PBS Ep 156: The Evolving Relationship with Stocks & Bonds

Patti Brennan: Hi, everybody. Welcome 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.

I'm really excited about our show today. Joining me is none other than Brad Everett. Brad is our chief investor. Stop. Joining me today is Brad Everett. He's our Chief Investment Officer, and we're going to be talking about stocks and bonds. Specifically, is the traditional relationship between stocks and bonds, is that broken, never to be seen or benefited from again?

Before we start, let's not be like most advisors in the world today. I'm not going to make the assumption, Brad, that everybody understands what a bond is and what a stock is. It sounds really fundamental. I think it's really important, especially given the topic that we're talking about today. Can you explain to our listeners what's the difference between a bond and a stock?

Brad Everett: Yeah, I think we could make it a lot more complicated, but I think at the very basic, a bond is debt. A company borrows money and then agrees to some repayment plan, which you pay back the original amount that you borrowed, and then there's some additional interest cost.

The cost to the borrower, that interest, is the income to the lender, the person that funded the bond or lent the money. Some loans cost more than others or have a higher interest cost than others.

The interest could be based on several things, credit quality, the borrower, the duration of the loan, general market conditions, interest rates, inflation, supply and demand, all these things that go factor into whether it's cheap for this company to borrow or more expensive. Is the interest rate low or is it high and the value of that.

Debt itself can change based on any changes in those factors that occur while the debt is outstanding.

Patti: Excellent. Basically, bonds, if I've got a $100,000 bond out there, I have lent, for example, IBM $100,000. If it's a 30-year bond, over the next 30 years, every three months, they're going to pay me some interest. At the end of that term, they're going to pay me my money back, my $100,000 back, right?

Brad: Yep.

Patti: That's called par. When you get the same amount that you lent to them, you get par. There's different types of bonds. You could lend money to the federal government. That's a treasury. What other kinds of bonds are out there?

Brad: There's local governments, so you could, municipalities, toll roads, things like that, for local building projects and things like that. But foreign governments, foreign corporations, all kinds of things.

Patti: The interest rate that you would get is based on those factors that you mentioned earlier, and basically the creditworthiness of the company or wherever you're loaning it to, right?

Brad: Yeah, that's part of it. If IBM is struggling with cash flow their business prospects aren't good, maybe you want a higher interest rate because of that. If they tell you they're going to pay you back in two years, maybe you would demand less of an interest than them saying they're going to give you your money back in 10 years. Yeah, so there's lots of things that can go into that.

Patti: Sounds good. The bond market we were talking about earlier before we started, the bond market is so much bigger than the stock market. A lot of people don't realize that. Bonds get traded a lot more than stocks do.

Let's talk about stocks for a second because that sounds good. I get money all along the way and then I get my money back. What could be wrong with that? By the way, depending on the type of bond, that interest you get could be tax-free. If it's a municipality. If it's a treasury, it could be state tax-free, etc. There's income tax considerations as well.

What about stocks? Why stocks? What's the benefit of that, owning a slice of IBM or another company?

Brad: Yeah, so that is the difference. With debt, you own a slice of the debt and you are entitled to some repayment. A stock actually gives you a small slice of ownership in the company itself.

Ultimately, the stock owner is entitled to the earnings of the company. You don't get that on a monthly basis. Normally, there's a board of directors or a management team that chooses what to do with the earnings. Either they pay it out in dividends, they reinvest it in the company in the form of earnings, investing it back into the business.

If you're going to reinvest in the company, maybe you have an idea that you can improve operations, capacity, efficiency or something like that. Theoretically, with the goal of increasing earnings over time.

As an owner of the company, you don't get your earnings, they put it back in the company. But if they do a good job of reinvesting, the price of the stock should grow as earnings grow because of the improvements to the company. That would be the idea of owning a stock.

