Episode 59: Investing in Context with Weston Wellington

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. Weston may not have helped us write the RISA fight song this time round, but he is really good at explaining investment stuff.

Alex Murguia 00:50
Hello, everyone. Welcome to this week's edition of Retire with Style. It's a foursome today we've got myself, Bob Wade, and a very special guest, Weston Wellington. And I will let Bob do the intros but take it away on Weston.

Bob French 01:12
Absolutely great. Thanks, Alex. So as Alex just mentioned, you know, we got a really great guest in today. Weston Wellington with dimensional fund advisors. So if any of you have some connection to dimensional as a client, or whatever it might be, you probably know what we're going to be talking about here with Weston. But you know, the official idea, or official title lesson has is, well, is it VP of investment strategy. But really, what he does is he explains stuff. You know, he takes all of the really, really complicated as smart regressions and math and numbers, and tries to make it reasonably understandable to normal everyday people. And, frankly, he does a really, really great job of it. And so we really wanted to bring him in here today, as we're getting into talking about how the financial media impacts investors. So we've talked a lot about kind of investment strategies approaches, basically, why active management doesn't work, why you can't time the markets, why technical analysis doesn't work. Why fundamental analysis doesn't work in the way that you think it does, or at least the people doing it is hoping it will do. And now we really want to dive into, you know, how do you deal with all of just that noise around you that the financial media is putting out there Alex always is talking about how he's watching CNBC at lunch.

Alex Murguia 02:53
For current events, Bob for current events. Okay, don't judge me. Hey, don't judge me. But for current events.

Wade Pfau 03:06
Alex, the new hot tip that what that was,

Alex Murguia 03:11
yeah, Palo Alto Networks is going down.

Bob French 03:13
What we have to do is just to rip into Alex for watching CNBC. But no, I mean, really, what we want to do is Weston has a wealth of experience with looking at what the financial media is saying. And then literally, you know, two or three years later, coming back and checking it, you know, providing some of that not fact checking us that's kind of the wrong word, the accountability of what they're doing. So we really wanted to bring West in for that. So Weston, thank you so much for your time here today. And, yeah, I think we'll start with kind of the big picture question. Does the financial media help investors? Let's let's start there.

Weston Wellington 04:01
Well, let me first say, I'm not trying to demonize the financial media. A lot of bright people who work for these organizations and they certainly have their their ultimate the investors best interest at heart. They're really trying hard, as hard as they can to understand what's going on in the market to the economy, and try to provide some a roadmap if you will, or education for their readers. Unfortunately, what they're up against is a market system, that if it's working properly, and I believe it does work properly 99.9% of the time, it's much more difficult to process the information we receive and daily newspapers or magazines, and try to improve our portfolio results relative to all the other things People who are reading the very same newspapers, that's the challenge. And it's such a difficult challenge that many people fail to appreciate just the scale of the difficulty. And no matter how many times they may have an unhappy experience, following advice, they read somewhere, they see there's they don't feel there's any real alternative. And they try to find another expert, who somehow will be able to crack the code this time around. But if markets are working properly, what we should expect to see is that not just individual investors reading newspapers, but also the majority of professional money managers who are paid to do nothing. But try to analyze all this news, we should expect to see they fail to achieve the objective of outperforming markets as well.

Bob French 05:55
Yeah, and that's, go ahead. I apologize. Go ahead.

Weston Wellington 06:00
So if if we understand how markets work properly, it leads us to the conclusion that for the overwhelming majority of investors, the ideal strategy is simply to diversify broadly. And then stop reading the newspapers, or read the sports section for entertainment.

Alex Murguia 06:23
Oh, no. 100% And Wade, just because, you know, when I started at McLean, you know, we need to switch to DFA and so I've been sort of well versed in this and Bob, you know, coming from DFA as well. But as Weston said, Weston is kind of like the, the impact, I got a good title here Western, I don't know if it works or not you had said BP would have. How about the input, you leave the infotainment division of DFA?

Weston Wellington 06:52
I'm not I'm not a real numbers guy. I'm a storyteller.

Alex Murguia 06:55
There you go. Exactly. And by the way, Wade? Weston. I think it's a great name. Weston Wellington. Wow. It's awesome. Yeah, it fits the whole story arc here. So

Weston Wellington 07:11
Western Jeffers Wellington.

Alex Murguia 07:17
Even better. No, no, no, no, I think it's great. And the last point that I think here is, because we mess around, Bob likes to throw out some words every now and then. And it just catches us by by surprise. There was one word you used. And I think it fits into this arc here. That I at the time, I didn't know it. No surprise, but I even looked it up when you were talking about the media. And the phrase that you use as the media's prurient interest, he fasting and things like that. And I was like, what, what is that?

Weston Wellington 07:48
I stole that shamelessly there was an article some time ago by Jane Bryant Quinn, one of the more responsible.

Alex Murguia 07:58
Yeah, remember,

Weston Wellington 07:59
There's a lot of opinion. In the end, the bold headline for her article was the big tease. How the financial media appeals to our prurient financial interest. And so I looked up pruient and I think the dictionary says something like, excessively interested in improper matters, especially sexual nature. So if we substitute the word financial, or sexual, we get our concern. As people trying to educate investors, we don't want people to be literally focusing on improper matters associated with the financial markets.

