EPISODE 25

[INTRODUCTION]

[0:00:05.3] Benjamin Felix: This is the Rational Reminder Podcast, a weekly reality check on sensible investing and financial decision making for Canadians. We are hosted by me, Benjamin Felix, and Cameron Passmore.

[0:00:17.2] Cameron Passmore: This is the week before Christmas.

[0:00:19.3] BF: Yeah.

[0:00:20.0] CP: We will have a new [inaudible] next weekend, the week of new year's but we have some good stuff week we covered off.

[0:00:26.3] BF: Yeah, we talked a bit about some, I guess, podcast housekeeping items, just some stuff more specific to the podcast than to investing or financial markets but still, important for us to talk about it.

[0:00:38.8] CP: Covered off the client's survey, we recently did, had some interesting data from that.

[0:00:43.9] BF: We talk about the market volatility and that was pretty much it. It was a good little episode.

[0:00:47.8] CP: It's time we [inaudible]. It's important information to share. Have a listen.

[0:00:51.9] BF: Yup, we'll talk to everybody, I guess, I was going to say see you but we'll talk to you in the new year.

[EPISODE]

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[0:01:03.4] BF: Welcome to Episode 25 of the Rational Reminder Podcast. It was a bit of an interesting weekend for the podcast, we jumped in the charts. It was kind of fun for Cameron to watch but I think we peaked at number 13 in the business category for all podcast in Canada.

[0:01:20.1] CP: With some pretty big names.

[0:01:21.5] BF: Yup, we're number three in the investing category so as you get more niche I guess, it's probably easier to get high up in the charts but in the investing category, we topped out at number three, we dropped off since then but it was fun while it lasted.

[0:01:33.8] CP: Yeah, if you're listening to the podcast and you do enjoy it, we would love to hear your feedback and any reviews that you can leave would be great.

[0:01:40.5] BF: Yeah, it's always, I mean, it's exciting. This is like my fourth child, I had to think about how many kids I have. This is like my fourth child so when we get a rating or a review, it's always, it's nice.

[0:01:52.3] CP: It's not always nice, we got one last week, which while nice to get the review, I know you text me right away and copied and pasted over to me. Why don't you talk about the review we did get?

[0:02:01.7] BF: Yeah, this is the first time we've gotten critical feedback through the iTunes review system. We've gotten lots of positive feedback but this is the first one that was, I don't know if I call it negative, I think we called it constructive. The listener wrote that they've actually stopped listening to the podcast according to them and they've unsubscribed and their complaint was that we do too much selling, we're selling our business too much.

[0:02:23.5] CP: But they said that they understand that's the point of it and that's actually not the point of the podcast.

[0:02:28.3] BF: We don't feel like we're selling.

[0:02:30.5] CP: No, we just think it's important to take an advantage of technology that allows us to share what we're thinking, we had a clients ask for that and happens to be a great medium to be able to do that.

[0:02:40.1] BF: Anyway, if we come across as selling our business, we apologize and if people do feel that way, we are conscious of it now. We'll be extra careful. I'm sorry if we offended anyone, I guess.

[0:02:52.0] CP: This is the last time we'll be in the studio for 2018.

[0:02:55.6] BF: People don't know we're in the studio.

[0:02:57.6] CP: We have a new studio, people may have seen it online, on Twitter and LinkedIn, we have a new studio. This is our last recording, we will have original episodes coming up next week. Special guests that I recorded a month or so ago in Los Angeles and then the week after, we have another guest.

[0:03:13.2] BF: You want to say who the guest is? It's a pretty cool guest.

[0:03:14.8] CP: Pretty cool guest. The guest is the executive producer of The Big Bang Theory, David Goetsch. Very interesting interview, he was a great guy, really fascinated the impact of this philosophy he had on him and then the week of new year's, we'll be with Robin Powell who is with the evidence tabby, the evidence based investor. Again, fabulous interview, he had a lot of great insights on what's happening in the UK.

[0:03:40.7] BF: Yup, he's done a lot of work in generating media to support evidence based investing. Anyway, two good conversations. Even though we're not recording, we will have stuff coming out and I think it's worth talking a little bit more about the studio, you kind of just glossed over it but we – within our office, here at PWL in Ottawa, we, I mean, it's a good closet. It was a closet, we actually got a closet and put the foam sound padding up, got a little Rational Reminder sign in here.