Patti: We toss around these terms, growth, and value. What you've described, if they're reinvesting those earnings, which it's all about the earnings. If they're reinvesting their earnings back into the company, the idea there is that they're going to grow, in such a way to have even higher earnings down the road so the value of the company explodes, which is a growth company.

A value company would be one that, you know what, we're just going to pay those earnings out to our shareholders in the form of dividends. Dividends are taxed at a more favorable rate than, say, a bond might be and the stock's going to do whatever it does.

Brad: They might have a great product that they sell a lot of right now, but they don't see internally opportunities to reinvest in the company. Maybe they don't have any ideas for bigger growth projects. They just say, all right, well, we made $100 selling such and such at the grocery store, so we'll just pay all that back out to the investor.

Patti: Something you said is really important. It's really up to the board of directors to make that decision. For example, when things aren't going so hot, for example, Boeing. Boeing is going through some rough patches here.

They suspended their dividend. They're not paying anything when they were historically paying a dividend every quarter. When a board of directors suspends or decreases their dividend, what happens to the stock price?

Brad: I guess it depends what the market believes is the reason. If they think it's because of a sign of struggle or lack of cash flow, I would think, detrimental to the business.

Patti: Exactly. A company like that has suffered as a result. Now, here's another question. I'm just we didn't plan on getting into this, Brad, but I'm going to put you on the spot.

Brad: Sounds good.

Patti: Why in the world would you ever invest in a company like that when the stock has gone down and they're not paying a dividend? What would be the benefit to the person who is investing in you know, a value company. That's a term.

Brad: I guess you would have to agree, you would have to believe that the price is already adjusted to account for the bad news. If the market has accounted for all the problems and you think the future value of the business is worth more than the current stock price, then it could certainly be a great investment.

Patti: You just brought something up that's really interesting to me. At the end of the day, the market is a market just like real estate or any market. It's just a bunch of opinions. The fact of the matter is. You are a mathematician. You're a whiz when it comes to these things and numbers.

At the end of the day, those decisions are based on whatever they believe, and they're going to invest accordingly. Some people believe that the stock is going to continue to go down and want to sell it. Some people think, "Oh, man, it's bottomed out. I'm going to buy low" because, hey, it's a great brand. They own the market. There aren't many competitors, and eventually, they're going to figure it out. Those are opinions, and that's basically influencing the price.

Stop. Can I have my paper?

Tech: It sucks. All right. I know. There we go.

Patti: That's OK. Is this all right? Are we getting into the weeds too much? I don't know. We'll figure it out. OK. We're just having a conversation because a lot of times this is the stuff that we talk about in meetings. I think people really appreciate the fact that it's in the conference room. I'm not assuming they know any of this stuff.

Right, good. Yeah. OK, that's good. As I look at my notes. Yeah, yeah, yeah. Flopping on the floor. OK. All right. It's a bunch of opinions. All right. Tell me when I can OK. OK. To pull this together, stocks versus bonds, we understand the relationship. You can have a...Stop. We understand how stocks and bonds work and the pros and cons. Here's a question I'm asked a lot. Why are bonds considered less risky than stocks?

Brad: Well, I guess, one...I'd say a great question.

Patti: Time out. Here's the deal. Just talk about, say, well, if IBM goes under, they have to pay off their debt before the shareholders get a penny. Look at what happened with GM during the financial crisis. Stockholders got nothing, but the bondholders got at least something.

This thing's driving me nuts, by the way. OK, go ahead. The thing, because I want to go. Yeah. No, no, you're good. Can you see it?

Tech: No, it's fine. If you just give yourself some slack.

Patti: I did. We're good. OK, so.

Brad: A bond is a contract and the company's obligated to pay that back first. The shareholders have nothing until. the debt is paid off before.

If something happens, in your example of an IBM bond, if IBM goes bankrupt, anything that happens as they sell off their equipment and products and things like that that they have left over, all that money would go back to the bondholders first and the stockholders would probably have zero.

