The Advantage We All Have But Throw Away - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 329. The whole team is at the table today, Brendan Mullooly, Tim Mullooly and myself, Tom Mullooly. Welcome, everyone.

Tim Mullooly: So there was an article in the Wall Street Journal, and it was kind of a similar message to what we've been fielding phone calls about from clients, and we've written about it and we've done videos about it, but the headline in the Wall Street Journal read that stocks typically climb, regardless of who's in the White House. Like I just said, we've written about it. The point bears reminding again that the stock market doesn't really care if there's a Republican or a Democrat in the White House. You just need to keep that in mind when you see volatile markets coming up with an election next week.

Brendan M: Or people telling you that you need to brace for impact or to lever up or do whatever. I don't think any of it's worthwhile.

Tom Mullooly: Yeah. Let's not let facts get in the way of a good narrative.

Tim Mullooly: Yeah.

Brendan M: Well, I was just going to say that the stats that they shared in this article, not that stats change anybody's mind, but this was a pretty good set of them. This is like 90 years of data here that they looked at. They even broke it down to, all right, so there's a president and do they have their party in control of the House and the Senate, meaning unified White House as well as Congress, or if things were split, because that's been a part of the discussion recently too. So for 45 years, we've had the unified group together, the market has averaged 7.45% a year in those 45 years.

Tom Mullooly: So that's like a total red wave or a total blue wave.

Brendan M: Yes.

Tom Mullooly: Control of everything.

Brendan M: Yes.

Tom Mullooly: All right.

Brendan M: So, 30 of those were up, 15 were down. Then we're looking at another 46 years where things were split in some capacity. We didn't have a unified one party in control. The market, in those 46 years, averaged 7.26% per year, and was up in 29 and down in 16.

Tim Mullooly: Almost identical numbers.

Brendan M: Yeah. If you stripped the heading off the data there, you wouldn't be able to tell the difference. Some people out there would have you believe that this is do or die.

Tom Mullooly: Oh, there's people out there who will tell you that the markets are bad when there's a democratic president, like the market cares. It can't tell the difference. The market doesn't go the polling booth and pull the lever.

Brendan M: The president and lawmakers in this country have an impact on what's going on, but I think the extent to which they have an impact on what goes on, on a day-to-day, month-to-month, year-to-year basis in something like the stock market is limited, and I think that it gets blown out of proportion. It's like a head coach or a quarterback on a football team probably gets more credit than they deserve when the team wins, and then also becomes the biggest scapegoat when they lose just because they're the figurehead, but it may not necessarily be an issue with them.

Tim Mullooly: Yeah. Like you said, the President and Congress, they can make policies for the country and businesses that do business in the country, but it's not like companies that are publicly traded are going to stop trying to find new ways to make money or prosper or grow their business just because a Democrat's in the White House or the Republican's in the White House. It's like, oh, this new policy's in place, guess we can't keep doing that. We've got to shut down business. They're going to adapt.

Brendan M: That's it. We're closing up shop. Exactly.

Tim Mullooly: Exactly. So companies are going to continue to adapt regardless of what the policies are.
That just speaks to the numbers here. I mean, policies, things have changed a lot over the last 90 years, and businesses continue to make money and stocks do well.

Tom Mullooly: Well, I think a lot of it comes down to, as we've said many times, managing expectations, but also keeping the proper perspective. I hate to get down to a micro level, but there was a point today, we're recording this on Monday, where the market, the Dow was down 950 points. And right before we turned on the microphone, the Dow was down 600 points. So the markets rallied 350 points this afternoon, or you could say, "Wow, it's down a lot today." Or you could say, "You know what, six months ago, when we were all freaking out about the pandemic, the Dow was at 18,000 and today we're at 28,000." So your perspective really matters. And since most people are investing, not trading, but they're investing for something in the future, five years out, 10 years out, 25 years out, even if you're retired, you want this money to last a very long time. Yeah, you may need some of it in the next three months, but the bulk of it is really for the future.

It really comes down, in my opinion, to resetting the perspective that we need to have when it comes to looking at this money.

Brendan M: Yeah. I think, just to piggyback on something you said there, I think that it's important to keep in mind that even if you're a retiree drawing down your assets, you likely have a much longer time horizon than any one presidential term can last. So if you're unconvinced that the president has an impact, I mean, they're in office for four or eight years. I mean, if your time horizon is only four years, I question how much of that money should be in the market at all.

