Episode 49 2023 Markets in Review

Bob French 00:00
The purpose of Retire with Style is to help you discover the retirement income plan that is right for you. The first step is to discover your retirement income personality. Start by going to risaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning. Well, at least the markets ended strong last year, right? There's gotta be a silver lining somewhere.

Alex Murguia 00:49
Hello, everyone. I'm Alex and I'm here with Wade. And just like they do in the Love Boat, I'd like to introduce a very special guest, a reoccurring guest, Bob French, just to give him as the victory back of the Love Boat. Welcome.

Bob French 01:05
Thanks, Alex. But I think you're dating yourself there a little bit. That's that's a little bit before my time there.

Alex Murguia 01:11
Yeah, that's okay. I don't mind. I mean, it's a 70s sitcom. But I saw the reruns for the record. And in the 80s. Well, the victory back when it was leveled was 80s. Hardcore. So yeah, I guess I am but so I know we'll have at least that's wrong. I don't want to be right.

Wade Pfau 01:30
At least one listener who's very excited because their specific feedback to the show was that we needed more Bob French.

Bob French 01:36
That's right. Who wrote that?

Alex Murguia 01:40
Yeah, more bob my cowbell. More Bob, less me probably.

Bob French 01:44
for your the cowbell one or the other?

Alex Murguia 01:49
Possibly possibly. What do we rope you in today for?

Bob French 01:54
with the beginning of the new year, we wanted to kind of come on and talk a little bit about kind of the year in review, or the market review of of 2022. You know, we all kind of know, it's not something we

want to fixate on, or focus too much on year by year type of performance numbers, you know, the exact numbers themselves, you know, don't make, I mean, they make a big difference. Don't get me wrong. I don't want to be cavalier about that. But, you know, they're kind of something that is a little bit noisy, and they're going to bounce around. But what's really important to do is kind of just keep abreast of generally, what's going on, what are the stories that we should be paying attention to what's what's happening out there? And how might that affect, you know, our longer term retirement investments. So that's kind of the type of stuff we want to be focused on here. And actually, before we even jump into the market review, you know, I think it's worth calling out why we're paying attention to this type of stuff with the retirement dashboard. That way, it's actually just updated here.

Wade Pfau 03:00
Yeah, that's right. Before we started recording, we were talking about things and realize we now have an episode for next week. And that's to go through the retirement income dashboard, which everyone can see, it's now updated for January 2023. And it's at retirement researcher.com/dashboard. And it's been almost two years since the last time I updated it, I've been neglecting it a little bit, but it's worth an update, because since the last time, interest rates are much higher. And that has a big impact on sustainable spending from investments from bonds from annuities. At the same time, though, in with inflation being higher at this point, although I think part of what we'll talk about today is we may have some relief on the horizon there. But at least with a higher starting point for inflation, that still creates some concern for the true inflation adjusted spending strategy in retirement. There's a big difference now between that and just assuming a simple 2% cost of living adjustment on spending. But we'll really dig into all that next week as a follow up in application for what Bob will be telling us today in terms of the urine review with how markets performed in 2022, as well as their recent past.

Bob French 04:14
Great, yeah, and that's really the important piece here. They kind of take all of this stuff that sort of happens in the market and figure out how it impacts that that longer term, which is really what a lot of that stuff on the retirement dashboard or retirement income dashboard, excuse me, really, really gets that. And again, that said retirement researcher.com/dashboard. But as we had said, you know, we'll really dive into it next week and really tear it down to give you some really, really great information there.

Alex Murguia 04:44
Yeah, check it out. I think it provides a lot of context and the titles of the tables are fairly self explanatory. But we'll get to that in the next one because I mean, the really today's Besides about how the markets moved, while, you know, we took a revolution around the sun, the retirement dashboard really talks about the context of all of that. So I think it's quite

Bob French 05:11
absolutely but talking about how the markets moved as we went around the sun again here, you know, let's let's kind of dive into some of the numbers, we're not gonna go point by point for the next half hour. But we I think it is worth touching on some of the high points here. And we'll actually start off on a good note, and just focus in on on the fourth quarter, you know, this fourth quarter actually was was pretty darn good across the board. So, you know, just running through a couple of numbers, the Russell 3000

index, which is a pretty good representation, a very good representation of the totality of the US stock market, you know, that was up almost 7.2% on just the fourth quarter, the MSCI World ex us index, that was up almost a little over 16% 16.2%, almost emerging markets up 9.7% s&p global reads, so kind of REITs around the world that was up almost 6.9% and the Bloomberg aggregate kind of the US bond market, that was up almost 1.9%, just on this past quarter. So overall, really, really solid quarter.

Alex Murguia 06:30
A couple of things with this, bobbin this this, just want to point out, well, real quick. We mentioned the Russell 3000. And we probably need an episode just on like indices when we get to into our investment themes. But as you can say, you know, the s&p 500 is representative of the market. I want to point that out, because the Russell 3000 You don't see that in the tickers of CNBC and the like, you know, it's effectively the, what is investable, 3000 stocks