Patti: Isn't that interesting? That's exactly what we saw during the financial crisis with General Motors. A bankruptcy judge, made the decision and paid off the bondholders first, but not all of their money, and stockholders got nothing. They got nothing. Then they redid their stock, and here we are today.

Brad: The opposite's true too. You would never pay the bondholder more than the very minimum that you have to be obligated to pay them. Then as long as they have enough money to pay that off, everything else goes to the stockholders.

Patti: Got it. Now let's fast forward 2022. Here we have this relationship, theoretically, that, hey, as long as you have stocks and bonds, you're well diversified. If one goes down, the other one goes up, and you're good. Well, we certainly saw in 2022. That didn't happen.

In fact, for those of you who may have been watching very closely that year, there was a point in time where bonds were down more than stocks. What's going on, Brad? Why did that happen?

Brad: Yeah, I think the natural logical relationship that you would think of between stocks and bonds is inverse. When stock prices rise, bonds fall, and vice versa. When stocks are rising, it's because investors are buying stocks. where do they get the money to buy the stocks? They sell something else. They're selling their bonds to buy stocks.

Patti: If I may interject, that's basically what we saw a lot of when interest rates were near zero. They're like, "Oh, I don't want to get one percent when I can at least get a dividend of 2 or 2.5." Go ahead. Sorry.

Brad: No, that's all right. Oppositely, if stocks are falling, it could be that stocks are out of favor and you can have this flight to quality, where investors are leaving what they perceive as a more volatile stock market to buy this "safer bond." You would see the opposite sell one to buy the other.

Patti: It's a supply and demand thing.

Brad: I think if you think of fund flows, to buy something, you have to sell something else, and there are other asset classes. We could go farther into the weeds, but obviously, bonds and stocks are the two big ones. It gets more complicated when you think of cash and private investments and things like that, debt that you could take on.

That makes it a little complicated, but usually, to buy something, you have to sell something else.

Patti: Excellent.

Brad: I think this inverse relationship historically can provide great diversification. If you have these offsetting returns in your portfolio. Historically, the comfort in that relationship is that you can kind of, without getting too much into the weeds of portfolio volatility.

If you have multiple assets, you get the weighted average return of those two things, but you could actually have less than the weighted average volatility of those two things if they have a negative relationship and kind of offset each other a little bit. Your return doesn't suffer, but your volatility can be significantly less.

Patti: Basically when I hear that, in English that tells me you're losing less when things are bad in the market and therefore you are going to recover much faster.

Brad: Yeah, that's the other side of it too. If your account, their portfolio trades within a narrower range. We could get into the difference between a mean and a Geometric mean rate of return. But yeah, I think...

[crosstalk]

Patti: That's why they pay us the big bucks, right?

[crosstalk]

Brad: Yeah, if you can reduce the downside, all else equal, I think you're better off long-term.

Patti: Very good. Very good. OK. We understand how that relationship and at least the theory. What has been happening in the last few years in terms of that relationship? Because they sure don't seem to be providing as much diversification benefit.

Brad: We've really only talked about this idea that the only appeal to bonds and stocks is like the non-appeal of the other one. There's just a lot more to it than that. I think, you have this comparison effect where the appeal of stocks is based on bonds not being appealing or the other way around.

Maybe I'm nervous about stocks, so I'll buy bonds instead. But that's just like such a small part of what prices react to. There's so many other things at play that determine whether the appeal of stocks or bonds exists other than just each other.

I think in a recent case, it's probably more inflation. A rapid increase in interest rates that that caused them to start moving together, not necessarily the characteristics of each other. There's this third thing at play to distort that what we think of as the normal historical relationship.

Patti: Let's explain to everybody listening. What happens when inflation begins to tick up, it peaked at 9.1. What happens? Why is inflation the thing that both stocks and bonds don't like?

