Episode 164: Investment Insights: What 2024 Taught Us

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Retirement planning, financial personality, market predictions, investment insights, 2024 review, S&P 500, value stocks, small cap stocks, international investing, market volatility, investment strategies, risk tolerance, market returns, diversification, financial advice.

SPEAKERS
Wade Pfau, Briana Corbin, Alex Murguia, Bob French

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.

Briana Corbin 00:41
Another year, another round of expert predictions that just didn't quite hit the mark. Wade and Alex, take a look back at 2024 what actually happened, what the markets got wrong, and why retirement planning is all about adapting, not guessing.

Wade Pfau 00:58
Hey everyone, welcome to retire with style. I'm Wade. I'm here with Alex, and we are ready to talk about the year in review as well, as well. It's getting a little bit late, I think, to just look at the year in review, but really focusing on what people thought was going to happen, what actually happened, and how you can apply that today, as all these forecasts are coming up for what's going to happen in 2025 to take the lessons from 2024 and see what we can learn about 2025 I have the basic idea right there, Alex, I think so.

Alex Murguia 01:30
We'll see if I have the basic correct. But yeah, no, yeah, you're spot on. Man,

Wade Pfau 01:36
yeah. Last week Alex was asking me questions. This week, we're going to do more of an investment themed episode, and I'll ask Alex some questions. Fire away, but before getting into the meat of the matter, what's new in the world? Alex,

Alex Murguia 01:48
Hey, you can't have it both ways. Well, you can't have it both ways. Wade, this is where no what's happening in my world recovering from a bad bone bruise, if you will. So hadn't been

playing I haven't been playing pickleball for two weeks, and it's felt like an eternity. I never knew I had this time.

Wade Pfau 02:10
I know you had a hand bruise. Is that what you're talking about?

Alex Murguia 02:14
Playing soccer with my kids in the house, which my wife also loves and yeah, and I'm embarrassed to say, but they were coming. It was like one on one drills. And I, you know, I obviously, I faked him out incredibly. So no, I made a move, and he lunged for the ball and my leg, I kicked my leg out to avoid that, but I ended up hitting the doorway. And my Yeah, my shin took it right on the bone. So it was one of those that there's a couple things I'm definitely afraid of, plantar fasciitis and shin splints from a soccer perspective, and so I just had to, like, shut it down for two weeks.

Wade Pfau 02:53
Yeah. No, did you break any vases? Also,

Alex Murguia 02:56
I have, but not, not in that. Yeah.

Wade Pfau 03:03
Bears teach us that not to play soccer indoors.

Alex Murguia 03:09
Yes, yeah. I was gonna try to quote something from the sidewalk. What's the one does shel strawberstein, the the end of the sidewalk? No, the sidewalk never Yeah,

Wade Pfau 03:20
I know you're talking about different but, yeah, I don't know. I don't know what it's called,

Alex Murguia 03:26
the Sidewalk Ends or something. Something about the sidewalk and ending or not ending, right? Some funny thing like that. I always love those books. I think those are the only books I read. Frankly,

Wade Pfau 03:38
oh yeah, they didn't have the other

Alex Murguia 03:39
thing I told you about, have you tried the hack that you and I were talking about the other day for reading?

Wade Pfau 03:47
I do not know what you're referring to. Oh,

Alex Murguia 03:49

maybe I was telling Trevor, yeah, I think I told you, this is where I buy. You know, I am big Kindle fan, so I read on Kindle, but then I buy the same book on audio books,

Wade Pfau 04:01
oh, for the dollar, whatever it is. And

Alex Murguia 04:02
then I listened to it on like two and a half speed while reading it. And my, my goodness, that helps me just focus in and plow through it. I've read,

Wade Pfau 04:14
oh, you follow along with no, you didn't tell me. Sounds interesting? For sure, I would have remembered,

Alex Murguia 04:23
yeah, well, yeah, it's amazing. It keeps you on track. So it's great for my attention span, simply because, you know, sometimes you can wander off, never with your book, by the way, but you know, you know how you can, like, wander off and start thinking about your day or whatnot while you're reading, and then you're like, Wait, what did I just read? And you go back to it, yeah. And so it keeps me focused on that. And then by having the speed of it, I'm not a very fast reader, I try to just like, really go slow and comprehend. But you know, that's not to say I can't go fast and comprehend as well. And so I found it actually quite well I've read. Had three books probably in four sittings doing this. Yeah, it's

Wade Pfau 05:07
in that two and a half speeds that's getting up to about where the limitations start, depending on the

Alex Murguia 05:14
narrator, chipmunks reading the book. But I kind of, I guess you habituate to that, and you turn it off, you know, in your head. But, yeah, I didn't start at two and a half. I started at two, then two and a quarter, and then I more than two and a half. I guess if you read I'm not, I'm not there yet.

Wade Pfau 05:34
Okay, well, that's an interesting life. There

Alex Murguia 05:38
you go. But that's it. By yourself. I gave a lot. Wait, I gave a lot. What do you got? Don't just say nothing at this point.

