Ep51: The Most Common Retirement Mistake

August 14, 2020

PATTI BRENNAN: Hi, everybody. Welcome back to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Joining me today is our chief investment officer, Brad Everett. Brad and I are going to talk about the markets and a little bit about the economy. I thought it would be a good time to get an update in terms of what's going on and what we're thinking about what's going on.

Brad, welcome to the show.

BRAD EVERETT: Thanks, Patti.

PATTI: Alrighty. Let's talk about COVID. I got an email from a client this morning, and I thought it was a great way to explain the spread of the virus. Basically, it was a visual picture of six people sitting at a table, each one working on their own projects. One of them is using glitter. Of course, by the end of this project, everybody has glitter on their project.

I thought that was an interesting metaphor for how this virus spreads. It's kind of like glitter, right?

BRAD: Sure.

PATTI: With that in mind, let's talk about COVID. Where we are with the vaccine, the market. The market seems to just not really care anymore. What do we think about the decoupling? It certainly seems like we're still in a recession, right?

BRAD: Yeah. It's almost like the market has completely ignored 2020 altogether. To think that the S&P is, what, six or seven percent below an all-time high right now despite the news is pretty astounding. I think you have…decoupling is a good word between the prices and fundamentals, where you have this race.

Can fundamentals improve in order to catch up with stocks in a certain speed, or if it takes too long, you'd think stocks would come back down to adjust down toward the fundamentals.

PATTI: When we talk about stocks, we're talking in general, but certainly, not every company is participating in this recovery, in this rally, right?

BRAD: Sure. I think this is probably even a longer-term issue than just now. You could really argue that the vast majority of the gains are concentrated in very few of the smaller stocks. I saw a stat this morning that the average gain on the FANG stocks since the beginning of 2015 has been 35.7 percent a year through the end of May.

We're a month and a half short. The S&P without those is up 3.4 percent per year, so there's an incredible gap there between the top 4 or 5 and the 495.

PATTI: That is amazing. So let's just restate this. The FANG stocks are Facebook, Apple, Amazon, Netflix...

BRAD: Google.

PATTI: ...Google, right. So you've got those five companies. And what timeframe was that stat?

BRAD: I believe January 1st, 2015 they started that calculation.

PATTI: So as of January 1st, 2015 to May of this year, the rate of return for those five companies was...

BRAD: 35.7% per year.

PATTI: ...35% per year. If you just take out those five companies, we're still talking S&P 500, right Brad?

BRAD: Yeah, exactly. Basically, the S&P 496 without those 4.

PATTI: Crazy. What's the rate of return?

BRAD: 3.48.

PATTI: 35% versus 3.48. We see this from time to time, but that is an incredible difference and really speaks to when we talk about the market, what are we really talking about. It's really NASDAQ. It's really those major companies.

BRAD: I don't know if there are very many portfolios on Earth that have kept up with the NASDAQ in the past five or six years.

PATTI: Amazing. So let's go back to COVID. The market has recovered, seems to be looking optimistic, as state by state, things begin to open up.

Here we are as we record this, it's mid-July. Now, all of a sudden, the number of cases are rising and states are beginning to rethink their policy and beginning to shut back down again.

So given that, we don't know – we never know – whether or not we're actually out of a recession. Certainly, the first quarter, second quarter, deep, deep, terrible contraction. Who knows what this quarter is going show, right?

BRAD: Sure.

PATTI: What do you think about where we are with the economy, and what do you think about a second wave?

BRAD: Sure. Yeah, there's a few things there. I think COVID wise, you almost have to rely on a vaccine at this point. We're going into an election.

If you just think of the math of herd immunity, if you made the argument that 10 or 15 percent of the country's been exposed, I think a lot of people would argue and doctors will differ here. But if you think 60 percent of the country have been exposed to it for herd immunity, you're looking at potentially another 175 million people that would have to get it in order to have this herd immunity.

Even at a very low, think of a one percent mortality rate, I don't know that any politician can take on that kind of risk. You almost have to keep the economy in some kind of state of not quite open yet. I don't think that in an election year anybody can explain away those numbers. You just have to wait out the vaccine.

PATTI: It is going to be really, really interesting in how the government responds to all of that. Not only from a policy, in terms of shutting down the economy again, but then what do they do to keep the grease on this machine to make sure that we don't really go into a deep, deep contraction.

