Consider This Program

Episode Date:

March 14, 2020 Episode

On This Show:

Big Joe Clark, CFP®: Managing Partner and Lead Advisor of Financial Enhancement Group

Angi Kinser: Event Coordinator at Financial Enhancement Group

Show Notes:

Topics Include:

- Is This Another 2008
- Coronavirus And The Economy
- Oil And Your Portfolio
- Market Volatility Positivity

Decisions Driven by Fear

We normally do not talk about our investment process on the show, but with a drop that we have seen in the market, the questions that we're getting from the media, and the confusion that's out there, we wanted to go ahead and dedicate this show to you guys and give you a little bit of an update.

We had questions divided into two. We were asked a lot about the causes and then a lot of people were asking their options. Can you explain how fear drives us to make decisions?

We are wired to do three things: survive, thrive and do it on the least amount of calories possible. You've heard of the flight or fight part of your brain, in terms of how things function. People will always move away from pain before they move toward pleasure. Pain always trumps. What happens with emotion, you go into that fight or flight. Your first wiring is to survive.

Here's the worst part of all of this: the human mind always gets very frustrated and emotional when events that have occurred consistently change suddenly. If you have three years of the market going straight up, people tend to have a tendency to believe that it should go up that way and they erupt with fear and panic when it doesn't. The other is also true. When we look at the marketplace in terms of where it is right now, most times you see a market fall 20%, which constitutes bear market territory. When a market is working its way up, we call it a bull. When a market is working its way down, we call it a bear.

It's not just the drop, it's the speed of the drop. Is this another 2008? In 2008, we had a period of time that started off with what appeared to be systematic risk. That was simply the market melting down. We don't see the coronavirus as a systemic issue. It is going to cause an economic slowdown because of the issues with China. This is a normal part of a market cycle for right now. This is not a 2008 issue.

The Slow Boat to China

What's going on with oil, as well as the coronavirus? How in the world can a virus affect our market?

Let's start with what a virus is. On average, according to our medical experts, there's 8-10 new different types of strains of the flu every year. They have different capacities to take you out: the older you are, the younger you are, the health you're in, the more susceptible you are to them. We lose thousands of people to the flu every single year in the United States. We live in a world where nobody can afford to take a chance on being wrong. You need to understand that one of the big parts of this is that you can have it and have no symptoms or outbreaks for 14 days. That allows for a lot more spreading.

The oil story is actually bigger and deeper than the coronavirus. Stay tuned for the next segment. There's an old expression: "the slow boat to China."

In this case, the problem is the slow boat from China. The federal reserve had an emergency rate cut last week of about 50 basis points. When they made that cut, they did it because they see a slowing down economy coming. The manufacturing world has material that they can work with today, because China had slow boats that were coming over full of products. We had docks that were full of inventoryWe're working our way through those wells. Your inventory gets depleted on the dock. Now you've got this period of time that they have to retool up.

Right now we're hearing that they're at 60-70, maybe 80% capacity. As they retool up, they have to get those boats loaded again and start that slow trip back to the United States. We're hearing that people are going to be laid off. The mortgage companies are supposed to give you a break if you don't make your house payment. There's all of these things that are being discussed and laid out there, but they're disruptive to a business cycle. Are they disruptive to all cycles? The answer is no.

The federal reserve rate cut was not based on where we are today. It's based on where they think we're going to be in the future. There was a huge argument in the economic world of people who said it was the right call and others who said it was a bad call. Obviously when you cut rates, you can only cut them so far. The 30 year US Treasury is probably up 20%, if not more this year already. That is because of the drop of the yield on the 30 year and on the 10 year.

It's just dropped. If you had a 10 that had $100 that you were going to put in a 10 year US Treasury, you would get sent about $0.70. You'd get $0.35 cent checks over the course of the year. Two or three months ago, you would've gotten closer to $0.80 cents, twice a year ($1.61). It's been cut almost in half. It actually got down into the 30 basis point area. It's moved rather rapidly. One of my biggest concerns for investors who don't understand bonds is that people are trying to buy a lot of bonds right now at this very low interest rate. They're told that they're safe or they've seen the return. Brokers love to sell bonds. This is not the time to be adding to that equation if you don't have to.