Wade Pfau 05:48
Well, I do. I tend to listen to podcasts. Well, 2.7 times speed is about as fast as I go, depending on the podcast. If it's a harder podcast, maybe two times. Yeah, I've never tried listening to audiobooks. At the same time, I haven't really listened to audiobooks, and it can be tough to make audiobooks. That's a question sometimes we get about the retirement planning guidebook. Currently, there's no audiobook since I updated every year that really creates it, and it's so so long, it's

Alex Murguia 06:17
tough to know. I've never, I've never listened to an audiobook until this time, or at least, I don't remember ever listening to an audiobook until right now. And, you know, I just did it more to almost like a metronome, kind of function that it has for me. Well, I read it, I noticed a difference immediately. So there it is. That's a life hack. Follow me For more advice on Instagram.

Wade Pfau 06:44
Here you go. Are you on blue sky? Are you on blue sky? Yeah, sky like, uh, blue oceans ready? Oh, yeah, I forget you don't always follow the news. Oh, that's another new social media. Oh,

Alex Murguia 06:56
I got you. I got you. Yeah, no, I don't are you?

Wade Pfau 07:02
I have an account, but I didn't really do anything after that.

Alex Murguia 07:07
All right, man, I don't have any posts, okay? And speaking about speeding things up, obviously we'll get some reviews about this little back and forth that we had to those people fast forward or don't listen your thoughts.

Wade Pfau 07:26
Yeah, you can, yeah, that is a life hack I use with podcasts. You can kind of fast forward through the beginning. A lot of podcasts do the opening before they get into the heart of the matter. They have some banter.

Alex Murguia 07:39
Right now, this conversation is very meta, isn't it?

Wade Pfau 07:44
Right? But as we get into the matter today, so if you are listening to this episode very early in the day, it comes out on Tuesday, February 4, we'll have a webinar at 2pm eastern time that I'll be doing on how much can you spend in retirement the if you want to register for that webinar, it's retirement researcher.com No, that's not right. It's risaprofile.com/podcast and we'll be, we'll be going at 2pm Eastern time. You can also register and catch the review of that, but if you're listening to it much later in the day, it may be too late. And so let's get into the matter for the day, which is looking back at 2024 not just to review what happened, but really to learn from what people thought was going to happen, what actually happened, and some of the highlights. Yeah,

Alex Murguia 08:32
I think at this point, with the speed of information, it does no good just to say, Oh, the SMP returned this. And what do you know? Right? I think what's more interesting is, at the beginning of every year and towards the latter half of the previous year, like the latter last two weeks, you start getting prognostications for the upcoming year. And and people take those too hard, and I think they take them too hard a lot. I i believe they realize that obviously nothing is written in stone, but still, they use it as guideposts for what's going to happen in the upcoming year. And those guideposts have knock on effects on people changing their allocation, people sitting in

cash saying, Oh, let me not invest or let me go all in, you know, things like that based on prognostications. And it may not be on one person, it could be a whole consensus of them. And so what I, what I used to do a lot when in McLean, when I solely just did the investments, I would always like to have a presentation ready. I titled it profits and losses. And it was, I didn't, you know profits being like, like the Bible prophets, you know, for you know, you know, P, R, O, P, H, E, T, profit and losses, simply because it's you like that you see what we did there. It's

Wade Pfau 09:48
no but we did that because it

Alex Murguia 09:51
was good to have fun, right? And really level set that you have to hold folks accountable from the stand. Point, if people, year after year, make certain prognostications and they're not even close to being right, then what's the point? But I think people just forget, from one year to the next that, oh, you know, hey, who knew this was going to happen? And so that's why they were wrong, and so, but this is what's going to happen next year, and I and I, and the reality is, every year, there's something that's going to happen. So it's that's not an easy excuse. And so just looking at 2024 because 2025 is, you turn on CNBC, you read anything, it's what's going to happen. This is what's going to happen instead. And it said with this level of confidence that it, it's not warranted, frankly. And so I always like to look at 2024 not by how the markets did, but what they said it was going to do, and what actually happened, right? And the S P returned, effectively. Let's just say 25% a little bit more, but let's just say 25% the S P returned, total return. Okay, I showed you the slide that I had for the second year running, yeah, which That in itself is like pretty interesting, but I've sent you the slides so you saw it. But what did you think would have been the highest expected return from one of the prognosticators, knowing that the S, P actually returned 26% and assuming that people kind of get this in the zip code, which you would think, right? What do you what would you have thought if you guessed,

Wade Pfau 11:25
I must say you sent me this slide right when you said you're logging in. So I did not actually see it. Okay. So what do you think? I guess the more prognosticators there is, the maximum anyone would have predicted would be higher, but we're saying, like, not the highest estimate, which could probably be 50 or 100% or more, but a general high

Alex Murguia 11:46
question, mind you, but you don't know which direction, probably

Wade Pfau 11:48
around 15% maybe around 15% 15% it returned 26

Alex Murguia 11:55
13% What do you think was

Wade Pfau 12:00
the lowest? Negative 20%

Alex Murguia 12:03
it came in at 13 and 12, like, oh, wow,

Wade Pfau 12:10
you're not everything. That's not an average. That's you have a bunch of people

Alex Murguia 12:17
giving their forecasts of the major like firms and Wall Street review of the Goldmans, if you will, and

Wade Pfau 12:22
the hut and their ant, the i between 12.