Bob French 07:01
in the US stock,

Alex Murguia 07:03
where the s&p 500 are, you know, the 500 companies are the most representative of the US economy. And so there's, it's, it doesn't give you the full sample. And so you can make the case that's a little more precise, the rest of the details and then what it is, you know, it's not just large evidence, the entirety of market now, something that we said, the theme of around the sun, you know, for whatever reason, we demarcate ourselves in terms of year end, you know, that can be any year year end, if the year in October was January. And we're doing a first quarter review. And we see these returns, where there's like a ticker tape parade like Oh, my goodness, look at this, what a great year we're having go go go, you know, the firt you know, when the when the s&p when the stock market returns positive in the first quarter, it has this percent of finishing positive for the rest of year, we think like that, right. But because this is the last quarter of what ultimately are four consecutive four quarters where it's not so bad, we tend to view these returns as well. You know what, it's still bad for the year so you're less sort of sanguine about it. It's kind of a cool little not cool. But it's an interesting thing, where people are like, well, thank goodness, the fourth quarter was up, because if not, it would have been a very poor year. Whereas what is a poor year, but it would have been even worse, whereas if these returns are in the first quarter, I think people's outlook is magically different, because it's new year, so I

Bob French 08:33
And actually to that point. You know, it's been a little while ago, but if you remember Bill Miller, for a long time, he had this streak. I think it was Bill Miller, but for a long time. Yeah. Every year he beat the s&p 500. But that was because they were measuring it from January to December. If you shifted the start point. He was not having a he was doing pretty well for himself still, but

Alex Murguia 09:02
he did not have the overall returns we were trying to discuss.

Bob French 09:06

He had you know, it's all in how we measure this type of stuff. But as Alex did point out, the only we do measure it by the year and unfortunately 2022 as good as the fourth quarter was That's how bad 2022 was overall, those first three quarters are bad enough to more than deal with a good fourth quarter again, just to run through the the numbers. The Russell 3000 Down 19.2 and call out the s&p there Alex the s&p was down 18.1 over the entirety of 2022 MSCI World ex us so kind of developed international that was down almost 14.3% emerging markets download more than 20% s&p global REIT again REITs around the World down a little more than 24.3. And then,

Alex Murguia 10:05
and reads just because we don't exactly know the overall are sort of stands for

Bob French 10:10
REIT stands for real estate investment trusts. So it's basically a diversified moderately, depending on which one you're talking about diversified portfolio of property holdings. And there's some specialized kind of forum type of things about how much they have to distribute and stuff like that in terms of their income. But generally, in a diversified way, if you're looking to include kind of real estate in your portfolio, which is pretty common. You know, that's how you would do it in kind of a broad, easily tradable type of fashion. So you don't have you know, own an apartment building in your IRA or something like that you own a REIT, which owns a bunch of properties, a bunch of apartment buildings, you know, either in a specific region, or you know, across the country, or whatever it might happen to be. But that brings us to, you know, the Bloomberg aggregate. So again, the US bond market, and over the entirety of 2022, it was actually down a little over 13% on the year. So bonds did not have a great year in 2022.

Wade Pfau 11:24
And Bob, just taking that a bit further, I saw that the numbers had come in for treasuries and long term US Treasuries went down a little over 26% for the year, which is the biggest of any of these numbers in terms of

Bob French 11:36
absolutely and you know, that's just straight up, that's, that's interest rates moving, that's, you know, that's what happens when interest rates move, you know, a lot of that was driven by, obviously, the long term bonds, which are going to have the most dramatic impact, based on what interest rates are doing? Well, you know, when interest rates go up, bond prices go down. But, you know, that's those are the things that have gone up the most, when, you know, over the past, what 2030 years, our interest rates have been coming down. So that's, that's one of the reasons that we talk about those being more volatile, and kind of more risky, based on those interest rate moves. So, um, but, you know, one thing I do want to stress, as we're talking about some of these numbers, you know, is, as Alex pointed out, you know, we're talking about kind of one year type of numbers. But we all kind of know, that one year is a little bit of a drop in the bucket. Now, I don't want to minimize this, you know, we all did just lose, depending on your allocation, call it 20% of your money over the past year, that's that happened. But it's always important to think about investing in that longer term, kind of context. You know, we don't invest for a year, we know that, if we're going to be investing, we're going to be putting our money at risk. And this is what putting our money at risk looks like, unfortunately, every once in a while

Alex Murguia 13:12
and if you even think about it when you're seeing what you're seeing the you know, what's the expected return of the s&p or something like that? Yeah, I don't know the exact number right now, when you look historically, but it's something like, you know, 10%, return with a standard deviation of 17. You know, something like that. And so that means 67 standard deviation is a measure of central tendency. And so what it's saying is that the average is 10, give or take, you know, but you know, just humor me, if the average is 10, then you can expect six 8% of the time, it's going to be 17, or, you know, with a standard deviation of 17, it's going to be 27, or negative seven. You know, that's a that's a wide range, but that's what, that's what that means when you say standard deviation. And so to some extent, a negative 19. On the Russell 3000 is bad, but, you know, it's it's not, you know, it's not unexpected, because that was 67% of them one more standard deviation, which, which is within the realm of possibility, you know, knows, then we can actually touch on that in a second. But I wanted to kind of call out that even if we expect extend this out to say five years, you know, that Russell 3000 return, the five year annualized return ending, you know, the end of the year 2022 was 8.8% per year. So if you held it over five years, you know, that was your holding period, return, you know, that 8% 8.8% per year, that's still I think about everything that's made this past year, everything that's been happening, you know, a pandemic, all of this. If someone came up to you five years ago, and said, Hey, look, the s&p is gonna return 3000 You know, I'm sorry, yeah, the Russell 3000 gonna return such and such And then I'm gonna give you a choice of these things happen, these things happen, these things will happen, you know, I mean, three possible things that happen, one of them is rosy, one of them is just normal. And one of them is this, this pandemic scenario that we just had, who would pick the pandemic scenario, as, you know, as being the things that happen, and still capturing these returns, I wouldn't, you know, on again,

