Why 'Good Enough' Can Avoid Catastrophe - Transcript

Tim Mullooly: In episode 209, we're going to talk about the dangers of loading up on individual stocks. Stick around.

Welcome to the Mullooly Asset Show. I'm your host for today, Tim Mullooly. This is episode number 209. Thanks for tuning in.

We touched on this in episode 323 of the Mullooly Asset podcast last week, but I wanted to use some numbers to kind of illustrate the danger of loading up on individual stocks and putting your entire account into just a few names.

Over the last few months, we've gotten some questions in the office that sound a little bit like, "Why can't we put everything into Amazon?" or "Should we be loading up on Tesla right now?" or "Why own anything other than these big technology names? Why own anything else?" The last week or so in the market has been a really great example of why we don't do things like that here at Mullooly Asset Management. We take a diversified, long-term approach for investing our clients' money.

Ben Carlson, over at Ritholtz Wealth Management, had a really great post a few days ago, and he outlined why even the best stocks out there have to crash or have to go down at some point. He talked about how the pandemic stocks, the stocks that have done really well during the coronavirus crisis, they've finally taken a breather over the last week or so. Names like Overstock.com is down about 40% in the last handful of days, Zoom is down about 20%, and Peloton is also down about 12% in the last week or so.

Technology stocks, like I talked about before, are also getting hit hard as well. The NASDAQ-100, which is made up of mostly the large cap technology stock names that you would think of, is down about 10.5% in that time as well.

These are all great reminders about why piling into what's working right now or what's performing the best at the moment is risky business. Without exposure to other sectors of the market, other areas of stocks, and other asset classes like bonds, your account could be down just as much as these individual stocks if your entire account was in them. For investors, that's really not easy to stomach.

Even from a longer term perspective, some of the best names over the last few decades have had massive drawdowns. I'll go through a couple examples for you. Apple. Apple's been one of the best performing stocks over the last few decades, but Apple has also fallen 75% or more three times since the 1980s and has fallen of about 50% or more multiple times on top of that in the same timeframe. Since 2002, Netflix has four drops of 50% or more and two drops of 75% or more during that time. Everybody's favorite today right now is Amazon. Amazon, since 1997, has had multiple drops of 30% or more and, get this, it even has a 95% drop in there. 95%.

As an investor, I don't know who could stomach watching their investment drop 95%, especially if your entire account is in that one name. The list goes on. I mean, Nike, McDonald's, Walmart, Microsoft, all of these best performing stocks over the last couple decades all have really big drawdowns in there that make it tough for investors to stick with those investments. So, I'm not saying that these stocks aren't good investments, but these drops are way more difficult to sit through if your entire account is in those names while they're going through those drops.

It's a great reminder of why diversification is an effective investment strategy for investors. It helps those investors remain invested through those inevitable drawdowns, and they're going to happen. They are inevitable. Diversification, especially when people are getting greedy in the market, may feel like you're missing out at times, but I'll wrap up this episode with a quote from Virtus Investment Partners about why diversification really works.

Diversification means always having to say sorry. You'll never be all in the best performing asset class, but more importantly, you'll never be all in the worst investing class either. It's accepting good enough to diminish the risk of catastrophe.

That's what we're doing here at Mullooly Asset Management. It's good enough for us, it's good enough for you, and it's good enough to get you where you want to go. That's going to wrap up episode 209 of the Mullooly Asset Show. Thanks for tuning in. We'll see you next week.