Alex Murguia 08:37
Look, it's a phrase I probably heard at this point 20 years ago, and it's stuck with me, and I'm bringing it up, because it was just such a cool, Vietnam's such cool use wording there that I was like, you know, I figured Wade you'd like that one as a as an homage to the Bob. Yeah. Right. So word of the day, but and the other. The other thing that caught my attention a lot when you did this, because going into the media, and you can sort of let it rip is how investment advice you said there, they have no other things available to them, how investment advice is kind of seen as the ability to forecast.

Weston Wellington 09:13
That's how most people think of investment advice. And it's, it's perfectly sensible. You would imagine people who spend their lives studying all these companies and economic data would be more successful than you could in identifying what's going to happen next, and more precisely, which companies I should invest in and which companies I should avoid. And so, almost no one comes to the conclusion that listening to these experts is a waste of time, unless it's carefully explained with a logical reason to do so. And so, what I've done for the last 28 years here dimensional is try to come up with

simple explanations and simple stories that illustrate why is it that in almost any other field, we can imagine, we want to go to an expert doctor, we want to go to an expert attorney, if we have a legal route, we want to CPA to do our taxes, why wouldn't it make sense to go to some so called stock market expert to figure out what the best companies are, though? And that's where I'll say we'll do you have five or 10 minutes. And we can kind of go through a couple of simple thought processes here and maybe change your thinking of it.

Alex Murguia 10:35
Yeah. And so then how do you approach it because in my head, your presentations were, okay, I'm gonna just lay the groundwork for what investment advice is knock that down, or just, you know, challenge you on that. I'm gonna sort of bring up mutual fund managers, and show you the results of that, but forgetting mutual fund managers, let's go direct to the stock pickers. And, you know, hit them, you know, what, what led you to that thinking in terms of how am I going to present a story around all the stats that I can show in a manner that doesn't bore somebody?

Weston Wellington 11:09
Well, my first order of business is to try to eliminate as many stats as possible. Yeah. Again, just focus on whatever the stats may show us. Why would we have expected to see that outcome? Why would the world work that way? So I'll start off with maybe just a couple of simple stats and say, your Mr. And Mrs. Mr. Investor, roughly speaking, how many stocks do we have today on let's say, the New York Stock Exchange? Well, roughly speaking, right, 2800. Okay. How many investors do we have out there? Well, a lot more than 2800, all over the world, who might choose to invest in some companies on the New York Stock Exchange, probably millions, 10s of millions, maybe even hundreds of millions. And they're all looking at that list of 2800 companies. And they're all trying to determine which ones among those 2800 are going to be the ones I want to own now, and which ones do I avoid? Now, think of the brainpower associated with all those individuals, combing through these 2800 companies. They're talking to chief executives, they're scrutinizing the annual report, some people may have knowledge about new products, or that are going to come out because they work right inside the company, or they're a supplier, or they're a competitor. There's 1000s, upon 1000s of bits of information that all these 10s of millions of investors have, and the function of the stock market. The reason we have it, is that it serves as a way to aggregate we take all this information from all these participants, who are reflecting this information in prices that they're willing to pay, or to accept when they buy or sell the stocks. Now, I would argue that almost everyone has some little bit of knowledge that might be useful in assessing the state of the economy or the prospects for any company. And someone in the audience might say, Well, I'm nothing special. I don't have any particular information, I would say, Well, let's take an example. Suppose you're the dentist in Peoria, who knows better than you if your patients are paying you on time or not? Probably nobody. Now, is that a big piece of information? No. But there's a mechanism to aggregate all this information into one place where people can act on it. That's the stock market. So what happens when people gather in the stock market? What do we all want to find? We want to find the great companies. We want to avoid the crummy companies. So it seems logical that with all this information about the prospects for companies, people are going to be willing to pay higher prices. For companies with clearly better prospects. They're more profitable, their sales are growing more quickly. They have terrific new products in the pipeline. Compared to other companies, whose prospects may be dismal. Sales are falling. The chief executive was just fired. But here's the

thing. If we look at almost 2800 companies, they trade every day. Somebody bought shares in the worst performing companies that did the ones with the worst prospects Somebody sold shares. In the stocks of the very best position companies, that's the definition of a trade. Every time a trade takes place, there has to be a buyer and there has to be a seller. So there's a whole universe of companies. And it seems perfectly plausible that the great companies will sell for higher prices than the mediocre companies. But there has to be some price for that mediocre company to attract a buyer or else a trade was to take place. So the way the stock market functions is, the cheap companies that mediocre companies will sell for lower prices. Maybe if the company has really dismal prospects, it will be an extremely low price. Just as maybe if a certain company has absolutely glowing prospects, the price is likely to be pretty high. But in every case, for all these companies, the overwhelming evidence is that the prices are fair. They properly reflect all the prospects for all these companies. Now, what's the implication? If prices on average are fair for all the companies, it means no matter how hard you try to find the very best companies in hopes of getting a better return? Most likely, because you have to pay such higher prices. They won't do any better in the stock marketplace over time than the mediocre companies are the really crummy companies. Now, do we see evidence that this can work? Is this what actually happens? We have financial economists who have studied these things for decades, we started to have good data about daily stock market returns for careful analysis along with the early computers back in their mid 1960s. It was an article of faith at that time among most professionals that, well, if you're a professional, you should be able to do a better job picking stocks than just buying whole massive stocks. Well, what the finance professors began to discover was that that wasn't true. They would take the performance records of all these so called experts, and compare their results to just a simple let's just buy every stock and do nothing. And time and again, the Do Nothing strategy that do no forecasting to do no stock picking strategy did better.