This is kind of a side bar. We're going to be recording another set of podcasts on the government response as well as the Federal Reserve response, what that really means, why they're doing it, what that could lead to in terms of our tax rates, inflation, and what it could mean for our children.

BRAD: Sure.

PATTI: Brad, you're so good at this in terms of breaking down the really complicated stuff into something that is digestible, and people can grasp. Boy, there's nothing more complicated than all of that.

Going back to this. Let's say that we get a second wave, double-dip recession. What do you think about the probability of that? Even if we're coming out of it. As we were talking, you marked the recession. Even if you have a little bit of improvement, the recession is theoretically over.

BRAD: It's a funny idea that we could technically be out of the recession already. Nobody's ever going to announce the end of it.

But if you say that the second quarter was the worst, in terms of GDP, even a very small fractional gain in quarter three, means we're technically out. Growth off the bottom is usually not that difficult, especially if GDP is down a significant amount, and you just have a 10 percent return to what you were before, then you're ahead.

A double-dip recession is certainly not impossible. It's happened before. I was just a little kid at the time, but I think in the early '80s that was probably the last one. Usually, there's so much pent up demand that it's really hard to not grow a little bit off the bottom and avoid that double dip. But it's happened before.

Not to always talk about politics, but it seems to come down to that. You really have to bungle the response if there was a second wave in order to have a re-complete shutdown of everything and go back to even worse than where we were.

PATTI: I think you're absolutely right. Let's take personalities out of the picture, forget, just talk about leadership.

BRAD: Someone's going to be president. We don't know who. That person will be responsible for the second wave if it comes back in the fall.

PATTI: Sure. The market's response to that - if I can make a crystal ball prediction - I have this feeling, I have this belief that even if we get a second wave, and even if states have to shut down, I don't think the market's going to freak out like it did in March. This thing of FOMO, fear of missing out, is very real.

BRAD: Sure.

PATTI: So many people sold stocks in March and never got back in. Nobody expected this kind of recovery this quick...

BRAD: Right.

PATTI: ...when the market was losing 3,000 points, 2,000, 1,000, up 500, but then right back down again. It was a really, really scary period of time. The people who sold never really got back in, because they were expecting that's the way markets do perform. They go back up, but then they go back down. It's a head fake, right?

Of course, we had the talking heads that said fundamentals are really bad. There's no way that the market is going to recover that quickly, because we don't even know what the earnings are going to be. Those people who sold said, "Gee, I was right. I'm going to wait until after it goes back down."

BRAD: A better entry point.

PATTI: Yeah, the old story. It hasn't. That train left the station.

I believe, can't guarantee it, don't know for sure, but knowing human behavior, I think if we do get a second wave, and if the government does have to shut down - I'm not even sure they're going to do it as drastic as they did before, but they might - the people who would sell again or sell this time, basically saw how the market recovered so quickly and are like, "Well, I don't want to miss out."

BRAD: Right. There wouldn't be so much volume going down.

PATTI: Exactly. That's what makes it. It's a self-fulfilling prophecy.

BRAD: Right.

PATTI: While nobody knows, and we do have an election to add and compound the issues, a lot of things are going on, US, international, trade. Isn't that interesting how all of the sudden, nobody's talking about China, and that was what everybody talked about a year ago.

BRAD: Right, sure.

PATTI: These things are always going to happen. There's always going to be reasons to be worried. There's always going to be reasons to be toning down the portfolio, etc. I will tell you, as you know, our belief. We believe that you tone down the portfolio as you approach that period of time of needing the money.

BRAD: Right, exactly.

PATTI: It's a time thing. That should serve.

Looking at another statistic. One of my favorite podcasts, for anybody listening today, is a podcast called "Animal Spirits." It's Ben Carlson and Michael Batnick. What I love about their podcast is they do a lot of this they kind of tease each other and jostle each other.

We do that an awful lot here at Key Financial, but we kind of keep it clean for the podcast.

These guys are so smart.

I was just listening to a recent one. They came out with a number that blew me away. To give the proper person credit, it's Jeff Wininger, who is a real data fiend. He's really terrific when it comes to calling the data, looking at the opportunities and things of that nature.

The top 100 companies in the US stock market, as measured by size, when you combine those, they are larger than all other public companies in the entire world.

PATTI: Isn't that amazing?

BRAD: Yeah, incredible.

PATTI: That is amazing to me in terms of market capitalization. The big are really getting bigger. They happen to be located, for the most part, most of them are right here in the United States.

