Financial Detox
Episode #130
How to Invest with Total Peace of Mind

[INTRODUCTION]

[00:00:29] Jason: Hey welcome to the Financial Detox podcast. My name is Jason Labrum and I'm your host in studio with my beautifully handsome good looking, talented... I said handsome and good looking. I must be really attracted to you today Alex.

[00:00:46] Alex: This is Alex Klingensmith. I thought he was going to introduce somebody else right there.

[00:00:51] Jason: It's you. My Jesse Waters look-alike. We got to get out on the street.

[00:00:56] Alex: I haven't heard that in a long time. When I was at that retirement dinner for our client the other day and somebody sat next to me and she's like, 'You look just like Jesse Waters.'

[00:01:05] Jason: Especially if your hair is a little longer.

[00:01:08] Alex: I'm not trying to look like Jesse Waters.

[00:01:09] Jason: Quarter of an inch longer. I think you should

[00:01:11] Alex: She did say though, she said, 'He used to be a little bit raw in the beginning. He was a little bit like too direct to people ad he's gotten a lot better.' And I'm like thank you I guess?

[00:01:21] Jason: It's not me madam. I'm sorry.

[00:01:24] Alex: We just had a radio show and a topic is… it ended in a way like, gosh, it's too much.

[00:01:32] Jason: Details boring. We tell sleep in our own show.

[00:01:36] Alex: But I think the point is you want people to listen to those things and take action. Maybe not take action but at least like remember and think like that was a really good topic. So we talk about risk tolerance and how broken that is. And then you got really excited as soon the show was over. So why don't you say what you said.

[00:01:52] Jason: Well, when the show was over I said, 'Here's what we should have talked.' The point is, take yourself, risk tolerance is a process we're... Our show is Financial Detox. We're helping people avoid financial toxicity, bad advice, toxic thinking, toxic behavior so that you can make better investment decisions and have the things that you want financially.

[00:02:15] Alex: That financial piece of mind.

[00:02:16] Jason: There you go. Financial piece of mind and financial independence, freedom.

So that's what Financial Detox is all about. So what I started with was the concept of what's my risk tolerance? How much risk can I tolerate is broken? And most advisors today will help you figure out how much risk you can tolerate and then they'll deliver a portfolio that is going to bring you that amount of risk. They are going to bring you right to the brink of your tolerance to the depth of your souls you'll be tested and tried.

And so I said take you yourself back to like 2008 because we all have short memories. Take yourself back to 2008 and think about how you felt when your portfolio was down, maybe 20%, maybe 30%, maybe 40%, maybe 50%. Your million-dollar account was now $500,000. Take a minute and think about that because if you were an investor in 2008 and you invested largely in equities, your portfolio was down 30% to 50% and that feeling that you had, that gut wrenching feeling of, is this like the end of traditional markets?

Is my money going to literally go away? What have I done? What have I done to myself? Years, and years and years of hard work and saving and you got to tell your spouse I've lost half of our money and that feeling, that gut wrench feeling is what risk tolerance investing is designed to make you feel. You fill the question out and the advisor then says to you, the stock broker or the computer screen if you're on a robo says, 'This is what you said you could tolerate. So chill out,'

[00:04:04] Alex: Timestamped FCC compliance records.

[00:04:07] Jason: Yeah, you're done. You're smoked. So that sucks. That is a horrible way to invest. That is a horrible way to create a portfolio and that was our point of our radio show and the point of that story because I was an investor in 2008. I knew how it felt when things went down and you're like there's just no way it can go down more. And it would go down more.

There's no way it's going to go down more. It'd go down more. And then you start your resolve is truly being tested. Your resolve is you're saying to yourself, 'Am I wrong? Have I been wrong? Is the data wrong? Does history, is it different this time?'

The classic saying; it's this time. It's different. It's going to take different shape and it's going to take a different feel. But in the end capital markets aren't going to change like that. They are not going to diametrically change. So the problem with it is where we are going with this show and this podcast for you is that there is a way you can invest with absolute total financial peace of mind.

[00:05:08] Alex: Let's use that same exact example then if we were to go back in time 11 years and say if we were the advisor to that person who was down 50%. Had $1 million and they were counting on it, they were lining themselves up for retirement. Let's say they were maybe three or four years out. What would our conversation with them around that time has been and what would their portfolio look like?

[00:05:30] Jason: Well, of course the conversation at times like that is, 'It's not different this time.' Volatility and up and down doesn't necessarily mean risk.

[00:05:37] Alex: That client would have been probably about a nine or a ten of our eleven strategies that we go with zero all the way to ten.