Brad: Yeah. I think when you have this normal low inflation, which is, the zero to two, two and a half percent inflation is the normal operation of things. Stocks can grow under a predictable, stable inflation regime bonds will continue to pay interest and coupons and things like that.

But there's almost like this hurdle when it's almost maybe sentiment-driven, but you get to this point where inflation seems too high. Then things start to act a little funny.

In the case of 2022, in response to higher inflation, the Fed and central banks everywhere started raising rates fairly rapidly, which is bad for bonds. There's a way more predictable relationship than between stocks and bonds is between bond prices and interest rates. That almost never fails. If rates are higher, bond prices will drop.

I think stocks can handle a little bit of inflation because as long as wages of the people that are buying the stuff are earning incomes or they're growing incomes fast enough to offset the increasing cost to companies to provide the things that they want to buy.

The company's expenses are rising, but consumers 'incomes are rising too. They could sell the same amount of stuff. If wages aren't rising and the cost of production is rising rapidly due to inflation. You've got that part of it, but then you also have all the debt on their balance sheet is being rewritten at higher and higher rates. Stocks don't look great either.

Now you have this time in 2022 where both really, really got whacked at the same time.

Patti: Since we're doing fundamentals, you and I do a role play. By the way, we didn't practice this, so we're going to pretend.

Brad: Give it a shot.

Patti: OK, give it a shot. Let's assume that you hold a bond. Pretend it's $100,000, OK? You want to sell it, you need to sell it, whatever, OK? Let's assume also that I want to buy a bond, and I got this wonderful $100,000, I got an inheritance, whatever, OK?

Now, let's assume that your bond is paying three percent, and new interest rates have risen to five percent. Now I have one of two choices. I could buy your bond, $100,000. For the next 30 years, I'm going to get three percent.

Or because it's a market, I can choose to get a new bond from that same company or municipality or whatever and get five. Hey, it's America. What do you think I'm going to do?

Brad: My only choice as the holder of the bond would be to reduce the price of it until it's appealing to you. Then the interest rates would equal.

Patti: For the record, $90,000. I'm not buying it for 90. You've got to go lower. Right?

Brad: [laughs]

Brad: Yeah.

Patti: Well, all right. See, that's the thing. It's a market. It's one of those things where we go back and forth. Brad, in that example, has to figure out. How much does he have to lower the price of his bond to entice me to buy it at that lower price, knowing that I'm only going to get the three percent per year.

Brad: Because in reality, I could do the same thing. I could take your $90,000 that you give me and then go back out and buy a $90,000 bond at the new interest rates.

Patti: That's why they're trading so much.

Brad: Probably just go back to the same place I would have been anyway.

Patti: What's the most important thing -- let's tell our listeners -- when you're looking at bonds, individual bonds, or what a bond manager. It's not the coupon, which is in English, it's the yield. It's the yield to maturity. It's math.

This is one area of the market that math is math is math. There are other factors is it insured, yada, yada. Now we understand why prices for an existing bond go down when interest rates go up. Then in the stock market, because the stock market isn't just looking at earnings today.

They're looking at, well, what are their earnings going to be next quarter and next year and yada, yada. The CEOs of their companies don't even know. They figure it out and say, "OK, interest rates are higher." Then their earnings are going to be lower as a result. I don't want to pay so much for this stock. They sell it.

Again, when I'm talking about they, it's mostly institutional investors that are doing their calculations. Now we get it. 2022, they both went down. Fast forward, here we are in this new interest rate environment. Yeah, we can question the benefits of diversification in stocks and bonds.

Let's talk about that. Should we bother? Should we even bother?

Brad: I think so. I think whether something is very minimally positively correlated like to say something as a .1 correlation correlations run from negative 1 to positive 1. Perfectly opposite all the way to perfectly in line so something that's like .2 correlation is a little bit correlated.

The difference between .2 and .1 and like negative .1 is subtle. I think there are still tremendous diversification benefits to being just a little bit correlated. In reality, to find something that's negatively correlated to the S&P is extremely difficult. There's almost nothing.