Tom Mullooly: Close to nothing.

Brendan M: So, if we're that focused on the near term, if that's your situation, then sure. And I don't think, whoever could be president. It could be anybody in the world. I don't think it would be a great idea to have money that's needed within four years at risk in the stock market. And even if it's eight, we're still talking about not a long period of time when compared to most investors' time horizons, their true ones, not the ones that we focus on sometimes.

Tom Mullooly: Yeah. I think the perspective part is what really gets mismanaged because people say, "Gee, I want to be smart about this." It's like the discussion we have about people who take their emergency fund and they put it into Netflix. Not really a good idea because you want to have that money when you need it most in an emergency. And six months ago during a pandemic, people needed emergency funds. And God bless you, if you had that money sitting in some kind of market invested vehicle, ETF, mutual fund, whatever, or an individual stock. We need to appropriately label, hey, this is money for the short term, intermediate, longer term. So it really comes down to managing people's perspective about time. Talking about time, interesting article about a certain 90-year-old.

Tim Mullooly: Yeah, I think there was most of the money that people have invested is for the long-term, and one of the most powerful elements out there in the market is compound interest. The easiest way to disrupt your compound interest is to make wholesale changes because of short term events like a presidential election. There was an article from Jason Zweig from a little while ago, it was about Warren Buffett and the "$300,000 haircut". So the article focused on how Buffett really became successful based on his understanding and ability to realize the power of compound interest.

Brendan M: Yeah. So the stat you always here is that like 90% of this guy's fortune was amassed after age 65 for him. So, obviously a savvy investor and one who came up analyzing businesses. He certainly has a level of understanding and skill there, as well, but I think that if you read a lot of what Buffett has written and said over the years, he said something along the lines of that he would trade IQ points for temperament and time is going to be our biggest ally when we're investing in the market. And that's what you're getting at here, is you can look at things you're able to spend money on today and you just have to weigh whether it's worth it when considered against what that money could be in the future for you.

And that's the question and thing that we're always having to consider when choosing to spend or save, and trying to fine tune the right amount to do both of those, because you need to live your life. But on the other hand, if you're spending money needlessly and you think of it in terms of, hey, what could this be 40 years from now? It could be a lot. It could be quite a bit.

Tom Mullooly: Right. We're going to link to the article in the show notes. Zweig talked about how Buffett's $82 billion, most of that was accumulated after age 65. He's now 90. So in the last 25 years, the numbers have really escalated, but that's not a free pass for people who are 57 saying, "Well, he's done all this in the last 25 years." He had all of these pieces in place, or many of the pieces in place well before he turned 65.

Brendan M: He bought his first stock when he was 10 or 11 or 12 years old. So, that's more the point is that you could start with small amounts when you're a teenager, and you're going to have an advantage over somebody who decides they're going to start doing this in their 50s or something like that.

Tom Mullooly: But you have to start with certain buckets. I mean, you have to have that cash bucket for your expenses this month-

Tim Mullooly: Yeah, of course.

Tom Mullooly: ... or the next couple of months. And then you need to have an emergency cash stash that's not invested in the market that's going to be there in the event of some unforeseen emergency. And then beyond that, we want to start talking about what you should be investing, and investing for the long-term.

Brendan M: Just take like the example that gets ... You can run the numbers however you want, but it basically looks at, let's say somebody started investing in their 40s and they were awesome at it. They picked all the best stocks, timed the market perfectly, but you started when you were in your 20s and just put it into low cost index funds and averaged in over time. You're going to do probably much better being the latter of those two investors, meaning the one who started earlier, even though the other guy is "better at investing" than you. That skill is going to be outweighed by the time advantage that you have. And I think that in 99 out of 100 cases, that's going to be how it works out. And we're so focused on how can we be smarter, savvier investors when a lot of these advantages are available to us and you don't have to absolutely kill it in the market to set yourself up nicely.

