Financial Detox Podcast
Episode #118

[INTRODUCTION]

Jason: Welcome to Financial Detox. This is Jason Labrum, your host, and in studio with me as always is my so handsome, wonderfully intelligent co-host, Alex Klingensmith.

Alex: It sounds like you want something from me, Jason. What is it?

Jason: I'm just glad you ate so you don't get grumpy during our podcast.

Alex: I am too. Thank you.

Jason: That was a good taco we just had.

Alex: Pretty good.

[EPISODE]

Jason: It was good. Welcome to the show. Here we are on I cannot believe it's October 2nd already. What the heck. This year's flown by. Here we are in the fourth quarter of the year. Markets are at all-time highs. We're going to talk about in this show what should you be doing in your portfolio given that markets are at all-time highs and we're also going to talk about just understanding the markets and the difference between the US markets, international markets, bond markets versus stock markets. I know we talk about that a lot, but I think it's really critical right now, Alex, that we continue to talk about it because these are the times when people start making either mistakes in their portfolio or, more importantly, they don't take the proper action to make sure what risk they have in their portfolio. Like what risks are present in your portfolio? Are you totally tilted towards large-company stocks and big companies and growth companies that have done really well the last five and 10 years? Or do you have the right asset allocation for the next market oncoming, undoing which is coming? There's going to be another decline. There's going to be another recession and so what to do with your portfolio today so that when that happens it doesn't hurt you as badly as it could.

Alex: Yeah. And I think, well, we hear these conversations daily with clients and prospective clients and peers and employees and everybody and making decisions based off emotions versus making decisions based off of actual objective, decision-making processes, systems that are going…

Jason: Yeah. A plan and discipline.

Alex: Yeah. You want to have an outcome that is in line with your expectations at least, so that when you - if you have an irrational emotion about, "Markets are all highs, I have a bunch of cash, I’ve had a bunch of cash for a long time.” We talk about that. We have a lot of examples of that. I'm not going to invest it in now because that's crazy because it's at - and what is markets anyways? Which market? Which index are you talking about if that's what you mean by the market? Is it the Dow? Is it the S&P, the NASDAQ, the international markets, the emerging, the bond?

Jason: Yep. You know, I just did a Facebook live event this morning for a group of realtors and it was fun. One of the things that we talked about was what are the markets.

Alex: Yeah.

Jason: And again, like in every one of the thousand times we've asked that question, the markets are the S&P 500, the Dow Jones, the NASDAQ 100. And so, if we add up all those stocks that exist in those indexes that people refer to as the markets, 630 stocks, when there's 40 plus thousand stocks traded in the world and yet we always refer to how are the markets doing and we’re referring to a very, very small subset of the overall market.

Alex: But the counterargument is those are huge companies that often sway other markets with them in other countries so that would be – I’m playing devil’s advocate, right?

Jason: That’s true though. That’s a good point.

Alex: So, if you’re like the 630 companies represent, I don’t know how many trillions of dollars of market cap versus the overall market cap globally.

Jason: Big, big time.

Alex: Pretty big companies. Apple’s in that list and Amazon and all these other big ones but so why wouldn't you say, "Okay. Well, I get what you're saying, Jason. 630 is not 15,000 like your portfolio is holding but I'm cool because that's a big enough slice of the market to me.”

Jason: Yeah. Well, what happens when we look back and study the market? You'll see that there are certain dimensions or certain factors that have consistently outperformed over longer periods of time. For example, we find that value stocks or fairly priced stocks tend to outperform less value stocks, meaning companies that are on a higher P/E ratio or companies that are more expensive called growth companies, the value tends to outperform them over long periods of time. Now, what type of performance?

Alex: Yeah.

Jason: Just like how much? What does that mean, right? Well, if we look at rolling five and rolling ten-year periods so that means every year starts a new ten-year clock and then the next year is another ten-year clock and so on so forth. I find that 87-ish percent of the time value stocks will outperform growth stocks on rolling ten-year periods. We happen to be in one of the

13% of rolling ten-year periods where growth is outperformed. I mean, growth stocks have done really well because of the Amazons, the Googles, the Apples, the Facebooks, the Netflix.