BRAD: I've actually heard the argument that actually could continue as big data becomes so important. The people that become large then have an advantage of having the data too, and they can become larger and larger.

PATTI: Absolutely. Again, it becomes another self-fulfilling prophecy. We're not going to make investment decisions based on that information, right?

BRAD: I guess with the size of the companies in particular?

PATTI: Here's the thing. I would say that, again, knowing our philosophy, etc. We are certainly going to overweight the United States, and we also overweight large, because we're looking at market capital, we're measuring it, and things of that nature.

BRAD: Sure.

PATTI: Having said that, this is not the time to abandon the other asset classes either, right?

BRAD: Right.

PATTI: Small companies become mid-size companies and become large companies. That's how those companies got there. Some of them did it really quickly, right?

BRAD: Sure, absolutely.

PATTI: Even though we come out with these stats, we talk about large, it's not to say, "Hey guys, just get rid of those small company funds that you have. Get rid of the international stuff that you had. By all means, bonds are dead money, so get out of that, too."

The principles of asset allocation and diversification that have been tested over every economic environment and every situation, they work over time. They don't work every time.

BRAD: Right.

PATTI: But they work over time. You want that compounding working for you.

BRAD: In every time there's been some example of something that's been doing really well when everything else hasn't that convinces you that you should abandon diversification and just go into that thing. But the recent 10 years, the large-cap growth has really been the thing.

Even value has not done well. Small-cap stocks have not done as well as large growth. You could really convince yourself that you could make a lot of money for the rest of your life if you only just bought US large-cap growth.

We have to believe. We don't know what the reason is, but eventually, that will end and something else will cycle and become a good performer again, too.

PATTI: An interesting stat that you actually came up with for the investment committee meeting. Again, a really, really wide dispersion with the Russell 1000 Value, that particular index is down 15 percent. It lags growth by 32 percent.

BRAD: That's just this year.

PATTI: That blows me away. That absolutely blows me away. That is really something.

Brad, it's beginning to feel a lot like the end of the '90s, where large-cap growth, large-cap growth, you had Greenspan in 1996 talking about irrational exuberance.

BRAD: Right.

PATTI: It just year, after year, after year, '96, '97, '98, '99, and same thing. Here, we preach diversification, etc. Back then, rightfully so, clients were like, "Well, Patti, we don't understand why you keep trimming off the large growth and buying the stuff that isn't doing anything." Like, "Let's not do that."

The problem with that is that if you don't trim from time to time, that overweight, it grows to so much, and then when it crashes, which it did, then you lose so much more money.

BRAD: Sure.

PATTI: Trying to keep people in 1999 in small-cap value, it was a Herculean effort, because that just had done nothing. Again, small companies' value underpriced, yada, yada, yada, whereas growth is going up, 30-35 percent per year. Then in 2000, don't you know, what happened to growth? It crashes and small-cap value is up 23 percent.

BRAD: If you don't trim, too, that position or that asset class becomes a larger and larger percentage of your portfolio. You can almost grow into a risk exposure that you weren't prepared for or didn't even understand you had.

Just when the thing is about to crash, you're at the highest investment percentage you've ever had in it.

PATTI: Again, use the math and let's make this real for people. You put $100,000 into something, and it grows year-after-year 20, 30 percent, 15 percent, and it's now worth a million dollars.

Well, if it's like what happened in the tech bubble - let's even just say it loses 50 percent, not the 70 percent that many of those companies lost, and many of them went out of business - now, you've lost $500,000.

Again, trimming is a good idea. You're never going to be out of everything or anything. It's just diversify, asset allocation, those principles. Again, they don't work every time, they work over time. You want to get that math, that compounding working for you to build true wealth.

BRAD: Sure.

PATTI: In the meeting that we had, you made a very interesting comment about comparing the earnings yield on the market versus the BAA yield. Can you talk to that a little bit for everybody?

BRAD: Yeah. Historically, it's been a good comparison between bonds and stocks. If you take the P/E ratio, let's say a normal P/E ratio is 20. That's high, but whatever. We're just making up numbers here. The earnings yield is the inverse of that. Instead of price to earnings, it's earnings to price. You would have an earnings yield there of five. The inverse of 20/1 is 1/5, so you've got a five percent earnings yield.

PATTI: By the way, folks, what you are listening to right now is a person who was a dual major at John Hopkins in applied mathematics and economics. This guy has just got a machine in his head. I couldn't do that math, but he can. You know what, together, this is what you get. It's amazing.