So if that client is in our IDA-10 strategy we call it, what do they own? All stocks?

[00:05:53] Jason: All equities, US stocks, large cap stocks, mid cap stocks, small cap stocks, international stocks, some real estate and a couple other alternatives

[00:06:02] Alex: Roughly what percentage is in US versus non-US?

[00:06:05] Jason: Roughly 70%

[00:06:09] Alex: Okay. And then how many stocks? How many positions would they have?

[00:06:14] Jason: Thousands. 12,000 approximately.

[00:06:14] Alex: So this is important because if you think back to that same exact person, what if I was... If this was another client of some other firm, if they had four stocks…

[00:06:25] Jason: Or seven like the $2.7 million portfolio we just saw that came out of regional broker dealer type firm and the client had seven stocks with two point...

[00:06:34] Alex: Because that's not apples to apples. If that person was down 40% or 50% and one of those stocks was Citi and another one was AIG, I had AIG in and I remember being like actually my money is gone. It does not come back because they…

At that time I didn't have a lot of money but to me it was a lot of money. If I was that person I'd have been like I really did just lose years of savings. You can and here's something that happens Alex, I may derail us a little bit but I think it's worth it. We have some great clients that are very intelligent human beings

I'd dare say much smarter than we are. And they continually associate a previous experience to their current portfolio or environment when they are so different. For example, a client who is a very smart great human being, love the guy had an experience where had a lot of QUALCOMM. Lots of QUALCOMM in his portfolio in 2008. It got hammered and he sold it at the bottom. He exited the position when it was down 60%. So he now associates everything with real loss.

Like volatility is risk, volatility is loss of money where it doesn't have to be that way. If you have any 12,000 stock diversified portfolio, you own some of the greatest companies in the world. 12,000 of the greatest companies in the world that continue to produce products, goods and services to people for a profit. They are not all going to disappear at the same time or anywhere near at the same time.

[00:08:11] Alex: So back to the question where we started to get on this point which is great, it's all part of the same point. What sort of conversation would we be having with that 10 investor in 08? And what would have happened the very next year and what would bring him back to referencing?

[00:08:26] Jason: The conversation would be, 'Look at your financial plan. You're still on track to achieve your goal and objectives. This is the volatility we knew, that was associated with target rate of return of 10%. We knew this was going to happen and it's happening and we're totally comfortable with it because we don't think that every publicly traded stock in the world is going to disappear.

I mean Apple's gone, Google's gone. Safeway is gone, Johnson & Johnson is gone, Bristol Myers is gone, Boeing is gone, Lithium is gone. They are all gone, every company in the world is gone. We don't think that's going to happen. So by staying put you'll do well. Those people who stayed put, did very well

[00:09:05] Alex: Because what happened the very next day…

[00:09:07] Jason: We recovered as the biggest year we've had in lots of years.

[00:09:11] Alex: And the average annual return including in 08 still tracks for that kind of success.

[00:09:15] Jason: It does because what happens is the biggest up years, the biggest positive returns always come after the biggest negatives. You just don't know when they are going down, and you don't know how much it's going down. As an example, I had people telling me I remember playing poker with a group of guys, we used to have a little poker game once every six months.

There’s like 10 guys.

We would have this poker game and I remember talking to a financial advisor who had just started in the business and he was definitely knew everything in the world. And he said, this was five years ago, at least He said, ‘I've got my clients all positioned, interest rates are going to go up big time. In the next 12 months interest rates are going up.’

And I said, ‘Wow that's cool You're the only person who actually knows what's going to happen in the market.’

The Fed doesn’t know. The best economist in the world doesn't know but you as retired from another career, started as a financial advisor three years ago, you've got it all figured out.

[00:10:24] Alex: You were picking on the poor guy.

[00:10:26] Jason: I might have I'm sorry if I did. It was just a good conversation, I thought, starter. He started to have conversation and he went on to tell me no, he knew for sure.

That was one example but there's multiple examples of people who said inflation is coming, interest rates are going up. They haven't. There’s been people who we know, who we have worked with who said, 'This market is going to go down. It's going to go down we should be in cash.' Five years ago, four years ago.

[00:10:55] Alex: I know but even more current and fresh is, I just wrote our newsletter to go out tomorrow. So I had all these headlines that I researched. I literally Googled 'major 2018 financial headlines.' And they were all like all over the board. All kinds of interesting stuff that happened but the last one was 'The worst December since the great depression.' That was second to worst headline.

The worst one was, 'Get ready. The market is going to collapse’ or whatever.

