What's Worked in 2020? - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 332. Thanks for tuning in. I'm Tom Mullooly. And with me today is Tim Mullooly and Brendan Mullooly. Hey, guys.

Tim Mullooly: Hello.

Brendan M: Hey.

Tim Mullooly: So it's been kind of a weird year here in 2020 with the markets and outside of the markets, as well, as we're winding closer to Thanksgiving towards the end of the year. It's been interesting to look back at how the markets have performed and go under the hood and see what's done well, what hasn't, at what times, and why potentially.

Brendan M: Yeah, I was just looking over client portfolios and how things have ebbed and flowed this year. And looking on a year-to-date basis, the story has been a lot of the momentum and technology names have done well, and people have talked about that being a result of the pandemic and continuation of trends that we saw in place last year, too. But if you want to break things down even further, though, in the last six months, some things that have lagged behind for a good amount of time now, a year or two, have actually been leading the way, meaning small cap stocks, mid cap stocks, value stocks, international stocks. So it's been a role reversal if you're just looking from May until now. Those names have made up a lot of ground and at the expense of the momentum and technology names have actually been lagging since around that period of time. So like a lot of other things, it depends on where you're measuring from, but just speaks to the idea of why we allocate to these different areas in the first place.

Tom Mullooly: I've got to believe that most people would look at the market this year and say, "Well, these work from home stocks are really where it's at." So Zoom has done really well. A lot of these technology related stocks have done really well, and they had their shining moment, I think in March, April and May. But what you're saying doesn't necessarily match up with that.

Brendan M: No, it doesn't. And I think the point is less that those names aren't good any more and more just that you can't have all of your eggs in one basket, or if you do, it's going to be a much bumpier ride. That's the point of why we allocate to these different areas because they zig when the other one zags. Meaning if momentum's struggling, maybe small caps are making up the ground and the overall portfolio is less volatile than if we just had one or the other, or tried to time when any of these in particular were going to be working, which I think is impossible.

Another thing too, to look at is that from January to May, we just talked about what's been leadership, but for the first five months of the year, none of those areas did anything. And if you had bonds in your portfolio, they were the only positive performer. So we've had different stretches of this entire year where you would have wanted to own one or the other, or maybe a couple of these and not another. But in a perfect world, we would know exactly when these things were going to work and for how long and we would only have our money in them for those periods of time, but-

Tom Mullooly: It doesn't work that way. It just doesn't.

Brendan M: No, it doesn't work that way. And so short of doing that is we can allocate to these areas in proportions that we think make sense based upon how we expect them to not only perform, but interact with one another over longer periods of time. And this year, we've gotten that in a microcosm. Not that one year is long-term, it's not at all, but we've seen these different pieces of the portfolios carry each other and take turns leading the way. And that's what we would expect over longer periods of time, 5, 10, 20 years. They're going to take different paths to similar results, meaning you're going to earn your returns in all of them, but it's not all going to come equally and at the same period of time.

Tom Mullooly: Well, as you like to say, the returns are always lumpy. They never come out in nice, neat, straight lines. It just doesn't seem to work that way

Tim Mullooly: Over the years, too, not just this year, but we've gotten calls from people saying, "Why can't we just pile everything into this?" Whether it's a sector or a stock, individual stock, or a fund. This one's knocking it out of the park, let's pile into that. And everything that you just said is the counter argument to that.

Brendan M: I would also say that not that we actually invest this way, but the moment you start to feel that way is the moment that you might want to move in the exact opposite direction.

Tom Mullooly: And we've had conversations-

Brendan M: We talked to clients over the summer that were like, "Why do we own small caps?" Or, "Why do we own international? It seems like they stink and these other things are doing well. Why don't we just shift it all to that?" And it's because by the time you realize that those things have made up ground, meaning like this last month or two, it's too late. The trend is already in place. So if you're going to shift back, all you're going to be doing is buying high and selling low, and that's not a recipe for success.

Tom Mullooly: Interesting how all of these different investment themes have bubbled up to the surface or bubbled up to the top of the list in one calendar year.

