Barenaked Money Podcast, October 8th, 2021

Episode 24: We interrupt your previously scheduled podcast...

Announcer 1:

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Announcer 2:

You're about to get lucky with the Barenaked Money podcast. The show that gives you the naked truth about personal finance with your hosts Josh Sheluk and Colin White, portfolio managers with WLWP Wealth Planners, iA Private Wealth.

Colin White:

Welcome to the next episode of Barenaked Money, where we get bare naked and talk about money. No, that's not a thing. We're just going to talk about money. Hopefully the bare naked got you interested. But hey, what's got everybody's interest right now is markets have plummeted. Haven't they Josh?

Josh Sheluk:

Plummeted. You're you're going to your media headlines type of mode. Aren't you Colin?

Colin White:

I just repeat what I hear.

Josh Sheluk:

Tumultuous, free fall, all these words I think we've seen the headlines come across.

Colin White:

Yeah, no, that's exactly what I'm playing off of so I'm going to trust you to walk me back from the edge and explain to me and put this in context, Josh. Can you help us out?

Josh Sheluk:

Well, yeah. First and foremost we should probably just start with what are the issues that we're seeing right now that are leading to this mark and downturn? Just to put it in perspective, we're not talking about a huge pullback here, maybe five-ish percent right now as we record this podcast. Which historically speaking, this is a blip. We have this happen quite a bit when you're investing in stocks throughout time. That said, people are a little bit worried about things. What are these worries and where do these worries stem from? Well, I think one I'll throw out there that we've been talking about a lot and seeing a lot of those headlines is China. And China is doing some crazy stuff and there's some crazy stuff going on. Most recently, the China Evergrande story that we had talked about I think on a short recording in the past.

Josh Sheluk:

China Evergrande, just to summarize for everybody, it's a 300, I don't know if it's 300 billion, but it has 300 billion in debt. It's a property development company in China, has 300 billion of debt and about 200,000 employees. It's a pretty sizable operation and they have recently defaulted on their debt or missed some of their, their debt repayments. It's a concern I suppose, and not so much with the company itself, but what happens, the question is what happens if some of these, these debt issues start to spill over to other companies in China? China is a very big economy, second largest economy in the world, pretty important to the global economics. And I think more importantly than that, the issuers of this debt or the banks that are financing it rather, the financial institutions that are financing it, could we start to see some issues with them if you have these massive debtors fail to repay?

Colin White:

Yeah and I think this is where we should put the disclaimer in, we think that has something to do with it. But again, knowing exactly what caused a market to move at any point in time involves untangling of the spider web that historians could work on for the next 20 years before they truly understood it. Josh you're pointing us it is very topical, it is top of mind for a lot of people and it's reasonable to expect there's some kind of causal relationship between that news story and what's going on. I'm not sure

what all the other stories are that contribute to this or frame of mind or a weather system somewhere in the Pacific or the triple witching of the contract expiry and the European Union somewhere. But yet there can be lots of little things that we go to unwind, but emotionally I think you probably have hit it on the head.

Josh Sheluk:

Yeah, well, there's millions of market participants and we're not sure what is driving each of them on any given day at any given minute during every given hour. There's, it's definitely hard to unravel all of that and you can just look at the headlines to identify some of the issues that we have trying to identify what the issues are with saying, "Yes, this is the cause of this and this is the cause of this." A lot of times the media will ascribe an issue to, or a pullback to one specific issue. And often there could be hundreds of different issues on any given day. And it's hard to say that, "Yes, that was definitely leading to that." And you'll see sometimes where it's like day one oil goes up, markets pull back, people are concerned about higher oil prices. And then day two it's like higher oil is good for producers, markets up today. This doesn't make any sense. Like you can't argue both sides in the same argument on two consecutive days.

Colin White:

Yep. But then again, I think emotion does play into it a little bit and I do think that the China is of a magnitude that does reverberate a little bit, at least from a storied perspective, if not from an absolute perspective. But to your point Josh, I don't think that these kind of pullbacks are unusual, like from a percentage bases. I think listening to you talk, not that long ago about how this is the largest pullback since 2020. This is largest pullbacks this last year? Really? That's the headline we put on this.

Josh Sheluk:

Yeah.

Colin White:

Wednesday's the worst day of trading this week. Yeah, it's only Wednesday. It's not a big data set you're pulling from there.

Josh Sheluk:

Yeah. It's like I said, in the grand scheme of things this is not really that significant. Yes it's the largest pullback in a year and a half, but we've had pretty consistent and

steady markets I'd say. Unusually steady and consistent markets over the last year and a half so having a bit of a pull back here is not shocking. I think people seem to be forgetting that markets tend to be pretty volatile. Again, nothing abnormal here that is taking place, at least not yet. You don't know what's going to happen next, but certainly it's not shocking.