Alex Murguia 12:25
No, the highest projected, sorry, I meant negative 12. The highest projected estimate was positive 13% the lowest was negative 12, right? And so the point here is that the S, P returned 26% and these folks were way off, you know, from the standpoint of they were under by half, the highest one, and the consensus was in like that four percentage range, if you will. And so this is where you have to ask yourself, like, what's what's the point of these. I mean, folks base their investment decisions on that, and look how off they were. The S, P returned 26% the highest possible estimate among the top Wall Street firms. 20 of them was 13% and the lowest was negative 12. The consensus was in the 4% range. If you take the median, that's how I'm determining the consensus. So if you think about this, these are 20 people with a team of 20 people getting paid million plus dollar salaries, Ivy League educations, and they can't get it right now. This isn't me trying to jam on them for being like, Oh, how can you be so silly? You know, kind of thing. It really is more of a thing of they're fishing in a dry lake, you know, kind of thing, the ability to fork. A lot of folks think, you know, a successful investment experience is being able to forecast hence, you know, you're always asking, What do you think about the markets? These are folks that get paid to do this. And they get paid to do this largely to instill confidence, or to begin to give you re give you a rationalization why they're changing their allocations, right? They come up with these, this sort of themes, and then they play off these themes, and then they say, okay, based on these themes, it's going to affect S P earnings by this much. And if it affects the S P earnings by this much, this is how it's going to then ultimately affect the returns. And they consistently get it wrong. You know, from this standpoint, if you go, it wasn't just this one year, right again, the highest was 13. The consensus was in the low mid single digits, and it was 26 but if you look at ninth, I'm looking here from a slot deck, right? But if you look at 2018 effectively here, the median estimate was seven and a half percent return. The market returned negative 6% I'm using now round numbers just to you know, make it easy, in 20 and so they overestimated by 14 percentage points in 2019 the median estimate was 13. Percent the market came in. Hang on, this is a small number. At 29% they underestimated by 15 percentage points. 2020 they expected 2.7 it came in at 1620. 21 they expected 1.2 it came in at 26.9 2022 they expected 1.2% it came in at negative 19. I'll stop now. 2023 they expected 6.8 it came in at 24 I mean, the theme is, why do they do this? I mean, you could just throw out random numbers at this point. In fact, the smarter thing would be, you know, I was looking at the numbers here, the S P has roughly been 10 and a half percent since 1927

Wade Pfau 15:54
Yeah. So that's your best shot. Guess at being right? That's your best

Alex Murguia 15:57

shot. Yes. But then here's the trick, and this is a loaded one. How many times do you think the S P has returned within 10 and 11% since 1927

Wade Pfau 16:10
it's gonna be pretty low. I guess

Alex Murguia 16:11
it is. But what's your guess?

Wade Pfau 16:15
So what percentage of the time? I'll say 5% Yeah,

Alex Murguia 16:17
five Yeah. You got it dead on five out of 99 so let's just say 5% pretty interesting, right? In terms of, you know what? What the heck's going on here, you know from that standpoint. And so you might as well just do that, because what's, what's the point of all of this? And the takeaway too, is when folks are doing their financial plans, and right now they're putting their expected return for this year, especially if you're taking a sustainable withdrawal rate, right? Thinking, You know what? Let me put 0% return this year, because the new elections and this and that, we have to let that settle so such and such, right? You know why? Why do that? You're making the same mistakes that that these folks will ultimately make. And so the takeaway again, as we level set, before we get into this sort of you know what happened in the markets this year is when you're listening to prognostications, buyer beware, even your own right. I mean, fact set right now is reporting that in 2025 the s, p is scheduled to rise. Hey, what do you think as a guest, just because we're having fun. Now, if

Bob French 17:26
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Alex Murguia 17:47
What do you think they would say?

Wade Pfau 17:52
I would just pick the historical number.