BRAD: Yeah, just need a pocket calculator and you could figure it.

PATTI: You don't even use a pocket calculator. Don't even say that, Brad.

BRAD: [laughs]

PATTI: You just do this stuff in your brain. I need the pocket calculator. But go ahead, I'm sorry. We digress.

BRAD: No, that's fine. That's a good way to calculate the yield of a stock, which is a weird consideration. Then usually, historically over the past 25 years, the spread between that number and the yield on BAA bonds, an investment grade bond, is actually very, very narrow. It's always very small. Almost 0.02 percent is the average gap there.

Right now, it's over one percent, which would suggest that stock prices aren't necessarily very low, are very high relative to bonds. In order for that number to align itself, either stocks would have to go up in price or bonds would have to go down. It's interesting.

It's a foggy number, because it's based on forward earnings, which is tough to figure out, especially if you don't even know what businesses are going to be open in three months. It's an interesting idea there.

PATTI: It also speaks to this concept of when interest rates are so low, it's OK for the P/E multiple to be higher. You used the number 20. When you look at long-term average, the long-term average is closer to 15, but you hear a lot of people saying because interest rates are so low, then it warrants and it's OK that the P/E is higher. It goes back to that whole concept of TINA, right?

BRAD: Yeah. You'd expect stock prices to go up when bonds are really unappealing.

PATTI: The fact of the matter is, like I said, TINA. There is no alternative.

BRAD: Yeah, you have to pick something.

PATTI: You got to pick something if you're going to invest. You're going to stick it in the bank, that's dead money. You're going to put it in a bond, the Treasury is paying all of 0.7 percent right now, and you're going to lock it in for 10 years, and by the way, you got to pay taxes on it.

BRAD: [laughs] Right.

PATTI: Dead money for 10 full years, or you put it into the S&P 500, you get a dividend of maybe two percent. By the way, that's taxed at a better rate, 15 percent tax instead of ordinary income, and you get paid to wait.

This whole idea of it's OK with interest rates being so low, the P/E multiple is going to float up, may not be representative of literally how expensive stocks really are. Given the behavioral aspect of all of this thing called investing, given the fact that there really isn't a very good alternative, I'll just stick it in the S&P 500 and go into a coma.

The coma thing works really well, because 10 years from now, I kind of have to believe, I don't about you Brad, but I kind of have to believe that when that Treasury bond matures, and you get your principal back, you got all of your 0.7 percent, again taxable at ordinary income, I got to believe that the S&P 500 is going to be worth a little bit more.

BRAD: I think that's a fair bet.

PATTI: What do you think? OK.

BRAD: I would take that.

PATTI: TINA is alive and well.

BRAD: Absolutely.

PATTI: This is kind of, hmm. I haven't said this out loud, but I'm going to say it out loud to you, and we're going to pretend that there aren't thousands and thousands of people listening to this. I wonder if this isn't all kind of orchestrated.

I wonder if maybe the government and the Federal Reserve know that that's going to happen, understand this concept called the wealth effect, which by the way, we see all the time.

The wealth effect, for those of you who are listening that I'm pretending that you're not listening, the wealth effect works like this. When people get their monthly statements, we, as a billion-dollar firm, get phone calls.

When those investments, that portfolio is down, they are nervous, and they are like, "We were thinking about doing A, B, and C, buying the car, doing this renovation, etc., and we're not going to do that, because we don't think it's a good time."

They're worried. When they get their statement three months later, they're feeling really happy. They're feeling warm and fuzzy. This wealth effect is alive and well, and they're like, "You know that renovation that we wanted to do? We're going to go ahead and do that now," and they go and spend that money.

That is a powerful concept. Again, those of you who are listening, we're going to record the next two podcasts. I hope to take this very complicated subject and explain why spending is so important to keep this economy alive and well. It's really important. I think that there is so much misinformation out there, and the headlines do not tell the story.

This idea of this wealth effect. The Federal Reserve, they're smart people. The government, again setting aside personalities, there are some pretty smart people there too. They learn. They learned from the Depression. They learned from Pearl Harbor.

They've learned from when Kennedy was shot. They've learned from when we went off the gold standard with Bretton Woods. They learn, they learn, they learn.

They learn what works. They learn what was not nearly as effective. They learned what has more of a lag effect. They learned. I believe that they're getting better at it. I believe that what they're doing now is the result of all of that learning. It'll be really interesting to see how this...

