Market FOMO: The Silent Portfolio Killer (and How to Avoid It) [Ep. 21]

Transcript
Note: The transcript of this podcast was generated using an automated transcription tool for informational purposes only and may not reflect the exact wording or content discussed in the episode.

Personal finance is more personal than it is financial very true and so our job is more like we're partners with our clients but we're also counselors

I remember in 2022 the worst year since 2008

from January one to September the market was just taking

but I remember talking to a current client

and I remember getting a message from him saying hey I want to go more conservative

(...) and I'm thinking is forty-six years old you don't want to go more conservative the bottom

and I remember just giving him a few statistics that he wanted to look at like the fact that since nineteen fifty

after a midterm election the market rallies

don't let fear drive this decision let's wait till December or January and then let's get more conservative(...) well then what happened it didn't even wait till the midterm election

the market soared

(...)

today should be a fun episode Robert we have to talk about market indexes I was thinking because it's close to the weekend I get to be here with you but i'll take that that should be a fun topic(...) uh... we're you're welcome now uh... so let's talk about when what clients are potential clients are people out there listeners they think about the markets right uh... they look at a particular index and they go hey the index uh... is up acts shouldn't my portfolio be up or x plus y

but I think it's a common misconception that people have where they think my portfolio needs to keep up with an index my first question would be and you can answer this what index(...) there's(...) more than twenty nearly thirty major S&P and Dow Jones Russell two thousand yeah that if you google indexes you'll see thousands of but there's almost thirty major uh... major indices so which one we gonna follow which one we talking about today I think S&P 500 most of our familiar with most people's comment but that's the most common one okay so what is the S&P 500 represent 500 largest US stocks okay so it doesn't have small cap mid cap international bond markets MSCJ

(...)

emerging none of that(...) so if I want to diversified portfolio and I'm focused on risk(...) then comparing myself to a hundred percent equity index that follows only one sector I could be setting myself up for failure right okay okay I see you are people gonna be comfortable with the risk most people are comfortable with losing thirty forty even fifty percent drops just by tracking an index but what I would tell you is if you're okay with losing that much you're okay with your portfolio possibly cutting in half and goals you're not necessarily focused on long-term goals(...) and you just want to track the S&P

(...)

go by an S&P index I mean that that's fine for many people that's not what they want but for that one or two percent out there that they're just concerned about an in particular index go by that and it would be

okay with it so somebody is once they achieve the rate of return of the dow or the S&P 500 if I'm hearing what you're saying and are comfortable with maybe losing twenty thirty or fifty percent sometimes I happens not all the time but happens

(...)

they should do that now I think I would add I think you would agree it kinda depends on what stage of life you're in right if you're twenty thirty forty fifty years old(...) if you're invested that way and the market even if it did drop fifty percent you're gonna be fine most likely right if you're not retired that's why I threw those ages out if you're not retired you're not needing the income and even better if you're still saving because then you can dollar cost average as the market comes down that makes sense but I think the game changes when we call the red zone if you're five years from retirement or five years in the retirement(...) you know and your portfolio drops fifty percent that's a problem because now you're selling you're doing the inverse of dollar cost average and you're selling at the bottom instead of buying at the bottom

(...)

that's why a lot of times it doesn't work well for them what worked well in your twenties and thirties may not work well as we get older and we actually accumulate that wealth you can afford in those catastrophic years to have losses like that you went from an accumulation phase of most your life getting closer if it's five years leading up to retirement or you're already in retirement you went from an accumulation phase to a distribution phase and it is more important and we talked about this in the past to lose less than the market in those negative years than it is to make as much in the positive in fact chasing a rally could be detrimental if you're catching all of the losses 2022 was a great example many people do not realize that 2022 was the worst year since 2008 and since we're talking about the S&P let's stick on that because many indexes lost different amounts this year but the S&P was down twenty percent in 2022

so if you're in the S&P and it lost twenty percent in 2022 it went down to eight hundred thousand if you started with a million lost a fifth right yeah but if you made twenty percent the next year are you back to a million now snow you have to make twenty five percent to get back to that million so what did the S&P do it lost twenty percent 2022 and then in2023 it may twenty two percent so for an average rate of return it looked like it was positive it wasn't it actually didn't get back to its break even until march of 2024

(...)