Bob French 15:24
and then so, I mean, it was a pretty typical five years span. And then if we go out to the past 10 years, the Russell 3000, annualized at 12.1% per year, you know, this has been a really, really good decade, even with everything that's been happening, you know, so even if we start expanding this out, even a little bit, because 10 years is not purely a long term timeframe, in terms of investing or retirement planning, you know, we're still seeing really, really solid returns out there, you know, not just in the Russell 3000, or the US stock market, but but across the board. I think that's always really, really important to keep in mind, as we're talking about this. And in fact, you know, this weekend, we actually released our outcomes razor, a kind of a quarterly newsletter, where I was actually talking about what does the long term actually mean? So I'm not going to belabor the point, you guys can all either have read it or can easily go read it. But, you know, I really want to drive that home that the long term is a lot longer than you think.

Alex Murguia 16:32
Well, but you you mean, it? You mean it from the standpoint of how long do we have I think, correct me if I'm wrong, I'm thinking I think you mean that as in? How long should the expectation be to capture unexpected market return? As opposed to, you know, as opposed to what your advisor tells you, when your portfolio is down? And they say, oh, long term long term, you know, that,

Bob French 16:58

unfortunately, is the right answer. It does feel like more than a bit of a Dodge when the markets aren't cooperating. But But you're absolutely right. You know, we want to be thinking about what long term means in the context of, you know, how long do we need to wait for lack of a better term, you know, to be able to let the fundamental risk and return relationships in the market kind of assert themselves to come out of for that random walk to cancel itself out, basically. But just to put some numbers around that, you know, looking at, and we go into this a lot more detail in the article. But you know, from 1926, through 2020, to about 14% of rolling 15 year periods for the s&p 500 index, actually last to five year treasuries. So 14% of the time over any 15 year period that you're if you were to pick that randomly. Stocks, last bonds, and not even crazy bonds, five year treasuries. This is something that's normal, this is something that happens, even over periods that people think of or think should be long term, but they're not. You know, another way to think about it is really what we're seeing isn't all that unusual. So to put, again, put some other numbers around it, this past year was the seventh worst year for the s&p 500. Since 1926. I says 97 years total, so seven worst out of that. But if we flip that around, what that saying is that, you know, we would expect the year this bad or worse, once every 14 years, which is kind of about what we're seeing, you know, go back to 2008. So I guess it's I guess that'd be 13 years. But you know, this is one of those few times when the markets being kind of neat, or kind of orderly, I guess you if you want. But this stuff happens. And it seems to be happening about as often as we expect. Let's take a moment to let the audience know that this show is sponsored by retirement researcher. You can learn more about retirement researcher at retirement researcher.com And subscribe to our newsletter, where You'll receive weekly actionable information for your retirement planning benefit. Retirement researcher is an online community devoted to helping you create the retirement income plan geared towards your goals.

Alex Murguia 19:45
Yeah, no, it's not. It's not the one year drop that that that's that's to be capturing my attention. And wait, I want you to chime in here. So you're saying the statement you said was 14% of rolling 15 Your stock period ended up underperform. Yeah, 15 year periods ended up underperforming bonds, that means like, you know, from 1926, add 515 years and then you know, what was the return from 1927? Add 15 years, what was the return, etc? Do that until present day? So, so roughly 85% of the time you do stocks outperform 15% Is that 14%? It doesn't weigh that, that that's just harkens back to the whole fragile decade for me and taking distributions and not not I'm not saying don't do it or anything, but like, you have to be prepared to accept these consequences if you happen to be in that 14%. But Wade, what, what does that impact you as strong as it's impacting me that kind of statement about me? Yeah,

Wade Pfau 20:46
I mean, absolutely. It's always the context of this is Retire with Style. And when you're accumulating assets, like the the question, what is the long term, when you're accumulating the long term may be longer than when you're in retirement, if you have a poor market performance over those 15 years, straddling your retirement date, that can create significant problems that extend well beyond those 15 years, just because you don't have the portfolio left at that point to maintain the lifestyle that you're looking for. So risk does have that bigger impact in retirement, but kind of pure accumulation mindset, it's a little easier to, to digest the numbers and say, Well, every once in a while, you'll have a 15 year period where stocks cannot outperform bonds.

Bob French 21:35
Yeah, it's a little different. If you're not right, before you retire, we start going into one of those periods, unfortunately. But yeah, but

Alex Murguia 21:43
these things are independent of each other. So if you're 50, I'm just gonna round you have a 15% chance. And this is your nest egg, and you're going into strategy that's all in on that. That's a it's almost like just

Bob French 21:57
right. And again, that's, that's purely stocks versus bonds. So you know,

Alex Murguia 22:02
I know, but it's, it's a bad it's a but it's not like you went down, but it's just one of these that I'm sure if stocks, underperformed bonds, you're going to start contemplating, oh, no matter what,

Bob French 22:14
but that's why people put part of their portfolio in bonds, or in other, you know, say an annuity or building out some of those other safety first.

Alex Murguia 22:25
I know, but this year, congratulations bunkered down. It's how you feel about feeling better? Right? You know,

Wade Pfau 22:33
ultimately, it's kind of are you safety first, are you probability based, and that's how much that data point causes any sort of concern really represents maybe which way you lean on that retirement income factor?