This is where we'll be recording the podcast from going forward and we've actually got two video cameras in here. So starting I don't know when, when we're ready I guess. We're going to start filming ourselves recording the podcast and posting those videos on YouTube. Hopefully that's nice for some people.

[0:04:27.5] CP: Yeah, it's amazing we're actually almost six months into podcasting. It has been fun and the goal is always improve them. Again, any feedback, love to hear it.

[0:04:36.2] BF: Yup, to finish off here, because we are rounding it out like Cameron said, we do want to give a couple of thank yous. Matthew Passy who is our producer, he's been with us for a few months now, he's been fantastic so thank you to Matthew. The PWL marketing team has also been very supportive of the podcast. Thanks to all those people. Anyway.

[0:04:56.3] CP: Do you want to talk about the client survey that we did?

[0:04:58.8] BF: Yes, we participated in the client survey, is it every year? Or every couple of years?

[0:05:02.3] CP: It has been every year now.

[0:05:03.6] BF: Every year now. It goes out to a bunch of advisors within our peer group and we had 199 survey responses which is pretty good, that's what have our –

[0:05:13.8] CP: I'd say roughly half of our clients participated.

[0:05:15.7] BF: It was good.

[0:05:16.6] CP: Then we get to compare those results to the client's responding to other viruses in our peer group across the countries so there were 6,874 total clients in the pool. It's neat how we get to compare our data with other peer firms. Some of the outliers really jumped out at me. I don't know if you noticed this or not but with 21% of our responses were age 35 or younger. Compare that to the group which had 3%.

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[0:05:42.1] BF: Yeah, it's crazy. It's a big problem within the whole wealth management business, right? That the client demographic, there are so many older clients and older advisors too.

[0:05:51.3] CP: Older advisors, the average adviser age I think is 54.

[0:05:54.8] BF: Yeah, sounds about right.

[0:05:57.2] CP: I mean, we have a lot of younger people in our team, you're 31.

[0:06:01.2] BF: Turned 31 yesterday.

[0:06:02.2] CP: 31 as of yesterday and I'm 52. It's certainly the average – our average age, younger than the average age in the industry. We also had far fewer clients over the age of 55 so of the participants, we had 42% over the age of 55 and the group average was, the group had 79% respondents over the age of 55.

[0:06:22.8] BF: Yeah, it's neat data. There's some other cool stuff in there too. The things that people value the most which is experience with clients like them, returns, which I guess you'd expect because that is clearly important and one of the most interesting paces of that survey question was that the higher net worth of the respondent, the more important returns and fees came.

I wonder what does that tell us? People are more aware as their assets grow?

[0:06:47.7] CP: Or I think people perhaps look at fees in dollar terms not percentage terms.

[0:06:53.3] BF: Could be.

[0:06:54.4] CP: Take a large portfolio, even a small percentage of a large portfolio becomes a large line item expense.

[0:06:59.8] BF: Yeah.

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[0:07:00.9] CP: Some of the values received that they saw in service, sense of security, peace of mind, no real surprise there I guess, knowledge of their personal financial situation. Progress towards their goals and, again, returns.

[0:07:12.8] BF: Yeah, that's interesting. Interesting to see what people who are actually receiving financial advice see as the value of paying for advice.

[0:07:21.0] CP: Then there's one question about expectation about annual returns going forward with the stock market.

[0:07:25.5] BF: I thought this was a funny question. Why would they ask clients responding to a survey but is it to just gauge how their expectations are going to match up with reality or –

[0:07:33.9] CP: Pick up on greed factor? I also thought the bands were kind of wide, 35% said between 0 and 5% and 45% said between 6 and 10. Hardly anyone had expectations over 10%. That's surprised me. I thought a lot of people would have expected higher returns.

[0:07:50.2] BF: It's funny that the majority of respondents of that question, 45% between six and 10%, that's more than we would expect for an 100% equity portfolio on average over the long term. People have – are people's expectations higher than they should be for portfolio returns?

[0:08:05.3] CP: One other piece of feedback that was in most persistent in the write in and I think a lot of clients may understand this, a lot of feedback about the online experience clients I have with us. I know this is very near and dear to your heart.

[0:08:17.5] BF: Yeah, we've been talking about it for years and it's been a challenge to actually do anything about it because we've always taken the position that we don't want to become a technology company because that's not who we are but at the same time, there are no – well, there have not been any third parties providing the services that we need in terms of technology but we know, especially based on this recent survey that it's a major pain point for clients and we're working on it.