Tim Mullooly: There was a cool example that Jason used to illustrate just how much the numbers can move with compounding if you give it time. So when this article was written, the Dow was at 28,500, which is relatively close to where it is today. So he said, if we start at 28,500 and it compounds at 1.6% annually until December 31st of 2099, so that's about 80 years from now, that would put the Dow at 100,000. So it went from 28,500 to 100,000 when you compound at 1.6%. Over that same time, if it were to compound at 4.6%, the Dow Jones would be at one million by the end of 2099. And if it were to compound at 7.7% annually, the Dow Jones would be at 10 million by the end of 2099. He also pointed out that over the last 30 years, the average annual rate that the Dow returned was 8.4%. Not saying that that's going to continue definitely for the next 30 years, but I mean, if you just look at the math, over time, the numbers get really big, really quick. It takes time though. So you have to give it time to work.

Tom Mullooly: We're all saying the same thing, that you have to be patient while the seed is starting to sprout underground and you don't see it yet.

Brendan M: Patience sounds good though, but this other stuff from the article highlights why this is so difficult. So Jason shared that Apple shares turn over about 211% per year, and that means that the average investor in Apple stock holds that for less than 25 weeks. That is insane. So everybody knows that you're supposed to be patient and you're supposed to give investments time to work, but in practice, it seems like there are a lot of people who are not doing that, even though it's widely available, everybody will tell it to you. The best investors, in fact, like Warren Buffett will tell it to you, but nobody wants to do it. It's the advantage we all have and just throw away.

Tom Mullooly: Now, when Buffett was 10 years old, he read some book somewhere that showed if you had $1000. If my math is right, he was born in the 1930s, 1930. So he grew up during the depression. At 10 years old, it was 1939, 1940, '41, something like that, and $1000 was a whole lot of money back then. But if you were to earn a 10% return, in five years, that money is worth 1600. In 10 years at 10%, $2,600. In 25 years, that same $1000 is worth close to 11 grand. It's crazy when you look at these kind of numbers, but you have to be there at the end to see it. His partner, Charlie Munger, said, "The worst thing that you can do to compounding is interrupt it." It's so true. And people get freaked out about who's the president, or the tax laws are changing or some other silly reason, honestly. And they rip up the script. Please don't do that.

Brendan M: I think Morgan Housel has said before that people are so happy, a lot of times with their home, their primary residence in terms of how much it appreciates over the years. And he thinks that a large reason for that is because it's one of the only assets people give enough time to work because you're living in it, so you don't notice. But if you stay in your home for two decades, three decades, of course the appreciation is going to seem a lot because you're getting decades worth of compounding there. And in fact, if you actually roll back the numbers and look at it, it's probably not as much as it would have earned in the stock market, but you're still happy with it, because compounding is magic even if it's at a lower percentage return than might've been available elsewhere. It's just the time advantage.

Tim Mullooly: There articles that we wanted to talk about today was from CNBC, and it had to do with inheriting money that's unexpected. So, something that comes as a surprise to you. You get a big windfall of inheritance or something, an estate is distributed to you.

Tom Mullooly: Probably one of our most talked about or phoned in topics. Would you agree?

Tim Mullooly: Yeah. We'll hear a lot from people, "Hey, I just came into some money unexpectedly. I don't really know what to do with it. What should I do with it?"

Tom Mullooly: Or how does this work?

Tim Mullooly: First off, I'll say that the people that are calling an advisor or a planner about something like that, they're doing the right thing. One of the things that they mentioned early in the article that I agree with is that if an inheritance is a surprise or it was unplanned, don't rush to do anything or don't make any hasty decisions that could end up costing you money, or it could be irreversible. That was one of the big takeaways for me from this article.

Tom Mullooly: Unfortunately, and Brendan, maybe you'll agree with this, is sometimes there'll be an unexpected windfall. People will do something with the money and then come to us and say, "All right, how do we fix this," or, "How do we clean this up?"

Brendan M: Yeah. I think one of the important points that the article touched on was the idea of when you inherit like a brokerage account from somebody, because you're going to get a step up in your cost basis, meaning whatever they bought the portfolio of investments for is irrelevant at that point. It's based on what it was worth on the day that they passed away and it became yours, by nature of whatever their last wills and testaments were.

Tom Mullooly: But that becomes the new cost basis for all of these assets.