Alex Murguia 17:53
All right, so 10% I would, if I'm doing this without knowing anything the fact that it's gone up over 20% the last two years, I would be like, Oh, well, it's gone up that much. The standard deviation on that 10% is probably 15, 17% more or less. So even though it is within normal limits, it's on the higher end of that. I would probably think seven, 8% just, just for the hell of it, if I'm saying it. But no, the average, the average consensus here, it's coming in at 14 and a half percent, 14.8% Yeah, exactly right. That's pretty ambitious. You know, not because of the forecast, but just because, not because I'm not sanguine about the US, but more you know, why not just do 10% right from that vantage point, but it's interesting that they're saying that. But I mean that, you know the for me, the lesson is, be careful as well when you're doing your financial plans, and

pretty much ignore whatever anyone's going to say right now, because, again, they don't know the random information that's going to come in. I mean, Monday alone. Right now, it's January, 29 so on the 27th on Monday, Nvidia drop $600 billion of market cap. It took the entire tech sector with the AI bent with them. Why? Because news came out that deep sea has created from China, has created a significantly more efficient way to develop and train Lang, LA, large language models for AI, initially, the whole thought was they created the whole thing, you know, for, I think it was like 5 million bucks, right? And it was going, what, what, you know, when, in reality, you know, they had, they were just piggybacking off the infrastructure that was already built, and they did find a more efficient way to train models, which will reduce things by orders of magnitude. And so markets have been correcting from that the on. But the point is, this information came in randomly, and boom, who would have thought? How can anyone predict something like that? It's. Right? And the effect that that would happen, and that's the silliness of this all, is what I think, like trying to play that game is, is just too tough, you know. And really, the better way to go about this is just your job as investor is not to be able to forecast. The bad news is, no one can forecast, as you just saw these Ivy League education, I think all of them went to Princeton. Wait, what do you think? Probably

Wade Pfau 20:26
there's always the schizophrenic nature of all that financial education, like even going through the CFA program, they tell you you can't forecast any of this stuff. But then they also try to teach you all the tools to make these looks like there

Alex Murguia 20:39
must not be enough graduates from Boston University in this, in this batch of prognosticators. But, yeah, I mean, it's, it's not a matter of intelligence. It's, to some extent, it's a little bit of hubris, I think. But ultimately, is they're playing a game that they can't win, and that's the bad news is to be a successful investor, you can't forecast. The good news is you don't need to forecast. You know, our job is to capture market rates of return, as we saw, the average was such and such, and capture that. It's not going to happen every year, but if you just stay disciplined and capture that and ignore all the, all the noise from, you know, from the daily news cycle, you'll be a much better investor over the long term. You know, that's my takeaway from what you're hearing. Now, in terms of 2024 I'm bringing up 2024 because these were all the predictions, none of the you know, for the most part, they didn't come to pass. If, by some chance someone had hit, hit that, you know, what are the odds they're going to get again, the de minimis zero, right? Yeah. Well,

Wade Pfau 21:44
not broken clock is right. A broken clock is right. Maybe

Alex Murguia 21:49
one more time, but that's it. You know, when it, when it comes to that, and so that, that's, that's my takeaway on what you're hearing now about what's going to happen to the markets going forward, and the like and and by capturing returns, if you really think about it, if you look at 12 month rolling periods from 1927 to September 2024 right? And that means that you're controlling for a lot of stuff. There's a lot of auto correlation here. That makes us a little, you know, there's a lot of dependencies of the samples. But let's just, let's just have that heroic assumption put away right now, because it's, it's fun to play with numbers, if you will. If you take a yearly rolling return, that means from january 1927 to December 1927 and then from February

1927 to January, 1928, and so forth. You just do that continually, right? If you do that rolling, rolling historical right over a one year period the market is positive 75% of the time. Right over a five year period, the market is positive 89% of the time over a 10 year period, 95% of the time, right? When you compare it to cash, you know, did it outperform cash over a 10 year period, it outperforms cash 86% of the time, right? And so that's where this idea of time diversification and just capture returns that are available for the taking. You do that enough. There you go. Now somebody may be thinking, heck, why not 100% equity portfolio? Wait, I've spoken a bit. Let me ask you that question in consideration of what I just said, that it's not about forecasting, hence, by evidence of what we just reviewed, why not just put it in 100% equity if you see over a 10 year period, it's going to be positive 90% of the time, 95% of time. And I'm sure over a 20 year period, now you're getting into the 100 what would be your response?

Wade Pfau 23:47
Well, that's something that may resonate with more probability based, folks. It's not going to resonate with safety first, folks, yeah, definitely. The probabilities are in your favor. And we do see, from time to time, advocating for 100% stocks. I think we even had a in our Q and A episodes, someone had asked about that. But you have to consider your risk tolerance and your ability to stomach short term market volatility, and that could be a pretty wild roller coaster ride. And not everyone is suited to withstand and not panic and stay the course with that kind of really concentrated, volatile investment strategy, 100%

Alex Murguia 24:27
the other one is, you know, the s, p went up for the year, let's say 25% just if you were to guess, how many updates do you think there were as a percent? It went up 27 25% so

Wade Pfau 24:42
last year it was a roller coaster. I think we talked about that too. We had some periods where it kept going down day after day, and then it recovered pretty quickly. So well, so maybe it was up two thirds of the days. Last year down 1/3 of the day, something like that. It was

Alex Murguia 24:57
up. I'm doing this not because I knew before I. Asking you I have it written down. So it was up 58% of the time. So that's, you know, 252 trading days. That's 146 days. You know, roughly speaking, it was down 105 days. So every one and a half day that goes up, one goes down. Think about following that every day, and think about every reason at the end of the day. Why this happened? When it nets up that much, right? It's like, what's the point to your to your thing? The biggest drawdown, that means consecutive down days. Then which that you know? What was the biggest percent down? It was 8.4% it went down 8.4% between July and August, mid July and early August, right? It took the market about I have it here at 32 days to recover. Trading days to recover. That's not bad, you know, on many levels.