Bob French 22:46
Absolutely. And actually, on that point, you know, with stocks and bonds being down in the same year, you know, I've seen a lot of people talking about that, because it is a little bit unusual. You know, a lot of times people talk about diversification, as you know, hey, you buy all these that types of things, you know, stocks, bonds, all the different stocks out there. Because, you know, when this thing goes down, the other thing goes up, you know, when stocks go down, and bonds go up, or the other way around. We didn't particularly see that this year. So, you know, I think it's worth kind of calling this out and putting some numbers around this and helping people think through this, because I've seen a lot of people out there talking about how this is, you know, obviously one year data, but proving that, you know, diversification is debt. You know, all of the million times this past, you know, decade diversification has died. But it's worth kind of talking a little bit about because it is weird. You know, and it is something that a lot of people are not having fun with, to put it mildly. So, just again, to put some quick numbers around it using the s&p 505 year treasuries, you know, the s&p 500. You know, again, Alex over calendar years, you know, it's been down 26, out of the 97 calendar years, five year treasuries, you know, it was down 12 out of 97 calendar years, and there's only been three occasions

where both were down at the same point in time over that same year. So 1932 1969 and then wanting 22, obviously, so it is really rare. But, you know, it's it's worth considering that stocks and bonds are pretty darn uncorrelated, they move independently of each other effectively. So, you know, over the total time period 26 to 22, the correlation was about as close to zero, as you can get it was 0.06. So effectively independent Even even more, more recently, since 2020. So these past three years, you know, the correlation is only about point one still really, really low. So,

Alex Murguia 25:11
what does that mean? Bob just so

Bob French 25:13
A correlation is just a simple statistic.

Alex Murguia 25:17
Well, the point one

Bob French 25:19
We'll get there, Alex.Correlation is just this this typical measure of, if I tell you one number, how much can you tell me about the other number? What's the relationship between these two datasets, in this case, the returns of stocks, and the returns of bonds. So a correlation of one means they're perfectly correlated, if I tell you one number, you can tell me the corresponding number in the other dataset. Net, negative one just means it's a negative, perfect relationship like that. correlation of zero means they don't they're not related in any fashion. You know, it's just random numbers to each other effectively. So as you get closer to one, the relationship gets tighter and tighter, more and more solid. So a correlation of point one. There's nothing there. There's something there, but not much. Alex looks like you want to jump in there for a second.

Alex Murguia 26:22
No, no, no.

Wade Pfau 26:25
We never actually mentioned but the five year treasuries were down 9.4% in 2012. So almost half of the s&p.

Bob French 26:34
Yeah. So another not fun year for those five year treasuries this past year. But you know, what, what I want to call out is, you know, they're moving independently of each other. So if you were to go through and just say, you know, what's the likelihood that two random independent things with these probabilities, you know, based on what the s&p 500 did, and five year treasuries did over this timeframe? What's the chance just complete random chance that they would both be down in the same year? Well, that works out to about a 3.3% chance, which if you turn it into how many years, we see, that's about three years out of every 97 or out of every 100 years, we would exceed both the s&p 505 year treasuries down in the same year. Well, this is our third observation over that timeframe. So again,

the markets actually being incredibly well behaved for us, which is very, very weird. In and of itself, but it we're seeing what we expect here.

Alex Murguia 27:45
It's just happens to be a plus one standard deviation event, and it happens. I mean, there's a reason that negative 20, whatever it was, I forgot the number Exactly. But negative 19. Negative 19, is, you know, it's out there. I mean, it's not unexpected, but is it? Would you expect that 67% of the time? No, but yep, could happen.

Bob French 28:06
It's something we've got to build into at least our mental models, as we're thinking about, Do I want to be putting my money at risk in the financial markets? Do I want to be in the stock market? How do I want to build out this portfolio and build out my asset allocation?

Alex Murguia 28:23
See the other point and I remember in our huddle up previously, we did talk about it, but okay, I think this is just conjecture on my part, right. And, you know, in the morning is I've been working from home, I do watch like, CNBC in the morning, because I just liked the game. I'm not necessarily looking at it for any insight. I just like the I love the markets, right? I just love listening to it. And I think there's just this overwhelming sort of news about like, the select group of stocks, right? The alphabet, the meta, the alphabet, changed your name, so that threw me off the apple, whatever, right? And you're looking at those, and those are down like 60% 70%. You know, it's like crazy numbers like that, at least at some point. Maybe they've gone up a little bit more since then. So it kind of just, it contributes to that negativity. And you had mentioned is diversification dead from bonds. You know, there's another reason you diversify, right, from specific company risk. And the reality is, I'll take a negative 19% Any day versus owning Facebook for the year, you know, that

Bob French 29:30
the fang stocks, which is what a lot, a lot of what gets talked about, you know, again, the Russell 3000 is the total US stock market, just put that benchmark on there, down about 19. A little more than 90. The best performer out of that group is Apple, and over 2022 was down 26.4 That was the best of the fang stocks the worst, which Alex called out Facebook. ended the year yeah. 64 Well, more than six 84% on that year.

Alex Murguia 30:03
Now, the only thing I would say about someone could say, Yeah, but I've owned it for five years. And that beats an 8% Return annually that that you would have had in the Russell put over 3000. I don't, I don't know. I mean, if you dropped 60 70%, one year, you got to do that takes a bite to do that takes a huge bite

Bob French 30:22
Those stocks have done really well over the past call it five years or whatever you want. I don't know where it falls out. But yeah, I mean, if we could, if you could, at the beginning of those five years be

able to confidently say, Hey, here's what my return on, you know, Netflix is going to be cool, great. You know.

