

## Ep. 213: Emerging Markets, Trade Wars, Small Caps & more - Transcript

**Tom Mullooly:** Welcome to the Mullooly Asset Management Podcast, this is episode number 213. I'm joined today ... This is Tom Mullooly and I'm joined today by Brendan Mullooly.

**Brendan M.:** Happy to be here. Let's get into it.

**Tom Mullooly:** Let's get this party started. So the concept behind our podcast is to kind of take the news headlines of the day and just chat about them. Basically what we're doing is giving you a little insight into some of the things that we talk about in our daily meeting. So Brendan, one of the topics that we saw in the media in the last couple of days was discussion on the rising dollar and how it sparks tumult in emerging markets. "Oh no, we're on fire, what do we do?"

**Brendan M.:** I just like the different phrases that they use for these things, they make me laugh.

**Tom Mullooly:** Tumult is one of those words that you only see in a headline.

**Brendan M.:** Yeah, and only about the stock market I think or geopolitical happenings.

**Tom Mullooly:** Yes.

**Brendan M.:** Yeah, I don't think I would ever use that word in everyday conversation.

**Tom Mullooly:** Certainly not discussing the Mets.

**Brendan M.:** No. But yeah, this article is kind of making a connection that has been made a lot this year, since around the beginning of February we've seen a downward move in the dollar. Last year reversed trend a little bit and it's moved up and what does that mean for emerging markets and emerging market meaning stocks and bonds.

We've seen stocks and bonds in emerging markets sold off with the rest of the market in early February but they haven't really recovered whereas some of the major US indices are still below their highs that were set earlier in the year but have kind of ebbed about half or so of that pull back off, depending on what day we're looking at the market.

**Tom Mullooly:** I think the trader mentality, I hate to paint all traders with the same brush, but the thought basically is dollar up, emerging markets down.

**Brendan M.:** Dollar up, how do we capitalize on this. Okay, maybe if you're a day trader, I don't know, I'm not sure what the philosophy there would be because I'm not one nor do I want to be one. You look at the moves in currencies so out of curiosity, I looked and ... in a year like last year, what did emerging market stocks do, like an un-hedged fund. They were up roughly 35, 36 percent. The currency hedged version of the same fund, which would negate this movement in the dollar that we've seen as US investors being in emerging markets was up 28, 29 percent.

Just to show the kind of effect that the dollar can either add or subtract from performance based on what currency fluctuations are happening, you can make the decision to hedge or not hedge your international exposure as a US investor and that kind of takes this dollar move out of the equation to an extent but I think you have to pick one. I don't think you can foresee these current ... no one in February was saying, "Oh the dollar has to go up from here." No one was predicting that we're only looking at the rear view mirror now and saying, "Okay, so the dollar's up now. What do I want to do with these emerging market stocks that I had."

The currency fluctuation was the only reason you owned emerging market stocks to begin with or bonds, I think you're probably making-

**Tom Mullooly:** It's a bad trade.

**Brendan M.:** I mean it shouldn't be a trade. If you're a trader than maybe that was the only reason for doing it and maybe you have a crystal ball that can foresee when the currency market is going to change on you, in which case I hope you got out.

For people who are looking to make money over a long period of time in the market, I think you probably own emerging market stocks for a different thing than just short term dollar fluctuations. I don't think that's why you own stocks in emerging markets.

**Tom Mullooly:** You know, along the same lines, one of the things that I know I've mentioned in discussions in the past is that stocks have a new ... they have a new news cycle every 90 days because they have earnings that come out. The narrative with stocks or even with a sector can change pretty quickly.

If we're talking about currencies or if we're talking about commodities, not only do we have fundamentals, I'm using air quotes, but not only do we have fundamentals but now we have the possibility of governments getting involved.

In 2008, the Russian stock market was closed for weeks because they just.... they didn't like the volatility that they had in the markets. When a certain person takes office and they say, "We want a strong dollar," or "We want a weak dollar," there's a government agency that's pushing or pulling one way or the other. It's hard to see how other areas of investing, like currencies and commodities, they're hard to gauge because you've got so many other non-market forces that can be pulling the strings.