Wade Pfau 25:56
So yeah, kept hitting new, historic highs and then having those big drop offs and then recovering again.

Alex Murguia 26:01
There were a lot of highs during the year the chart, it was too many green dots for me to sit down and count them off, frankly. But you know, the other piece that I think worries people is,

oh, the market's hitting new highs. I should stop now. The reality is, it's the market's job to hit new highs. If capitalism is working, if the economies are working, it should be going up, earnings go up, you know, that's how it is, you know. So there's nothing actually wrong with that. In fact, it's you kind of, that's, that's, that's not necessarily a bad thing, that's, that's fine from that vantage point. So, yeah, it was, it was a pretty interesting year in that regard. Go on with

Wade Pfau 26:41
you're hitting some of those, like market ups and down type highlights. Any other special events that happened? Yeah,

Alex Murguia 26:46
current events, if you will. But I don't need to rehash that. Everyone always sees those news, you know, the year in review, on the news and things like that. Where, you know, I was trying to make a funny but I can't right now. I think what was interesting is, at the beginning of 2024, you had an inverted yield curve, you know. And those are things that, oh, that those portend a recession, right? Another reason why get out of the markets, right? That, that kind of thing, Oh, my God, the market is pricing in a recession. Look at the look at the yield curve. Now, if you look at inverted yield curves, there is something to that, but unfortunately, there's a lot of false positives of that they predicted. You know, the joke is, what five out of the last two recessions, you know, like, what? I don't know what the actual joke is, but it's something along those lines. But interestingly enough, the yield curve, you know, you know, with with the Fed, that they had three major movements. They went up. They went up by 50 basis points in one shot. And then they have two consecutive on a monthly basis, 25 bibs and 25 bibs. And so you can make the case that was somewhat brute force, you know, bringing the raids back up. But ultimately, the yield curve is in line with what you would kind of expect, you know, relative the numbers and the spread between the low and the high years, who knows, but it's taking on the shape where it's no longer inverted. And so that's an interesting pay that's an interesting take from the standpoint of, you know, the bond markets kind of give you a sense of the expectations of what's going to happen. And, you know, we just went through a few years of everyone saying, Okay, well, rates have kind of adjusted. You know, the bonds took up the brunt of that, not this past year, but the year before that. You know, they did. You know that I think the aggregate bond market was down about 1% in 2024 and in my estimation, considering everything that has happened over the last three to four years within the bond market, you know what? There's a lot of people that would take that in a heartbeat, right? That kind of performance in consideration and how it's set up now going forward. So that was, to me, something that was of great interest from the standpoint of something that happened in 2024

Bob French 29:02
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Wade Pfau 29:30
Okay, now another couple issues that I think we hear about quite a bit, so the S, p5, 100 had a really good year kind of tended to outperform some of the other market indices. Anyone who's been investing in international stocks for a long time has been underperforming the US market.

So maybe a question that people may have is like, is International Investing dead, or should they only invest in US stock? Markets, or is there still a role for global diversification?