[0:08:43.2] CP: Yeah, we heard loud and clear and we're actually working on it now. We think we found a solution so –

[0:08:47.4] BF: I hope we have an announcement within four months. I don't think that's over promising. Anyway. Last week, we had – that wasn't last week, sorry. That was – when was Glenn? Three? Two episodes ago?

[0:08:57.9] CP: Two or three weeks ago, Glenn Cooke.

[0:08:59.3] BF: We had Glenn Cooke who is the founder of Life Insurance Canada website. He came on and talked about life insurance, clearly. Michael James who is one of my favorite Canadian personal finance bloggers. I don't know if he read the transcript or listened to the podcast, if you listen to the podcast, that's pretty cool. I think Michael James is pretty cool. Anyway, he picked up that episode with Glenn and he wrote a blog post about it.

What Michael found interesting was the reasons Glen gave for when you would buy permanent life insurance. Michal kind of said, "I never really got one, you would do that before," but after listening or reading or whatever it was, he got it. What Glenn said was, if you have [inaudible] RSP in TFSAs, if you want to guarantee a death benefits, so like Glenn, during the podcast gave the example that he grew up without financial means so he wants to make sure his kids have financial means when he dies. Therefore, he's got permanent life insurance.

The last reason that Glenn gave was, if you want to make your legacy as large as possible. That one hinges on the idea that insurance will grow faster than investments after tax if you're investing the taxable account. Michael, he kind of gave commentary on Glenn's reasoning but one of Michael's comments was that he would need to dig in to the details of universal life insurance policy to understand if that's true, if you can actually build more wealth with insurance than you can with a portfolio.

Now, we've looked at that so we can talk about it with probably two or three years ago that we really dug into this but I don't know – I don't think it would have changed. In the past, when we looked at it, even if you're taxed the highest marginal tax rate, it's really tough to claim that

you're going to get a better return through insurance at death at normal life expectancy than you would get through stocks, even with taxes taken into account.

[0:10:38.5] CP: Yup, maybe less volatile.

[0:10:40.1] BF: Yeah.

[0:10:41.3] CP: Especially at end of life if that happens to be a bad time in the market, there's always that.

[0:10:45.2] BF: Sure, you could make the argument. But given a long enough, like say it's someone who is 30 years old or 40 years old, given a long enough time horizon, you'd expect –

[0:10:53.0] CP: Well, especially with the low cost investment options available today.

[0:10:55.5] BF: That's another big part of that conversation, yeah. Well, the cost inside of UL book. You can make the argument that while you can buy an equity index in the UL policy but you're going to pay a two and a half percent fee.

[0:11:04.6] CP: Correct, you can get the same cost structure.

[0:11:06.9] BF: Anyway, you can't really compare, even after tax, you can't really compare equities and insurance. But, you can very easily compare taxable fixed income investments to say, universal life insurance policy with a guaranteed investment inside of it. Which we have a low fee, you're buying GICs or whatever inside of a UL policy. You don't have those high sag fund type fees.

Anyway, to answer Michael's question, not that he asked us this question but to respond to Michael's comment, if you think about it from an asset allocation perspective, if you want to add in an insurance to your overall asset allocation to build your wealth in a tax efficient manner, you can do that but it means that you're replacing fixed income with permit insurance.

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If you take, I don't know, 10% of your assets and put it into a permanent insurance policy, that becomes part of your fixed income. Now, what's the implication of that?

[0:11:56.9] CP: You have to make sure you have more equities so if you were 60/40 before, maybe now you're 70/30.

[0:12:02.0] BF: Right, it's not like you just go with – if you're 60/40 investor, you go put 10% of your net worth into permanent insurance policy and expect to have more wealth at the end. That's not the case because now you've decreased your equity exposure effectively.

If the goal is really to maximize after tax wealth, whatever you allocate towards insurance counts as fixed income which means your financial market portfolio gets more aggressive which might make you sad if you're a 60/40 investor and you're stuck with a 70/30 portfolio, it takes a certain level of rationality to live with a 70/30 understanding that you have 10% in a permanent policy.

Anyway, those are our thoughts on that. We did have a pretty good listener question.