losing less is more important in trying to capture everything on that side if you can lose less in the market(...) you can leave some on the table during those up years and you're going to be ahead

because it's so important is what I'm hearing from you to minimize the downside right you want to capture as much of the upside as possible but maybe you leave a little bit of the gain on there because you're reducing your risk what I'm hearing you say is you probably want to be even if you're an index fund if you're doing yourself for you probably want to have different index funds and I want to be diversified not just the S&P 500 when you think about it what are bonds and those are you kind of like your breaks(...) so when the market the inevitable swings that we're going to get that inevitable corrections that you're going to get on average every fourteen to eighteen months if you don't have any powder driving your just right in the market if you go back more than a hundred years one of the smartest philosophies to do investing is when the markets up take some chips off the table when it's down put those chips back in it sounds simple enough but when it comes to emotions and it comes to to writing the market people don't think like that they let emotions drive that decision and they get called up but if you're falling just an equity index you have a hundred percent of your assets in it you also don't have any powder dry to take advantage of those days. I was about to ask you that

it comes to stocks

(...)

does it make sense and what's the downside if somebody has a hundred percent of their money in stocks whether it's in one sector uh... or just even if it's diversified but it's a hundred percent stocks what are the pros and cons of that

the pros is that long-term you'll just track the index of that year that you want to follow in whatever their average returns are that's what you're going to make that would be the pros the cons is you're not diversified let me ask you a question has the if we're following the S&P has the Dow ever beat the S&P up or down(...) has the NASDAQ ever beat the S&P the Russell 2000 the bond market all major five U.S. indexes that we look at in any given year one can beat the other that's right so why are we focused on the S&P when we build financial plans or meet with people and build financial plans for them we focus on the long-term goals why risk money you need to make money you don't need for the ninety five plus percent people out there that are going for long-term goals

most people can't afford to have those big swings are those catastrophic losses so they don't need to be in a hundred percent equity model now could you be leaving money on the table at times if you're not in a hundred percent equity model? yeah maybe in the short term but it's all about long-term planning it's all about missing the catastrophic losses and not chasing the rally

what do you think in that regards what do you think the biggest mistake people can make here

(...)

is getting their diversified portfolio

(...)

to a single index because a single index is not diversified so again it goes back to planning they have to understand what they're trying to chase and not let fear drive a decision what happens a lot of times is emotions right the market's up so people go oh I'm missing out I need to be in more equity so what are they doing they're chasing the market if you're chasing something if you're chasing something and then you're behind it so it's up they go I gotta get more aggressive and then what happens that inevitable correction we talked about where you get that 7-15% sometimes even 20% dip and so they're buying up here and then they get the dip and then what happens the fear again the fear again kicks in the fear of and they sell at the bottom and they sell at the bottom and then what happens so it's literally opposite of what your mind tells you should do but when you're immersed in the emotions and the fear then you make dumb decisions it's like when they tell you don't go gambling with your rent money you know the people who win at the casinos that you always hear about winning they went prepared to lose and then they won because they went with more of a statistical or tactical measure the people that have the rent money and go I need this I can't afford to lose this what happens all logic goes out the window and they end up losing it all

fear controls everything and in the stock market you can't you can't let fear drive that decision why is it that the stock market(...) and casinos things like that why is it the only thing that we get emotional about think about this(...) let's say you like steak let's say you're a steak eater and you go to the store whatever store you like I know you pick on me about whole foods but let's just say it's tom thumb or one of those you go to a shop at Walmart okay you're at Walmart about whole foods you're at Walmart getting your all-natural all grass-fed beef steaks and you go one day(...) and your favorite steak

(...)

the price is cut in half do you buy more if it hasn't expired yeah good point so it hasn't expired they're just putting on a deal they're putting on a deal so you got plenty of time before expiration they're just they're just they have it on sale would you buy more what about if that same steak doubled in price(...) would you buy more or would you buy the same amount that you normally buy? you're probably gonna in theory buy less or not buy it um yeah I know where you're going but don't wanna so why is the stock market the only thing that when it's up people decide they want to throw more money at it and when it's down they're too fearful to get into it they're following what the news is saying but what they don't realize I think they realize but they don't care to admit during that time is the news gets their ratings by selling fear not rainbows and butterflies you're not gonna watch that we get hooked to what's going on in the down times so fear controls a lot and it shouldn't you have to use and I'll tell you one more

story let's go back to COVID

(...)