I can't wait for five years from now. I don't know about you. I just can't wait to see in hindsight how this thing all worked out. Did what they've done and what they might do with the stimulus. Did it work? How quickly? How effective was it?

Then I'd also be interested, again five years from now, when this is a semi-coma, it's not the long-term coma. When I wake up from that one or we all do, what the international markets based on what they did, how did they do compared with the United States.

To pull this together, we've been talking about this. We always talk about this as a team, our investment committee. Let's talk about what we've observed and how that has influenced our decisions in terms of what we do for our clients and what we do for their money.

Let's talk about bonds.

BRAD: Yeah.

PATTI: Take it away. What are we doing in bond portfolios? What do we think about bonds? Is it something that people should be investing in, given what we just talked about? It's pretty much dead money. Why bother with bonds in general, and what have we done as it relates to our client portfolios?

BRAD: We use bonds for two things. The primary reason is for cash flow. If you have a certain amount of money you need in a year from now, especially at any given time the stock market is volatile. If you need money a year from now, that money should not be in stocks.

PATTI: Just to clarify, Brad, when you say for cash flow, you're not talking about living on the interest on the bonds.

BRAD: Correct. You'd have to have a pretty significant portfolio to be able to live on the interest on bonds nowadays. The principal will be far less volatile than holding a position in equities. We have it there as a go-to place that we trust will be there when we need it, and rate of return is way down the list of things that we care about from a bond.

The other reason is stability. Just for mental health, you want to be able to sleep at night. Not every client can, and they shouldn't have to, bear the ups and downs of the stock market if they don't...

We always start with the financial plan first, what kind of rate of return do you really need, and then we back into how much volatility you can bear to accept, and then find some compromise there in terms of how the portfolio should be allocated.

We want you to have enough equities to reach your goals but not stress you out any more than you have to be stressed out.

PATTI: It was really interesting. First of all, when you think about where bonds are today, and you think about a 50-50 portfolio, a 50-50 portfolio today, if half of it's in bonds at one percent, you're going to get a half a percent, right, from that part of the portfolio.

BRAD: Right.

PATTI: If the other 50 percent is in stocks, let's pretend that you think that stocks are going to do seven percent. Half of that is three and a half. The total rate of expected return on that portfolio is four percent.

A lot of people may not be OK at a four percent rate of return, right?

BRAD: Right.

PATTI: It was fascinating. Jeremy Siegel on another interview, he came out, and I thought it was really interesting. He believes that 75-25 is the new 60-40. Isn't that interesting?

BRAD: Because bond yields are so low.

PATTI: Right, that people are going to be forced to accept more volatility in the equity side of their portfolio to try and give them the opportunity to get a higher rate of return, because if takes 5 or 5.5 percent to achieve your long-term objectives, you're going to have to stomach the risk that comes along with that, because we're not going to get it from that half of the portfolio that's sitting in bonds.

It's always comes back to financial planning. Everyone is different. What's the need? What's the ability? How are we going to orchestrate this from a cash flow perspective?

Again, it's time.

We do this five-year cash flow. We know how much money each client is going to need from their portfolio for the next 5 years, for the next 10 years, and for the rest of their life, and we build the portfolio to make sure that there is no risk with that shorter-term money. That's our go-to money.

We may not even use it. If the market's going nuts, we'll re-balance, and that would be a great place, too. Give them their $5,000 a month.

BRAD: Keep selling stocks.

PATTI: Yeah, because we have to re-balance anyway, so here you go. You need it anyway, so that we don't get too out of balance, but in those times, as we had them in March between the tax laws harvesting and the re-balancing, we lean on that safer money.

BRAD: Yeah. The bonds allow you to let the stocks go through their cycle.

PATTI: Exactly. With that in mind, we made a change in the fixed-income side of the portfolio. Why don't we talk about that?

BRAD: Sure. Kind of coinciding with the drop in interest rates over the past several years, most actively managed bond funds -- and not to a large degree, but you have to find rate of return somewhere -- so usually the best way to find extra rate of return in bonds is to drop the credit quality, invest in something that is not as high grade.

Maybe you go from government bonds to corporate bonds, or you go from corporate bonds to barely solvent corporate bonds.