[0:12:39.9] CP: That was a very good question actually. Basically, he's a fan of behavior based explanation for factors which is what we talked about. Small cap investing, smaller stocks are riskier therefore how I expected return. Value stocks which are stocks have gone down in price, they've gone down in price for a reason, there's a risk story to explain the higher expected return.

But, if two stocks had the same size, the factor and the same value or price factor but one is more profitable than the other. How can the profitable stock be riskier? That was the question.

[0:13:12.7] BF: Was basically saying like, in the last podcast, we took that deep dive in the factors and we kind of, not bashed but just – we stated that we're not the biggest fans of behavioral explanations for factors. Size and value, you can make behavioral –

[0:13:29.8] CP: How's being profitable riskier?

[0:13:32.2] BF: Right, that's the big question. They said okay, I hear you guys, you don't like behavioral explanations but I also know that you guys like the profitability factor so how do you reconcile that?

[0:13:41.7] CP: Exactly.

[0:13:42.5] BF: Why would a more profitable stock be riskier? We do have – we do have a risk based explanation for how that works on a portfolio and what it is, when you take two stocks like what Cameron said, you take two stocks and you hold constant size and relative price.

Market cap is the same and the exposure to value. Well, that's what I said, the relative price. So, dollar price is the same but one's more profitable, the one that's more profitable has got to be riskier and the reason it has to be riskier is because it has the same relative price as the last profitable stock.

[0:14:11.4] CP: The market is pushing the price down to that level, even though it's making a profit.

[0:14:18.1] BF: It's discounting the additional profits at a higher rate which means it's a riskier asset. That's the risk based explanation for profitability in portfolios. There are other ones too.

[0:14:27.1] CP: Interesting thing about risk is that risk isn't arbitraged away. Because people might say well, if that's the case, people would arbitrage that away over time and how they price was asked, said no, if it's riskier, you have to command the higher expect return, otherwise, why would you invest in it?

[0:14:41.3] BF: This is why we – I can't say that we disagree with behavioral explanations for factors because there's a ton of fantastic research and data showing that they make sense. The challenge that I have with behavioral explanations - I don't want to go too deep into this because we talked about it last time but the challenge they have with behavioral explanations is that they can be arbitraged away.

If people can behave more rationally. Now, will people behave more rationally? Who knows? But will risk go away? Will people all of a sudden be willing to take more risk without the additional expected return, no. That doesn't change.

[0:15:11.0] CP: The client asking question this week which had to do more research on but about a market timing model that has been shown to deliver higher expected returns and I'm like, "Well, what's the reason for that higher expected returns?" Everyone has access to the same data and if someone else finds that data, that can be arbitraged away because there's no reason to expect that model to persistently deliver higher expected returns.

[0:15:32.2] BF: Yeah, I mean, the behavioral explanations hinge on people behaving irrationally and limits the arbitrage, there are reasons that people will not arbitrage things away and that's what behavioral explanations for factors hinge on, we had a long conversation about that recently but again, I'm not comfortable taking client's money and investing it based on other people's behavioral biases or limits to arbitrage. Because if someone figures out a way to get around the limit.

[0:15:58.7] CP: Or a model is not rooted in academic evidence.

[0:16:01.4] BF: Yeah, anyway we gave the risk based explanation for profitability and we dug into why. We reiterated why we are not crazy but behavioral explanations for factors.

[0:16:13.6] CP: So given what is happening in the markets, do you think we should maybe talk about that a little bit?

[0:16:17.9] BF: Oh you mean you want to go to cache?

[0:16:19.2] CP: I am not suggesting that but I think it is good to view what's been happening.

[0:16:24.3] BF: Yeah, all around it has been a pretty bad year in the stock market. Canada by the S&P/TSX is down about 9% for the calendar year, year to date and US market is up a little bit in Canadian Dollar terms.

[0:16:40.3] CP: Yeah, thanks to currency.

[0:16:41.2] BF: Thanks to currency but down in US dollars or down for Canadian hedge investor and international and I just looked at XCF which an international equity ETF listed in Canada. So this is a Canadian Dollar return.

[0:16:53.7] CP: Taken currency, yeah.

[0:16:54.9] BF: It is down 7.17% for the year and the DFA 60/40 portfolio is down just over 5.5%.

[0:17:03.7] CP: So kind of garden variety volatility, right? If you just look at the numbers, nothing that dramatic there.