Alex Murguia 30:44
Bill Miller is calling,

Bob French 30:46
we will be having this conversation, you would be on your private island in the Caribbean somewhere, not talking to anyone. But, you know, unfortunately, we can't do that we can't make those predictions. So, you know, what we have to do is kind of take the market as it is and make the best of what we can. Well, let me get my crystal ball here. But I think there's some some really important stuff to be taking away here in terms of, you know, thinking about what this means going forward. So one is, well, now we have one more year in our dataset, you know, now we can use this information to give us more of an idea of what the market will look like. Going forward, we got one more year in our average returns, we got one more year in all of these types of numbers. The other thing we want to be thinking about is how is this impacting myself? You know, we've seen, you know, some pretty wild market swings in the past, call it three years, you know, how what New information has that giving you about yourself in terms of your risk tolerance? Feel? You know, and how does this change? You know, one of the ways I was thinking about this is, you know, we're always finding out new information, I want to look at going back to the tech boom, or the tech crash, I should say, you know, that was, you know, a couple years where it was just kind of not horrific returns in any one year, but a couple of years of pretty commie returns. That is one sort of way the market can crash. How did you feel about that? If you were invested during that period? Go back to 2008? You know, that was a very sharp, very sharp, very short crash. How did that make you feel? Did you feel differently there? Now we've got 2022, which is kind of, you know, hopefully, we'll kind of be in that same kind of 2008 type of mental model where it was very short, very sharp, with a pretty solid rebound after the fact. I can't guarantee that obviously, hopefully, we see something like that. But you want to be thinking through how do those make you feel? How would I be able to deal with that? What did I do during those time periods. And that gives you some really, really good information about your own level of risk tolerance, both within your investments,

Alex Murguia 31:04
Now, Bob, what sort of reading here, you know, previous years returns and somebody could could could kind of say to themselves, well, Alright, great. You can read a newspaper, you can like put things down on paper and write notes and tell me what I already know. Right? Kind of maybe. What about going forward? Bob, what about going forward? That's what I mentioned. you almost need to though like record yourself talking into something because five years from now, I think that's going to decay. start journaling, your thoughts or something like that? Wade, because I know you're big into the interest rate stuff and things like that. And you may know this better. And this is a cold question. We didn't like rehearse this one. But something I've heard is just like, information. How about the argument? Yeah, but arrays are rising, and stocks don't go up when arrays right when arrays when rates rise? Sorry, I couldn't see properly. I mean, directly. I know the answer. But what do you guys think? What are your thoughts around that?

Wade Pfau 34:32

I don't know. We're three weeks into the January 2023. Now and I'm working on the book updates. And already since January 1, interest rates have gone down quite a bit and it's so it's fixed. Yeah, markets have been up.

Alex Murguia 34:46
It's not just a continual rise. Yeah.

Wade Pfau 34:49
Yeah, it's really just hard to know what to expect and whether interest rates is one of the hardest variables to try to predict other than today's interest rate is your best estimate of what future interest rates will be. So there's not a whole lot you can go beyond that sort of statement.

Alex Murguia 35:07
Bob, do you place a lot of credence in the wells, stocks are not going to be able to go up until the rates stop going up?

Bob French 35:14
No, I don't know, I kind of come back to what we just said there about how you know, the best predictor of future interest rates are today's interest rates. It's a really bad predictor. But it's the best one we got. So you know, we start from there. And one of the really important things to think about in terms of forecasting future expected returns, is that your interest rates, you know, what the interest rate environment, that's part of how expected returns get built out, you know, that's part of the, you know, depending on exactly how you do it, you know, that's part of the risk free rate, as part of, you know, the different risk premia that go into building out your expectations of future returns. The other one is you can even just look at, you know, periods when interest rates have been rising, just look at stock market returns in the 80s. You know, that was not a last quarter. That was not a period where, you know, the stock market as a whole was doing particularly poorly. I don't remember the exact numbers off top my head, but you know, there was a, there's a reason, you know, we have, you know, like Wall Street and all those different types of movies, because the market was doing phenomenally well back then.

Alex Murguia 36:33
I want to say it again, this is top of my head stuff, but the the bull market that the longest running bull market that ended like when the.com crash and all that I think started in I want to '82.

Bob French 36:43
or very early 80s Yeah, I forget exactly. Or even that type of timeframe. Oh, yeah,

Alex Murguia 36:51
I think it was around '82. And, you know, it's just rates warrant are low.

Bob French 36:56
So uhm

Wade Pfau 36:58

Beginning of the boom. But before we get too far beyond these points to just, you may want to mention the value versus growth aspect, which is an area that valued men hit hard for a long time and had a had a good year in 2022.

Bob French 37:13
Yeah, no, we definitely want to talk about this one, because it is something that is really important to think about.