Alex Murguia 17:34
Weston, let's frame it. Let's frame it in the positive that going to the beach strategy. There's something

Weston Wellington 17:42
The more time for golf to lower your handicap. I had a I had a an advisor say You know, my, my client saw your presentation. What really nailed it for him was when he talked about this was the low handicap strategy. You have more time for golf. So you've got your golf game better. I love that he said that.

Alex Murguia 18:05
Yeah.

Weston Wellington 18:06
Now it's hard for many people to believe that but the numbers when they first came out, many people, many so called professionals dismiss them. But as time went on the the iron logic of this approach has taken hold. And now, so called index type funds, which make no effort whatsoever to do forecasting. Our I think there are eight out of the 10 largest mutual funds today are index funds, which didn't exist when this research first start. So there's been a very real shift in how investors perceive the wisdom or so called wisdom of experts stock picking advice. And as a result, investors have a better chance of having a more pleasing investment outcome. It's been a great innovation triggered by academics in the

ivory tower, but it's made a very real difference to the everyday investor who is now getting better returns than they were decades ago.

Bob French 19:16
Yeah, and I mean in to bring it back to the financial media aspect of this. They've still got to say something, you know, they've still got to talk about something. There's only so many ways that you can say, diversification is a good thing.

Weston Wellington 19:30
And the thing to remember is if you if you pay somebody to make a forecast, they will make a forecast. Yeah, so they're trying hard. That's their opinion, and some of them will be right some of the time. Some of them will be wrong. A lot of the time when you add it all up. Most of the experts are not able to add value for you as an investor. But we all have opinions and if somebody wants to pay me for a strongly held opinion I'll be happy to volunteer.

Bob French 20:01
And actually going back to something you said a little earlier, you were talking about how we look to a lot of people look to the financial media for those predictions. But if we look at what mutual fund managers and money managers generally do, which is all they do, they don't actually beat the market themselves. I think that's a really, really important point to emphasize. And we actually talked about that last week, you know, to really dive into that and talk about these guys can't do it. Why do you think reporters can? Why do you think you know, someone spouting off with all of those different incentive structures going on? Why could they pick Cisco versus EMC?

Alex Murguia 20:45
I would even take that one step further before Weston answers, and that, that's for ICU, CNBC, and some of these folks are professional money managers, professional advisors, and I really know what they do for their clients, you know, but there's this duplicitous nature, between what they do for their clients, quote, unquote, indexing, versus how they present themselves on screen, which is this the sort of, you know, we're making, we're playing with Bob about tap dancing, but they're just like a dancing bear on screen to kind of give this illusion of value by moving deck chairs on the Titanic kind of thing, where at the end of the day, they you know, what they do for their what they what they say is, it's kind of different than what they're actually doing for their client and they rationalize, but oh, this just play money. And this is how I would fool around. I don't think they realize people are looking at this for advice. And so they're doing everyone a disservice by continuing to spout on silliness, if you will.

Weston Wellington 21:42
It's hard to sit still.

Alex Murguia 21:45
Wait, do you mean me in general, as a general matter, or in particular this

Weston Wellington 21:54

in most other spheres of activity, more activity tends to give you a better result. But this is one situation where it doesn't tends to be present. I don't know who said it first, but maybe one of our financial advisor clients, but he says investment portfolio is kind of like a bar. So the more you handle it, the less you have.

Bob French 22:12
If you're looking for more personal advice, please know that our show is sponsored by McLean Asset Management. Learn more at McLeanam.com. That's McLeanam.com. McLean Asset Management is a wealth management firm where we help you design and implement the right retirement plan for you.

Alex Murguia 22:38
No, no, no 100% the other the other piece, and maybe you have some thoughts around this is it's an interesting profession. Because a lot of times, we just went through a series of podcasts on technical analysis on fundamental analysis on general market timing, etc. And a lot of times I we made a point to say that the audience member could be listening to us and describe what we're saying. Because, you know, our conclusions are somewhat that if someone did happen to outperform, it's hard to remove luck from that equation. You can't disentangle luck from skill from that equation. And if you look at the persistency studies, etc, etc, you really have to tilt towards the answer of luck, you know, Buy and buy. But, you know, to some extent, I don't know if that's a satisfying answer for folks listening in like, Oh, they're just saying everyone's lucky. So you know, what I that has no counter to it. You know, how do you how do you respond to that if it ever does come up?