What we were finding is that a lot of the bonds that we invested in were steadily degrading in quality. We used to have significant allocations to government bonds in our core offerings. Over time, again, in the chase for yield and rate of return, the credit quality dropped, and the government bonds were taken out of a lot of the core holdings.

We made an allocation change from global bonds, which were also on the edge of being high-yield debt at this point and sold that. We already have specific allocations to high yield. We want to know that what we allocate the high yield actually is the only risk you have in high yield. We don't want to put 10 percent in high yield and find out you actually have 20 because some other holding had it, too.

As international bonds started to drift down in quality, we made the decision to move from global bonds in general and move into US government bonds. Lessen this hidden high yield exposure that we had and then kind of return to the government bond positions that we used to have hidden in other positions.

PATTI: The rationale behind that also is it's a different kind of a hedge. Our research has shown that when stocks are freaking out, and going down 30-40 percent, what does really well? Government bonds. By the way, the longer the maturity, the better it does.

To have that hedge, again, to smooth out that return, it's a really important aspect of managing a portfolio. When you're hoping to have that, and it's not there anymore, you want to make sure that that's being managed.

The other thing that was important in our research is that as we were going through COVID, you found and I found in all of the research that the stimulus and the government programs -- whether it be the central banks or the government programs -- what we were doing in terms of all of that, the fire hose approach from both entities, was huge.

To give you an idea, in the United States, those people who are receiving unemployment benefits, two-thirds of people getting those weekly checks are making more than they were when they were working. That is incredible stimulus. There might be some moral hazard.

Those people are not going to want to go back to work. Why bother? That program's going to end at the end of July. There probably might be another stimulus program where it gets extended. They're taking about lowering that extra $600.

That's what we did. Then we compared it to the central banks of Europe, Japan, etc., as well as what they did while all of this stuff was happening from a government response.

It wasn't as robust. In France, for example, they did a lot, too. France was the biggest stimulus, if you will, in Europe. They were replacing 80 percent of a person's income. It wasn't 110 or 120 percent. That's OK because that's their thing. Only time will tell.

What we have learned is that that stimulus, and what the Federal Reserve does is really, really important. I am not sure that the international markets are going to do quite as well as the United States, or at least the economies.

We're learning, we know, the economy is not the market. They are two completely separate animals even through a lot of people think they work hand-in-hand.

BRAD: Right.

PATTI: They sort of do, but they don't work hand-in-hand. It gave us pause. To brainstorm on that whole thing, we made a significant change in our retirement accounts. Why don't you talk to that?

BRAD: Because of that, I think there's a tremendous advantage, especially at a time like this. Give or take a few percent, I think the US is 51 or 52 percent of the world's market caps and stocks. There's only one or two organizations that are responsible for making all these decisions on stimulus, interest rates, and things like that.

The other 50 percent of market cap is a phenomenal amount of parties involved. The idea that there's a real cohesive organized effort there to coordinate that, the policy response can't be as quick and as large as what we can do here.

In longer-term accounts, when there's no tax impact, we made the decision to go from strictly international investments, strictly ex-US investments to a more global approach, where a manager can navigate the policy responses and say these seven countries or areas we really like, these three we don't. Within that, then say which companies and sectors are going to have a pretty good chance of working their way through this.

Rather than just, say, give them a bigger opportunity set to pick from, and say, rather than expecting you to choose only from international stocks, if there's a company in the US that you want to invest in, too, let's do it. There's opportunities to give them the ability to look across that whole perspective.

Again, back to that market cap stat, we have 50 percent of the market cap, but 75 percent of the best performing companies since 2011 are out of the United States. There are phenomenal opportunities there.

PATTI: Let's go back to that. People need to process that. That's really important, because when they look at their investment mutual funds, they think when my investment mutual funds haven't done that great, what's going on?

Talk a little bit about the currency influence on rates of return.

BRAD: This has always been, well, not always, but call it since 2013, has been a very deceptive part of what we think how the world stock markets are performing. International markets have not been that bad. They haven't been that great to a US-based investor.

In order to invest in a company overseas, you have to convert their currency back to dollars to sell your investment. You could argue that in a given year, anywhere between four and six percent of an international investment you've lost because of the appreciation of the dollar compared to the international currency. That's been going on for seven or eight years now, and that's a pretty big effect.

PATTI: It sure is. In their own currency, these companies are doing fine and dandy. They're doing great, right?

BRAD: Absolutely, yeah.

PATTI: When you look at it that way, then 75 percent of the companies are doing better than the US.