Alex Murguia 30:02
From my view, this is one of those things that you see every, every three months, I'm sure you'll start seeing it. Yeah, the s, p, you know, gave, gave you 25% the international developed markets. You know, I'm using the MSCI e fee index, uh, effectively. Well, the MSCI World, ex us, rather that came in at 4.7 this is a one year period. Over the last 10 years, it's annual. The S P has been annualized at 13.1 which just take us take a step back. Look at all the things that have happened in 10 years. And the S P is coming in at 13% annualized. You know that's that's pretty good. And as an aside, it shows you also the silliness when everyone gives you this every year. This is what the sustainable withdrawal rate is right now, based on what we think the market is going to happen. You know that that kind of thing, but yeah, the s, p, last 10 years, 13% International, 5% it doesn't take a genius to say, wow. What the heck am I doing here, right from that vantage point. But even then, I will still caution, look, at the end of the day, they are always just infrastructure items and things like that that you can consider and you can point to to say, haha, that's why. But you know, if you look at the numbers, it's a little more than just that, you know? I'll start by saying there's no reason to think, let's say those GLP and GIPS drugs right? Now, let's just take Eli Lilly, right? I think they do that bound. And let's take Novo Nordisk, or whatever they do those epic right? And they're based in, I want to say, Denmark or something like that. Not, not here. They're in Europe, right? There's no reason one of those should outperform the other, right? And so to me, from the standpoint of of investing, you want to expand your opportunity set if it's going to provide the same type of expected return, the benefit of that is that they may not in the pharmaceuticals, may happen, maybe a high correlation. But in general, if you aggregate European stocks that are similar, like that, and you aggregate domestic stock, there's no expectation that one should outperform the other because of some secret thing or because of where they're domiciled. It just is what it is. I mean, at this point, they're all globally exposed, right? The benefit is that you just have a wider opportunity set from that for diversification like the S p5 100. Well, why invest in the S p5 100 when you can invest in the S P 1000 for the same expected return, you know, kind of thing, right? In addition to that, there is a diversification play where there is a higher correlation, but it's not one, you know, from that standpoint, I mean, just evidenced by here one year, 25% the other one was 4% right? But it could be where next year, the s, the International returns 14% in the s, p5, you know. And from that some you just want to be there for those opportunity sets. Why? Because underlying that is the expected return for developed international stock market in aggregate, versus a US stock market should be relatively the same. And if you look at the numbers here, there's a couple things. If you remove the Maga, The Magnificent Seven, I said bad guy. Oh, my goodness, if you remove the Magnificent Seven, you know the Help me out here, meta alphabet. And I was gonna say Google and Facebook, I was like, Oh, they changed their names. Meta alphabet, Nvidia, etc, etc, if you remove those from the S p5 100, the S p5 100, which just was just a smidge over the E fee right. Now, don't get me wrong, they're still in the index, and they deserve to be part of that, etc, etc, but I say that to show you how concentrated, you know, the S P has become with regards to these large players. Now, granted, the S P, because it's a market cap weight index, you're always going to have that type of representation from high stocks. But I just want to point out, from a breadth standpoint, there wasn't much of a difference. You know, the US is fortunate. You know there that these companies happen to be domicile in the US and not in Denmark, if you will, from that standpoint. But that being the case if you look over the longer term. I mean, here, I don't I'll tell you here, from the things from 1970

to 2001 and I'm using 2001 because effectively, international stocks have underperformed the US since about I'm sorry, 2000s 2011 All right? Since 2011 there's been that, that schism where the US has just continued to outperform versus international on a year by year basis, right? But there are long periods of time where that's just not the case, and those long periods of time represent you. Investment horizons, right? And so from 1970 to 2001 the US returned 11.56% 11 and a half percent. The US world, ex us returned 10.9% so that's a difference of about half a percent every year. It's not insignificant and significant, and significant, right? But then in 2002 to 2011 that switched all of a sudden, the US from 2002 to 2011 returned about 3% whereas international stocks returned five and a half percent. Right there, the US underperform annualized for a significant period of time, roughly 10 years, by 2.6 percentage points a year. So now let's take 1970 and bring it all the way down to 2011 right? So I gave you two snippets where one outperformed the others for a significant period of time. Now bring those two snippets together, and what's the net from 1970 to 2011 the US perform 9.46% annualized international stocks 9.62% let's just call that a wash, right? I mean, technically, the US underperformed by about point 16 of a percent, but let's just call that a wash. Now, the benefit that you get from that is the reduction in standard deviation, because you're bringing in these two asset classes that actually, as you saw from those returns that I showed you in the first and second one there were, there was a difference in those returns aggregate, they end up being the same within the portfolio. Through the magic of diversification, you get kind of the only free lunch available, which is you reduce the standard deviation, having those two asset classes in a portfolio granted since 2000 and and change in and 12 or so we've been in that US has had a heck of a run, right? Not to dissimilar from january 1970 to december 2001 but as a song from Barbara Lewis goes, our day will come right at some point if you're an international investor, so I you have to remove recency bias from the equation. And recency bias isn't Oh, the last three days, this has happened. The last three years, this has happened. No, we're talking investment horizons. And investment horizons, to be able to be statistically significant, to the to be able to get a T stat that's greater than two, you need lots of you need to have a lot of sample sizes within that. And so that's, that's that's not me being cute. That's just the name of the game when it comes to determining Is this worth it versus not. And so from a recency bias example, I would say, hold that thought. You know, there's still plenty of reasons you would want international exposure. And I've shown you in the in the example that it just went through, there's these things come and go. You know, I wish I could tell you when that would happen, but I can't. And the reality is no one can. I mean, if these the first chart I showed you, when these Wall Street analysts are kind of predicting what the stock market is going to do, when they absolutely can't do that, what makes you think they can drill down even further and let you know that international stocks are going to outperform domestic stocks this year, and that's where you should be,

Wade Pfau 38:21
right. Right, right, challenge. So another question that comes up, and I have a feeling the answer might be similar and maybe related to the these Magnificent Seven you were talking about, but a small cap in value, we expect there to be a premium for because of the risk for investing in small cap stocks, in value stocks, but they've underperformed. Are they dead or is there any hope? Yeah,