Weston Wellington 23:37
Well, one of the things I like to point out is that in 2002, I believe it was the Nobel Committee, awarded the Nobel Prize in Economic Sciences to an individual who had never taken a course of economics or taught economics. Well, why did they give this gentleman a Nobel Prize in Economics, is a psychology professor Daniel Kahneman. And the award was for his recognition of the importance in the the methodology, analyzing human behavior, particularly under conditions of uncertainty. And they emanate the most useful conclusion from not just Dr. Kahneman, but many other researchers in his fields that for whatever reason, human beings appear to have evolved to be overconfident. Now, maybe it helped us survive when you're near starvation in the savanna, you know, many centuries ago. And if you're overconfident about your ability to pump the next Gazelle and get fed, maybe you're more motivated to get out of the cave and go find it. For whatever reason humans do appear to be overconfident. There are all sorts of simple experiments that provide well documented evidence. Men are More overconfident than women. But all of us are overconfident to some degree. And that overconfidence can lead us to believe we are smarter in identifying patterns and trends in numbers than we really are. Now, most investors, particularly those who have any experience with investing in stocks, if you ask them, do you think stocks have a higher return than bank CDs or Treasury bills? They'll say, Well, yeah, sure. That's why I invest in stocks. Well, if you're an academic, like Bob's dad Ken French and you ask academics like him? Well, how long does it take looking at the data to be confident that stocks have a higher expected return to Treasury bills? Now the answer will vary depending on what the date is that you're looking at. But something, something around like 30 or 40 years, it was five years of data isn't enough. 10 years of data isn't enough. 20 years of data starts to tell you something, but you're not really confident, you need so much data, to be confident of your

assessment that stocks are likely to outperform treasury bills, it's much more noisy than most investors realize. So they're often easily persuaded that a money manager with two or three or five or even 10 years of data performance is obviously telling me something about their smarts, probably not. I got one striking example by not mentioning any names,

Alex Murguia 26:38
no mention names, please.

Weston Wellington 26:44
I read what he has to say. For years, he always has interesting things to say about companies, the outlook for things and he, to the best of my knowledge, he ran a mutual fund for many years. And to the best of my knowledge, he's the only mutual fund manager to outperform the Standard and Poor's 500 index for 15 consecutive years. No one had ever done it before. And to the best of my knowledge, no one cents. Okay, so maybe he's the one exception that proves the rule. Well, so I kept a copy of that story. And then five years later, there was another story about the same individual who at that time, had done so poorly, with his mutual fund that he finished dead last out or something like 800 Other mutual funds in his particular category. So, question here for us, as investors puzzling over this. Was he really smart for 15 years and then suddenly got really stupid? Or was he maybe kind of lucky for those first 15 years, and then

Bob French 27:56
And Weston even to add on to that. You know, we're thinking of the same person here, if you measured his performance over those 15 years, where he beat the s&p 500. But you shifted the start of the year to a different month. He did pretty well still. But he certainly didn't have that same sort of track record. It was luck, even at the sense of where do we start the measurement?

Alex Murguia 28:25
And you're not in both of you aren't even commenting on? What was he driving those returns from because you had set your benchmark them to the s&p 500. But perhaps he was taken advantage of value premiums during a time when value outperformed. Hence, there was a mismatch, you know, relative to the risk of the s&p, but I digress.

Weston Wellington 28:44
It could also be the case, right? If you got time I got one more war story.

Alex Murguia 28:50
No, no, no, no, no, no loaded up loaded. This fight. This is a conversation so

Weston Wellington 28:55
Many years when I was working for another brokerage firm, and I was technically their director of research. And so my job was to identify the very best no load mutual fund firms. And there was just one firm that I visited. And that's how I came across dimensional actually does, and there was a very engaging portfolio manager but a straight shooter kind of guy. And he was among the several funds that he managed was a small cap growth fund. I don't forget the exact remember the exact name but

they've never they're not always remember, the portfolio managers name will remain. He was a good guy, and he said,

Alex Murguia 29:32
They're all good guys.

Weston Wellington 29:36
And so he told us interesting war story about the Fund had gotten launched, I think in early 1986, or maybe you're late 85. It was a very small fund and 86 in an 86 There was a brief sort of rocket ship move in the so called Home Shopping stocks. Home Shopping Network went public that year. I don't recall the price of the IPO, but it's skyrocketed in the aftermarket. Everybody wanted a piece of it. It went up something like, you know, three or four or five times, but just an enormous winner. Well, if you're a mutual big mutual fund firm, and you got a stock allocation on a hot new issue, you get to kind of decide, well, which fund are you going to put it into? You're going to spread it around among a whole bunch of funds, or maybe put most of it into one fund and see what happens? Well, they put most of it into one small aggressive growth fund that this guy managed. And because this one stock was such a superstar performer, the entire fund that year had a return, as I recall, so they well over 100%. Well, pretty cool. So fast forward to like 19, it was 10 years later. So it would have been like 1995, I remember reading the Wall Street Journal, they would have their, their list of top performing funds, and the top performing funds for the previous entire 10 year period. Was this fun? I thought, Huh? That's kind of interesting. So then I checked the data on year by year, and I discovered that for the most recent nine years, the Fund had underperformed the market. But because it had such a sensational return that very first year, it carried the performance on an aggregated basis all the way through, and it was the number one performing fund for 10 years. And then if you think, okay, it's I can't prove it. But I think my suspicion is a lot of that terrific performance for that one first year was attributable to one stock that did so well. So it's highly unusual. But there's a case where it appears, one stock determined, a 10 year super performance record,

Alex Murguia 32:05
but it was a heck of a stock.