Alex Murguia 37:20
You want to frame that just so people understand what what we're getting at because wait does

Bob French 37:25
it so you know, actually, this gets back into that conversation about, you know, as I mentioned, the different risk premia that go into building out expected returns. So there's a lot of different Risk Dimensions. value versus growth is one of the really common ones. So you know, value stocks versus growth stocks, it's really kind of, you know, growth stocks are those high fliers, and everyone's really, really excited about, you know, they have a hot to put it into kind of market type of terms, they have what's called a high price to book or, you know, some other metric, so, but the market, they're expensive, the markets willing to pay a lot for, you know, whatever the accountants say this thing is worth. On the other hand, we have value stocks, which are not expensive, you know, the market is not willing to pay as much for whatever the accountants say, this company is worth, you know, those are your capital intensive manufacturing type of companies generally. Whereas growth is while those Fang stocks, all those really high flying tech stocks. And, you know, for a while now, growth stocks have been beating value stocks. And, you know, we're starting to see that that turnaround, and I should say, one of the reasons we're talking about this, is because, you know, when you start kind of breaking it down value stocks, you know, we expect to have a higher expected return or have a higher return than growth stocks over the long term. And as I just said, growth stocks have been doing real well, for a long time now. So a lot of people have been kind of having that conversation. Is that Well, one still true? Is that something I can rely on going forward? So, you know, it's, it's nice to see this kind of coming coming around. Definitely, obviously, we have no way of predicting if this will continue or not, but, you know, value, you know, over the past year has done incredibly well in the US large value.

Alex Murguia 39:26
But this is on a relative basis because it's negative, but relative to

Bob French 39:33
relative to growth, we've done well, but to put it in perspective, large value and small value in the US stock market. So large value stocks and small value stocks. Those were the two best performing asset classes in the US. You know, it feels weird to say but, you know, negative seven and a half and negative 14 and a half percent respectively on the year. On the other hand, the two worst were are small growth. So small growth companies and large growth, large growth companies. They're down 26 And a third and a little more than 29.1% respectively themselves. So if we're looking at them on a relative basis, the value premium in the US. So the Russell, the returns of the Russell 3000 value. So

basically all the value stocks out there, minus the returns of the growth stocks out there in the US, it was up almost 21% value beat growth by almost 21% Over the past year.

Alex Murguia 40:33
21 percentage points,

Bob French 40:35
Yes, excuse me. You know, in developed International, the value premium was little more than 17 percentage points. And even in emerging markets, the value premium was up a little more than 8.1%. So, I mean, it had a really, really great year. You know, again, we have no way of guaranteeing or anything like that is, you know, as we always do, and we talked about these types of numbers, but it's nice to see that everything's gonna work in appropriately here. So are you getting close to or are you in retirement? Well, investing during retirement is a little bit different than during your working years. Your investments are there to help you pay for retirement, and now is when they need to earn their keep to make sure you're on the right track, download retirement researchers eight tips to becoming a retirement income investor by heading over to retirement researcher.com/eight tips, again, get retirement researchers eight tips becoming a retirement income investor by going to retirement researcher.com/eight tips. That's the number eight tips.

Alex Murguia 41:48
I think I think what I would add is I think this is important. And from the from the vantage point of how you interpret this. Somebody could be listening to a saying, Well, yeah, it's obvious the frothiness of coming is coming off the market. Look at the returns of the fangs, there's a secular rotation going away from growth and into value and values represented by these industrials and the industrials are the ones that have been in hard from COVID. So they've already been prepping for it, where all the technology companies are right now having to reassess their capital structure had these mass layoffs. And so it's obvious what's going to happen. I think it's going to continue for a while longer. I'm saying these things I'm always trying to pair it with here on TV, right? It's easy to say this after the fact and all of this, and oh, I can see this rotation continuing. Because the infrastructure is back in play and the farm equipment and the railroads and blah, blah, blah, blah, blah, blah. I don't know Not so fast. He asked me, they don't know that they're sort of backing into a story here. You know, largely, I mean, maybe they're right, but Yeah, who knows? is what I would say, Bob, OD bueno. What are your thoughts on that? Wait, because I think everyone knows where wait and where Bobby and I stand on this kind of these kind of statements that are made about secular rotation and this and that, what what goes through your head when you start hearing people talk about the rotation back into value.

Wade Pfau 43:11
I just try to tune it out. I'm not like

Bob French 43:16
For those of you not watching the video if we have this stuff on YouTube Wade just gave the most withering look I've ever seen.

Alex Murguia 43:26

Yeah, Wade doesn't, You see I get dirty. Wade, doesn't wait doesn't get dirty. He's above it. He's above the fray. What was your Bill Belichick response Wade again?

Wade Pfau 43:40
I did not demean myself.

Alex Murguia 43:45
I don't mind. I'm a cord cutter. So I can't watch No, you ignore it right? You just You just

Wade Pfau 43:52
I can't I don't have cable TV anyway to watch that stuff.

Alex Murguia 43:56
You don't

Wade Pfau 43:57
No

Alex Murguia 43:59
This is a Tom podcast. Really? Well, you can't Cut cut cut the cord or you just don't listen to anything.

Bob French 44:06
I don't have cable. I don't have

Wade Pfau 44:08
you don't need cable anymore. But that's a completely different topic.

Bob French 44:11
Hulu and Netflix. Amazon Prime.

Alex Murguia 44:14
That's fine. Yeah, I'm a whole part of it is that I'm just lazy to call it in and stuff like that. But that's me. That's on me, man and you But effectively, what you're hearing is you ignore that stuff. You don't pay any attention to Oh, my goodness, and how I'm going to incorporate this root sector rotation into my capital markets assumptions.

Wade Pfau 44:37
That's right. Yes.

Alex Murguia 44:41
Okay. Fair enough. That's I agree. I just wanted to point that out that we people don't really think about some of the other stuff about this value premium and stuff like that. It's a resume story. Well, that's, you know, we can have a conversation about that, right? But that's, that's where I'm tilting towards. But what about the folks that will say well, you If you look at the Bollinger bands or if you look at the 200

day moving average or if you look at this, it's it's, it's right now above a certain amount. And until it hits this resistance value is going to continue to outperform growth. These kinds of Chartist, if you will, what's, what's your take on that, Bob, when people come at you with those kinds of things about how much longer we'll evaluate how you word it, I just want to know your word.