**Brendan M.:** Yeah, I mean I would add to that .... I would extend upon hard to gauge and say harder to gauge because the stock market itself is already hard to gauge and impossible to forecast so,

**Tom Mullooly:** Good point.

**Brendan M.:** Yeah, you're taking on more risk when you invest in something like emerging markets because they're tied to currencies that may have governments that are dictatorships

running them. That's a risk that you're hoping you're going to be compensated for over the long run by earning higher returns.

**Tom Mullooly:** Hoping.

**Brendan M.:** That's the idea. It usually has played out over a longer period of time.

**Tom Mullooly:** Okay, so we also spend some time talking about one of the headlines that we saw here, Will Small Caps Leave Large Caps Higher?

**Brendan M.:** Yeah, so there's this narrative that if the Russell 2000 is doing well, that it bodes well for the bigger stocks because again, we're talking about the risk spectrum here and people think that smaller stocks are a leading indicator of risk appetite, just like emerging markets might be. Investors are thirsty for higher risk assets because they feel good about taking those risks and the reward that they should receive for taking them.

The article that we're mentioning kind of dismisses that and it had some numbers to back up this whole small caps are ... if small caps are doing well, it's good for large caps. It's kind of just like a bunk thing that people had made up to have something to talk about all the time. I don't think it's true.

**Tom Mullooly:** You have to have something to talk about.

**Brendan M.:** Yeah, I mean if it makes you feel better that's great but in terms of putting together a portfolio, both large cap and small cap stocks, probably have a place in an investor's portfolio and they're going to ebb and flow over time, I think they're not going to perform exactly the same all the time, which is almost precisely what you're looking for in a portfolio when you're combining asset classes or different styles of investing. You want things that are going to work at different times to kind of pull you along and whatever the narrative is for owning it, you can make up stories about how small caps lead large caps or large caps lead small caps, I don't really know.

There are more intelligent reasons to own stuff like that, but I don't really have a problem with what they were discussing in this article. It's nice to quantify it at least, to see if it's true.

**Tom Mullooly:** Okay, so shifting gears, it was 2007 when Goldman Sachs came out and said that oil, which was at 140, was going to 200 dollars. They made a prediction, they couldn't have been more wrong. Oil went from 140 to about ... went to 140 to I think 36 dollars. Goldman Sachs in the last couple days came out and said, "Don't worry about rising rates until the 10 year treasury yield hits four percent."

**Brendan M.:** Whether we're talking about stocks or bonds, it just seems like investors and maybe the financial media too just have this infatuation with round numbers whether it's a round number on the Dow or three percent on the 10 year and now it's four percent.

**Tom Mullooly:** People were flipping out when it hit three percent.

**Brendan M.:** Yeah, I thought we were all supposed to be gone now because the 10 year hit three percent. Wasn't that supposed to end the world?

**Tom Mullooly:** We were also supposed to be the bugs that fly into the little bug zapper.

**Brendan M.:** Just going to spontaneously combust wherever we are when the 10 year hits three percent.

**Tom Mullooly:** Three percent.

**Brendan M.:** I don't know why four percent specifically is going to make us worry more about stocks.

**Tom Mullooly:** It's a cumulative thing. We have to have more interest rate hikes. We have to see more activity in the bond market to get the yields to those kind of levels. A lot has to happen for us to get to four percent.

**Brendan M.:** There's so many narratives you can spin off of that though because if we're at three percent and it's going to go to four percent, if the fed is raising rates to get us there, then isn't the economy doing well?

**Tom Mullooly:** Right.

**Brendan M.:** Right, but then there's also inflation. Is that what's going to ... is that what's going to trigger these fears in the market, like eventually inflation reaches such a point where it becomes a problem? I don't know. It's really tough to say, it could either mean the economy is ripping or it's ripping to the extent that it going to go down soon.

**Tom Mullooly:** We agree that two percent growth economy is not ripping?

**Brendan M.:** I mean it's fine. I don't-

**Tom Mullooly:** I'm kidding.

**Brendan M.:** Yeah, I just ... I think saying that we're going to grow at a faster rate than that is asking for a lot.

**Tom Mullooly:** We can't predict what's going to happen.

**Brendan M.:** No, but ... I don't know, I think saying that we show grow at a higher rate than we currently are is pretty ridiculous too, like why? Unemployment is super low, so why should we be growing more than two or two and a half percent or whatever we're plugging along at.