Weston Wellington 32:09
Now, can we call the portfolio manager skillful for picking it? Okay, maybe some of you will. I think there's a big dose of luck in that 10 year record. But get your hands on that one hot IPO that switch the performance record around?

Alex Murguia 32:24
I think there's a lot of there's a lot of points here while you were you were speaking one of them that that got me because you're right, then you're pointing out these anecdote. But there's, there's tons of these. And we could go and talk about performance studies of the top five how they do the next five years. But then this podcast gets boring, right. But this is relevant right now with the arc font, right? And I'm sure that's kind of the the punching bag of sorts, at least it will be you know, soon enough. But what was the point that I was thinking of what you were saying that is, okay, it's a top performing font over the last 10 years. But I'm willing to bet, and I'm off on the numbers, because I'm making it up. But over

95% of the investors in that fund today, never experienced those returns, they've experienced returns that were poor. And I think this is something that's endemic in the industry, where there's a top five, everyone money flows in and no one experiences the return, I'm thinking of the Ark fund even even but there's a lot of little, there's an ecosystem of stories around that, that I'd love for you to kind of unpack if you will.

Weston Wellington 33:29
Well, I think what you've you've uncovered a sore point among the investment community that you can find many examples where you look at the performance, and you'd look at the cash flows. And you can see that the preponderance of the money tends to come in after the terrific performance, not before.

Bob French 33:50
Yeah, as soon as that money comes in, they basically just start indexing because, right, want to lose it. Right.

Alex Murguia 33:58
Yeah. And, you know, I think you're gonna get that with with, with a couple of folks that are that, you know, stuff that's happening right now, the other storyline, I was thinking when you had mentioned, the sort of this one stock pick, you know, they've sort of carried them right for 10 years is newsletters. You know, I've seen ads for newsletters, where it says our picks over the last 15 years have returned 10,000% Right. And one of those picks is Amazon and Tesla, you know, or two of those picks are Amazon and Tesla. And okay, you know, nice, but you know, they discount the other ones or they don't even see you know, are they equally weighted? Are they not equally weighted, you know, etc, etc. How would you how would you sort of advice people advice or, you know, provide advice to our consumers about how they should read or what questions they should be asking themselves from a from a strobe light detector. When when folks are making statements like that and how that game has really played among the newsletter audience among the newsletter providers.

Weston Wellington 34:57
Well, one thing I would like to point out as if someone is so successful, based on this newsletter record a legit newsletter record? Why don't they start a mutual fund, even with a minimal amount of assets and actually demonstrate that they can do it with real money. It's not enough to say, you know, writing from my basement, or a computer, yeah, I did this. Well show me you actually did it. That's the beauty of the mutual fund industry. Is that the record is there for everyone to see. Did you do it or not do and again, I'm not gonna mention specific names here. But I can think of one individual in particular who was I love reading his stuff. He's he's a, he's a quite a cantankerous writer, although a graceful writer, and he's always willing to make very extreme predictions. But my look at the record of the the mutual funds in the font family that he represents. I don't see much to talk about. So don't tell me about all the war stories about how you made this or that prediction. Tell me how you took that insight and actually either bought stocks or sold stocks at an opportune time to take advantage of it. Now we can all see and in effect independently verified? We just don't see it. No, I agree. And if we look at people, if there really were a recipe for timing the market, we should see it somewhere in the Morningstar database upon 1000s and 1000s of funds. It's not as if people haven't tried. There's a title of a Morningstar article, I think, quite a few years ago. And it was about one another market timing Strategy Fund closed. Now,

why does the mutual fund close? Well, in almost every case is one reason. They ran out of money because people got fed up with a poor performance and they cashed in, and there was no more money to manage. Hence, they closed Well, there have been any number of mutual funds over the past few decades that followed, or advertised that they followed a market timing strategy, most of them have vanished, the van vanished because they couldn't deliver on what they said they could do.

Bob French 37:32
Yeah, and it's even more to that point. You know, if someone could do that, they also wouldn't be telling you as a, you know, newsletter, subscriber about it, write it themselves, and then be sitting on an island somewhere,

Alex Murguia 37:51
they monetize it differently, they monetize it differently, monetize it.

Bob French 37:58
Give it to you for 40 bucks a month, it's worth $40. So

Alex Murguia 38:04
well, but even even then, because Because Weston sometimes, Wade, Bob and myself, we get we sort of, we want to we don't want to come across as these sort of wet blankets all the time. So we throw in the Hey, we'll give you the will will give you the logic that maybe there is somebody that's very special out there. Maybe there's a him or her that's very special out there and can outperform, you know, bar and it takes us 30 years to figure that out. So in year five in your turn, maybe they're okay, maybe there's someone special out there. But if there was that person that could do that. You said newsletters but they would charge you right up until the point of their value. You know, if I if I can outperform the market by 5%, I'm going to charge you 4.99% Right. Thoughts on that and your observations on that.

Weston Wellington 38:57
I would also take it that's absolutely spot on. But I would also take it in a slightly different direction. And say, I think looking looking at the Las Vegas Skyline they're delivering Casino.

Alex Murguia 39:15
What's your favorite, by the way?