Alex Murguia 38:47
no, no. What's the Mark Twain? Quote, right, I've been widely over exaggerated, but I'll say this, and you use the word risk, I believe there's a risk store to tell, but there's a lot of research

coming out that it's not necessarily a risk story. It's, you know, to some extent, some people say it's a behavioral story that you're seeing. The to some extent, you could say, Listen, I whether it's a risk story or behavior story doesn't matter, because it's a systematic thing that you're seeing. It's not something that, once it's recognized, it gets priced out of the market, right? Ultimately, that would be a bad thing, you know, hey, this is priced out of the market, you know. And small caps, the jury's still kind of out there, but that being the case, I want to present to you. I saw this, and I thought, you know, this is a great explanation of why investing in values. To you know, to me, makes a lot of sense. You know, now, before I say that, I have to level set there is nothing wrong with a market portfolio. There's absolutely nothing wrong if somebody holds a globally diversified market portfolio, like the global version of the S, p5, 100, or if you you want to be 100% Globe, you know, the S, p5, 100. Why? Because that's how the world chooses to allocate its capital. And so that's fine. Any deviation from that is some sort of quote, unquote bet. So I can't argue with that, right? That being the case, I believe there's different areas of the market that present interesting risk profiles, and that it's not an inefficiency. It's just your compensator for taking on escrow risk in certain areas of the market that not everyone wants to go all in on. You know, that kind of thing that being the case year to date, value, large value, return, 14.7% I mean 14.37 let's just say 14% right? 2020, large growth, yeah, 2024, large growth came in at 33 small, small value came in at 8% small growth came in at 15% right? So what's going on here? And this is probably at this point 1010, years of underperformance for both value and small relative to growth. And if I say value and growth the market the s so think about S p5 100 value index, S p5 100 growth index. And then there's just the S p5 100, which is a blend, if you will. And the blend is always somewhere down the middle, right? So you have to ask yourself, What's going on here? Now there's two ways to go about this way, and that's because the value stocks, to me, the risk story is value stocks from an accounting term their price. You know, when you look at them at price to book, that means they're selling. They're selling very competitively relative to the growth counterparts, from a price to book standpoint, that means that you can just take the tangible value of their assets, sell it, and you'd get a higher return relative to the price that they're being sold for right now in the stock market, right? You know, that kind of thing. And so a price to book ratio of one indicates that if I were to sell the furniture in this business, you know, everything that's tangible, you know, I could sell it for $20 and it happens to be that it's selling at $20 price per share in the market. So that would be a price to book of one, you know, that kind of thing. And so stocks that are priced with a low price to book ratio, they're almost being sold at a discount relative to their book value. Why? Because there's usually something going on. There's usually some distress. And I'm setting this up because value can get more valuer, right? It's that catch a falling knife phrase, right? And so you want to make sure that the value index, what is AI, is technology taking over the world, and all these old school companies are going down, they're going down the path of the horse carriage relative to the car. And an interesting way to look at that is to break down the price to earnings, and because you want to get a sense of what's really the breakdown of this separation over the course. And what I mean by that is, if I look at value stocks, and the quality of the earnings have gone down significantly over the last 10 years, then maybe there is something to be said for Yeah, this is, this is a depleting Well, this is, these companies are all going to obsolescence, you know, kind of thing relative to their growth counterparts. And so if you break down large growth by their price change, and large value by their price change in the US, the price change over the last 10 years for large growth has been they've gone up 310 for 320% 10 per 320% this is the Russell 1000 growth has gone up 320% the Russell 1000 value has gone up 77% so growth stocks have gone up 320% versus 77% of value. So the price, the price in the in this equation, price to earnings ratio, the price has gone up 320% versus 77% the earnings for these growth stocks have gone up 145% versus 50% for their value counterparts, interestingly enough, Right? So the price has gone up 2.2 times the rate of the earnings for growth companies, and it's gone up 1.5 times for value. To me, that indicates that you know value. Okay, the price has gone up 77% fine, modest, but their earnings have gone up 50% so if their earnings have gone down 50% that would be a significant Whoa, what's going on with this whole group of companies? It stayed relative. It's been healthy, I would say. And frankly, you know, I'd be more concerned about justifying a 320% price increase with only a subsequent 140 5% earnings increase over the last 10 years. Obviously, the market is pricing in future growth. You know, from that standpoint, that's the only way to do it. So the change in PE ratios for large growth stocks, they've gone up 72% over the last 10 years, meaning that their PE is now 37% right? Whereas. PES of large values, large value companies, their PE ratios have gone up 18% but they're still at 19.7% right? And so to me, I still have a healthy exposure to value. And again, this is not investment advice or anything like I'm just giving you my hot take, if you will, and wait chime in. But if you have the large growth, their price to earnings ratio over the last 10 years have gone up 72% right for a current PE that's standing at 37% relative to large value where they haven't been decimated. From a fundamental standpoint, is what I want to bring home. You know, the spread between value and growth isn't this fundamental accounting thing. The spread is just due to this idea that growth is going to go on forever and ever. And that's we know. Investors are not willing to pay $37 for $1 of earnings, as opposed to $19 for $1 of earnings in the value I'm fine with that, you know, in terms of my exposure to value, and again, I think everyone has heard us over the last years, at this point that they know we're not forecasting or anything like that. I'm just kind of seeing, is there something fundamentally off with value? My answer is, I don't see it. You wait, what's your take on what I just said? No,

