Tom Mullooly: Welcome back to the podcast. This is episode number 401. I am Tom Mullooly, and joining me today as he has for the last few weeks, Casey Mullooly. Hello there.

Casey Mullooly: Into the four hundreds. It feels good.

Tom Mullooly: Let's go.

Casey Mullooly: So we're going to continue to do what we've been doing for the last couple weeks here and review the latest so, Tom won't you start us off with what you got.

Tom Mullooly: So there was a story in Bloomberg recently about more crypto meltdowns to come thanks to Fed mistakes, which I kind of chuckled when I read that headline because I really want the message to be that it's just my opinion, it's not a fact, but it's just my opinion that a big reason why the market has done what it's done over the first half of this year is because of crypto. As this has become more volatile people have been leveraging, borrowing against stock market assets and real estate to speculate in cryptocurrencies and as these cryptocurrencies, which I'm just going to say my, again, my opinion, I don't think they have much to offer in the sense that, when you buy, invest in a bond, you're going to get interest plus you're getting your principle back. When you invest in a stock, you get all the future growth potential, and you're probably going to get some dividends if the company has been around for a while.

Tom Mullooly: You do get some benefit from owning, tying money up in these assets. But with cryptocurrency, it just to me seems like the greater fool theory. Like I'm just buying it with the idea that I'm going to sell it in the future at a higher price to some greater fool than me. And so this particular comment about more crypto meltdowns are coming thanks to the Fed came from a fellow named Dan Morehead, who is, he's from Pantera Capital, which is a cryptocurrency hedge fund and he said the Federal Reserve has by way of its policies and keeping overnight rates too low and manipulating the bond market the worst policy mistakes that he's seen in 35 years of investing. Funny, the guy's been investing as long as I have. He said the Fed, although they're working on correcting the overnight rates being too low, he said that the Fed doesn't really seem to understand what their manipulations are doing to the bond market and thus filtering through to the crypto market.

Casey Mullooly: See, I would disagree with him because I think the Fed knows exactly what they were doing, and this is exactly what they want to happen.

Tom Mullooly: This is exactly what they and I agree with you because they're trying to ring some of the excesses out of the market before we tip over into a recession. And so you look at the, I hate calling at this, the great recession of 2008, 2009, that was based in basically real estate speculating, where people could put no money down or make these liar loans and be able to buy big properties. When the rates adjusted, nobody could afford their homes anymore. Big problem.

Casey Mullooly: Now nobody can afford their JPEGs of rocks. Sorry. I just had to get that in there.

Tom Mullooly: So in the recession of 2000, 2001, 2002, this was really from the dotcoms that exploded.

Again, like cryptocurrencies these valuations grew to the sky. NASDAQ was up, I forget the number, but it was up something like 50% in the fourth quarter of 1999, some just outrageous number and flirted with 5,000 on the NASDAQ. It lost 80%, eight, zero percent of its value over the next two years. I was there to see it, but what the Fed does is try to ring these excesses out of the markets and this is how they do it.

Casey Mullooly: So what you're saying is the market moves in cycles. I haven't been around as long as you, but seeing the excesses of the market last year, kind of just didn't feel right with me and I know feelings are fleeting, but 2021 and coming off of 2020, that is what isn't normal. What we saw in the market and in crypto and in NFTs and SPACs, I think that the level of just pure speculation that was going on throughout pretty much throughout the entire year, I think that, that was the quote unquote, mistake.

Tom Mullooly: Let's just talk about what's happened since the pandemic. With the pandemic the Fed pushed rates back to zero in the spring of 2020. They flooded the system with lots of cash so the banks suddenly had lots of cash. We had very, very low interest rates. People were home with nothing to do and that's when we started to see the speculation increase. So we saw meme stocks like GameStop and AMC and all these other crazy stocks take off. We saw all of these work from home plays take off. That's just the stock market. Then we saw money flowing into cryptocurrencies, which were already starting to begin in 2017 with speculative excess. So then we saw the rise of these things called SPACs, which when you tell people what they are, they shake their head. They're like, that's like crap on a stick. That's nothing, but people were doing it.

Tom Mullooly: And then non fungible tokens, NFTs, and people were like I could buy a Rogers Hornsby baseball card for less. It just didn't make any sense and so we saw all this speculation. And so part of that was Fed doing monetary policy where they drove interest rates to zero and they flushed the banking system with cash. That was to keep the economy out of the ditch. Then Congress also approved three different CARES Act packages over a period of a year and a half where they basically, instead of saying, hey, we're going to let the Fed just do their thing and flood the system with money, we're going to try this grand experiment where to avoid a recession we're actually going to send money to the individuals.

Tom Mullooly: Now we've got the consumer sitting at home with a lot of cash so the money goes somewhere. Very few people did nothing where they just left it in the bank. So when I hear people talking about the upcoming recession, you know what recessions start when the consumer stops spending money and actually starts cutting back. We still see consumer spending happening. It's happening at a slower pace. It's doing exactly, we're seeing exactly what the Fed wants to have this whole thing scripted out. It's working.