Alex: Go back to that for a second though. So, you said something, P/E ratio. That's a pretty jargon-y industry term like what is a P/E ratio and why do I care?

Jason: Good question. The P/E ratio is the price to earnings. So, you take the price of a stock divided by the earnings and you get P/E ratio right so you're finding out is this company expensive given the amount of earnings it has.

Alex: Earnings is like revenue or income?

Jason: Yeah.

Alex: Okay.

Jason: So, what's really important about that is eventually things align with earnings, right, because people are not going to continue to pay for something that doesn't have earnings. They either are paying for expected future earnings or they're paying for consistency in earnings, so a low P/E ratio means the company is a good value. Maybe. It doesn't mean you should buy it. I'm not saying buy all low P/Es but it means that that company is not expensive given the amount of earnings it has. Whereas a company that has a high P/E ratio means you're just paying more for the earnings of that company has and you're probably doing that because it has higher growth rates and higher expected earnings in the future.

Alex: So, like I'm going to buy an iPhone at premium value because it's…

Jason: Are you?

Alex: I'm just saying hypothetically.

Jason: Don't do that. Get a droid. Samsung.

Alex: I already did. Or I could get the extreme other example is I don't even know the name of the phones anymore, but the ones that are cheap that you're like, look, I have Verizon and they always send me like if I want to upgrade.

Jason: The Jitterbug?

Alex: Maybe Jitterbug, but I think a value phone I guess and then iPhone is like you're paying premium for it and you just know that that's what it cost even if you think you're paying more than you should and they do the same thing essentially.

Jason: Kind of, yeah. I mean, you're just paying up for more expected earnings and growth. Now, does that happen?

Alex: 87% of the time it does apparently.

Jason: 87% of the time the value companies outperform so the companies that are better priced, lower priced given their earnings tend to outperform. But we're in a unique time right now and I think why this is important to our listeners is it is right now could not be more critical as we've hit new highs, new highs, new highs. We're in the longest bull market run ever and that's not the biggest percentage move in stocks so there still could be room to go so that's for those sitting on cash on the sides. It's probably time to get invested. Maybe you don't get invested at your full, if you're an aggressive growth investor, maybe you just get in as a conservative investor now, wait until things come down. But if you're invested, it's really critical that you take the time and the energy and get help from somebody like the Financial Detox team at Labrum Wealth Management if you wanted to, to evaluate where the risks lie in your portfolio right now.

Alex: What needs to be readjusted.

Jason: Exactly.

Alex: Maintain your portfolio.

Jason: Right, because most likely, I mean, three years ago when we were on KCBQ and KFMB doing our show and we would do our $100 portfolio challenge, we would get people bring us their profiles and they were heavily overweighted towards US and large-cap just because that's the way most portfolios are in good times or bad. And it's served them well, right?

Alex: Yeah. They've had a good run.

Jason: They've had a good run. Eventually that run is going to stop and we really should have a nice diversification to your portfolio and I think right now if you just look at the valuations meaning the price per earnings of international stocks versus US stocks it's a much better value elsewhere than the US and as this market turns around or things change, it will not always stay the same so you have to rebalance, you have to set up your portfolio, and you have to continue to review and monitor which is what we do.

Alex: Well, and the other thing that you kind of touched on just now, so we talked about value and growth and those are things that have changed recently that are worth revisiting and seeing where your portfolio sits in those two dimensions but the other one that's impossible to ignore lately is that the United States large, mid and small, I think have all experienced really good recent success, recent past one, two, three, four, five years even.

Jason: Right.

Alex: And then very recently, within like year-to-date numbers, you look at your portfolio as of January 1st like international indexes and emerging market indexes are negative, right?

Jason: Big time like significantly negative.

Alex: And what does that mean? Like, so if you're like, "Well, I should sell my emerging market and buy US large-cap?" That's what most emotions would do, right?

Jason: Most people would do that and unfortunately, you're doing just the opposite of what you should do. So, you want to make sure that you own all the major asset classes and as they go up or down, you want to trim and rebalance. You know, we call it our tolerance band rebalancing where we set up a target weight for each asset class, a maximum weight, a minimum weight. And as those maximum or minimums are breached, we then will either if the maximum is breached, we'll trim it and add it back, bring it back to the target weight. Or if a minimum is breached, we'll actually add to something that is terribly out-of-favor and nobody wants and everybody's selling and it's in the news. But what happens is it's a philosophy and a discipline that we've built logic into software to help us do that with no emotions and it allows us to buy low and sell high consistently over years and years and years. And that adds huge alpha return that adds great return to our client's portfolio with less risk because you're de-risking and adding return.