**Tom Mullooly:** Don't really know.

**Brendan M.:** Just because we have in the past?

**Tom Mullooly:** We also saw our friend Jim Cramer back in the news with a pretty good headline. Cramer Teaches Investors How to Use Charts to Detect Phony Rally's on Wall Street.

**Brendan M.:** The issue that I have with that is maybe just the headline, because it's basically telling people that they can predict the future by using some form of analysis. When you go into the article, it basically just talks about how Cramer like to use fundamentals and technicals, which I think is smart.

**Tom Mullooly:** Well we call it playing the piano with two hands. We got the fundamental side and the technical side.

**Brendan M.:** Right, and they're both equally important and they both have flaws too.

**Tom Mullooly:** I don't ... what's a phony rally?

**Brendan M.:** That's what I don't understand and that's the headline that's slapped on it. I'm not sure that Cramer actually said that-

**Tom Mullooly:** Probably not.

**Brendan M.:** A fed manipulation probably, is that what he's talking about?

**Tom Mullooly:** More click bait.

**Brendan M.:** I don't know.

**Tom Mullooly:** There was an article in the Wall Street Journal talking about how ESPN has become weakened because it's become consumed by politics. Did you know that ESPN was a sports channel?

**Brendan M.:** Don't really tune in much anymore aside for the games. I used to watch Sports Center growing up pretty much every single day. Not really something I'm tuning into that much anymore. I think maybe part of that is that Twitter has become way better for ... in terms of like in games ... I'm watching games with Twitter open and its fun. That's kind of the entertainment that Sports Center used to provide.

**Tom Mullooly:** A little bit of sideline chatter.

**Brendan M.:** Yeah, they also can't show as much of the highlights as they used to be able to back in the day so they have to fill it up with something. Yeah, it's pretty tough to escape politics these days so I'm not sure that it's really a fault of theirs, it just might be that the industry is changing in the way people consume sports and news is not the same as it used to be.

**Tom Mullooly:** It would be pretty interesting though if Disney, the parent owner of ESPN, were to buy Twitter and kind of figure out a way to run them side by side.

**Brendan M.:** Yeah, that would be very cool.

**Tom Mullooly:** Didn't they have Monday night football game that was already on Twitter?

**Brendan M.:** Yeah.

**Tom Mullooly:** It was live on Twitter? I know they had a Met game on there-

**Brendan M.:** On Facebook.

**Tom Mullooly:** Oh that was on Facebook, first week of the season, boy that made me really mad.

**Brendan M.:** I don't like the games themselves being embedded into the social media platforms but I would like some aspect of watching them ... I don't know, I'm not sure how they would do it but I don't know it seems like the best in game to ... you pair the game with Twitter, I would say is the way to do it.

I don't know, maybe there's something there, maybe there's an opportunity for someone to swoop in and buy Twitter.

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**Tom Mullooly:** So as financial planners, we all kind of read the same article and walked away scratching our heads. This one was Three Things to Do if You Can't Afford a Down Payment but Still Want to Own a Home.

**Brendan M.:** The article, what it talked about really was just like knowing your numbers and knowing what you have in savings. They were recommending ... not recommending but they were saying that you can buy a home without putting 20 percent down because for some people, you basically have to weigh your options. Do you want to put all of your savings, so that you put 20 percent down and have a slightly lower payment or do you want to put 10 percent down and have a safety net still and just have a slightly higher payment because you have PMI.

People freak out when they hear PMI but it pays to just run the numbers and see. What if I put down this much? What if I put down that much? How much is the payment going to change? There are many factors that go into qualifying for a mortgage and buying a home. People are always worried about saving the down payment, which is obviously important but it's more important that the monthly payment fits into your cash flow, because you're not going to get approved for a mortgage if that's not the case. You could have a 20 percent down payment for

whatever home you want but if you can get approved for a mortgage, you're not going to get it regardless.