Wade Pfau 46:26
well, I don't dig as deep into the weeds on the investing topics, but I still feel comfortable with the idea that small value should have long term potential. So yeah,

Alex Murguia 46:39
there it is. Yeah, no, I agree. And so that's where, you know, when people say, Oh, it's values, time to now, you know, sector rotation. Now it's the value play. Now it's the growth play. Now it's whatever. I don't care about that. I'm just taking it from the standpoint of, look, there's nothing fundamentally wrong with value. You know what? I believe it's a risk story in the sense that they have higher cost of capital, and because they have a higher cost of capital for investors to invest in them, there's a higher implicit expected rate of return than for growth companies, you know, based on the fundamentals. That hasn't necessarily deteriorated to the point that, oh my God, you're buying a whole bunch of horse carriages at this point, as opposed to, you know, cars and so that's, that's what I'm looking at when I see that. Now, the same case could be made for small small caps, small growth, you know, effectively us small growth and us small value. Interestingly enough, you see the same thing between small growth and small value, as you saw with with large growth and large value. But to a lesser extent, what's interesting to me is that small growth, you know, this goes back to do I invest in growth stocks, you know, relative to others and based on earnings quality, small growth over the last 10 years, the price have gone up 104% small value, 62% the earnings of these companies, small growth has gone up 122% so the price has gone up 104% over the last 10 years, the earnings have gone up 122% for a small value, the price has gone up 62% the earnings have gone up 114% that's you're flipping the equation that way. You know, from what you saw in large if anything, the fundamentals, the earnings fundamentals for smaller companies, look quite sanguine to me. Not that I'm making a

prediction, but they just do, you know, just on balance, to the point that the PE ratios on small valley is 14.3 but there's not this degradation of earnings. So to me, that makes a lot of sense. And let's finish it off with international over the last 10 years. You know, think about US stocks right over the last 10 years international stocks, the price has gone up 27% the earnings of those companies have gone up 28% almost like a one for one relationship there, sitting on a PE of 16. Remember, I didn't let me go back to the US, s, p, went up 186% with a 96% run up in earnings. So it's almost the other way. It's almost a two to one ratio with a PE of 27 and so to me, regardless of what happened in the past, in terms of you take the information of what it's telling you right now, I feel completely fine with having an allocation to international stocks, having a nice allocation to small cap stocks, and having a nice allocation to value stocks, knowing full well that, yes, this, this demarcation between the two may continue, but on a fundamental earnings basis, I'm fine with it. I don't have an issue with I don't quarrel with that. I. So that would be my takeaway. And to me, that's the best answer that I've heard when it comes to should I allocate to value? Shall I allocate to size? Shall I allocate to international stocks? You know, to me, it's, you know, you want the opportunity set. And based on what I've just reviewed, there's no reason to think that the opportunity set simply isn't there anymore.

Wade Pfau 50:22
Absolutely, yeah, and it's not a matter of forecasting, but just pointing out that if you're diversified in these asset classes, don't abandon hope. There's no particular reason to do that. It's still over the long term, no reason to expect that these won't eventually just have their time to shine.

Alex Murguia 50:40
Yeah, it would be very different if the PES for value went down, because the earnings had gone down by 70% you know, that kind of thing, you but you just don't see that. And so what we did, from from a mathematical calisthenics standpoint, is not too different than what you do when you're kind of doing the expected market return going forward, where you take the dividends, etc, and you just roll it up into an expected return. That's kind of what I did there, to begin to analyze these differences between them. So in terms of my or the review for 2024 is, listen, there were a lot of forecasts that went wrong by so called smartest people in the room because they're playing a game they can't win. There's no reason to continue that insanity in 2025, you know, number one, and then sure, asset classes and the s, p, had a great year. I mean, it really did. But, you know, does that mean that it's going to be negative 20 next year to make up for the plus 20 this upcoming year? No, I think, as Wade said, the average is probably the central tendency. Is the best here. And I would continue with that. And then the other question that folks always have is this whole value versus growth, size versus large, international versus domestic. And I think we broke that down, and how to think about that based on what happened last year going forward. Well, based on what happened last year and the years before that, you know how to think about that going forward. And I think that's a wrap, my friend. Yeah, thank you

Wade Pfau 52:15
nailed it all right. So thanks everyone for listening to retire with style. That's your year in review, and what you can learn from that on a looking forward basis, and we will catch you next time on retire with style. Thank you everyone. Wade

Bob French 52:31

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