Tim Mullooly: It's interesting too, especially with, there's been a lot of discussion about why even own bonds right now when rates are so low. I mean, that was a topic of conversation for it feels like months earlier this year. I mean, interest rates are historically low, but it doesn't necessarily mean that bonds are a bad place to be. And like you were saying at one point this year, that was the only place that you wanted to be or that you made any sort of money.

Brendan M: Yeah. I mean, you appreciated your bond allocation despite the fact that it wasn't yielding a lot then either because you're going to appreciate it for reasons outside of what you're getting in terms of yield. At no point during the last five years should you have been excited about what yields were, and especially not now. I mean, a year or a year and a half ago, they might've been relatively higher based on where they are today, but they weren't anything to write home about then either. So I don't think you were buying bonds then for the yield either and you're probably not now, especially if you're considering it on a real basis, because after inflation, this is probably not something where you're going to be earning money. However, the alternative is having more money in stocks and that may or may not be something that you are interested in based on the volatility that that's going to throw off. And if bond yields are negative on a real basis, then cash certainly is.

Tom Mullooly: You bring up an important point because we've also fielded many calls from people who say, "I just want to sit in cash until after fill in the blank event is over." You talk about real returns, and if, like you said, the real returns on bonds are negative, meaning after inflation, what are you going to get on cash?

Brendan M: Less than that.

Tom Mullooly: Far less than that.

Brendan M: Whatever the difference is in the yield.

Tim Mullooly: Monetarily, less than that.

Brendan M: If your bonds are yielding 1% on a nominal basis and adjusted for that to get to your real return, your negative, then cash earns nothing. And so it's 1% less than whatever your bonds would get, obviously short of any price fluctuation due to what's going on with interest rates. But that would be my expectation. So yeah, I mean, if you're worried about having money in bonds, I don't think cash is a solution. So your alternative is stocks or collectibles. And I don't think your allocation is only shaped upon returns because if everybody's allocation was only based upon maximizing returns, then everybody should just be 100% long stocks. And it's not the case because people have needs in terms of spending from their portfolios. They have stuff that they can either handle or not in terms of what they have to see their account doing in the interim, because like it or not, investors are checking in on what's going on. So these are all other things that factor in to make your allocation what it is. It's not always about just maximizing returns.

Tim Mullooly: From a psychological standpoint, it's interesting to look at the calendar, and like you were saying, going back six months, a lot of the areas that people didn't necessarily want to own, that's when it was time to switch into that. But at the same time, I feel like six months ago it was around May, and that's after the market bottomed in March and rallied for all of April. May was around one of the first times when people started to get comfortable again, like should we be buying stuff? Like is this recovery for real? But they were asking to buy all of the names that were literally topping, in a sense, in terms of relative performance at that time. So it's just interesting to see how perfectly that lined up this year for people from a behavioral standpoint.

Brendan M: Right. They were doing what was comfortable, meaning, okay, I'm going to put money back to work if I have cash or if I sold out during the correction, and I'm going to do that into what's been doing best. And that seems like the right thing to do, but when you make comfortable decisions like that as an investor, you're usually not setting yourself up for success. And in fact, you should be looking to do the opposite in most cases.

Tom Mullooly: Interesting to note that March was probably one of the worst months in the history of the market. April was one of the best months, if not the best in the history of the market. And as you pointed out, Tim, we started getting a lot of calls from people just starting to sniff around in May. "Gee, is there anything else we ought to be buying?" The market was down in June. Market was down in September. And a lot of people thought, well, we ought to go into hiding before the election. October into the election and beyond the election, market's been pretty solid. You can't use the calendar as your predictor tool. It doesn't really work that way.

Brendan M: Or events, as if we get to the other side of one event and there aren't more events on the horizon. There always will be.

Tom Mullooly: There's going to be another one right behind it. Yeah.

Tim Mullooly: The unfortunate thing is that sometimes those feelings could work out for people and that distorts their opinion in their mind and from a behavioral sense, like it could've worked out for them. It's interesting that it's been like textbook the wrong thing to do at multiple times this year in 2020, just from a calendar point of view. We've had a pretty good demonstration of those behavioral aspects that we were just talking about.