Bob French 45:25
This is one, don't say anything, if you don't have anything nice to say, type of situations that there's no value there, there's nothing useful. There. All of that information is already in the market. Everyone knows what the price is done previously. That's already that's already in those prices. What matters is what happens next. What matters is that next piece of news, and not just that next piece of news, how that next piece of news squares with what the market expected to happen? No, because you could very easily get a great piece of news. But if it wasn't as great as the market, expected, marketing could still come down. It has nothing to do with the previous price movements.

Alex Murguia 46:12
And okay, so you that's a way of saying these charts and all these things so useless, doesn't matter, because we're looking back. Okay. How is the Can you still make a good case that look, there's a value premium over the long term, that that makes worth shifting away from a market portfolio?

Bob French 46:30
Absolutely. I mean, it is a risk based story. So you have to decide if that risk, the specific context of that risk makes sense for you, if you like that particular risk trade off. But yes, there is absolutely no reason to believe that the value premium is gone away, or is broken, or doesn't work anymore. You know, pick your pick your terminology. You know, in fact, you can make a pretty strong case that the, the rationale behind the value premium is even stronger than it was previously because the spreads between value and growth, you know how expensive or cheap they are.

Alex Murguia 47:11
That's that's where I was going with this. This is an important point. And we don't want to unpack that.

Bob French 47:15
The spreads. I mean, they weren't as good as they were weren't, as I shouldn't say good, weren't as big.

Alex Murguia 47:21
And what do you mean by spreads, just because I know, even if it just doesn't spread,

Bob French 47:25
I guess you could say the, you know, how much of the market is willing to pay more for a growth company versus a value company. Those are just phenomenally massive right now in a historical context. So what that saying is, and again, I want to be very clear, there's no guarantees on any of this type of stuff, it is a risk based story. You know, markets are noisy all of the normal,

Alex Murguia 47:52

we're not predicting I get it, we're not, we're not predicting

Bob French 47:54
what I would say is based on the size of these spreads, I would expect the return my expected return for the value premium would be higher now than it's been in the past. Now, obviously, value, the value premium is positive 2022. So my expected return in coming into 2022 would be a little higher than it is now but it's still really friggin high.

Alex Murguia 48:20
Okay, so if I said it like this historic, and I'm making these numbers up for the audience listening, if historically, the PE on growth stocks has been 25, that means that you're willing to pay $25 for one dollars worth of earnings. Right? So the historically, the P for growth stocks has been 25. It hasn't I'm using. Yeah, and PE for value stocks historically has been 15. To say a number Were you willing to pay $15 for one dollars of earnings, hence, you know, there's a premium to growth stocks because they're more expensive. So that spread is 10, a PE of 10, a P of 25 versus a P of 15. Right, let's just say that's a historical spread, you're saying that historical spread has not compressed in the slightest, even though value has outperformed. But you know what I'm saying? Yeah, it's value stocks haven't worked at more expensive on a PE level, in fact,

Bob French 49:21
say the historical average spread on that PE. And again, this is just round numbers, examples. This is entirely wrong. But you know, if we were to say that was 10, on average, historically, you know, prior to 2022, you know, say it was 17. You know, now we'd be at like 16. So it's come up or it's come down a little bit, but it's still massively bigger than, you know, we would have we would expect to see historically or we have seen historically, excuse me.

Alex Murguia 49:51
That's important that that's the end of the way I see that is again, no forecasting here, but Okay, so just because value has outperformed growth for, let's say two years, even if it's three years just to say three years, you know if that spread is still significant. That's, that seems. That seems interesting to me. I don't know how I can say that we we're not saying I'm all in, I'm not all in

Bob French 50:19
one of those one of those if 10 years ago, you liked the value premium, it made you love it now. So it'd be as the same logic, it's just the numbers have shifted around such that the expected return of that value premium is probably higher than it was in the past.

Alex Murguia 50:40
Perfect. And that's a good, that's a good ending point here. Wade, since we socialize it earlier, the dashboard and just to bring this podcast this episode to close, what do we do with all this? How can we use all of this information, you know, in terms of a volatile return investor to make sense of potential distribution strategies, and, you know, teeing you up to kind of peak everyone's interest for the next week's podcast?

Wade Pfau 51:10
Well, we we didn't talk about inflation yet. But that's going to be an important variable. You should we should probably bring up the inflation.

Alex Murguia 51:19
Yeah, talk about Yeah, sorry. I was I was using my 50 minute limit, right? We can go longer.

Wade Pfau 51:24
I got a bonus length episode today.

Alex Murguia 51:27
Yeah, go on. Hit up inflation. Not sure.