BRAD: It works the opposite way. There's been times that the dollar has significantly depreciated versus other currencies. There would be a significant you call it kind of a tailwind behind international investments.

Not only are you investing in companies overseas that are doing well, you're also benefitting because you're invested in their currencies instead of ours, which has depreciated at times. The cycles are not quick. It's always kind of a 5 to 10-year range. It happens all the time.

PATTI: Just to close this loop, where is the dollar now? Is it up? Is it down? Where are we on that?

BRAD: It's been a very long upward trend, but it seems to have flattened out a little bit. There's two kind of effects, and they're working oppositely each other, so the dollar's really flattened out.

There's the trade deficit. We buy a lot of other country's stuff, because theirs is cheap and ours is expensive. They don't buy ours, because ours is expensive and theirs is cheap. We flood the world with dollars to buy these things, and you would think, theoretically, that should eventually work to devalue the dollar.

The opposite effect is that our interest rates are still higher. For foreign investors to invest in US interest rates, even as low as our government debt is paying, it's still higher than…

PATTI: What they can get.

BRAD: …everybody else. That creates the opposite effect of demand for dollar. They're kind of offsetting each other to a certain degree.

I guess you would think that as interest rates collapse, all toward this very low number, that the effect of causing dollar demand is probably diminishing. Eventually, it has to end, whether it's this year, or three years from now, or whatever. It can't go up forever.

PATTI: Again, we do not want to abandon international all together.

BRAD: Exactly, yeah.

PATTI: Boy, that would be the last thing you'd want to do, especially at this point in the cycle. When you look at that, the dollar moving sideways in the global, it makes a lot of sense.

Why didn't we do that in the non-retirement accounts, Brad?

BRAD: The problem is with asset classes don't move together. You have bonds going up and down that don't even correlate to each other. Short-term bonds can go up and down differently than high-yield bonds.

Let's think of the extreme case. You buy a balanced index fund, a 60-40 portfolio, the entire holding can go up even though there's components of that that have gone down. By segmenting your portfolio more, you can pick and choose which parts, even though your whole portfolio is going up, 40 percent of it may be down, but that gives you a tax loss opportunity.

You can kind of capture that for your taxes, reinvest, keep the allocation the same. But you've got these different component parts that you can pull out.

If you need cash, you want to be able to pick where to take it from. Not just have this bundled mutual fund that doesn't give you the choice of whether to sell stocks, bonds, international, US, whatever. The more we can segment, it gives you more flexibility and option when you need the money.

PATTI: Option is the magic word. It goes hand-in-hand with optimizing. What we're trying to do is optimize, not just for rate of return, we're optimizing for risk. We're optimizing for time and cash flow. Most importantly, taxes. Taxes, taxes, taxes.

The more that we can save money on taxes for our clients, it doesn't show up on their quarterly reports, but it can have a material impact over time.

BRAD: Sure.

PATTI: Brad, thank you so much. This was great. There's a lot of content here. We could talk all day long. It's a good summary of where we are, what we think about where we are and what we're doing about it.

BRAD: Thanks, Patti.

PATTI: Thank you so much for taking the time to join me and join everybody else, who's really not listening to this podcast. [laughs] But you're listening.

Thanks to all of you. Thank you for joining me and joining Brad. Thank you for always tuning in. I can't get over how many people are listening to these podcasts week after week.

We're really grateful. We're so hopeful when we do this that it's providing some value, taking some really complicated stuff, boiling it down into terms that you can understand, help you to see why we might be making certain decisions. If you have any questions, go to our website.

By the way, that whole concept of the depression, and why I don't believe that we're going to go into another depression, in about a week, we're going to be launching a white paper that will go over the 15 reasons why we don't think we're going to go into a depression now or ever.

It's a paper. It's educational. We're going to build on that thought leadership. We're going to talk about there's going to be another one that's going to launch on the government debt and how it's basically setting records every single day, and what we should think about it. We're going to talk about the Federal Reserve and have another white paper on that.

We're trying to add the thought leadership that we kind of have within our four walls. Actually, it's more walls than that, but between our walls. We talk about this stuff all the time.

I want to share it. I think it's so important, especially during times like this for all of you to have access to the information and give it to you real. We're not going to paint this great, rosy picture if it's not a rosy picture. We're also not going to say it's the end of the world if we don't think it's the end of the world.

With that, I thank you again. Thanks for joining me. I hope you have a great day. Take care.