And since 2012, something like the aggregate bond index probably would have been a pretty decent piece of a balanced portfolio.

No one got killed for having their money in bonds. And in fact, they earned decent returns along the way, and probably balanced out the stock risk of their portfolio to boot. And that's pretty much all you were looking to do anyway. There was no need for that alarm.

Tim Mullooly: Definitely. I mean, history is really all that we have to base things on. So I'm not saying just completely disregard market history, but at the same time, I think it's important to remain flexible. And Ben wrapped up that post saying that he's long open-mindedness in the future, and I think that that's a key point. You can use history as a guide. Like you said, don't learn too specifically for what happened.

So Ben also had another post and this is something that we've touched on in the past, but it's been a while, so I thought maybe we could quickly revisit the topic. He wrote an article about how employers can help their employees save more money. How not necessarily employers can trick their employees into saving more money, but if you just change how some of these retirement plans work from either an opt-in to an opt-out for their 401(k) enrollment, it could definitely help people save more money. What are your thoughts on auto enrolling people into workplace retirement plans?

Brendan M: I think it's generally a good thing. I mean, we've seen in our practice here instances where people might've been auto-enrolled in a plan and maybe they weren't necessarily 100% ready to begin contributing to a 401(k) yet, but that's more of like a personal financing. And unfortunately I don't see a lot of employers helping from a personal finance perspective with their employees, like just getting your cashflow and balance sheet, doing the right stuff from the onset. So they don't help you determine if you should be contributing or not.

Yeah, they're not involved in that aspect of their employee's lives. And I mean, I don't know how receptive people would be to them being involved to that degree.

Tim Mullooly: Yeah, for sure.

Brendan M: So absent that, a little bit of planning that could probably better the situation, I think on the whole, getting people automatically, sending even a nominal amount, like 1% or 2% or 3% from their paycheck into something like a 401(k) on an automatic basis that they need to specifically say, "No, I don't want to do this," too, I think you're going to get more people saving. I mean, I think that's the best they can do. I don't think it's perfect, but it's, I think good enough. And I think it's a general good for society, the more that employers are doing stuff like that, helping people, encouraging them, making it easy to save.

Tim Mullooly: Yeah. Definitely. And Ben pointed out in the article that, I think the numbers were from Vanguard, but they showed that employers that had auto-enrolled versus voluntary enrollment, the savings rate went from 6.6% up to 10.3%. And we talk all the time about how you can't invest your way out of bad savings habits. So, just generally across the board, I think a higher savings rate for people is generally a good thing. Like you said, obviously, I personally hate to see people piling money into a retirement plan and then having to take a big loan out of the account and pay interest on that loan to pay it back when, if they just did a little bit more personal finance in their own cashflow, they could have avoided that potentially by sending less money into the account from the start.

Brendan M: Also though, I agree with that sentiment. It's the easy solution. If somebody had to take a loan from their 401(k), it's like, "Oh, well you shouldn't have sent money into the 401(k)." But I think the actual problem there is it's their actual cashflow and what the spending needs are, because you shouldn't automatically forsake investing in your 401(k) just because your cashflow is upside down. If you can't afford to put like 1% or 2% or 3% of your salary into something like a 401(k), I feel like you should be cutting back in other areas before saying, "No more 401(k)."

Tim Mullooly: Yeah, the 401(k) shouldn't be the first lever that you pull when you're adjusting your cashflow if you're trying to save more money.

Brendan M: Listen, I don't know everybody's situation and there definitely are people out there who that is the solution for, and there shouldn't be money going into their 401(k) because they don't make enough to support their current lifestyle and there's no fat to trim in their monthly budget. And for those people, yeah, they'd probably be better off not putting money into an account where they have to then turn around and take a loan or pay a penalty to get it back. They should just have all those dollars go into their bank. But for somebody else who really can afford to put some money into a 401(k), but the monthly budget's just got some items that need to be paid attention to, and you just have to decide, is this really how I want to spend my money kind of thing. I wouldn't turn off 401(k) contributions so you can run up the credit card total every month. That's not a good trade off.

Tim Mullooly: Yeah. Agreed. Overall there are more pros to cons for the auto enrollment. If you're not sure if your workplace offers, or if you automatically get enrolled or if you have to voluntarily opt-in, it's something that you can call and ask about, which leads us to the last thing that I wanted to bring up. There was an article in the Wall Street Journal about how a million mortgage borrowers fall through the COVID-19 safety net. And this was highlighting how early on in the pandemic, there was a forbearance program offered to people who have federally guaranteed mortgages. All you had to do was call and ask to be placed in this forbearance program. And you could delay, I think it was up to a year's worth of mortgage payments. It would be tacked on at the end, but you could essentially skip it for a year and if you need that money to pay other bills.

But they talked about in the article, how there's just over a million borrowers now that are at least 30 days past due on their mortgage payments, and of those one million borrowers, 680,000 of them have federally guaranteed mortgages and would have automatically qualified for this forbearance. So I think the message for me, for people out there, is that there are a lot of new programs that have come out in 2020, new relief valves for people that you could use you need it, but no one's going to come knock on your door and say, "Hey, would you like to sign up for forbearance or opt-into this?" You actually need to call and ask yourself and take the initiative. The same thing goes with the CARES Act. A lot of people have been taking money out of their retirement accounts, but people might be forgetting that you need to qualify for that. So I think calling and seeing if you actually qualify for these things is super important.

Brendan M: That's a crazy stat that so many people are behind on their mortgage when there was help available to them that they didn't take. And you wish that places would reach out and be like, "Hey, there's help for you. If you're not paying your mortgage, there's a way that you can have some relief here in the short term." But yeah, ultimately it's on individuals to take advantage of programs like that. And sometimes it means picking up the phone and having to sit on hold for 20 minutes with your mortgage company until you get a human being and just ask them a question. And once you've done that, I mean, just to at least explore your options out there. Don't just bury your head in the sand or assume that there's no help for you.

In a lot of cases, especially as it pertains to debt payments, especially if you can call and speak with some of these companies, I think you may be surprised sometimes that they're willing to work with you.

Tim Mullooly: So just in general, I think if you're unsure, don't assume one way or another that you definitely do or definitely don't qualify for something. Couldn't hurt to just call up and ask. I mean, the worst that they could say is no. I feel like that's the message there from that post. We'll link to everything that we touched on here in the podcast in the show notes over on mullooly.net. That's going to wrap up episode 325 of the podcast. Thanks for tuning in. Catch you next time.