Weston Wellington 39:16
I'm not a gambler so I can't even Of course. I've been there for some client events.

Alex Murguia 39:23
Of course you have Cirque du Soleil kind of guy.

Weston Wellington 39:30
Most people go to Las Vegas if they're overconfident thinking, Yeah, I'm gonna take the casino for some money and most of them fly back a little cooler or maybe a lot cooler. And you know, the odds are against you, obviously. And it's obviously odds have to be against you. Otherwise it wouldn't be

these billions and billions of dollars where the glittering casinos that have been built. It's all been built with gamblers money. They leave town with less than they brought. But I also do think that the reason one reason we see glittery casinos is that for whatever reason humans are hardwired to want to speculate. Fun, and people have been doing it since biblical times, if not before. So, I would always tell investors and advisors. No, I don't, I don't think you should like scold people, if they want to speculate, just set up a separate smaller entertainment account, and go have some fun. You want to go to Vegas, you know, figure out how much money you're willing to lose and have a good time, see some shows, gamble, have some drinks, maybe you'll make a little money, most likely, you'll lose, but have a good time. You want to speculate and stocks the latest hot technology trend Oh, fine. Just don't do it with your retirement savings. Do with your entertainment account, and go have some fun. Just don't make it a big part of your financial life.

Alex Murguia 40:56
Weston, this is that you brought up a word here that I want to sort of unpack some more. And that's speculate and, and Bob, this is where I'm gonna bring in Dan Wheeler. And we spoke about him previously. And it's in his passing West and who was super impactful guy within our industry. But he said something that stuck with me as well. First, it was your period comment that what dad said, What's the difference between speculation and investing? Because that's another term that people can throw back at us and say, Oh, we're just being, you know, select it. You know, if we think it's bad, we'll call it speculation. And we think you're doing the right thing. We'll call it an investing. But dad said, Dan said something that stuck with me, which was when you speculate you're taking a bet that, you know, something may work out may not but I'm just betting you know, that kind of thing. And like do your casino comment, hey, at least had a good time we're investing is that there's this expected return. Now, that's a phrase that I'm using. But there's some science behind that phrase for folks that are listening in, right that we won't get into right now we can get into and get into the premiums and stuff like that. But when you're investing, there's an expected return over the long term that you're going to get for taking on a higher level of risk. What that timeframe is depends on the volatility of that underlying asset class, etc, etc. But there's an expectation of a return that you can be fairly confident of getting. How do you present that concept to folks? Because I think it's important that speculation versus investing.

Weston Wellington 42:32
Well, I would hark back to earlier writers like Benjamin Graham, who discussed much of the same thing, I think, is much of his book security analysis, which really kind of laid the foundation for a genuinely intellectual, analytical approach to the investment question really set the foundation for all the future, security analysis and later financial economic science to come. And he emphasized the distinction between speculation and investment. And investment was much more determined by having some logical foundation for that expectation of either a certain income or a certain capital appreciation, or a speculation, like you point out is simply a hunch and you gamble with that hunch. And once again, nothing wrong with speculating, as long as you understand and speculating and you need to learn the first most the most important lesson I think is Dan would say he has to learn to distinguish between speculation and investment. And I think what if I may say I've sort of run aside commentary here. I think a lot of the enthusiasm regarding crypto is a function of individuals unable to distinguish between speculation and investment.

Bob French 44:02
Curious if you should be looking at a Roth conversion or what a Roth conversion even is, head over to McLeanam.com/roth to get McLean's free ebook, here's a Roth conversion right for you, and learn about when you might want to do a Roth conversion. And when you might not just head over to McLeanam.com/roth To download your free ebook today.

Alex Murguia 44:27
Yeah, no, that's a good point. Another point that Bob brought up in the previous podcast that I think merits, you know, just you your take on, and that's because you brought up Graham and Dodd is the whole fundamental analysis because they're effectively the blueprint for fundamental analysis. And Bob was pointing out that fundamental analysis plays an very important price discovery role in the stock market. Unfortunately, the people that benefit from that price discovery We are the folks that index as opposed to the folks that are actually doing the fundamental analysis, right? What's the what's the let's westernize. That concept a little bit?

Weston Wellington 45:11
Well, Benjamin Graham himself, often referred to as the father of security analysis, certainly made the case for the importance in engaging in rigorous fundamental analysis. But it's also I think, telling that shortly before he died, I think it was sometime in 1975, or 1976. He had some very kind words to say, for the whole concept of indexing. Meaning it didn't mean fundamental analysis was not worthwhile. But he was clearly smart enough to understand that, with all the people engaging in this industry of fundamental analysis, as he so carefully laid out, the likely result was that security prices would be fairly priced as a result of all that analysis. And as a result, if they're fairly priced, that means when you show up at the marketplace, hoping to find undervalued securities, you're probably not going to find them, because they're already fairly priced, as with all the so many other people engaged in this fundamental work.

Alex Murguia 46:26
Now, and this goes back to your earlier comment. Let's just say there's roughly 3000 stocks and 100 million investors. Good luck.

Weston Wellington 46:32
Maybe you'll find it, maybe you won't.