Over the last decade, maybe commodities, cash, and managed futures are the only ones with actual negative opposite correlation.

Patti: In English, and I keep on saying that, Brad, I know you speak English, but I need real basic English. Basically, what I'm hearing is they are correlated positive or negative. If stocks are going nuts, the other thing isn't doing so hot. Then if stocks are losing money, this one's up negatively.

[crosstalk]

Patti: There's nothing that is perfectly negatively correlated. By the way, we probably don't want that anyway.

Brad: I was going to say, I don't think the appeal of negative correlation is not even that great to me because we could. We could have things that totally offset each other all the time and guarantee that we never make any money at all. You wouldn't lose any, but you also wouldn't make any.

To have a perfect offset, we could buy the S&P and immediately sell calls at the same place and just guarantee very little money. We would have two things that had negative correlation. I'm not sure that that's really the appeal.

In terms of stocks and bonds, even if they're slightly positively correlated, it still gives you tremendous benefits in terms of moderating returns. If the S&P is down 10 and your bonds are down 2, then in your 50-50 investor, your portfolio is only down 6. Sure, they both moved in the same direction, but just not as drastically. You've smooth out return in between those two extremes.

Patti: Excellent. Let's go. All right. We are where we are. What do you think going forward? We're here to advise people about, and I'm going to timestamp this. This is what June, June 5th of 2024. We are in this stable interest rate environment. The Fed hasn't really done anything quite yet.

What do you think investors should do in an environment like this, whether we are and we could talk a little bit about hard landing, soft landing, or no landing at all. Let's do that. People are hearing that, Brad. I think we should just put it out there and say, "All right, this is basically what they're saying."

Brad: That will probably define the relationship between stocks and bonds going forward is like which one of those it ends up being. Whether it's hard, soft, or no landing at all. The probabilities are evolving so your original question of what you should do about it...How much are you willing to bet on one thing or the other happening?

I think you want to be prepared no matter which one happens. Again, major institutions have a lot of money on the line. They would like to know which of those things is going to happen, and they want to assign probabilities to that and have insurance and hedging one way or the other.

I think for most of us as regular investors, I think, what can we do to make sure that we're OK no matter which of those happens and we don't have to be so dependent on making a bet on one of those things or the other.

Patti: Especially because people who are making strong bets one way or the other at the beginning of this year were probably wrong. Everybody was saying interest rates were going to go down by now, yada, yada, yada. Getting back to this hard landing concept, a hard landing is, and it sounds like we're flying planes.

Basically, it's a hard landing. In other words, they're talking about the economy. GDP and a hard landing would be if we are headed for or in a recession. I don't know if I told you this, but I heard something today and I wish I could give the woman credit.

Historically, at least, when a recession occurred during a tightening cycle or after a tightening cycle, historically that recession started. 10 quarters after the first-rate hike. What that would mean in today's environment is, OK, if we were going to do the average, we're headed for a recession in the fourth quarter of this year. OK, so go figure.

A hard landing is a recession that the economy really suffers. Unemployment goes up. People are losing their job, etc. The headlines and people are freaking out. What's a soft landing?

Brad: I think a soft landing is the Fed or whatever central bank. It just has the perfect speed of raising rates to try to slow down the economy, that the economy slows down at a reasonable pace without going so far as to have those same problems.

You get inflation into the range that you're comfortable with without creating the job loss, without spiking interest rates so high, so quickly that companies have a hard time paying their debt off. That's when you have problems like you said in the hard landing and you would head into recession.

You can avoid a recession or you would have maybe a very mild recession in the event of a soft landing. I don't think anybody officially defines a soft versus hard landing. I think it's more of like guideposts for how to think of the extreme nature of it.

Patti: It's interesting. I think the first time I heard about soft landing was when Alan Greenspan was the Federal Reserve chairman and he got us where he wanted us to be without putting us into a recession. That's interesting. OK, so now what's this no-landing scenario?