in March of 2020 the market started hitting the United States is shutting down I mean I remember we were sitting there and we're human right I know there were times that we went home with knots on our summit going I hope tomorrow's gonna be okay I hope a month from now is gonna be okay

(...)

and I remember us having those conversations of do we do this do we do that and it came down to do what's worked overtime tomorrow the sun is gonna rise

(...)

the market's gonna open and so this is a buying opportunity because this too shall pass so what did we do we started just dropping money back into it 2% here 3% here getting in at those lows because we didn't know where the bottom was nobody did anybody that tells you they did they're wrong but you started buying well then what happened 4-5 months later the market was roaring back(...) but we met people that sold out at that bottom because fear made them do something they shouldn't have done they threw all common sense out the window and they were they were moved by fear yeah fear and greed you want to be greedy when others are fearful and others are greedy reminds me here we're always hiring financial advisors to bring on staff and typically the newer ones the younger ones uh... whenever the market pulls back this has happened to me I don't know four times maybe the newer advisors who are in their early twenties so it's their first rodeo in terms of helping a client in a time where the market just dropped 20% 25%(...) and in our weekly meetings they'll be like well what do we do if a client wants to go to cash or if they do how do we go or maybe not cash but they want to go more conservative right somebody is in an 80% stock portfolio the market's down 20% maybe they're down 10 depending on you know the model but the client wants to go more conservative and sell stocks a portion of it after it's gone down and what I always tell men if somebody wants to sell stocks and it's not because they need the money that's a different scenario they're not retiring but it's purely because the market's dropped you the financial advisor are not doing your job if you cannot persuade them and get them to understand why that doesn't make sense the sell after the market's dropped that's a problem these conversations

(...)

they have to happen in the good times right you want to determine should I take less risk when everything's great after a couple last couple years the market's been over 20% each of the last two years and 2025 it hasn't been a bad year either we're annualizing over 10(...) this is the time to decide okay do I want to take less risk don't wait for September October November let's say the fed doesn't drop interest rates and a market comes down 20% and then you wake up and decide hey I want to take less risk you want to do all of that thinking and decision making when the you know the odds are in your favor when the stacks in your favor and that is when the market's up you know it reminds me of the story when we talk to the new advisors and there are the young advisors maybe they've been in the game for a while but this is their first down market they're experiencing and we always have to remind them that

personal finance is more personal than it is financial very true and so our job is more like we're partners with our clients but we're also counselors our job is to educate them on historical trends and as you like to say history doesn't always repeat itself but it sometimes rhymes and while you were talking it made me think of you know

(...)

people that people that normally wouldn't freak out I remember in 2022 the worst year since 2008 and the year finished off bad but that wasn't actually the worst part of the year from

January one to September the market was just taking now it had a nice little rebound that fourth quarter(...) but I remember talking to a current client he's at the time forty six forty seven years old got a few million bucks

(...)

his plans on track so he can afford to take less risk is on track to retire when you track to retire right he wanted to retire early when it retired fifty five good for him but everything look good and I remember getting a message from him saying hey I want to go more conservative(...) and I'm thinking is forty six years old you don't want to go more conservative the bottom so immediately pick up the phone and I call him and we can't say a name but I call him and I go no you don't and he goes I just you know I don't I don't trust this I think it's going to go down further and I remember just giving him a few statistics that he wanted to look at like the fact that since nineteen fifty so this is 2022 nineteen fifty nearly one hundred percent of the time since nineteen since nineteen fifty after a midterm election the market rallies(...) we're in September(...) we're a month and a half away from a midterm election and so I go hold tight if you want to get more conservative don't let fear drive this decision let's wait till December or January and then let's get more conservative(...) well then what happened it didn't even wait till the midterm election October the market soared

and I can't remember is like sixteen seventeen eighteen percent from the bottom of uh... September to the end of the year right it was crazy for him that was a half a million dollar decision I remember getting a message from him in December going thank you Robert you save me I go it's not our job to just make trades are just to be order takers when we want to be a star job to help educate and to let you see through clear lenses and for him that's what he needed and he loved it is still thinking today but then I called him because I wanted to I wanted to play devil's advocate here go now let's go more conservative so in that call my k you know thanks for giving the compliment you know we don't get paid to make trades were fee only fiduciaries we get paid to manage money so I go now if you want to go more conservative now let's do it of course what do you think he said that now I want to be more aggressive why because the markets hot right solution it's all about the about following the plan(...)