Alex Murguia 46:38
How would you argue, well, and not argue it's probably too strong a word, but what would be your response to someone that says, Yeah, but Western, we're just talking now about newsletters. Those folks are, those are people that couldn't make it. You know, you're talking to or they're good writers or whatnot. They're history made. Now we're just getting there film majors. And they couldn't make it, if you will. Then what about mutual fund managers? Yeah, but those are long only portfolios. Those are very pedestrian. You know, where it's at, if you're somebody, you're going to make it in the world of hedge funds and that world, and that's where it's at Not, not this sort of vanilla mutual funds, active managed mutual funds.

Weston Wellington 47:17
Mutual, the argument goes, mutual funds are for little people to find a little people but if you're smart and wealthy, something better for you. So I'm blanking on the exact dates, but I think it was somewhere around 2007. Warren Buffett, the famous investment or German searcher Hathaway, he made sort of a public complaint about hedge funds that he says, You know, I've offered a wager to any hedge fund manager, or people who want to select hedge funds will have a wager I'll put up money. And I'll put it in an s&p 500 index fund. And you will take your hedge fund results in will run for 10 years and let's see who wins and whoever. Whoever has the better performance wins the bet and he's in a no one's taken me not one hedge fund manager has taken me up on this bet if they're so clever, and they're so confident they can pick the right stocks because they're so smart. Why isn't one of them volunteer to take the other side of that? Well, finally, not a hedge fund, but a hedge fund consultant. took him up on the bet. And so they bet was a million dollar bet. And started I believe, January 1 2008. And it was to be for 10 years. And the hedge fund consultant could choose his suggested hedge funds, several of them if he chose, and Warren Buffett chose the s&p 500. And that was drawn for 10 years and no 10 years. Whoever wins wins the bet, and they both agreed it would be donated to their favorite charity. So what happened the first year 2008. You remember what happened? The s&p 500 in 2008. He got crushed. Down 37%. The basket of hedge funds. I don't know what the exact return was it did considerably better than the s&p 500. So right away, Buffett is deep in the hole. But after about nine years, maybe nine and a half years. He was so far ahead. These hedge funds clipped so called clever hedge funds that his opponent essentially threw in the towel and conceded defeat.

Alex Murguia 49:43
So you're saying they're also winners, they're they're underperformers and quitters.

Weston Wellington 49:49
I mean, they ran the numbers for the whole 10 years and I haven't numbers buried somewhere if I can dig them up. But essentially and it wasn't just that he picked three good hedge funds And the two of them were so stinky that they lowered you, all five of the hedge funds underperformed the s&p 500, some of them by a material amount. So here's a hedge fund expert who claims to be able to pick not just good hedge funds, but the very best hedge funds. And he can't seem to do it. He can't do it. What are the chances you're gonna come up with do better than he did? No. No. It seems like the again, the odds are stacked against you, you're paying a lot of fees. And they try hard. And some of them do very well. But a lot of other ones, they don't do so well. And they disappear. And so keep in mind, I tell people, it's, you know, it's like, if you went to a World War, two bomber pilots reunion dinner, like in the late 1950s, the look around the room and say, you know, look at all these happy guys have been drinks here. I guess being a bomber pilot isn't very risky. only looking at the ones who came back. That's the problem with ignoring what we call survivor bias. You don't see the record in any database of all the hedge funds that disappeared? They're gone from a database.

Alex Murguia 51:30
No, no, if you're very true. This is a personal question here. Because we, Bob and I, when we started this, we made a kind of a funny that, you know, when we started speaking with clients, we would make these PowerPoints and kind of take your concepts and just make them our own, if you will, right. That's about that's codeword for pretty much computer stolen stuff. But,

Weston Wellington 51:57
but property, but we'll ignore that.

Alex Murguia 52:01
Yeah, forget that. But we would we would, you know, we kind of okay, let's see, let's see, let's see three views, performance, whatever. And we will update this, I made a point to say we used to update it quarterly. And then after a while, it's that sort of the song remains the same kind of thing, then we just said half a year because things get busy, we will update it every half year, then after I will update it a year. And then you really have to push yourself to kind of keep on updating it because the stories that we just said, remain the same over and over and over. And that's because of there's a reason for that the economic underpinnings, honey, it's that I'm just curious, how do you push yourself to kind of do this? Because you are this? You're the the pied piper, if you will, of sorts of these of these anecdotal stories that you put together? I mean, do you see this at a very meta level at this point where you can kind of have this ready for the next 30 years? All you do is don't put the names on it. And you just have somebody like can replace names and off you go, right? I mean, how did what goes through your head when you're kind of like how do you how are you talking to yourself to sort of give it a new spin because it's it's so obvious over and over and over, but people still don't get it if you were?

Weston Wellington 53:15
Well, the beauty of news is it is news. It hasn't happened before. So there's always going to be some event that people will be able to oh, well, this time it's exact conquering event. I mean, Russia in invades Ukraine. I mean, it's huge. I mean, they have a global event, that's been more worrisome. And we can go back aways but that's beyond the memory of many, many, if not most investors, we didn't have negative interest rates, again, for most of financial history, like 5000 odd years from what I can see. So every now and again, there will be events that seem to be shockingly different, interspersed with many more, that's just the same old, same old markets often tend to go down before the economy starts to weaken, it tends to go up before it starts to strengthen. But somehow people seem to forget that explanation

Alex Murguia 54:14
to current events.