Alex: So, devil's advocate again because I love these conversations lately because I'm looking at - I talked to a lot of new clients that are checking us out for the first time. That's kind of I spend a lot of my time doing actually, which is really fun.

Jason: Yeah.

Alex: But a lot of times they're like, "Well, what do you do with money? How do you do this?" and then we'd say everything you just said and they say, "Well, I've owned the same stuff or most of the same stuff for a while and it's sitting really good and you're going to tell me that, you know, how do you know what to do next? Like my United States large-cap portfolios totally beat your, you know…"

Jason: Diversified portfolio.

Alex: "Your 60/40 that you're saying I'm supposed to be. And given my financial plan, I don't need to take more risk like I'm doing better than you." And they're not wrong in some instances, and they have tracked their performance. They know what that means. They know how to not do mental accounting so we're talking about people that are paying attention, but it's a fun conversation for me because same thing you said in terms of, well, so let's pretend like you have just US large-cap. You bought just the index one let's say which is better than just buying 10 or 15 stocks like some people do also, right, just individual stocks, which is interesting, but then what happens when this shifts? What's going to happen versus or 60/40?

Jason: Well, and I think you also have to look, not to interrupt but to add on to what you're saying, you have to look at how you got there. Was it intentional or was it lucky? Did you just happen to have that or did you intentionally go out and say, "I'm going to overweight my portfolio to US large and to technology stocks because I think those are going to be the best performers over the next five to ten years?" and some people may have done that and that was an awesome prediction and an awesome guess, phenomenal job. They got very lucky and that's great but is that going to work again, right? What's the next guess? Where do you put your money today going forward? And I'd always go back to I don't care if I have the best performing portfolio in a year. I just don't want the worst performing in a year and I always want to be in that top quartile. If I'm diversified appropriately and I have the right exposures and I do not take unnecessary risk in my portfolio then I'll end up in the top quartile and I'll be very consistent. Over time, that's going to be a better long-term return than the highs and lows of trying to pick your good one and getting it right but then you pick one and you get it wrong.

Alex: Yeah.

Jason: The best example I had a client the other day, it was a newer client talking about how, "Oh, I got some good ones and blah, blah, blah," and then he was just the honest guy. He goes, "I don't want to tell you about all the bad ones I have. I just like to think about the good ones." Like, we all do that whether you say it or not but you look at people who try and pick individual stocks or trying to bet on sectors, advisors who are trying to bet on sectors and move your money around based upon which way the wind is blowing.

Alex: They only remember the good stuff. They tend to have short memories when it comes to the bad choices. Not a big deal though. It's only all of your money in your future, right? That's it. Maybe your kids' future and grandkids' future. Say whatever, you forget the bad stuff. It's only the way you're going to meet all your future liabilities by having a basket of portfolio, a basket of stocks, bonds, diversified mix of assets that then pays you a rate of return that you get to live on for the rest of your life.

Jason: That's where the conversation always ends when I talk to these people who challenge our investment philosophy is I say, "Look, the good stories about the Amazon you bought or the Apple you bought 10,15, 20 years ago, I love those stories. They're great but we have such a responsibility to our clients that it'd be irresponsible for us to manage money the way that you have. No offense but because if it's lots of people's money and it's all their money, that's just too much luck involved. We have a responsibility to deliver an experience that makes sense."

I want to pause for just one second because we have a couple great people that help us make this show possible. They're the kind of people we like and trust and so we want you to know who they are.

[ANNOUNCEMENT]

Jason: Hi. This is Jason Labrum, your host to Financial Detox. One of our partners, JR Phillips at the JR Phillips Group is the man who can help you with real estate. He's your local North County source for all things real estate. For over 13 years he's built a business built on trust and referrals where the client always comes first and comes before the commissions. You can check out JR Phillips online at TheJRPhillipsGroup.com or give JR a call at 866-883-6065.