Colin White:

Why don't you comment on the likelihood that we would see a big market drop absent a recession. [inaudible 00:06:09] How much of a correlation is that?

Josh Sheluk:

Yeah. So just to give some context to why we say this is a pretty normal occurrence. If we go back to 2011, global stocks have declined by at least 10% in every one of those calendar years, except for 2017. We're going back 10 years, nine out of those 10 years the market has pulled back more than 10% within that calendar year. And I believe that we've only had one negative calendar year during that period of time. So from January 1st to December 31st only one time markets have been negative over that period of time. Yet nine out of 10 years the markets have pulled back at least 10% during that calendar year. Again, totally common occurrence for stocks to pull back. That doesn't mean that the end of the world or that you should run out and sell because a lot of times it is just a temporary pullback and things continue climbing after that.

Josh Sheluk:

Now what you are pointing to is when do we have some really severe or prolonged pullbacks? And when should we really be concerned about that? We define a severe prolonged pullback as anything that's more than 20% sort of top to bottom in terms of downturn for the stock market. And typically, and I believe there's only one instance that type of pullback has occurred outside of a recession and that was 1987. What we could look at is what's happening with the economy as a whole? And if we think the economy as a whole is still on solid footing or still growing, then it's highly unlikely that we see a significant and prolonged pullback as I've been calling them. So something significantly more than 10% or into that 20% and beyond range. When we look at the economy today, we're still just recovering from the recession that we had last year. Which by the way, accompanied a 20% pullback in the markets or more.

Josh Sheluk:

Growth this year is going to be very strong, I think that's clear. Growth next year is on track to be pretty decent. And we still have a massive sort of shortfall in the people that are working. There's a lot of people out there in the labor force that are looking for or should hopefully soon be looking for jobs. As more people work, the economy should continue to improve. Businesses will continue to make money. People will get paid money and spend that money and that should continue to drive the economy higher. Our point of view right now is economy decent, at least stock market. Yeah, maybe pulled back here and there but should continue marching higher in the bigger picture.

Colin White:

All right, so let's stop being cold heartless mathematicians. And let's admit that this makes people feel bad, Josh. And feeling bad is an okay thing. It's part of life. We can look at all kinds of things as to why people feel bad. And some of it comes from, "Hey, look my account. This is the absolute top number my account ever was because I watch it every day. Anything less than that, I feel like I've lost money." And if that's how you're going to do your bath, there's going to be a lot of days that you're not going to be happy because there is undulation in returns. Anchoring to that big number is setting yourself up for [inaudible 00:09:36] . You're not going to be up every day if you're exposed in the markets.

Colin White:

We're having conversations with clients as we record this where, yeah they're down 3% or 4% from their peak, but the accounts are pretty much exactly where they were three months ago. You've got just as much money as you had three months ago, three months ago you were ecstatic. Today you're apoplectic because you're going to lose all your money. It's the same balance in your account. So just take a look at it from a couple different perspectives and hopefully that will give you some comfort and start to allow the natural feelings that you're having that are okay to have that are very valid, gradually dissipate, slash showing yourself and allowing yourself to see this from a couple of different perspectives. Are there any other favorite cognitive biases that you've been talking with clients about recently, Josh?

Josh Sheluk:

Yeah. There's lots [inaudible 00:10:30] these are always interesting I think. This is a field of study called behavioral economics or behavioral finance. I think you and I are both pretty fascinated with. And actually if you don't like anything about finance or

economics you may still like this aspect of things because it really gets into psychology and some of the sociological aspects of our day to day life. It's really a fascinating branch of study of the whole finance and economics thing. Couple things that you talked about there, calling it, I think are super interesting is you're constantly living in a state of regret if you're looking at your account every day. Because three quarters of the time markets are not in an all time high. So they're making all time highs about 25% of the time, so one out of every four days. But three out of every four days you're living in regret because you could have sold the day before at a higher level. But that doesn't preclude the idea that markets tend to go up over time and you'll be generally better off if you're holding onto things.

Josh Sheluk:

It tough when you're looking at things every day and actually there have been studies that have shown the more frequently you look at your account, the worse you tend to do as an investor. Our first word of wisdom from this podcast, don't look at your account every day if you don't need to. It's not really necessary, we're doing that.

Colin White:

The other action, other reaction people have is the bias towards action. Something terrible is happening therefore I have to do something. And again I've used this analogy before and forgive me for those I'm repeating it to but it's aced in how we evolved as human beings. And when the saber tooth tiger came into the camp, the group that got up to fight the saber tooth tiger, some of them survived and they got to stay in the gene pool. The group got up and ran away. Some of them were successful and they stayed in the gene pool. The group that just sat there to see what was going to happen next, they all got eaten. There's nowhere in our genetic makeup to just sit there and see what's going to happen in a time of stress. If you're looking at your account on the regular and you're good at getting stressed, you're going to have a bias towards action. And that normally revolves in, "Hey shouldn't we have sold or should we sell now? And should we buy in later?" Which is a whole market timing thing. And Josh what's your opinion of market timing?