Weston Wellington 54:16
They're easily persuaded that this time, it's different. So part of the reason I keep coming up with more current examples is to link them to what well actually it doesn't seem to be that. They'd be referred in some details, but it rhymes.

Alex Murguia 54:33
There's that piece but but in terms of underperformance and things like that, that's pretty consistent. I mean, over and over that.

Weston Wellington 54:41

There will be there could be periods when some superstar I mean Citadel is the superstar today and Jim Simons or whatnot. General Jim Simons, no longer will will manage your money. He's basically giving it all back. Now that he has a big mother lode of fees that he charges for years and years. He doesn't need your money anymore. So, even if you want to have Jim Simons manage your money, you can't.

Alex Murguia 55:04
But even that's one in how many? Right? Right? I guess that the it's we're running up on time and we could go on forever. But this is more for Wade, sort of to bring it back. In your, in your, in your conversations with advisors, once they get the joke of okay, the investments, you know, you need to be more strategic in nature, etc, as opposed to tactical? How much of a sense do you hear from them saying, Well, how can I add value? And it's ultimately in the planning, it's the stuff that Wade's writing about. It's the, you know, it's that kind of thing where you create bespoke investment approaches with a financial planning piece. How has your perspective on that over the years change, especially considering you started in as a mutual fund sort of evaluator for your previous firm, to where you are now?

Weston Wellington 55:53
Well, I think the the industry has changed to a considerable degree in terms of the nature of assets being managed, so that a much larger fraction of the overall investor pool that are using index like funds, or some version of that, and so I would say, to a large extent, we've almost not entirely but we've largely won the so called debate about whether active management is going to be more useful or not. And now a bigger question is, well, if that's the case, why don't we all just invest in low cost index funds? And who needs an advisor anyhow? Well, number one, many investors, maybe not most, but I think many investors still have trouble staying in their seats, in an index fund, or index type Fund, which when markets go down, you know, you're going to lose money, you don't have the myth that maybe somebody can protect you, you know, you're going to lose money. So there's still that temptation. But also, I think life in general, particularly for wealthier investors, seems to get more complicated year by year. We have more and more complex tax code. We have more issues about retirement planning and various buckets. Do we have a 401K? Do we have other types of retirement savings? How much one should I claim Social Security? I think some people figure out there like several dozen different social security claiming strategies. Well, which one should I pay to kind of be best for? My spouse? And I? How do you unraveled Medicare Part B, I would I attended a financial advisory conference when there was some expert talking about Medicare and what, holy cow, I didn't know what I didn't know. Sure. I'm glad somebody else's, like, you know, on top of this kind of stuff, because I didn't want to have to figure it out. So I think there, there are lots of things that adviser can do for an individual, including maybe acting as the financial quarterback to make did you have that wheel updated when you had you adopted another child or something? And have you checked the beneficiary of your IRA account? Oh, do I have one? Wait a minute, I'm not sure I did. There are a lot of things to keep track of, to make sure you're going to achieve what your investment portfolio is trying to do a lot of moving parts, and the wealthier the client, the more complex seems things seem to be

Alex Murguia 58:27

No, that's great. And Wade, just maybe as we wrap things up here. You know, you've heard Weston here get, you know, provide his steak. Wade just has the second edition of his retirement planning guide book out. We released yesterday. So by the time you hear this, probably a few weeks into it. But when you're when you're thinking when you were hearing Weston's answer, wait, I need you think about that within the context of the book that you just released, cuz he was talking about Social Security was talking about Medicare, etc, etc. I mean, that's where an advisor can really add monetary value your thoughts with

Wade Pfau 59:04
Yeah, yeah, I mean, for just listening to this is a great masterclass and all these concepts, and I did that investment education for myself 10/20 years ago, and don't really think about it all that much these days, because mainly letting you guys talk about these topics, because I am focused more on those planning issues and the investment piece, it's really been commoditized to a great extent where there isn't a lot of value to be added by choosing investments and therefore it is important for advisors to offer that value through other outlets through the Social Security claiming and the Medicare decisions in the long term care planning and everything else that goes with building a financial plan and I focus particularly at retirement but of course pre retirement as well. That's where ultimately the value can be added in, and where a lot of the attention can be paid to increasingly in the future for advisors.

Bob French 1:00:03
Yeah, and, you know, I think at this point, Weston, thank you so much for your time here this afternoon. This was a really, really great discussion. We didn't talk too much about the financial media, but really, really great history lesson on, you know, just kind of how to think about a lot of these kind of big concepts around investing. So again, thank you so much for your time. It was a really, really great discussion. And, you know, we'll see you around.

Weston Wellington 1:00:34
Good. Thank you very much, Bob. Great opportunity for me to talk to you folks.

Alex Murguia 1:00:37
No, that's great. Yeah, thank you, Bob, real quick, financial media. They they they they try to play on your fear and greed. And that's pretty much it.

Bob French 1:00:49
They're selling your eyeballs?

Wade Pfau 1:00:51
They gotta come out with every month, something to say.

Alex Murguia 1:00:55
Thank you, Weston.

Bob French 1:00:58

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. All investing comes with the risk including risk of loss. Past performance does not guarantee future results.