Mark: Hello. Hey, it's Mark Robertson from Caliber Home Loans. If you're like a lot of my clients who probably have been led on into a mortgage by a super low rate that didn't exist, I've been doing loans here in San Diego since 2001 and I differentiate myself by giving everybody a straight story from the very beginning. If you're somebody who appreciates a very transparent approach and you don't want the smoke and mirrors that comes with the mortgage industry, I'm your guy. You can reach me at 858-401-9353.

[EPISODE]

Jason: Some people believe though that there's this core satellite or a conviction list. You should build your core portfolio and then go out and then things that you're highly convicted of, and companies that you think can be the good to great companies or companies that are going to do something really unique in the world and industry.

Alex: ECG now, right, environmentally and sustainable stuff for some people right now.

Jason: Well, maybe that but maybe it's just like, "Hey, I believe that Amazon is going to take over. I mean, it's not only a retail company. It's a data storage and cloud computing and it's all these things and that's where the world's going." You know, we have people on our investment committee who are huge proponents of pharmaceuticals, and drugs and hospitals and healthcare because they believe that with the baby boomer population getting older, they're going to use that so that's a thematic investment play. And I think that all those are okay as long as they're done with a very small portion of or a piece of the portfolio. It's not the whole thing because, man, all you got to do is get one of those wrong. And if you look at the way the tech market came undone, the NASDAQ, it took so many years, 15 years for the NASDAQ to get back to its high that it hit in 2000, took 15 years to get back.

Alex: Well, that's a whole index, not to mention all the one-offs that people did put their money in.

Jason: It disappeared. Yeah.

Alex: It went away or broke down and never came back. So, the manic investing is fun, but maybe not the prudent way to…

Jason: Probably not the core. I think to summarize this and make this useful for our listeners is, you know, the markets at an all-time high. It's really important that at this time you're peeling back your portfolio to see where the risks truly lie and look at some historical data and make sure you have the very best portfolio for the future, for the next year, two, three, five, 10 years and that’s going to bring you to a more well-diversified, a better-balanced portfolio, probably the ones you have. We have a great couple analytical tools. We partner with some of the largest financial firms in the world. Partner is probably the wrong word. Collaborate, we collaborate. That's right. We collaborate with some of the largest financial firms in the world. We have technology. They have different technology. We run your portfolio through this analysis and this tool to show you a deep dive into where your exposures are and what type of portfolio you have and then we’ll compare it side-by-side to what we do and make sure that you're getting the best of what we have to offer and we show you how to improve it if you can. That's really our $100 portfolio challenge.

Alex: We have to have a new name for it though. I keep telling you.

Jason: Why?

Alex: Because remember, somebody said it sounded combative or something and we’re not combative. So, you like the appealing to human being thing, right?

Jason: Right.

Alex: Try this one. What about the $ 100 Portfolio of Physical?

Jason: Whoa. I’m going to have to wrap my head around that one.

Alex: Well, you go to the doctor and he tests everything and he tells you where you’re up and down on levels and things.

Jason: Portfolio of Physical.

Alex: I don't know. Just thinking.

Jason: I like it. It’s good. We’ll think about that. Tell us what you think. Go to FinancialDetox.com and let us know what you think. By the way, you can get a hold of us anytime at 877-707-8889. That's 877-707-8889. If an email is easier, just shoot an email. Write to jason@financialdetox.com. I think we need to shift gears a little bit because there is so much money tied up in 401(k)s today.

Alex: Yes.

Jason: Everybody's money is in a 401(k), a lot of money is in a 401(k), and you have employer contributions and it's a great place to save in a lot of situations because you're getting free match. You’re getting a match from your employer, and that can mean as much as 20, 30, 40, 50, 100% return on the money you put into that immediately into the 401(k).

Alex: Free money is good.