Casey Mullooly: Yeah.

Tom Mullooly: But for this particular guy, all the air is coming out of his speculative market and I feel bad for the guy.

Casey Mullooly: You have seen some real life horror stories out there about when we saw the Luna, which is another cryptocurrency blowup, we saw that around the middle of May and people were talking about how they lost their life savings because this thing was Luna and Terra were tied together and Terra was touted as a stable value type fund where it never goes down and...

Tom Mullooly: Now they're considering bankruptcy.

Casey Mullooly: Yeah and people believe that and put their life savings into it and pretty much got wiped out. And I feel for those people because I think the hype and the, I don't even want to call it advertising, but just the whole mantra of crypto is speculating and being able to get more people in and sell it to someone for a higher price and that was, a lot of people bought into that and now they're seeing that it's not exactly true, but I hate saying that you just have to learn lessons that way, but you kind of do.

Tom Mullooly: Yeah. And we seem to see this every so often. So we saw things unravel in 2008, in 2000 to 2002 in 1998, long term capital management hedge fund made up of probably the smartest guys in the room.

Casey Mullooly: Yeah.

Tom Mullooly: I mean, Ivy league economists, they blew it up to the point where the Fed had to actually step in and bail them out to keep markets afloat. So we can keep going back in history and finding all of these different times where we had speculative excess and that's what's happening. Warren Buffet has a great quote that says when the tide goes out, you find out whose been swimming naked and that's what's happening now with crypto. And it's, again, just my opinion, but I think that a lot of the volatility that we've seen in the first six months of this year in the stock market is coming from the crypto market.

Tom Mullooly: Why? Because people have been borrowing money to invest or speculate in crypto and when they get a margin call or when that asset is down, they have to find money from someplace else. So they sell the most liquid asset they can get their hands on. Apple, Microsoft, their S&P 500 ETF. So that is where we're seeing a lot of these liquidations coming from, in my opinion. And so, as long as we've got people speculating on things like crypto, or I don't know if I'm going to step on a third rail by saying this, how many people bought homes in the last two years with cash?

Tom Mullooly: Where did that cash come from? That money was coming from borrowing against securities in their portfolio at a brokerage firm. I'm not going to name one, but you know what I mean? So now we've got a problem because they borrowed money and with the idea that the stock market goes up forever so we'll just, it'll pay for itself and we bought a house at the top of the market, or pretty close to the top of the market. Now that's starting to drop in value. Oh, no. Like maybe this didn't work out the way we thought it would.

Casey Mullooly: Yeah. I think point being that you got to be really careful when you're borrowing against securities, when you're using things like margin and leverage. That is how the really, really bad things happen in the market.

Tom Mullooly: So over my career I have made a lot of money and lost a lot of money trading options, but yet when I talk to clients about options, they're like, oh, I've heard options are really risky. I've also made money trading commodities. I've lost money trading commodities. And people say the same thing about that. But the thing that kills people more than anything else, anything else, margin, debt. Debt, it makes you, it forces you into making a poor decision at the worst possible time.

Casey Mullooly: It's hard to get yourself into big holes when you just keep personal finance simple.

Tom Mullooly: Right.

Casey Mullooly: When you live below your means, you keep your investing decisions simple. It's simple, it's boring, but it doesn't put you in that spot where you have to make the decision whether or not to pay off your credit card debt or liquidate your investment account. That's an impossible position to be in and when you keep things simple with your finances it's really hard to put yourself in those spots.

Tom Mullooly: I think the whole idea with living beneath your means comes along with a superpower, another muscle inside of yourself that people rarely exercise and that is the power of saying, no. No, I don't need a new car. I can fix this one.

Casey Mullooly: Yeah.

Tom Mullooly: Or no, we took a vacation a few months ago we don't need to take another one.

Casey Mullooly: Yeah. We're just getting back to the speculative market last year. I mean, especially, I know people my age, seeing it on social media where these overnight crypto sensations are, or the people putting out option strategy TikToks, it's like, you feel like everyone else is advancing faster than you, making more money than you and you have this fear of missing out and you act on that. But I think if, like you just said, you could have just said, no. I'm good. I don't have to do those kinds of things. So there's that social aspect to it as well, but I know we're kind of the level headed guys in the room, kind of talking about keeping things simple and it's not sexy or fun, but I don't think investing should be that. I think it should be like watching paint dry.

Tom Mullooly: That's exactly what it should be. Part of watching paint dry is letting these investments run themselves and so Casey, you've got some information on some of these approaches that indexes or indices take to help things run smoothly below the surface.

Casey Mullooly: Yeah. So I just want to say we're going to talk about some companies and some funds, and this is not to be taken as investment advice or a recommendation. With that being said, the Russell indices, which are some of the most popular index funds out there, they run a rebalance or reconstitution of their funds every, it's the fourth Friday in June of every year.