I think it's just important to ... it's important to know that there are different kinds of mortgages out there and not all of them involved putting 20 percent down. You weigh all of the different ways that you could finance a home together along with renting and just see what makes the most sense for situation based on cash flows and savings.

**Tom Mullooly:** That's so important, I mean a lot of folks, when they come in for their first round of financial planning, they're focused on assets. I think we sent some people off because we initially start talking about cash flow. Cash flow drives the bus. I can't stress that enough when people come in for financial planning.

**Brendan M.:** Yeah, it's the building block of every plan. You can't really figure out a retirement income projection ... you can't plan for retirement if you don't know what you're going to need every year and how you know what you need every year is based off what you need every year now and as that changes over time, then obviously you update and they're going to be things that change if this is a really long term retirement projection for somebody who's younger.

If you're pretty close to retirement, you would especially need to know your numbers because that's going to dictate what your portfolio needs to throw off in the future. You can't really ... can't do anything in terms of investing your money if you have no idea what you're aiming for. If you don't know what you're aiming for, then how do you know if you got there or not?

**Tom Mullooly:** Spending another minute talking about click bait in our line of work, we saw this headline the last couple of days, Stocks Could Shed Half Their Value Next Year, Warns Hedge Fund Manager.

**Brendan M.:** Yeah, I mean obviously coming from a hedge fund manager, it's somebody talking their own book, but everybody does that to an extent. Stocks could also double their value next year, I don't know.

**Tom Mullooly:** One guy's opinion, that's what make a market.

**Brendan M.:** Yeah, I mean how valuable is it to say that? He'll look like a genius if on the off chance that actually happens and if it doesn't, then we'll just never hear about it again and he'll forget about making that outlandish prediction. There's no downside of him making that prediction.

**Tom Mullooly:** There's no downside in making that prediction but there's a cumulative effect for people who read these headlines every day. Maybe they don't read past the first paragraph but they read these headlines, or they see these 38 second interviews on TV, where that's the headline that gets their attention and they don't read any more of it. There has to be some kind of, I don't know, fear gauge that gets raised with all of these click a bait type of headlines.

**Brendan M.:** Oh no doubt. I'm just thinking back to the beginning of 2016, when the market took a little bit of a dive, who was it? Was it RBC who came out and said or-

**Tom Mullooly:** The market's going to zero or something like that.

**Brendan M.:** They were like "sell everything", was the headline. You have to read past headlines and look at what the article actually says, I don't know. People take that at face value. People are scanning things. We forget being in the industry, most people don't have the time to sit down and read a couple of articles about what's going on in the financial world, they're probably just glancing at the headline and when they see that, that's like, "Oh crap, I guess I have to do something because that sounds important." It may be not important or it may be completely ridiculous and it's kind of up to the reader to discern that and it can be tough.

**Tom Mullooly:** It has to be taken with a grain of salt.

Last night on the Met game, Gary and Ron were talking about hopefully someday, Montreal will have another expansion team. You're the general manager of an expansion baseball team, who's the first pitcher you going to take? Who's the first hitter you're going to take?

**Brendan M.:** Who's available? Are you just asking for best players in baseball?

**Tom Mullooly:** Yeah.

**Brendan M.:** I would probably take Mike Trout as a hitter, I think that seems like a no brainer.

**Tom Mullooly:** Pitcher?

**Brendan M.:** Scherzer.

**Tom Mullooly:** Okay.

**Brendan M.:** Yeah. What about you?

**Tom Mullooly:** I would probably start with ... Scherzer's great no doubt, but he's got a lot of seasons, he's got a lot of mileage on that arm.

**Brendan M.:** That's true, that's fair.

**Tom Mullooly:** I may think about someone a little younger. I may start with someone like deGrom or Syndergaard I mean, deGrom's going to turn 30 this year. Hitter, I would probably go with Trout.

**Brendan M.:** Yeah, that dude's got another decade of boringly being ... I think-

**Tom Mullooly:** He's 25?

**Brendan M.:** I don't know maybe ... is there some kind of like a bias being on the east coast? Because I literally never get to watch Mike Trout play. Is that the reason why it seems like he just is underappreciated somehow? He's the best player in baseball, I don't think that's disputable, right? Harper's good, Altuve's good, I don't think they come close to matching the consistency and level of play that Mike Trout has though.