So here we are in June 27th and all the major market industries are up double digits, 10% to 18% year to date. who knows what the future is but the point is, nobody can predict…

[00:11:37] Jason: Not the short-term movements of the markets. I think we really stack the odds in our favor and we have a high probability of predicting what they're going to do with the long term. And here's why. People say, ‘How do you have much faith?'

I have a really good large client who just says, ‘I don't understand where your faith comes from. I don't understand why you're so convicted.’

I said, ‘Well, for 21 years I've been researching this and I feel like I have a very good understanding but I also want to go back to some logical common sense.’

And I say this, as a investor if you're going to deploy capital you're going to give your money to somebody either by buying their stock so that they can use your money to further their growth and expansion and operations of their business.

That's what happens when you buy a stock.

Or I'm going to buy bond which means essentially I'm lending my money to somebody so they can use it for their business operations and they can continue to grow and do what they need to do and going to pay me back my money at maturity. So buying a stock, buying a bond if I'm going to do that I'm deploying capital. I'm going to demand a rate of return. I'm not going to do that If I don't get certain rate of return.

And it's been fairly well established since about back in the 1800s when we had the two crisis and things got… If you buy stocks, you buy ownership in a company your rate of return in a publicly traded liquid market stays somewhere between 8% to 12%. It's just what it ends up to be. Long term averages.

And bonds it's 4% to 5%. Could that change? Maybe. It could change a little bit but is that going to absolutely go away? I don't think so because people would stop investing in stocks.

I think that it's too important a function for markets in the global economy. It's just how it works.

[00:13:22] Alex: Capitalism would have to fundamentally change. What do he say when you explain all that about your faith?

[00:13:30] Jason: "Yeah I get it but did you see the headline."

And I'm like, I don't care about the headline. Because I mean I can pull you a million headlines that are wrong over the last year. They are just guesses and people guess but what happens if they get one guess right like a broken clock being right twice a day then they pounce on that and announce it and sell newsletters and tell everybody how they predicted it. They don't tell the how their other 38 predictions were wrong over the last year.

[00:13:56] Alex: I want to go back. This is good. I want to recap a little bit of what we've said we would say to the person if they were a client in 08.

They'd have 12,000 stocks here in a 10.

Your financial plan is you need to be a ten. This is what we expected. I'm sorry it doesn't feel very good We'll take you to launch, we'll go golfing. Or we'll just remind you to go do things you do have control over. This will come back, it will be okay.

[00:14:20] Jason: Let me stop you because I think what happens is you sit, you don't have to eat or golf. You would sit down with a client with their financial planner up on the screen like we do all the time with all the toggles on the left hand side showing their outcome and we'd show them that they are still in a successful, they are still successful.

[00:14:37] Alex: That's where I was going with next.

[00:14:42] Jason: Because intertwined entertainment is not deductible, the new tax rule. Do you realize that? How stupid that is? So if we take a client or a group of prospective clients out and we entertain them that is not a deductible business expense. That is not a business expense per the IRS anymore.

[00:15:03] Alex: So there's two things we would do further besides telling them to go back and do things that are fun, they can control to make them really have faith and confidence and that everything is going to be okay and have the information, the education, the empowerment. But one of them is yes, stress testing a financial plan, given historic volatility of your ten.

The second thing I think is really important and what I want the people listening to this show to maybe take away from it, if you're doing it yourself or if you're kind of checking out what your current advisor is and testing the to see how it compares to what we're saying is what does it look like in terms of… So we said 12,000 stocks, widely diversified. 70/30 domestic versus abroad. Maybe seven to ten, asset classes, but then how do you manage that going forward?

Because we tell the person, we'd say look, when this kind of thing happens and when different asset classes start to move this is like your favorite thing in the world to talk about. I'm not going to take it from you but.... But how do you do this so that on long you capture what you're supposed to capture and you remove emotions from the process.

[00:16:09] Jason: We have a graph that we'll post up as a link to the show and the graph will be target rate of return and how your portfolio changes and your target rate of return changes over time. And I'll describe it briefly. But if you think about if you have a target rate of return, you need to get 6% to achieve your goals and objectives.

[00:16:30] Alex: Well this guy was ten.

[00:16:30] Jason: Well let's say you need a 10% rate return to achieve your goals and objectives. You have to be willing to accept volatility in order to achieve. That's all great, we've all decided that. But there will be a time where the market does extremely well and performs better than we expect. Let's say we started in middle of 09. I mean you'd have a great better than a 10% performance. You're going to have a 27% performance.

Well there will be a point there where your target rate of return is no longer 10% because your portfolio has exceeded the rate or return of a 10 and you saved enough. I mean, savings side. The one you had invested grew so much temporarily that your new target rate of return is not a ten, it's now an eight.