so I was wrap up this episode uh... you know we're talking about the indexes why it may not matter right that that you're out for me or matching it may again it depends on how old you are I would argue and reason how old you are matters is when you're gonna need the money how far you are from retirement or need your new retirement or cash flow need from the investments what your appetite for risk is uh... so some people out there your five that's actually a price a ten years away plus from retirement uh... and you can't you have an appetite for fifty percent drop yeah go ahead in the S&P 500 or one of these again if you're comfortable with that fifty percent drop and you don't need it for ten years uh... other than that you might want to look at some analysis and on what the ramifications are if you have a cash flow need in three years and a market drop fifty percent how that's gonna impact all that

(...)

rapid wrap the show up for us what else do you want our listeners to know Robert I would say to your point if all you care about is matching an index go get nine index but don't forget about the important things what is retirement look like for you if retirement's not a goal for you if leaving a legacy is not a goal for you fine do an index but for most people not all people but for most having a financial plan understanding downside risk not capturing all of the downside is important to them but let's take it a step further

(...)

tax strategies

(...)

health care and retirement social security roth conversions a state and legacy plan(...) if you don't have a plan put in place that understands the risk of the market is well diversified and allows you to capture a mixture of different indices you set yourself up for failure or could be so the biggest takeaway is have a plan work with an active manager that understand your needs understand your risk tolerance understands your goals and invest appropriately

well we get to do the mailbag robert so you ready for the question of the day uh...

(...)

it's not addressed to you but you're gonna get the answer comes straight from molly molly you nor hay molly uh... i've known a molly okay I don't know if it's the same molly how often

(...)

hI robert she doesn't know that but how often I molly how often should I rebalance my portfolio(...) that's a good one I think it just kinda depends(...) I mean I know the generic answer that many people will give you rebalance every quarter are put your four one k on an auto rebalance for every quarter I mean that's a good generic answer but it just depends if you want to be an active manager of your portfolio if you're a do-it-yourselfer you know and you've got the time(...) then look every day and decide as one stock gets up or one sector of the market gets up you can rebalance actively not many people have sector goes up one goes down maybe sell some of the winners buy some losers

you have the time for it but not everybody has the time to look at it every day because they do have full-time jobs are they're taking care of family or they're taking care of kids and grandkids

so what I'm hearing you say is if you have an advisor like what we do we're managing it daily right so if a listener out there has an advisor their advisor should be looking at daily and seeing when it makes sense might make sense quarterly they may not touch it for six months if it's still in alignment but for your do-it-yourselfers let's say somebody doesn't want to work with an advisor they're just doing it themselves and they want something kind of low maintenance quarterly that should suffice to get it rebalanced and in the correct allocation yeah I would say so I think most people don't want things on autopilot so I like active management and I think most people do too and there's years like two thousand and nineteen with that the the market was just on fire everything was up so what I rebalanced every quarter not necessarily because that could make uh... that could give performance it would have performance but then it could give you taxation right you could be realizing taxation that you might not need to and depending on how long you've held that position you could be doubling your taxes by recognizing short-term gains versus long-term gains and we could course do a podcast on that one day but so there's years that maybe you don't do as many rebalances but I would tell you that the more volatile the market you know we were just talking about 2022 being the most volatile year the worst year since 2008 sure well there was a lot of rebalancing going on because that volatility creates opportunity for active managers to take advantage of so if it's on kind of autopilot you may be missing the boat and for some people maybe that's okay but the for for the majority of people they want to take advantage of that and I guess the last thing uh... I would add is it depends on what type of account right to your point the taxation if it's taxable that makes sense but if it's an ira attacks uh... deferred account ira for okay you you that's not gonna be an issue might make sense to be rebalanced more frequently again emphasis on might because an example you gave the markets going up yes there's no taxes if you make it more conservative but you it might not make sense to sell those winners and by losers if the markets on a prolonged uh... bull market hundred-percent I hope that helps I think I think molly will be truly appreciate your wisdom there you answer a lot more of it so I appreciate you uh... well thank you everybody for listening feel free to share this episode anybody out there who may be za do-it-yourself for or is in indexes the pros and cons it's it's I know some advisor s always say it's a bad thing no you'd have to work with them with an advisor I disagree some people don't need to work with an advisor fair comfortable with uh... the pros and cons of of index investing and what comes along with that thank you everybody

(...)

thank you everybody for listening