Brad: Yeah. No landing, I guess, would be you somehow have this drift toward the inflation number that you would like to have but it goes very slowly and almost stagnates at a level that's probably a little higher than what you would have wanted, but not so high that you're willing to continue to raise interest rates to get down to where you're at.

I think you've almost like you've done most of it, to get inflation down from six, seven, the really lofty numbers down to, you said you wanted it around two, but what if it stops at two and a half or three?

Do you say, hey, all right. How much do we care about this last half a percent? Do we the economy is still growing, albeit slowly, but it's growing. Are we willing to stop that to get rid of the last half a percent of inflation?

I think, you've got this real. last bit of the decision there. You've done most of it. Right. How far are you willing to just get the rest of it?

Patti: That's really been the argument recently because inflation peaked at 9.1 and they got it down. They raised like crazy so fast and markets crashed because they thought,

" Oh, for sure, we've never seen them do this this quickly."

Here we are, inflation's, it got down as low as three percent. More recently, it's been about three, four. They haven't done anything. The Federal Reserve is data-dependent. That's what they keep on saying.

What I'm hearing and what I think we're all hearing is, well, maybe the Fed is going to be OK. Maybe they're going to change that target from that two percent, fixed in stone. Maybe they're OK with three.

Especially since it's an election year. I think it's also interesting, especially because it's an election year, you're hearing these rumors of the Fed. Are they really independent yada, yada, yada. If they cut rates in, for example, September, what are the optics of that?

Given that backdrop and because every time is going to be different, nobody can predict. It is an election year. Given their role as independent. Given the fact that, we're doing OK. We may be growing slower, but people aren't losing their jobs left and right, which is the big thing. These are families. I mean, this affects people.

Maybe they'll just keep it the way they are. Given that, OK, let's boil this down. What are we telling our clients? What do we tell people who are listening today?

Brad: Yeah. If that's the way it ended up being, how does that flow through to stocks and bonds? I think we would live in a world where interest rates stayed higher than certainly what they've been for the past 15 years.

I think knowing that you were going to have higher rates for a longer period of time, I think in a lot of ways, the longer end of the bond curve has been largely unaffected. I mean, it's been affected, but not quite like the short end.

If you thought that rates were going to last longer, maybe there's now maybe more of the natural upward-sloping yield curve. As longer-term debt gets rewritten at higher rates, thinking that it might stay because there's been this real unwillingness to commit to borrowing at higher rates because I think everybody's believed that rates won't stay up that high.

I'm like, I don't want to borrow at six percent right now, knowing that I, in a couple of years from now, I can borrow at four and a half.

Patti: Which is very interesting. I'm glad you said that because that's affecting the housing market. People don't want to go out and sell their home and get a mortgage and pay seven plus percent. They're not doing that.

Again, this is where the concept of a market really becomes powerful and the implications. The long end of the curve, you mentioned that. Now, when we think about that, Brad, the longer-term rates, meaning for a 30-year bond, for a 20-year bond, those are long-term. What's weird right now is they're actually paying less, or the long end is you get lower interest rate than the short end.

The Federal Reserve, again, just to kind of bring it home. They manage or they influence the short-term bonds. The long-term bonds is the bond market. Again, opinions. What do we think bonds interest rates are going to be in the future?

Brad: The expectation of future short-term returns. You could look at a bond, a 20-year bond as a chain of linked one-year bonds between now and then. If you have the short end of that is very high, but then you expect the next 17 years to be fairly low that blended out is something lower than what they are today.

You have this expectation theory that if we all believe that rates are going to drop, long-term debt certainly can be cheaper than short-term debt. This no-landing scenario would theoretically lengthen this beginning period of higher rates. Then maybe you'd see. longer-term rates adjust accordingly.