The Oil Price War

"Success is never dependent upon one thing, but failure can be." James Clear, *Atomic Habits*

We're hearing a lot about the oil price war. We come from a period of time where if a news story broke, if it was in the press, you could count on it being true. Today there's not enough journalists to vet the story. As soon as the headline comes out, everybody's running with it. Your mind is still predisposed to believe the more times you hear it, the more real it must be. I don't agree that they've talked about oil enough. Russia had a deal with OPEC and when the price of oil fell on a demand situation, there was less demand for oil.

The natural response from an oil provider should be: will you supply less oil? If the demand is shrinking, you decrease the supply so you can stabilize the price. It makes sense economically. Russia and OPEC had a deal that they would both curtail the amount of oil that they were selling to the markets, except Putin pulled a fast ball and said, "no, we're not going to." Russia turned and started sending out more oil. They're financially in trouble, so they really couldn't afford to turn the coffers off. Saudi Arabia said, "you may be bigger, but we have more oil and slashed the price." The price of the gas tanks begin to drop precipitously.

It's interesting that OPEC and Russia are having this war, but how does that affect you? Here's what happens: a big part of our economy is based on energy base workers that are pulling out oil truckers that are driving the oil cutting. Oil companies are expensive to run and so they use a lot of debt, which is called leverage. When you hear me say they are very leveraged, it means they've used a lot of debt to finance their operations. They're betting they have to make a little over $46 a barrel on average to break even. When oil is selling for $35, you're losing money every time you have to put oil out.

The bond market says this is okay. Companies are being pulled out of one credit spread, but they're not measuring apples to apples when you're making that economic comparison. When people aren't buying gas and the refineries tanks are full, they can't take more oil. When the barges are at the docks full of oil and we have no place to put the oil, they're going to have to give the oil away for free. Then you have to stop the pipelines that are shipping all the oil over. All of this is problematic, for the economy and could be more long term than the coronavirus.

Q&A: Current Market Volatility

How does a market decline affect my 401k? Your 401k, if it's like most 401ks, is invested in various mutual funds. Inside of those mutual funds, you have stocks, bonds, and cash. When they talk about the market, they're typically talking about the S&P 500. Most people don't pay attention to the Dow Jones Industrial Average that much anymore. It just makes for great headlines because the number's bigger.

The S&P 500 had fallen 18% in 13 trading days. It's a big move very quickly. When that happened, the value of your 401k changed. It most likely went down. In your 401k, you've got various investment options from large cap stocks to small cap stocks, to international holdings, to bond funds, to cash. You have to have at least four different things. Those are the big broad areas. How your 401k did was impacted by what choices you've made inside of your 401k. One of the things we do with new families is help them allocate their 401k correctly so their inside money matches their outside money.

How will mortgage interest rates react? The interest rate yield is going down and they have not responded as quickly as the bond market yield. When a bond yield falls, it means existing bond prices or values go up. You can get confused on bonds very quickly if you're not careful. Professionals who sell these get confused too. The yield on the bond market has fallen. That would argue that the yield on a 30-year mortgage and a 15-year mortgage should have also dropped. It has, but not in an equivalent amount. You can get a 30-year mortgage right now somewhere in the low threes. I've heard some people say in the high twos. If you've got more than five or six years to pay on your mortgage, I'd refinance in a heartbeat.

Is it best to go through the same company or go out and find somebody else? It depends. It's who wants to do the loan? I don't know if they would be happy to refinance for you if they're already holding a note at a higher rate? No, because most of the loans are sold off. Most of the time, your bank is doing the servicing of the loan. That's how you make the payment too. They've sold the loan off in what's called a

CMO, or a Collateralized Mortgage Obligation, which is essentially a bond fund. Other investors actually own it. The only way they refinance it internally is if you qualify again.

Is now a good time to invest new money? It all depends on what you're trying to accomplish. If you are a longer term investor, this is a good period of time to add new capital. I've already fully funded my 401k for the year.

I've already fully funded our backdoor Roth IRAs for the year. I also know my timeframe and that's a hard thing to tell somebody specifically without looking at the rest of their financial resources. We call it dry powder. When you have money that's in cash, it's out of the market. What are your liquidity needs? It's really hard to answer that question for anybody with a general answer. I would not be adding anything at all to the bond side (to the fixed income side). I think that the market is far more overstated right now to the positive than the equity market is to the negative.

Is there an upside to downturns? Yes, absolutely. Benjamin Graham, who was Warren Buffett's mentor, is given credit for saying “in a market downturn, stocks returned to the rightful owners.”

FINANCIAL ENHANCEMENT GROUP, LLC

CONSIDER THIS WITH BIG JOE CLARK, CFP