Brendan M: Yeah, a good year for diversification and patience, but easier said than done.

Tom Mullooly: A little bit of news. Tesla is being added to the S&P 500. We don't normally talk about individual names on this podcast, but this is something that I think is worth talking about.

Tim Mullooly: It's interesting, because I think earlier in the summer, it looked like they weren't going to be added to the index, but now they are. And just from a calendar point of view, the year that Tesla has had has been incredible, to say the least, and some people are now worried that are they getting added to the index at the top of their market cap or their performance right now? And we don't know. I mean, I read an article, people said that they had similar feelings with when Facebook got added, and it ended up working out Facebook continued to grow and to go up. But yeah, some people are worried about Tesla getting put into the index and what it might mean for the index overall, since the S&P 500 is cap weighted.

Tom Mullooly: You want to explain what that means?

Tim Mullooly: Yeah. I mean, cap weighted means the largest companies that have the biggest market cap, they account for bigger portions of the index. So they move the index more than the smaller companies of the 500, if you're looking at the S&P 500.

Brendan M: Right. So, we're not adding like number 499 when we talk about Tesla going in. This is going to be-

Tim Mullooly: It might be in the top 10.

Brendan M: This is going to be a top 10 holding in the index moving forward. So, it'll have an impact on what the day-to-day fluctuations look like. And I don't think there's a more polarizing company out there these days than Tesla and founder Elon Musk. So, a lot of opinions about whether this is good, bad, or otherwise.

Tom Mullooly: I think the jury is pretty split. There's a large percentage of people out there that think this entire company is a fraud. And then there's other people who say, "This is the future." We don't know.

Brendan M: It's probably something in between.

Tom Mullooly: Right.

Brendan M: I think if you're too far on either end of the spectrum, like most things, you're-

Tom Mullooly: You're going to wind up getting burned one way or the other.

Brendan M: Also one of the benefits of an indexing approach is even if this company is one of the largest holdings in the fund, if Tesla does turn out to be super bad or super good, it's not going to pull the entire index with it. It's still based on what's happening with the other companies. So for most folks, having index exposure to companies like this is far more palatable than watching a stock like Tesla ping around. I mean, this year it's been fun volatility, meaning that it's up big time, but there have been some absolutely gut-wrenching draw downs in Tesla and other big stocks like this. And if you're in an index, you don't necessarily have to deal with the day-to-day dramatics of that while still getting exposure to the company, assuming it does well over time.

Tom Mullooly: I'm not trying to infer anything with what I'm about to say, but when the trouble started at Enron, they were the seventh largest company in the S&P 500. And to your point, that's a company that over a period of time vanished. And if you're a holder of the S&P 500, it's one of 500 names. Yeah, it was one of the largest ones, but it didn't a material impact on the overall return.

Brendan M: We've seen that over the last decade with a stock like GE.

Tom Mullooly: Sure.

Brendan M: That was a huge holding. Performed terribly. And the index marched higher.

Tim Mullooly: I mean, we literally just put out a video ... We're recording this on Wednesday. We put out a video today where Tom, you said how when you started your career in 1986, the Dow was at 1500 and the S&P was-

Tom Mullooly: 205.

Tim Mullooly: At 200. Yeah. And now it's in the 3000s. So both-

Brendan M: How many big companies have come and gone since then-

Tim Mullooly: Exactly.

Brendan M: ... I guess is the point that Tim's making.

Tim Mullooly: Yeah.

Tom Mullooly: That would make a good video, just going through the 30 names in the Dow. Very few are left.

Tim Mullooly: Yeah. I mean, in the S&P too, like you just said, Enron was the seventh largest company and it went to zero, and over the span of 30 years, the S& P is still up 20 fold.

Tom Mullooly: Right.

Brendan M: So the index exposure can ... If you owned one of these companies outright and it went to zero, like an Enron, then you obviously lost everything. I don't think that you share that same risk if you're investing and you have 2% or 3% of the portfolio in something like that because you own an index fund. I mean, sure. It's going to matter, but not to the extremes that it could, if you wanted to own outright.

Tim Mullooly: Yeah.