Maybe that fixes it. Maybe all the people that were sitting on the side, not willing to buy a house at seven percent, have to just hold their nose and do it because three years from now, it might be the same thing.

Patti: That's exactly right. For those of us, and I'm showing my lines in the middle of my forehead here there have been many periods of time during our history where interest rates were much higher for a long period of time.

It's not the worst thing that could happen if they did stay higher from an economic and a stock market performance and a bond market performance. Historically at least, if you look at the math of things, when you look at long-term average annual returns, the rate of return that you get on that bond piece tends to be about the interest rate, in the environment in which you invested, right?

Brad: When we started, yeah.

Patti: Yeah, so that, to me, understanding, and you know, and we all know, we're looking at things holistically, and we're going to tie this together in terms of, what do we think is going to happen this year, next year, etc.

What really matters? Nobody really knows what's going to happen, so what are we going to do about it? We've got to look at this holistically to figure out. When are people going to need the money? That's what really is the question, right?

Brad: Yeah. I think we've been talking about this relationship between stocks and bonds as if...In a general sense, that's the only thing that matters. The relationship of different types of bonds to each other can be very different. The relationship between different kinds of stocks to each other can be very different.

If we're the difference between how we would handle this for somebody that's adding to their portfolio, accumulating assets, that's 35 years old and is 35 years from retirement. The way they would combat inflation is totally different than somebody that's taking cash out on a monthly basis.

Patti: That's the biggest risk we have, isn't it? The inflation risk. There's a reason why the Federal Reserve is they're really paper-focused on inflation because it really hurts people. It really does.

That's the biggest risk that investors have in terms of they've got to make sure that whatever they're doing increases at, at least the rate of inflation after they pay their taxes. That their rates of returns, the purchasing power of that dollar remains about the same. Ideally, it's going to grow.

A dollar becomes dollar. That's the whole point of accepting the volatility of stocks. You hope that it's going to work for you and grow in value after inflation and taxes. That's the goal.

Brad: Otherwise, you don't want to there's no reason to do it.

Patti: Right. I'm going to end with this because we're just talking about stocks and bonds. But, hey, 5.3 percent on an institutional money market account that we're getting right now, that's not bad. Why not just do that?

Brad: Yeah. I think that's a valuable tool for that group that is taking money out right now. Again, the relationship to stocks and bonds is not as important for somebody like that because we're more worried about the relationship just among around interest rates itself.

Cash and short-term bonds will respond very quickly to increases in interest rates and the same as they will increase decreases in interest rates. We want to have things available...They need money next month. We need to make sure that thing is available next month.

Patti: Irrespective of what somebody is saying on TV. By the way, the other thing I heard this morning, another opinion on one of these talking head shows, they think that interest rates are going to go up after the election. Not go down, go up.

It's all across the board. When people are talking about this stuff, it sounds so rational. It makes so much sense. Yeah, I could see that happening. Well, it just goes to show you nobody really knows.

We want to be prepared for anything, which is why that cash bucket makes so much sense for people who really know that they're going to need the money for retirement, tuition, whatever the case may be. Excellent.

Relationship between stocks and bonds really hasn't changed that much. It never really was a perfectly negative. It's just that, one may lose less or earn more than the other, That's been historically, and that hasn't changed.

Brad: I think actually the positive relationship is more historically common than the negative relationship.

Patti: The negative correlation has really happened only like 31 percent of the time in the history of the market. This is more normal than people realize. I thought your point about within that asset class, there's lots of different types of bonds, There's lots of different types of stocks. Boy, is this year a perfect example or what?

You get the tech stocks and stocks and then, the mega, tens, or whatever they're calling them. Stop. What do they call them? The top ten stocks? I forget what the term is. But anyway, you've.

Brad: All right. The Magnificent Seven.

Patti: Thank you. We've got this year is a perfect example. You got the Magnificent Seven, setting records and going nuts. Now they're growing at 30, 40, 100 percent. Whereas the rest of the market's not doing so hot. But they're making money. They've got their earnings, etc. Nobody wants to invest in them, but there may be good values.