[0:17:08.9] BF: Well it is nothing that dramatic when we are talking about percentage points but when you are looking at your – I mean the numbers they add up. 5% on a half a million dollar portfolio that is not a small negative number to see in an account. So I get that people feel anxious but you are right, this is garden variety. This is nothing.

[0:17:26.8] CP: And we all saw a whole generation of investors that have had a great decade since 2008. I haven't really seen a lot of real down side and I can tell you this is nothing like 2008 downside at all.

[0:17:38.3] BF: I asked you about that this morning. Because people are nervous now and we always talk about how we never get client phone calls and we haven't had any recently but we've had more than zero and so I ask you, what is it like in 2008? Like if people are nervous now and people are asking us for reassurance now, I mean this year's negative return was maybe a day.

[0:17:59.0] CP: Oh absolutely, there are days back then and the market was a lot lower where the Dow would be down 400, 500, 600 points day after day just getting knocked down like crazy. You see assets just melt away like we were down 15, 20, 25% and these are diversified portfolios.

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[0:18:17.5] BF: Yeah, you mentioned that we've got a generation of people who haven't seen much or any real volatility. I found one post about that that was – I mean it was crazy. I almost found the data hard to believe but it is data. So you can't not believe it. It is what it is. It was opposed by Jared Kizer. He is with Buckingham which is kind of like a similar-ish firm to PWL in the States.

And he wrote about how from March 2009 through October of 2018, the S&P500 has had returns that it would not be unreasonable for nobody that's alive to ever see again. That is how good they were in a risk adjusted basis. So the actual percentages and this is from March 2009 through November because I got more recent data than he had from the beginning.

[0:19:06.6] CP: So from the bottom, March 2009 was the bottom.

[0:19:09.6] BF: So annualized return of 16.97% with a standard deviation of 12.44%. Now I had somewhere else in my notes that for a different point but that is significantly higher returns with significantly lower volatility than the broad history of the S&P500 going back to 1926.

Now what Jared Kizer did in his post is he took all of the monthly returns from 1926 through October 2018 and he used the method called bootstrapping to create 100,000 116 month periods. So 116 months is the –

[0:19:45.1] CP: It was 90 years of monthly data in a pile, in a bucket.

[0:19:49.4] BF: Correct.

[0:19:49.6] CP: And you are going to pull from that bucket to bootstrap into your sample then fill the number back in and re-pull.

[0:19:55.0] BF: Correct, so you record the number, put it back in the bucket, pull the next one out and the significance of a 116 months is that that's the number of months from March 2009 through October 2018 so -

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[0:20:06.3] CP: He replicated that time series on a bootstrap basis from over 90 years of data.

[0:20:12.1] BF: Correct.

[0:20:12.5] CP: Got it.

[0:20:13.3] BF: So if we assume that it is and it is not reality. But if we assume that every possible monthly return is captured in that big data set, obviously it is a model. It is not reality but if we make that assumption then what we can do is recreate 100,000 variations of reality.

So his finding which was it blew me away and he wrote in a post about it that it blew him away too, is that of the 100,000 samples only 0.57%, so less than 1%, nearly half of 1% of the 100,000 samples produce risk adjusted returns as good as or as better than the actual returns of the S&P500 over that time period.

[0:20:54.1] CP: So we have a generation of investors that had experienced something that is so unlikely to ever happen again.

[0:20:59.5] BF: Yeah, well Kizer writes in the post that probably nobody who's alive now will ever see returns like that again anymore and so it speaks to your point though. That is 2009 through 2018 so that is roughly 10 years where anybody that started investing over that time period of course you are not –

[0:21:16.4] CP: So we have a generation of basically taking more risk you'll get more return. So you have risk seekers as oppose to risk avoiders. So you really don't know what it's like until you lived through it.

[0:21:25.0] BF: Right, I am probably guilty about that too. Maybe, I don't know I feel like I am pretty good at being detached emotionally. But I am a 100% stocks. I don't worry about the volume I accounts. But you're right, I have not lived through a 50% drop anyway. So that this whole thing kind of got us thinking about what is normal volatility.

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So we know the S&P 500 had, Jared Kizer wrote that the post was called 'The S&P 500 Goes Supernova'. So we know the S&P 500 has gone supernova over the last 10 or so years and we're probably never going to see that again but we look at the broad set of data, what is normal actually look like. So we didn't do anything fancy but we don't really need to. You'll go back to 1980 for global stocks and this is using the MSCI World Index. There had been 11 corrections of 10% or more and 8 bare markets with a decline of 20% or more that lasted at least two months.

