Consider This Program

Episode Date:

May 9, 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

Andrew Thrasher, CMT: Portfolio Manager at Financial Enhancement Group

Show Notes:

Topics Include:

- Short-selling with Andrew Thrasher
- The 4% Rule & Your Retirement Budget
- Labor Friction
- Changes to RMD’s with the SECURE Act and the CARES Act

Short-selling with Andrew Thrasher

In a normalized marketplace, at the Financial Enhancement Group, we use three different ways of looking at the market. We look at it from the narrative (the standpoint of what we believe is going on in a long term picture), from the fundamentals (a valuation standpoint), and through the lens of what things are doing relative to one another. There are a lot of conversations right now over whether we're going to be in a V-shaped recovery or a W-shaped recovery. What is a short covering rally? What does that mean?

There's different ways that you can make an investment. You can make an investment by going long stock. You buy it. Let's say you have an interest in owning Apple or Nike and you think that they're going to be doing well in the future, so you buy their stock. You’re now an owner, a very small owner of Apple or Nike. If it’s the opposite and you think that Apple's not going to sell a lot of iPhones, Nike's not going to sell a lot of basketball shoes, you think their share price is going to go down, you can short those stocks. The way you do that is by borrowing those shares. You'd go to your custodian, TD Ameritrade, Charles Schwab, Fidelity, whoever it may be, and you say, “I want to short a hundred shares of Nike.”

They say, “Okay, we have some Nike inventory to loan to you.” Then they take out a position where they're now long Nike and then they let you short it through those shares. When we see the market have such a strong correction to a move lower, there are a lot of people that start shorting in that market, expecting it to go down more when we have a bounce. We can start looking at the data and say, “is this move higher based on people getting long (meaning they're buying shares) or is it because it's just those that were shorting are now unwinding those positions?” That person who shorted a hundred shares of Nike is now taking off that short, but he's actually getting long. It's not a bullish position to be able to get long Nike. He’s just no longer bearish on Nike. We want to evaluate the internals of the market and see the reasons that stocks were sent in whatever direction they're going in. That's something that I do every single day.

What does the covering really mean? What happens? Covering is just undoing that short position. When you go back to TD Ameritrade and say, “I've been short these hundred shares of Nike, can you undo that trade?” When you're short something, you then buy it back. Essentially you're buying them back. I'm doing it with a hundred shares, but probably not with a million shares. It depends on the size, but if you have enough of those people, it can then push those stocks higher.

One of the things that we'll look at is how much of a stock is being shorted right now? If we start seeing those stocks go higher, we know that there could be a short squeeze as those people cover those positions. That could then send the stock even higher. The squeeze is that pain point. The market is starting to go up, you shorted the stock at 50, it fell to 30. You thought you were in the money, then suddenly the stocks went back to 60 and now you've got a 20% loss. Because you've borrowed at 50 and the stocks now at 60, you're being squeezed. Whenever you do anything on a short, you're doing it on margin. You get the infamous margin call where you're being forced to liquidate positions and you have to choose them.

Are we in a period of a market recovery or a period of short squeezing? Where are we? I personally don't look at it from the short-squeezing viewpoint. Looking at it historically, we've seen the market come down a lot and then the market bounced a lot. That's fairly normal. If you were to bounce a ball on the ground, the harder you throw it down, the higher it's going to bounce. The market works in the same manner. That momentum that sent it lower, will be reflective when it comes back up. We've seen that now as we had a big recovery.

The 4% Rule & Your Retirement Budget

How much money do I need to be able to retire? There is a rule that was put into place that we don't buy into. It came from a guy named Dr. David Blitzer. Blitzer is the one who picks what company goes in the S&P 500. He's now controlled by Dow Jones. He made a statement back in the early nineties. That's where the 4% rule came from. If you put a hundred percent of your money in the S&P 500 and he pulled out 4% a year, you would never run out. That is inaccurate. I do not believe in it. However, there is a percentage that we believe you can use, but it's based on the current valuation of the market.

What are the latest calculations that we're hearing? It really depends on who you are. In accumulation, your two biggest objectives are to acquire as much wealth as you can and to save as much money as you can. We always say saving the right percentage of income, but where would you save it? I'm not talking about the stock market now. This is the thing that people forget about. It's from a tax standpoint. You're trying to build tax diversification: money that is after tax, before tax and already taxed.

How does the 4% rule impact those who were planning to retire this year? Anytime you have a major correction where things are overcooked, either the market went too high or undercooked, too low, the valuation of the underlying companies change. When we looked at it in 2000, I told people they could take out 4% a year. I was younger and hadn't built the company that we have today. I bought into the 4% rule.