Then the bond market, a lot of people say, "Oh, why not just buy a bond, buy a treasury?" People can do that. But boy, sometimes there's a lot of value to having that, actively managed even more so than maybe stocks.

Brad: Sure.

Patti: Because there's so many different kinds and so many different things to consider, not just interest rates.

Brad: Right.

Patti: Excellent. If I hear you right, what you're saying is, OK, fine and dandy, we're going to have whatever we have this year. Nobody knows what's going to happen. There's a lot of talk both ways. Interest rates are going to go up. Interest rates are going to go down. The economy seems to be humming along just fine, thank you.

The Federal Reserve it doesn't seem to be in a rush to do one thing or the other. The most important thing that people listening today that they need to consider is what? Fill in the blank.

Brad: Well, I think we almost end every conversation talking about how it comes down to an individual's plan and cash flow. I think it's just that alone is the first place in determining what asset allocation is appropriate, right?

Patti: If you set it up ahead of time now, this is where I get on my, whatever. What is it? Yeah. OK. I'm going to get on my soapbox here, as you well know.

Really the key here is what your financial plan is saying and when are you going to need the money and what are you comfortable with? What's not just your risk tolerance but your capacity to accept the risk without putting yourself in position where you could run out of money?

Brad: Then within that overall framework of 100 percent equities to zero bonds or 50 50, 70 30 or whatever it is, we on our side want to figure out what the risks are and, are they likely or are they unlikely? But then what would we do, to prepare for any of those things happening?

Brad: Excellent. Basically, what you hear me say a million times here, and that is, I want to understand what's going to make that family fail. I want to understand where they are vulnerable.

You've got to run the numbers. There's no guessing. You can't guess on this stuff. It's just too important. Because you know what? We don't want a client and we don't want anybody listening today to do something and then be 75 years old and look back and say, I wish I hadn't.

Nobody knows what's going to happen in the future, so you just run the models. What if this happened? What if that happened? That's stress testing. That we understand at least in advance what their capacity is to accept whatever that thing might have been.

Whether it be inflation, whether it be higher taxes, whether it be this or that, somebody getting sick, things of that nature. It's those cash flow surprises, I think, that people are often surprised how impactful that really is, on their portfolio and the decisions that we make.

Anything else?

Brad: I think that's it.

Patti: Sorry for my soapbox, Brad. You know me. I do tend to get on my soapbox there. It's just so important, I think.

Brad: Absolutely.

Patti: I know you have too. You've had those conversations with clients. Thank you so much for joining me, Brad. This was really fun. Again, it was fundamentals. We did get into the weeds a little bit. Hopefully, there's something here for everybody, right?

Brad: Yeah, definitely.

Patti: Excellent. Thanks to you for joining us today and listening to us going back and forth and bantering. Brad's so smart and he's got the math all up here. Thank you so much for bringing that down for all of us mere mortals that don't have your intellectual capacity and your intellect. Stop. What am I saying?

Brad: [laughs]

Brad: No, keep going.

Patti: You're doing great. All right, all right. Come on, Brad. All right.

Brad: Just another minute or so.

Patti: Right. I know. Here we go. How long are we talking? All right. Oh, my goodness. OK. Mostly thanks to all of you for listening to Brad and I for 45 minutes as we talked about the fundamentals, stocks and bonds, and even cash, how they work. Is the traditional relationship between the two completely broken, never to be seen again?

Most importantly, what should you do about it, especially in this calendar year? What changes should you be considering? Thank you so much for joining us today. I'm Patti Brennan. Brad Everett, you are the best. Thank you so much for joining me today. This was fun. Thank you.

If you have any questions about this or any other topic, please feel free to. Go to our website at www.keyfinancialinc.com. Even more importantly, on this day, June 5th, 2024, I hope you have a great summer. Take care.