Brendan M: So, you have this unique opportunity where you've inherited a portfolio of stocks and it's a taxable account, but you're not going to have much, if any, tax ramifications, depending on how soon after you're assessing the situation to reset things. And Tim's absolutely right that, I think talking to somebody like an advisor makes a ton of sense because what had been working for whoever left you this money is very unlikely to be what you need in your life moving forward. So it's an opportunity to assess it and you're not going to have to think of any ramifications of unwinding this portfolio. Think about your own goals and what you might do with this money. And I think in most cases, that's what who left it to you would want you to do, whether it's making a new investment portfolio or taking a large chunk of it to cash so you can buy a place or start a business or support your family. I mean, it's a unique opportunity and you shouldn't just pass that up or make decisions on a whim.

Tom Mullooly: I know that sometimes even when one spouse passes away, there's a lot of confusion about this. Some people mistakenly believe that they have to maintain the original cost basis or the whole thing gets stepped up. And the situation for the surviving spouse now changes in the sense that their income needs may change. So now we have to shift from something that may be a growth portfolio into an income only type of portfolio.

Brendan M: Yeah. I mean, if the situation has changed, maybe the portfolio wasn't set up to support income coming out of it, or maybe it was, and that's no longer going to be the case anymore because there was a big payout from a life insurance policy or something. So, I mean, you can reassess. And if it was a jointly held asset, then half of the cost basis is going to change on the account, so that actually gets a little trickier than when it's one person's asset or the others. And so again, you want to consider what that does in terms of the tax liability of the portfolio and what you could change as a result of that if you need to.

Tim Mullooly: I mean, if it's a retirement account too, there's a whole other set of circumstances that come into play. The article talked about the changes that the Secure Act put into place this year, that if you're a spouse, that there are exceptions to that as well. But if you're a non-spouse and you inherit an IRA, let's say, I mean, before the Secure Act, you would have been able to do a stretch IRA and stretch this out over your whole life expectancy, so you have money coming in every year, but the Secure Act got rid of that. And now you have 10 years to empty the account from when you inherited it. So there are a lot of different changes, whether it's a taxable account, like you were talking about, or a retirement account, like an IRA. There are different things in there that if you don't know what you're doing, you could end up making some mistakes that could end up costing you more money.

Brendan M: Yeah, I think either way you want to speak with some professionals, even if your plan is to just straight up liquidate a retirement account or a brokerage account. I mean, you at least want to understand the tax ramifications of that. So if it's not an investment advisor, you should at least be talking to whoever helps you with your taxes. And if you don't have somebody, it's a good time to just pay a professional for a few hours of their time to make sure that you're not making a mistake or not understanding the situation, like Tim, you alluded to. Like if you're pulling from inherited IRA, you don't have to pay those taxes personally. You can have that withheld on your distribution, even if you just want to take the money and run, so to speak.

Whether it's a financial advisor or an accountant. I mean, there are some different avenues depending on what you want to do, but starting to talk to some sort of professional makes sense. And if they're not the right one, then if they're a good, honest professional, they'll send you to the type of person you need to be speaking with.

Tim Mullooly: They also noted in the article, which I thought was interesting, they said in a sense, keep it close to the vest if you get a significant windfall of money, just because you never know, if people hear that you've come into money, you don't know who's going to climb out of the woodwork. You hope that you don't come into a situation like that, where people put you in an uncomfortable situation where they're asking you for money and stuff like that. But that is something, unfortunately, that you do need to consider as well. So, they said be careful who you tell, if you're getting a significant amount of money.

Tom Mullooly: You never know. People get weird when it comes to money.

Tim Mullooly: Yeah, definitely.

Brendan M: Definitely don't go to friends or family members for advice on that. If it's your situation, I think I'd speak to a professional who, at least your conversation will be confidential with.

Tim Mullooly: Yeah, a non-biased third party.

Brendan M: Yes.

Tim Mullooly: Someone detached from the situation.

Tom Mullooly: Just an observation that I've seen over the years is that people who go through these awkward things, where friends or family come out of the woodwork, those people then become super prepared for their own demise. They've got everything mapped out, which is, it's an unfortunate benefit that comes out of it.

Brendan M: It's a nice thing to do for whoever you're planning to leave money to, is to just make it as cut and dried as possible so that there's no drama or as little of it as possible.

Tom Mullooly: Well, that's going to wrap up episode 329. Thanks again for tuning in, and we will catch up with you on episode 330.