We're going to take some risk off the table. When do we do that? At the top when your target rate of return has moved from a ten to an eight because things have done so well. Your portfolio has grown. Your money has grown so much that you don't need as much return to see what you wanted to achieve. So therefore we take risk off the table at that time.

There will also be a subsequent event that happens when the market goes down. Don't know when, don't know how severe. But there will be a time where now that 8% which was originally a 10% and now an 8%. Now, we're back to like 11%.

We need an 11% rate or return to meet our goal so at that point we're going to add risk back on or go into a higher rate of return investments. I like that wording better. We're going to move to higher rate of return investments and now that's the cycle that we're going to follow. Which is basically establishing a systemized disciplined process to trim profits when things are well. Take chips off the table, so to speak, when things have done really well. And to add risk or to buy things when they are cheap.

Sell high, buy low. Buy low, sell high.

[00:18:28] Alex: You're starting to have a favorite term on this whole thing.

[00:18:29] Jason: We call that tolerance band rebalancing. But it's a really easy way to make it work extremely well and it's not about headlines, it's not about hyper emotions of what's going on that day or that week.

[00:18:43] Alex: That's a problem, what you just described is the opposite of what our emotions drive us to do.

[00:18:48] Jason: Totally the opposite. Human instincts.

[00:18:53] Alex: So behavior would say, using very simple terms like, 'Okay, my account is up, I'm not going to sell the stuff that's super up, I'm going to buy more of, emotionally I'm like I want to buy more of the US large cap [inaudible]… or when I'm down and I'm hurting, I'm like I'm going to get rid of all of the stuff, that's really down…

[00:19:12] Jason: Emerging markets looks terrible. Who wants emerging markets in their portfolio? We're going to buy more.

[00:19:19] Alex: For people that are listening, that's what you're saying in a very nice way.

[00:19:22] Jason: I'm not even crazy.

[00:19:22] Alex: You're not kidding either.

[00:19:24] Jason: And I'm not kidding. That's why it works so well. It's counter intuitive, it's opposite of human instinct and emotion. And that's actually why it's really quite simple. If you establish processes and procedures and you have a plan in place to do that and to do it ahead of time you have to have the plan place ahead of time and you have to rehearse what it's going to be like when you are there.

[00:19:47] Alex: How do you rehearse that?

[00:19:48] Jason: Rehearse it in your mind. It's like catch fly as a pilot. So I'm a private pilot, an instrument rated pilot and one of the things I was taught to do is catch fly. Which means if you are sitting down in a chair or you relax, you literally close your eyes and you go through all the scenarios. So I close my eyes and I imagine an engine failure.

My engine just failed. Now, do I have that checklist memorized? What am I going to do? What's the first thing that I need to do? And I go through those.

[00:20:20] Alex: Freak out

[00:20:20] Jason: No. That would not be on the list. Catch flying is just think through. Let me give you another example

Extreme leadership a book about some great unbelievable, honorable war veterans who to have turned their experiences in leadership in Navy seals into the business world. They talk about the structure and the discipline and the planning which the seal teams go through in order to become the most effective, awesome, just unbelievable operating machine. The reason why they are so good and the best fighting machine and the best division military in the world is because they rehearse and practice what's going to happen.

They rehearse and practice what could happen every outcome. So we have to do the same things with our portfolio and our investment strategy. We need to sit down and rehearse what we're going to say, what we're going to do, how we're going to act when that volatility does become reality. Also it could be volatility up or down. What are we going to do? How are we going to act when the market goes through the roof and goes up and all those things that you don't want to sell because they are making so much money and I'm trying to tell you sell them.

You have to rehearse that and practice it. Because if you don't, if you just make a plan and say I'm going to deal with that one when it happens, will do something different than what you should do because you haven't rehearsed and practiced the right behaviors.

[00:21:47] Alex: That’s awesome. And I also love that we do a much better job that most and this is what people as what are our differentiators are. I think a lot of people talk about this but where we shine and what we’re built for is bringing it back to your life plan. What's the purpose? What's the purpose and what's going on with you right now because what's going on right now might be mellow. But when you're about to sell your house and buy another one or about to retire or when a loved one passes away or when you get divorced or...

All these big life events that's where some of the most true value of what we do... You got to be able to tie it all back to like, okay, what is the purpose and what does it mean in terms of executing upon that? Not just talking about it in therapy session mode but like, okay, are there any actions we take? Is this part of it or run some scenarios and see what you can give the best probability of success you can go and have that piece of mind.