So well clearly where we are now, we are not even close to a 10% decline all around the world. So we are not even in that.

[0:22:25.9] CP: Yes that is global, that is not just the US market.

[0:22:28.3] BF: No that's global stocks, correct.

[0:22:29.8] CP: So if you have a global portfolio.

[0:22:31.4] BF: It is not overweight in Canada. That is just global and that is in US dollars.

[0:22:34.3] CP: Those roughly every three years you have a correction of 10% or more?

[0:22:37.6] BF: Right.

[0:22:38.1] CP: And every four to five years you have a decline of 20% or more.

[0:22:42.7] BF: Right. Now this year from the high point of 2018 to the low which is basically now, the S&P 500 has had a drop of 13%. So that is not the year drop that is from the high point because it went up for a bit.

[0:22:57.6] CP: Peak to draw off.

[0:22:58.1] BF: To the low point now. So 13%. Now we started wondering, okay well how abnormal is that if it is abnormal at all? So what we did is we looked at the annualized return of

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a few indexes and overlaid the standard deviation and just moved one standard deviation for the mean, left and right to look at what is a normal return. And we'll talk about the numbers but basically we are so well within normal that it is not even worth talking about almost. But it is because people are nervous.

[0:23:27.9] CP: So what I understand that deviation is how much in terms of time?

[0:23:31.2] BF: Well it's 68% of outcomes are captured within one standard deviation.

[0:23:37.9] CP: Each side.

[0:23:38.7] BF: Of the main.

[0:23:39.1] CP: So going back to 1926, the data you dug up of the S&P500 has had an annualized return of just over 10% with an annualized standard deviation of between 18 and 19%.

[0:23:50.5] BF: 18.62 to be precise and not just – we have to come back to the S&P500 going supernova post where remember the return - was in the 16.97% with a standard deviation of 12.44 and you look at the full dataset and it's got substantial –

[0:24:09.7] CP: 60% higher return with the – whatever that is, 40% less standard deviation.

[0:24:15.0] BF: Yeah, so I thought that in itself was –

[0:24:16.9] CP: Put the band on that and let's just round it just to make the math easy. So 10% plus or minus call it 19, two thirds of the time. So 10 minus 19 is minus nine. So two thirds or I guess in a normal distribution, one third would be negative or below the expected mean.

[0:24:34.2] BF: Right.

[0:24:34.6] CP: So these are absolutely normal bands that we are in right now.

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[0:24:37.2] BF: Yeah, I mean the spread for one standard deviation on either side of the average return for the S&P 500 going back to 1926, we're looking at between negative 8.5% deposit of 28.73%. So for US stocks anyway, there's slightly negative in US dollars, slightly positive in Canadian dollars but either way, we are within one standard deviation of the mean. So that is – I mean that is the definition of normal. That's the closest to the mean in the standard normal distribution.

So we looked at Canadian stocks too, annualized return going back to 1956 of 8.89%, standard deviation of 14.9%. So this year we are bumping up on the second standard deviation from the mean for Canadian returns but still, I mean we are within the normal distribution that is the definition of a normal return. Assuming that returns to normal distribute it which are not perfectly but that's okay.

[0:25:28.3] CP: And while you may not be happy, if you have a proper strategy that you know is being rebalanced you won't be upset.

[0:25:34.2] BF: Right, Ken Fisher had a great tweet. When prices go down, so markets are down right now and like you're saying, some people are feeling nervous or sad or whatever but Ken Fisher tweeted, "Can you just feel the falling market making people who were more optimistic become more pessimistic? Rationality would argue for lower prices making people even more optimistic." It's true. Prices go down, expected returns go up.

[0:25:57.4] CP: If you believe in capitalism.

[0:25:58.9] BF: Right, Ken Fisher is the gospel of capitalism.

[0:26:02.6] CP: Speaking of social media and Twitter, you see the stats I dug up here? I saw on Twitter this afternoon, the question being raised by this post was, "What impact will Twitter have this time compared to 2008?" So I just dug up the data. So in 2008 Twitter had six million users. Now it is over 328 million users and look at Facebook. Facebook had a 100 million monthly users in 2008. Today, it's 2.2 billion monthly users so.