Jason: If I have a match up to 3% and it's dollar-for-dollar up to 3%, which is what we offer our company and I'm putting in let's say 6% of my pay, I'm getting a 50% return on my investment from the match. That match is a 50% return on my investment, day one. That's unbelievable. I mean, even if I go and put in 9% or 12%, the return on my investment is huge right off the bat. So, 401(k)s have become a big asset for most people. What is that asset for? Well, when you're done working, you're going to take that, put it in a diversified portfolio, you're not done investing the day you retire. That's not the end of your investment time horizon. That's actually probably the beginning of your investment time horizon because now it becomes critical. You manage that money correctly so that it can spin off the maximum amount of income for you over your whole life. So, that's income planning or distribution planning. 401(k)s are a big deal and there's a lot of things that I think people do wrong in their 401(k)s. There are some things that I think we're going to help change the 401(k) industry with, with our new 401(k) product, but what would you say about these or what do you think are the best questions to address that we've received from our customers and clients?

Alex: Typically, it's almost exact same the first part of this conversation which is I've had this 401(k), I've been contributing money, which is a great way to automatically force yourself to save just like paying down principal on your home through a mortgage, amortized mortgage, but I think now that it's many of these parts of the market are at all-time highs, it's really, really important. If you haven't already been doing this hopefully to at least annually, but we usually look at it quarterly, where's your money inside this thing? And is there any sort of plan with how you're doing this or is it randomly just picking stuff because you saw it on the news or because somebody told you about this one index or whatever? Target date funds, I would say we tend to like more than not like. However, there's so many plans that are still overpriced and on the inside. And that's unfortunate for you because if you're hearing this, you probably don't have much control over that. But if you find out that it's overpriced, it's almost your responsibility and I would do it if it was me, but to take it to the people that are responsible and say, "Look, I think we could make this cheaper somehow, and we all benefit."

Jason: Yeah. And we can help you. We'd love to look at your 401(k), look at the allocations you have, and we'll help you pick the best choices from within that list of funds and then also if it's not good, we'll let you know.

Alex: The 401(k) Physical.

Jason: Yeah. 401(k) Physical. That's a good one. Okay. So, 401(k) Physical but we'll give you information then you can take it back and be the hero at your work and say, "Look, I have some information. I think we can lower the cost for everybody in our whole company."

Alex: Or the finance department is like, "Man, come on, another project for us? Are you kidding me?"

Jason: Yeah. Exactly.

Alex: But it's worth it because they'll save money too.

Jason: Well, something that we're excited about is the whole target date fund thing and maybe an evolution that could be coming of multifactor target dates. So, in English what that means is a target date fund, which is inside your 401(k) and most often nowadays it's the default investment option so it's where your money goes by default if you don't go pick your own lineup. And that's great because people and target date funds are typically doing better than those choosing their own investments. There's been some studies on that. However, what happens is if you're a 43-year-old and I'm a 43-year-old and we have completely different risk tolerance, and I have not very much money saved and you have tons of money saved.

Alex: Outside of 401(k) even.

Jason: Yeah, either, including 401(k) and outside, and you're contributing a whole bunch of money and I'm not contributing very much, well, we probably shouldn't be in the exact same portfolio. However, target date funds are targeting the age you would turn about 65 and they're automatically allocated correctly. That's great. They're rebalanced, automatic.

Alex: One factor though.

Jason: They get more conservative the closer you get to retirement. That's great but it's all driven off of one thing.

Alex: Our age.

Jason: Age. Well, we know. Everybody knows that not all 30-year-olds invest the same. Not all 40s, not all 50s, not all 60s. They should not be invested the exact same way. There should be some other things that take into account like I believe people's inherent ability to withstand volatility is important.

Alex: More important probably is understanding what is the rate of return they need to achieve what they want to achieve given their outside things that we don't necessarily know about on the 401(k) online questionnaire.

Jason: Right. Like what about other money you have invested, what about your spouse's other money they have invested, what about how much you're saving your 401(k)? What's the percentage you're putting in? What is the percentage your spouse is putting in? Take all those factors and then come up with the target rate of return to help you meet your goals. See, before 401(k)s started, there was pension plans or defined benefit plans called pension plans and some of you may have one, right? A pension plan is when you're retired, you get paid that pension most often for the rest of your life. Exciting. That's great, but there's not very many pension plans around anymore. It shifted the burden from the company who normally paid all of the money into the pension plan and it shifted the burden to the employee where now the employee has to start saving money and the employer maybe makes a match. But the way pension plans worked were very specific. They took your income. That's another factor, right, is how much money you make, and they looked at, at retirement you probably want to live on about the same amount of money or maybe 80% of that amount of money and how much do you need to have in your investment bucket at the retirement date so that you can then sustain your future expenses.