[00:22:39] Jason: There's a lot of technical things behind that too. And you have to be able, as an advisor, you have to have the tools, the knowledge, the experience, the team to go and execute that vision, that process, that procedure which…

It's not. I mean when you talk about getting the right allocation, you talk about executing tolerance, boundary crossing across multiple households, you talk about applying low cost investing and you have to be free from conflicts of interest. Unfortunately, most advisors operate in a world of suitability and maybe they have a dash of fiduciary responsibility in there but they still bounce back and forth.

[00:23:13] Alex: They have the series 7, they can get paid to sell stuff.

[00:23:14] Jason: They can get paid to sell this off. Their firm, more problematic is not the advisor because I know so may advisors are great human beings and they're sincerely interested in helping people. They want to do a good job. But they work within a structure that their firm is getting paid additional revenue to sell certain products, to distribute certain products through their sales force versus others

And when you work with a suitability advisor or a broker dealer firm, it is happening all over. All the firms. I won't name names but you can't really... The only firm that doesn't accept compensation for selling certain products is what's called an RIA only. A registered investment advisory firm. A stand alone. They can't have a broker dealer affiliation and it is the same with the advisors at that firm. The advisors at that firm have to be investment advisor representatives.

[00:24:11] Alex: This is why Vanguard and Charles Schwab have gotten so large is because they have eliminate the bid ask spread which is... I think that's probably the most vague way that they make money these giant broker dealer firms. Because they'll say it's free to trade even now. You buy stock we won't charge you 300 bucks.

[00:24:27] Jason: If they take cents per share out of the trade.

[00:24:32] Alex: You don’t see that ask spread where Schwab would have to compressed down to almost a no spread and you go buy from Merrill and the spread is ten times more.

[00:24:40] Jason: Maybe. I don't know about that. There's so much complicity but the bottom line is if you're working an RIA registered investment advisory firm or an IAR investor advisory firm representative you're dealing with a group of people who generally speaking and I think almost always speaking cannot and should not be accepting compensation from any products they sell directly. Their only form of compensation should be the money you pay them directly.

So therefore you’re in a transparent relationship and you know that there isn't backdoor compensation happening which could potentially be driving you towards products that are not the best.

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[00:25:17] Alex: It goes all the way back to the poor guy in 2008. Did he have a fiduciary portfolio that was well diversified and tied back to his plan or did he have portfolio that was not?

[00:25:30] Jason: Or did that advisor just sell him some annuities and so that…

He sold them the annuities once he was down. Because that felt good and then he didn't get any other rebound and so it was bad.

Anyways, here's the deal. I mean in summary to kind of wrap this up we're trying to have fun with the topic that is maybe not so much fun and trying to make it just palatable and digestible. And financial detox this show is about taking bite size content such as risk tolerance. Should I be figuring out my risk tolerance or should I be figuring out a target rate of return. That's byte sized content.

You can understand that and digest it. And it can make a profound effect. It will absolutely have a profound effect on your results on your personal finances. That's what we want to help encourage you to do. Stop thinking about risk tolerance. Don't think about risk tolerance. What is my risk tolerance? Think about instead what is the rate of return I need to achieve my goals. And then once you establish that say to yourself, have your advisor help you, is this portfolio, the volatility this strategy it's going to deliver something I'm comfortable with?

You don't just ignore volatility. I'm not saying that. You go about it a different way where you figure out your target rate of return. You say hey, is this something I'm comfortable with? Then do some catch flying as I said or do some visioning. Think about what is it going to be like when that happens? How am I going to react, what am I going to do? Play that out, multiple times in your head. Have a system and a software so that you can run that through, stress test your portfolio.

[00:27:10] Alex: You can also email us. We'll go catch line.

[00:27:14] Jason: We'll catch line with you any tie. The point of the show is to educate and empower our listeners to make better decisions and be free from financial toxicity but it's also for us to help people. And4 we do that through the financial detox team, an intelligence driven advisor. You can get hold of us anytime by calling 877 70 7 88 89. You can also check us out at financialdetox.com. We invite you and to give us your questions. Let us know how we can help you.

Email us too. We're available. Go to financialdetox.com. You can get all of our info there but we're available to help you do this and do it right. You can invest with financial piece of mind and you can invest successfully by harnessing the power of the markets instead of trying to guess them and have a headline driven emotional roller coaster of inexperience. You don't need that. It's not Financial Detox and we will help you get it done the right way if you so choose.

I'm Jason Labrum your host of Financial Detox in studio with Alex Klingensmith. Thank you so much for listening and we invite you to again, check us out at financialdetox.com. We'll catch on the next show. Have a great.

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