**Tom Mullooly:** He's fun to watch and we don't see him enough on the east coast because he plays half of his game out in California.

**Brendan M.:** Maybe he'll move soon, I know he's a South Jersey guy so maybe, I've heard Philly.

**Tom Mullooly:** Article today in the Wall Street Journal about the brokers at Merrill Lynch are bracing for pay claw backs.

**Brendan M.:** What does that refer to?

**Tom Mullooly:** What they're talking about is, they're changing the pay scale for brokers on some of the cross sell opportunities that now exist. 10 years ago, Bank of America absorbed Merrill Lynch. Over the years, they've warmed up to the idea of selling credit products to Merrill Lynch clients.

The brokers get paid based on if their client take a mortgage with Merrill Lynch or if they do some kind of securitized loan with their brokerage account as a pledged as collateral, or they open up a credit line or credit cards, things like that.

The brokers would get paid basis points when their clients take out loans with Bank of America. Well they changed the pay structure, the pay grid, which always happens and so now they're actually talking about doing a retroactive claw back on numbers that were run already this year.

**Brendan M.:** How far back are they going to go? That can't be popular with the employees.

**Tom Mullooly:** They're going back to the beginning of the year.

**Brendan M.:** Wow.

**Tom Mullooly:** They talked about how this is going to affect brokers at Merrill Lynch but then as you read through the article, and this is really, I think the takeaway from every topic that we've touched on in this podcast today is when you read through the article, Merrill Lynch has thousands and thousands and thousands of brokers. They're talking about this maybe affecting a couple of hundred brokers, not a big number but it was a great headline. Like, "Oh Merrill Lynch brokers are going to have to take a pay cut."

**Brendan M.:** What are they doing? The change is lowering the pay out for the brokers?

**Tom Mullooly:** They're lowering the pay out on the credit products that their clients are getting involved in. Instead of maybe getting 10 basis points, I don't have the article in front of me but instead of getting 10 basis points, now they're going to get something like eight basis points.

They're looking at-

**Brendan M.:** The claw backs are interesting. I think I know in terms of what the outcome would be, in terms of will these products be as pushed now because the incentive is lower and I think the answer, like every industry will be for the rest of all time is probably not.

**Tom Mullooly:** Probably not.

**Brendan M.:** Look at the incentives and you will see how people behave because that's how the world works.

**Tom Mullooly:** Last question for today, do you know how to drive a stick?

**Brendan M.:** I do not.

**Tom Mullooly:** Do you know any of your friends who know how to drive a stick?

**Brendan M.:** Yeah, a couple.

**Tom Mullooly:** Okay.

**Brendan M.:** A couple, yeah.

**Tom Mullooly:** When I was buying my first car, automatic transmission was an option, that was extra, along with air conditioning. Those were options. Now, the 2018 Jeep Wrangler comes with backup cameras, standard, true lock differentials, standard, I don't even know what that is but if you want a stick, option. Getting a stick is an option. Something wrong with America today.

**Brendan M.:** I don't know, I mean its just easier to drive with both your hands.

**Tom Mullooly:** I think once you get the hang of driving with a stick, it's a different experience. You have more control over the car, I definitely believe that but that's just me and I guess I'm an old throwback.

**Brendan M.:** What I hear when you're saying all these features are now ... they're not features, they just come with it, you know like backup cameras and all these things-

**Tom Mullooly:** They're all standard.

**Brendan M.:** Everything gets better over time and we just don't realize it 'cause it's slowly ... it slowly creeps into our lives, like the backup camera thing was probably like a cool new feature a couple years ago, now it comes on every car.

Technology just updates so fast and we get used to it so quickly that we don't appreciate it at all.  
**Tom Mullooly:** You get into a car that doesn't have backup cameras, you're like, "I have to turn around and look when I'm backing out of the driveway?" Makes no sense.

Well thanks for listening to episode 213 and we will catch up with you on 214.