[0:26:30.1] BF: What does that do though, it makes information spread more quickly? Does that make markets more efficient?

[0:26:33.8] CP: Does fear spread faster? Do people look for – because people when things go bad, people want to take actions and then will they be perhaps looking for other strategies if you don't have a sound strategy that you believe in now?

[0:26:43.7] BF: Or that the people trading the ones on Twitter? Who is doing most of the trades? The institutions. So are the institutional traders sitting on Twitter waiting for their signals to sell?

[0:26:51.2] CP: I don't know.

[0:26:51.7] BF: I don't know either. I think there is an argument that it can make markets more efficient because I think that you can do the dollar sign hashtag thing to talk about stocks so people are very easily able to share information across a big platform with tons of users.

[0:27:05.4] CP: But there is also a ton of data going out showing these arguments that we're making which is this is kind of normal. Some people do some really cool data point analysis.

[0:27:12.6] BF: Well this is normal. There is no argument about that but the challenge is even though this is completely normal, we talked about this last time I think, people have a bias for action. So that the market is going down, stuff is happening, you feel like you have to do something and that is probably normal. That is probably an evolutionary response to danger.

[0:27:31.8] CP: Danger, definitely.

[0:27:32.7] BF: Yeah, so people feel like they needed, I don't know, I don't know if it is going to cash or if it is changing the strategy or buying a different fund or whatever it is but we've always got to keep in mind that even if you make the assumption that you can time the market perfectly on the way up. So you know through some clairvoyance that the market is going to drop. So you get out, okay step one, now what? You got to get back in, when do you get back in? I mean you don't know and we got to think about –

[0:28:01.2] CP: So someone has to buy from you, right? And they're wrong. So they are making a mistake by letting you out and then they are going to be dumb to let you back in at a low price because there's always a counter party in every trade.

[0:28:14.5] BF: Yeah I found a great -

[0:28:16.2] CP: And a lot of smart people on the counter, the counter side of the trades.

[0:28:19.2] BF: I found a great chart from Vanguard and they showed that 12 of the 20 best trading days and this is for US markets from 1979 through 2018 occurred in years with negative annual returns. So you see a fantastic day, best day I have seen in years on the market. So you decide, "Okay I am going to get back in. It's time." Pretty good chance that day is going to occur within a year that is negative and the same thing that's on the flip side.

Nine of the worst trading days occurred in years with positive annual returns. So again, you see a terrible day so you get out, pretty good chance it was a positive return. The other piece of this market timing discussion is that returns come in bursts. If you miss the good days which you can't predict, there is a pretty good chance your returns are going to be substantially well. Your returns will be substantially lower if you just stayed in.

[0:29:04.7] CP: One of the best analogies I ever heard on this was going to a hockey game. So the hockey game starts, it's all no score, you go and get a hotdog and all of a sudden two quick goals while you're not in your seat. So the point is to be in your seat. You don't know when the goals are going to be scored.

[0:29:17.3] BF: Exactly and there are different things that people try and do like using for example the Shiller Cape is a common one. Cyclically adjusted price earnings. So if the market evaluations are high well, you use that to get out and you use that to get back in. There are studies done on this as well and it - over 10 year periods explains about 50% of the difference in returns. So I mean even 50% in itself is not great but that is only over 10 years.

You shorten the time frame, one year, pretty well zero explanatory power. So if you are trying to time the market using the price earnings there is no data to support doing it.

[0:29:48.6] CP: So you'll hear next week in the podcast one of the things that Dave mentioned, Dave Goetsch is to embrace volatility, embrace the risk and this gave him tremendous amount of peace in his life. So I think that is the key takeaway, embrace risk, understanding your strategy.

[0:30:01.9] BF: Embrace risk, it is absolutely embrace risk. You need risk if you are not taking the right kind of risks, if you are not taking risk, you should not expect a meaningful expect of return.

[0:30:11.1] CP: Why would you deserve a higher expected return if you didn't take on the risk? It makes no sense.

[0:30:13.6] BF: It doesn't make sense in a capitalist society anyway.

[0:30:15.9] CP: Anyway that is good for this week.

[0:30:17.1] BF: All right, so everyone enjoy your holidays and I hope you enjoyed the episodes that we have coming up and we will be back with new material in the New Year.

[END]

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