Bob French 51:32
Okay, we'll touch on inflation. So obviously, inflation has been a really, really big topic. You know, for the past year, plus, however long it's been I forget exactly off the top my head here, but been a while. But we haven't heard quite as much about it over, especially the back half of the year, especially the fourth quarter. And that's because inflation has been incredibly low, you know, over the past few months. So the annual inflation over 2022. You know, again, US CPI type inflation numbers, the annual inflation was about six and a half percent. To put that in context, the December the monthly inflation, you know, last month was negative point 1%. So we had a miniscule amount of deflation actually, which deflation in the long term. That's a big scary thing a month to month, that's not unusual. So just to put that out there, but the last kind of, I'm sorry, wait, I think you're muted there. But the last kind of big number change that we saw was actually all the way back in in June, when inflation jumped 1.3% that month, but ever since then, it's been kind of low decimal typing numbers, you know, point one, point 2.3, I think we had a month or 2.4. So pretty, pretty small amounts, you know, that six and a half, the bulk of that came the the first half or so, of the year. And, again, getting back to Alex, your point there about, you know, cool, we can we can all read the bureau of labor, labor, statistics, press releases and, and get those numbers ourselves. What we care about is what does this tell us about the future, what's gonna happen next. And that's some really, really interesting stuff on you know, one of the ways when I know you do the same thing I do here on is when we're looking at future inflation, what we actually can do is we can use the market to predict what inflation is going to look like, over time. And what we do is we basically just subtract the tips yield from, you know, the nominal Treasury yield. And the difference there, that's how much the market is expecting inflation to be, that's how much someone is willing to pay to get rid of inflation, you know, they're still gonna get that Treasury return, just in real, real fashion and inflation adjusted fashion. And those numbers was that

Wade Pfau 54:18
I was just looking at those numbers on January 1, and over the next five years, it's 2.3%. That's kind of the built in expected average inflation rate. And that's actually the same as over the next 30 years, too. So we're looking at long term expectations of 2.3% inflation, which is historical numbers.

Bob French 54:36

Yep. In fact, it's even gone down since then. So wait, you were looking at January one numbers. I pulled the numbers. We're recording this on Thursday. So the Wednesday numbers, that five year was 2.09%. So over the next five years,

Alex Murguia 54:50
Okay, so So me being a bit of a, you know, just to stir the pot. What Why doesn't the Fed then say okay, well, it seems controlled. If the expected two years the same as the Swift 32.3, that's a good number that's within my mandate. Let me stop raising rates. Why doesn't Oh, care about that?

Wade Pfau 55:10
Well, I guess you have to know what those expectations may involve people believing what the future will be. And if the Fed did something different, that's the kind of shock that Bob's talking about, where suddenly the expectations need to change.

Alex Murguia 55:28
That's the perfect answer. I just wanted to kind of I'm trying to play the role of somebody listening, saying, Well, you know, isn't the Fed reading this? Why don't they just stop? And your answer is, well, it's kind of the expectation is that the that's why it's this, you know, I know that, you know, that kind of thing.calll the chess game.

Bob French 55:51
The other piece of information that I think is worth calling out here is not just the Fed movements, but actually the unemployment rate, you know, we're seeing really, really low unemployment numbers, which is normally something that kind of drives up inflation, you know, more people have jobs, companies have to pay those people more to get them to, to hire those people. So there's more money just kind of circulating around in the economy, which tends to push up those inflation typing numbers. So that's, that's also in the mix there as well. So we're, you know, potentially looking at pretty darn low inflation numbers over both the the short term, you know, right now, we're looking at a one year inflation number from the market's expectation about 1.8. You know, all the way up to the 30 year is 2.1. Something, you know, the putting that into context, the historical average annual inflation is about 2.8 2.9%. So we're seeing below average inflation over the long term here are expected me

Alex Murguia 56:59
Yeah, but I go to the store right now. And eggs are seven bucks.

Bob French 57:04
You can show me all this change starting from

Alex Murguia 57:07
I again, I'm not It's not me talking. Um, you know, you have people listened to that and say, Bob, these are just numbers, you crazy, eggs are seven bucks.

Bob French 57:20

You know, we're starting from the point where we are right now, just like, if we were gonna look back at the 1950s. You know, there's, there's no more penny candy stores. I don't know if that's the 1950s or not, but, you know, earlier on, there's no penny candy stores anymore. You know,

Alex Murguia 57:37
another way to maybe say that is what's done is done, the inflation that has occurred has occurred.

Bob French 57:41
And very emphatically going forward. As I mentioned, you know, long term inflation or long term deflation is scary and economy wrecking, we don't want to go backwards. So, you know, I mean, what we're looking at is what happens moving forward?

Wade Pfau 57:58
Yeah, 2022 is a tough year, though, but interest rates are higher. Now, inflation is higher, but ultimately expected to come back under control as long as things is progressed as people expect them to. And that does lay a foundation for better retirement spending numbers and before and if you've used our funded ratio tool, just the rise in the interest rate you're able to use, and that does help dramatically. So now, as I'm getting to the stage of being closer to putting the finishing touches on a revised edition of the retirement planning guide book, The it looks better the case studies look better, the having higher interest rates helps dramatically to improve the funded status of a retirement plan. And so that is at least one optimistic note to to

Alex Murguia 58:47
corresponding inflation with it.

Bob French 58:49
So the other thing we call out off that point, I, you know, if you've done the retirement income challenge in the past the retirement researcher and you want to get a better result on your funded ratio, now's the time to sign up for another one. So

Alex Murguia 59:04
and then, next week, we'll go into the dashboard. Sounds good. All right, that kind of extends the good news of for an environment. All right. All right, everyone. Thank you for listening, and we'll catch you next week.

Wade Pfau 59:22
Thanks. And thank you, Bob.

Bob French 59:24
Thanks, guys. Was a lot of fun. Wade and Alex are both principals in McLean Asset Management and Retirement Researcher. Both are SEC registered investment advisors located in Tyson's Virginia. The opinions expressed in this program are for general informational and educational purposes only and are not intended to provide specific advice or recommendations for any individual or on any specific securities. To determine which investments may be appropriate for you, consult your financial advisor.

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