Josh Sheluk:

Doesn't work. Doesn't Work.

Colin White:

Did you want to use more words there?

Josh Sheluk:

Not really.

Colin White:

All right. Well.

Josh Sheluk:

Okay but you know, here's the thing. One it's very difficult to do, if not impossible. Very challenging and one of the things that we usually look at is, okay maybe you get it right one time, but then you got to get it right a second time. Not only do you have to sell at the right time before the market pulls back, but you need to buy again in the market when, after the market has pulled back. And that's very challenging for people to do.

Josh Sheluk:

First of all, you're fighting all these biases that we're talking about because when things are good, you have a natural tendency to want to allow those things to keep going. When things are bad and you have a natural tendency to want to avoid that. It's the last thing you're going to want to do when things are bad to put your money back into the market. If we were here in March 2020 and the COVID pandemic has banished everybody to their homes for the foreseeable future and we tell you now is the perfect time to buy if you've been sitting in cash. What do you think you're going to do? You're not going to be dumping a whole bunch of money in the stock market. It's a bit of a mugs game, I think in both [inaudible 00:13:49] .

Colin White:

The other thing is let's just go back to March 2020 as the example is you decide to dump your money in. My follow up question is, how long have you been sitting on it? Because it's a very good chance you've been sitting on it and the market hasn't even pulled back to the date you actually had been sitting on it. You feel all smart with yourself because you were A) had the money B) had the courage to do something. But if you've been sitting on it long enough you actually were still buying in at a higher point than you could have gotten in the market a few years.

Colin White:

But again, opinion is that market timing doesn't work. You need to get it wrong. You need to get it right too often in order to be effective. And even if you get it wrong once

every 20 times, you can wipe out all of the gains that you've had from getting it right. We're not going to hold ourselves out as market timers because we don't think it's possible. And these things that are natural and they happen the best thing it's just to ride them out.

Josh Sheluk:

Yeah. One of the other biases that I think is really topical right now, at least for us is recency bias. This is the tendency to remember things that have happened most recently, first and foremost in your mind. And what we had happen this year, people have a really short memory. What we had happen this year is markets have basically been up almost every month. Up to September. When you have such a good, consistent, steady run for stocks and then you have this pullback all of a sudden you're like, "Wow, this doesn't really happen that often, like what's happening?" But if you look at the, again, the bigger picture, the longer term you would see that yeah this type of thing happens all the time. You just need to go back a little bit more into the past to remember that.

Colin White:

Yeah and there's interesting things that creep in again. When people call up to complain about losses it's, "My account is down $20,000, $40,000, $80,000, whatever the number is." But when it's up, they talk percentages. So you have a conversation with somebody and they say, "Yeah, my account is down $40,000." Okay. "Well that means I have to work an extra year."

Colin White:

No. How did you get there? How many buses do you have to get on to draw that conclusion? You're thinking your account is permanently down that amount of money? It's confusing of fluctuation of a market. Because again it's recency bias. If my account is dropped by this much, within three years I'll have no money left. No, just because it happened in the last month, doesn't mean it's going to happen every month for the next three years. That's not reasonable. That's not how the world works, but it is how our mind works.

Colin White:

Again, all due respect to people's minds because they are human and they behave in human ways, but there's a lot of things built in there that cause you to feel that it wants to act which can be acting against your self-interests. There's a lot of studies

have been done about how much we feel pain versus pleasure and depending on the study, it's two to six times. If you feel happy, it takes six times as much happy to make up for one unit of pain, depending on what field that you happen to be looking at. But it takes a lot more happy to make up for a little bit of pain. There's a real motivation for people to never see their account go down. But the problem is Josh, we gave them that alternative to say, "Hey, we can put all your money into GIC's at 1.4%?" "That doesn't make me happy." "Okay. So where do you want to go from here?"

Josh Sheluk:

Yeah, it may make them happy in the short term when they don't see their account going down. But 10 years from now when they run out of money because inflation's been running 3% for 10 years, they're not going to be too happy with us.

Colin White:

Yeah. It's a slow unhappy that reveals itself over time.

Josh Sheluk:

Sounds like almost a no win situation for us. Doesn't it?

Colin White:

We are a little masochistic, but it's a choice that we've made or a calling that we have.

Josh Sheluk:

Yeah. The other, the last one here I think biases that our first and fourth, I should restate that. Catherine edit this out. Another bias that is very prevalent right now is hindsight bias. And that's the bias where you look in hindsight and you say hindsight being 2020, I knew this was going to happen. I should have done this. I should have done that. And I think the thing today is, well, we knew that the market was high. We knew that the market was at all time highs. We knew that it was right for a pullback. We should have sold a month ago. And in this is hindsight bias at work. Perfectly in action. You did not know that markets were going to be down a month from now. You did not know if we stand here today you might say one thing's obvious. One was obvious, but it just wasn't.