The market had overshot itself, right. The valuation was not nearly matching the price that the market was offering. People started putting money back into the market and I told people that they could take out about 2.5% and be okay for a retirement period without a problem. Then March 10th, the tech wreck hit and the market began to sink quickly. People who were taking out 4% weren't able to keep up. The distribution wasn't there. If you go to that accumulation we talked about, that was saving the right percentage of your income and the tax diversification in preservation. That's when you're adding money, but it's not as important as what's already in your nest egg being bigger than what you're adding in. What really matters is the average return. You have to have a discipline that lets you go through what we just saw in distribution. It's the tax rate of each dollar you pull out and the amount of volatility between distribution points. The lower the amount of money that you pull out right now, the better off you're going to be. We always have three months worth of money in cash in people's accounts and we just moved to six months worth of cash.

If people were to retire in 2020 and last year, they thought they were doing great, saving and making all this money, and now all of a sudden this happens. Should they still proceed with their retirement plans? If they were set up correctly prior to this, that means they already had money in cash reserves that they're able to use. It's very easy to get diluted either by a market being down when it shouldn't be, or a market being up when it shouldn't be. It's easy to get emotionally responsive to where the DOW is or where the S&P 500 is, without looking at the underlying value. If I were retiring today, I would probably mark it down a little bit more from where we would normally go, certainly not 4%, because I think the economy has more struggles ahead of it. I would be very concerned about the inflationary pressures that have to come to fix this, that means inflation going up as opposed to inflation going down. Buying something that gives you a fixed income that is restricted as prices go higher, destroys your purchasing power. That's another way of saying destroying your retirement.

Labor Friction

What happens when the economy opens up? How is this going to look? Is there going to be 100% employment or 75% of what it was before? What's the market going to do? I would answer that with what Adam calls “labor friction” and the example that I used on the market Carver week. When you talk about responding to normalcy, it’s not going to happen. People look at the unemployment rate, which is probably closer to 18 to 20% right now than it is 13%. When we look at the unemployment rate, part of labor, fear of friction, we presume if a body is let go of one job, that they can go to another job. That's not the way that it works. Most of us have specialized training and education.

If you're planning properly, then you really shouldn't find yourself underfunded, but we’ve had questions. Is working longer the answer? Is borrowing from my portfolio the answer? Can you know what's changed with borrowing from your 401k or your life insurance policy? What are the options? The SECURE Act came out December 20th of last year. The CARES Act hit March 27th, after the Covid-19 virus came into play. A lot of changes have occurred today. You can borrow money out of your 401k up to $100,000 that you're vested in, before it was $50,000. You can withdraw that same amount of money out of your 401k and pay the taxes back over three years if you've been affected.

Changes to RMD’s with the SECURE Act and the CARES Act

What's a Required Minimum Distribution? It’s the age that you have to take money out of your tax deferred account. When we talk about required, what does that mean? That means that the IRS wants their money. You've reached the age and they've deferred your taxes long enough that it's time to pay.

The SECURE Act came first and at that time you had to be 70 and a half. What has changed now?

In the SECURE Act, before the virus ever came in, your RMD had to start technically in the year after the year you turn 70 and a half. That meant that if you started at the year you were 71 you actually had to make two distributions before April 1st. Now instead of that rule, you no longer have to take Required Minimum Distributions. If you're 70 and a half, you have to take them starting at age 72. What if you turned 70 and a half prior to June? You still have to take them.

The CARES Act was the one that was created by the stimulus in 2020. No RMDs are required this year. It doesn't matter if you're 75, 85, or 70 and a half, you do not *have* to take a Required Minimum Distribution this year. You *can* still take it. That's where you get into tax planning strategy. What if you have an automatic withdrawal that you can stop? You can put back the money that you've gotten the last 60 days and say, I changed my mind, I want to put it back in. Before that you can't. Do not let a rule that has been put into place excite you into doing something that you shouldn't do. If you do not start all financial planning conversations with your 1040 in front of you, you are making a mistake.

Disclaimer: Joseph Clark is a Certified Financial Planner™ and the Managing Partner of Financial Enhancement Group, LLC an SEC Registered Investment Advisor. He is the host of “Consider This” found on WIBC Saturday mornings from 6-7a.m. as well as *three other Indiana-based radio stations. Joe has served as an Adjunct Assistant Professor at Purdue University where he taught the capstone course for a degree in Financial Counseling and Planning.*

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