Tom Mullooly: So understand that you may not own a Russell mutual fund or a Russell ETF, but please bear in mind that many of the investments that you have are measured against these indices.

Casey Mullooly: Yeah. The Russell 2000 is a popular, is the small cap index. The Russell 1000 is the larger cap index and then you have the Russell 3000, which is often used as a better representation of the market than the S&P 500. S&P 500, 500 stocks, Russell 3000, 3,000 stocks. So they ran their annual reconstitution and I just kind of wanted to get into the weeds a little bit to discuss how these re-balances are done. These funds have filters and they're filtered by market cap so the top 1000 names in the ranking by market cap go into the Russell 1000 and then the bottom 2000 names are in the Russell 2000. They also offer funds like growth and value. And one of the more interesting things that we saw was Meta, which is the parent company of Facebook was removed from the Russell 1000 growth fund into the Russell 1000 value fund, which you think of Facebook, I mean, that was probably one of the poster childs for growth stocks over the last decade and to see it go from a growth fund into a value fund is pretty eye popping.

Tom Mullooly: It is. I don't know if it'll stay that way, but at the moment that's where it is. At some point mature companies or I should say companies mature, and then they become more value plays. 40 years ago a hot growth stock was AT&T.

Casey Mullooly: Right.

Tom Mullooly: So, and that was before the breakup of all the Baby Bells and all the spinoffs after that and now it's a very mature company.

Casey Mullooly: Yeah. So just at a high level, the growth are, like you said, the younger companies that are growing faster than their counterparts and the value companies are the more stable. And I mean, value is often confused with cheap in the investing industry, but yeah, just saw that headline and kind of thought we had to talk about it because that is, that's pretty wild. Some of the other names to jump in, or some of the other names of note here in the Russell rebalance. So the largest 10 companies by market cap saw two new entries. We saw United Health Group and Nvidia into the top 10 of market cap. They replaced JP Morgan and Visa. The names aren't really important, but it's this idea that things are changing under the hood and companies are coming in and companies are going out based on what's happening underneath the surface.

Tom Mullooly: Yeah.

Casey Mullooly: Which I think if you were to try and replicate this on your own, you would be facing a lot of logistical nightmares. When people want to own the hottest stocks or the hottest investing names out there we often tell them, well, we do own those things because we own these index funds that are heavily weighted based off of how the index constitutes itself. These things are in there. So we do own them. They're just under the wrapper of an ETF.

Tom Mullooly: Right and if you tried to do that on your own, first of all it'll be very difficult to get the exact weightings of the Dow Jones or the S&P 500. You can just buy an ETF that will do it for you and when there's a change in the index, whether it's the Russell 1000, the Russell 2 or 3000, the Dow Jones, the S&P 500, all of that calculation and all of the transactions get done for you without a capital gain getting passed along as well.

Casey Mullooly: That point is so key.

Tom Mullooly: It is. People just overlook it.

Casey Mullooly: Yeah. So just a couple other interesting things. Just wanted to mention here. Microsoft joined Apple as the only two companies that have over 2 trillion in market cap. First time ever that's happened.

Tom Mullooly: Wow.

Casey Mullooly: Crazy. And then some interesting names are joining the Russell 1000 index and this-

Tom Mullooly: These are large, the largest 1000 names.

Casey Mullooly: And this brings it full circle because two of the names really jumped off the page to me. So these were small cap names that moved up to the big boy index in the 1000 and that is Avis Budget and AMC Entertainment.

Tom Mullooly: Wow. These were meme-

Casey Mullooly: These were two meme stocks.

Tom Mullooly: Yeah. It also works in reverse. In 1999... It's a quiz question for you.

Casey Mullooly: Yeah.

Tom Mullooly: 1999, the seventh largest company in the S&P 500?

Casey Mullooly: Enron.

Tom Mullooly: Yes.

Casey Mullooly: Wow.

Tom Mullooly: And a year later.

Casey Mullooly: Zero wow.

Tom Mullooly: Zero.

Casey Mullooly: Pat myself on the back there.

Tom Mullooly: You should.

Casey Mullooly: I was six.

Tom Mullooly: Just gone.

Casey Mullooly: So I think our point being here that I know we talked about crypto to begin and some horror stories there about some of these cryptocurrencies going to zero and people losing a lot of money. I think that, that's a real possibility when you're investing in that space and you have to be really careful there, but when you're investing in index funds and the broader market as a whole, these things are reconstituting themselves under the hood, which means that they're going to be catching up with the latest trends and we're confident that these are never going to go to zero because they'll adapt to the changes happening in the market. So just keep that in mind when you're investing out there. I think that's going to do it for episode 401 of the Mullooly Asset podcast. We appreciate you listening and we'll be back with you next week.