Josh Sheluk:

It seems obvious now and we can go back to 2008, 2009, where we had the really big financial crisis. And after the fact there were so many people that came out of the woodwork saying "This was obvious, it was obvious that this was going to happen." And you look at their track record and say, "If it was so obvious, why you doing something at the time?" You were actively investing in the market, but you didn't actually see this. It just seems obvious in hindsight.

Colin White:

No because you take a look at the track record of people who are featured as having been prescient in a moment in time and this yeah, that was their one time. They had no track record before that and no track record since that. Law of large numbers. There's somebody out there who happened to time a trade just right now and I'm sure the microphones will find them. And I'm sure they'll be able to spin a very interesting story about why they were able to see this coming. But at the end of the day that person's always going to be out there because there's so many market participants at any point in time. You're going to be able to find the person who got it just right.

Josh Sheluk:

The next natural question for me, Colin, is you have all these emotions that are driving you, nuts. Making you panic, making you worried, making you do one thing or the other. How do you deal with it? What, what are you supposed to do with?

Colin White:

From what I've read about emotions in other people, because I've been told, I don't have much of a relationship with my own emotions. It's having a process. And it's funny because we did a presentation on stage one time not that long ago and we were having a conversation about process and the people in the crowd said it was almost like we were having a gag reflex. Process and process it's like, well process is the answer. It's having a set of steps that you repeat that have been proven to be successful in a variety of situations and that you're reflective on from time to time. But it's a process that you execute rather than trying to figure out how you feel. You know, what's my gut telling me? What direction should it be going?

Colin White:

But it's having that process and being reflective about that process and making sure that you put a lot of thought into your process. And in our case, it's about having a

group of people around the table executing it. That again we do have some different perspectives at the table. And try to remain, not getting over confident in anything. Because that's where you make the mistakes here. If you get really super over confident that things are going to go a certain way, that's where you can cause a problem. What would you add to that, Josh?

Josh Sheluk:

Yeah. Process driven, analytical, driven data driven. If you're taking these things all that way, all through an analytical lens, as well as having checks and balances in place and I think we have those checks and balances so as much as you say or there's something to deep down inside and calling that makes you act the way that you do, by having other people or contrasting opinions to act as that check and balance so if you're too emotional one way or the other, somebody can bring you back to center. All of these things are important. It all focuses around having that process, having a set of steps that is repeatable, dependable and proven to be effective over time.

Colin White:

I guess I would add, don't be confident. The smartest people I know aren't sure. And being super confident in what happens next or what you should do now and taking disproportionate wagers in a particular direction, whether that's going to cash or going to 40% cash or deciding all your money's going to be in energy or it's all going to be a Bitcoin. Being really super confident to what happens next, that's when you can blow stuff up. If you remain cautious in that I'm not sure which way this is going to go and you take a balanced, diversified approach to things, then the key to long term success is just not ever blowing yourself up entirely. If you can avoid that, then you dramatically improve your chances having financial success.

Colin White:

It's not about hitting the winning shot. It's not about being in the perfect asset class. It's not about getting one thing right. It's never about getting one thing right. It's about never getting every, getting a big chunk wrong. Being overconfident, we can look back. When Joe Biden became president that was going to be terrible with stock markets. The pandemic was going to crash the global stock markets. Donald Trump was going to be confident and either it was going to be good or bad depending on the point in time. But all these times people get super confident. If you acted on that impulse and behaved rashly and took a big bet or took a big decision based on that

belief, you could have caused yourself some very real, meaningful harm to your financial situation. Again, being really confident that you think what's going to happen. Just don't do that.

Colin White:

Thanks for hanging out with us. We hope you found this a little bit interesting. As always we're available questions and we do take requests. If you give us a request, who knows, we may show up being referred to in a future podcast amongst our tens and tens of listeners. There's a free t-shirt in it. Maybe. I guess maybe Catherine can get t-shirts done. We need swag. That's what we need, Josh. Swag.

Josh Sheluk:

Yeah. We'll send them something from our closets if we really need to. We'll come up with something.

Colin White:

Merch, sorry. The kids call it merch. We need to get some merch for our podcast.

Josh Sheluk:

I think it's getch. It's getch.

Colin White:

See, look I can't even keep up.

Josh Sheluk:

Yeah.

Colin White:

Thanks everybody.

Josh Sheluk:

Bye now.

Announcer 2:

This information has been prepared by White LeBlanc Wealth Planners, who is a portfolio manager for iA Private Wealth. Opinions expressed in this podcast are those of the portfolio manager only and do not necessarily reflect those of iA Private

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