Alex: Sounds like a disciplined process.

Jason: Very disciplined and so you solve for a target rate of return. You knew that if this person has this much money going in and they get this amount of return, their net worth or their assets will be large enough that it'll sustain their income for the rest of their life.

Alex: What happened to that model, huh? We started living too long?

Jason: Well, look what happened. There's a lot of pension plans mismanaged their money and they made unrealistic expectations about how long people are going to live and they built models that gave them increases in pay throughout all of retirement and that they lived longer and they took their money a lot longer and the pension plan ended up broke.

Alex: Generous actuaries, huh?

Jason: Uh-huh. So, that's why a lot of the burden is shifted, but I don't think what should've shifted so much is the thought process.

Alex: Yeah.

Jason: And the thought process can be much more about how do I solve for my future needs and how do I get a portfolio that's sizable and sizable enough that it can generate income and pay me for the rest of my life in retirement and you don't even have to buy an annuity that has huge commission and locks you up. Although that may be the right solution for some people, probably not. Maybe not.

Alex: It's interesting.

Jason: Right. So, that's some thoughts on the 401(k). I think what the action item is there and the way to make sure your 401(k) is working for you because this is what matters is that you are getting detoxified, you're making better investment decisions, and we're moving you closer to your financial goals and objectives. That's the point. That's the purpose of the show. Let us look at your 401(k) and we'll help you or take it and let us run it through the portfolio analytics and maybe we can bring some value to you. Also, we have one of the great things to use as our financial planning tool where you can kind of integrate all of that stuff together and look at your full financial picture because it really comes down to what is the full picture. Looking at just your

401(k) or looking at just your Amazon stock or just your Facebook stock in bits and pieces is not probably the right solution overall. You want to start taking a comprehensive look at everything, how it works together, and how are you going to achieve your lifetime financial goals. That's what we're going to help you do.

Alex: So, email us. Call us, right?

[CLOSING]

Jason: Yeah. Shoot an email, jason@financialdetox.com or you can give us a call at 877-707-8889. What are we going to talk about on next week's show and then we'll close up, Alex?

Alex: Next week's show. Let's talk about bitcoin again.

Jason: Next two weeks.

Alex: I'm just kidding.

Jason: I can't do it. Get my friend Tom on. He's in Singapore and China chasing bitcoins. I don't know if he found any. You'll have to ask him.

Alex: Well, last week we talked about financial planning and the race to zero and Professor Joe Pecore was on the show.

Jason: Yeah. That was fun.

Alex: This week we talked about this timing of the market thing and the whole all-time highs. There's probably going to be a consistent kind of thread throughout these because of where we're at and you can't just not talk about it because people want to hear about that I think, I hope. I think it be really good to just talk about more about the 401(k) thing for now because it's a big project that we're working on. I mean, you're doing something right now with our 401(k) team that we've never done before and almost I don't think anyone's done it before.

Jason: Not really. Yeah. We are launching what's called an aggregate group plan. So, basically, we built a 401(k) plan for companies and plan sponsors. It would be equivalent to going to Costco and getting a deep discount because Costco buys so much of something and getting a Mercedes-Benz through a Costco discount program. So, we're basically…

Alex: Don't say any more yet. That's a teaser for next show.

Jason: That's a teaser.

Alex: I want to talk about that because I want to send that show to all the people that could benefit from that.

Jason: I think that's a good point. So, we'll talk about the new 401(k) called Smart Index 401(k) and what's coming up with that. I think also it's always worthwhile to talk about like what you said we have talked about, just how to invest, how to get that portfolio set up correctly, but I think the 401(k) is a big one and I was going to say something else and I've lost my train of thought because it was worth saying.

Alex: The physical thing.

Jason: The physical is great but we'll pick it up. We'll pick it up on the 401(k)s and as always, we thank you for listening. We hope you enjoy the show. We love you to give us a like and, of course, a good review if you want to. If not, give us a review and help us make us better. Thank you for your time. Thank you for listening and welcome to the Financial Detox show. Have a great one. We'll catch you on the next one. Bye.

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