Tom Mullooly: So Tim, you saw an article that was written by our friend, Robin Powell.

Tim Mullooly: It's called Not Your Job, and he talked about how there are some misconceptions or myths about what every day investors think that their job is. So we'll go through the three of them. They're points that we have touched on before, but they're always good reminders for people. The first one that he said, the first myth was that your job as an individual investor is to outwit the financial markets.

Tom Mullooly: False.

Tim Mullooly: Right. That is a myth. It's not your job to outwit the financial markets. It's your job to, if you want to invest, you participate in the financial markets, but you don't need to outwit it. You don't need to think that you're smarter than the rest of the collective market.

Tom Mullooly: I think the portion that, if there is a portion of your assets that you want to try and outsmart the market, it's with the tippy top of your financial pyramid. It's the little, teeny tiny part of your account that you'll speculate with.

Brendan M: It's the sprinkle on top of the icing on top of the cake.

Tom Mullooly: Right.

Brendan M: Yeah. And I think that should be in full acknowledgement that you're probably not going to do it, but that it makes you happy to try and that you want to do it with a piece of the portfolio, because if you actually believed that you were capable of that, I think you'd probably want to do it with all of your money. So, I think you need to not only keep it to a reasonable portion, whatever that means for you, but also acknowledge that it's for fun and that if you got lucky, that you got lucky and that you're not George Soros.

Tom Mullooly: It's Vegas money.

Brendan M: Yeah.

Tim Mullooly: Piggy-backing into the second point. You said like, if you could do with all of your money, you would. The second point was the top fund managers happily share the fruits of their hard work, meaning that if they had the ability to outsmart the markets consistently, they wouldn't have to sell their funds or their track record to individual people like that. So piling in-

Tom Mullooly: They'd just do it themselves.

Tim Mullooly: Right. Exactly. So just piling your money and with just a star fund manager might not be all it's cracked up to be.

Brendan M: Right. So, not only can we not reliably do it, but nobody else really can either. And on top of that, if anybody can for a short period of time, we have no way of identifying that beforehand. So how would we know that they're the person to be allocating to? We wouldn't.

Tim Mullooly: And then the last point that he brought up, the last myth was that success is hurdling some market benchmark. It goes back to the first one, outwitting the financial markets, trying to just beat the market. I guess that could be a goal for you in terms of defining success, but over the long-term, I don't think individual success should be measured by whether or not you beat the market.

Brendan M: Yeah. I mean, you could beat the market every year and if the rest of your plan isn't in place or you're not saving enough, or your lifestyle is out of control, you could beat the market and still run out of money in retirement. So I think that's a pretty meaningless goal to be shooting for. I think the goal should be to just achieve the returns that you're going to need to do what you want with your money in the future. And I think that taking the risk of trying to beat the market often puts what that actual goal should be getting what you need at risk, because you have to do more and try harder and take more risk to try to beat the market. And that may be throwing off the only goal that actually matters, which is getting what you need in the future.

Tom Mullooly: Yeah. He reached a good point in the article where, I think he used the analogy that if 50% of your money is not in the market, if it's in bonds, or 75%, whatever the ratio is, if you're trying to keep up with a yardstick that is 100% stocks and you're 75% in stocks, first of all, it's going to be very difficult to do and you're going to have to swing for the fences all the time to try and hit a home run.

Tim Mullooly: Yeah. Trying to do that would just encourage reckless investing or trading or trying to do something to make up for the fact that you're lagging behind the market, when in the grand scheme of your own personal life, it doesn't matter.

Brendan M: Yeah. If you're not 100% stocks, don't measure yourself that way and understand why you're not 100% stocks. There's probably a good reason for it. And the reason for that is more important than whether or not you're clearing some benchmark each year. If you're not 100% in the market, then it's probably because your plan either doesn't require you to take that much risk or it's something that you found that you're not capable of sticking with over the years. I mean, there could be a whole host of reasons for that. So then to after the fact say that you're a failure because you didn't beat some apples to oranges benchmark is not doing yourself any favors.

Tom Mullooly: Okay. Let's going to wrap up episode 332. Thanks again for tuning in and we'll catch up with you on the next episode.