Episode 172: Understanding Market Volatility

Wed, Apr 02, 2025 9:49AM • 53:01

SUMMARY KEYWORDS
Market volatility, VIX index, tariffs, inflation, tech sector, government spending, retirement income, financial planning, asset allocation, investment strategy, market uncertainty, economic growth, consumer spending, monetary policy, diversification.

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

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 resaprofile.com/style and sign up to take the industry's first financial personality tool for retirement planning.

Briana Corbin 00:41
Markets feeling choppy. Wade and Alex. Dive into volatility, the VIX and how tariffs, tech and inflation are all stirring the pot. But don't worry, it's not about panic. It's about having a plan. Let's steady the ship and ride the wave.

Wade Pfau 01:00
Hey everyone, welcome to retire with style. I'm Wade. I'm here with my trusty co host, Alex, and it's April 1 April Fool's Day. So we're here to present you with a very special April Fool's episode of retire with style. By popular demand, we're going to have an Alex centrick episode. He's our investment guru, and with everything going on in the markets right now, we thought it's really important to just take a step back and think about the role of market volatility in the economy and what it does to portfolios, and also how to think about it as a long term investor. We know a lot of people are concerned about the way things are going in the economy and and to just take a step back and really think about the best way to approach that as a long term investor. And of course, that's an area where Alex has quite a bit of expertise, so he's got a lot to share with us today. Alex, isn't that right? Well, yeah,

Alex Murguia 01:52
we'll see. We'll see after the episode, Wade. Now, Wade and I have been trying to come up with a bit April Fool's joke, and we couldn't come up with one. So the best I could do waited, I'll be April's fool. How's

Wade Pfau 02:05

that? That's right. Yeah, I had all kinds of ideas, and then I just realized, right now, as we record this, this is actually the episode coming on April 1. So we didn't get to implement any broad schemes, or it

Alex Murguia 02:17
is what it is the world, the world will have to wait for next year,

Wade Pfau 02:21
right? That's right, we'll get something good, all right. But,

Alex Murguia 02:25
yeah, Wade, usually, obviously, it's retired with style. And we, we, we like to keep things retirement income centric, but we realize investments play a role in, in many, in every strategy, effectively, and in moments like this, like, you know, there's, there's always, during my professional career, there's probably three or four events that happen during the year. They're not all equally weighted, but there's definitely three or four events that happen during the year that always give people pause for concern. And so we think we're going through one of those right now, and we want to address them simply put, and not from the standpoint of what's going to happen next. But we've always found that if we break down what's happening right now in a somewhat definitional sense of it, it tends to be give folks solace just knowing what's going on. Because I think there's a lot of Bucha buzzwords floating around, and sometimes we take a lot of things for granted, and they begin to escalate on themselves. And so we we just naturally feel knowledge is always a good thing to sort of level, set Absolutely.

Wade Pfau 03:36
And as we get started on this today, this is kind of a because of what's going on in the markets, not a lot of planning in advance, but you're doing a webinar today for the retirement researcher and McLean Asset Management and and the broader retire with style community. Because we didn't have really advanced notice on doing that. It's too late to actually see the live webinar, but if you do want to see the visuals, and along with the content Alex is describing today, we'll have a link in the show notes, and we'll make the recording available through retirement researcher.

Alex Murguia 04:07
That's a great point. Yes, we are releasing this podcast on Tuesday, April 1, and we I are also having a live webinar on retirement researcher for all for all of our members and and the like. And so we're going to be speaking about a lot of concepts today. So if this is something of interest, yeah, feel free to on the show notes. We'll have a link for the webinar directly where you can see it, and some of the concepts will have corresponding charts, which you know during this podcast, because this is an audio version. It's more difficult to do the imagine a chart that does this, right?

Wade Pfau 04:49
Yeah. So historical data,

Alex Murguia 04:51
exactly. So Knock yourself out if you want to see it live and not live, but you want to see a recorded version.

Wade Pfau 04:58
I think that's the. Big call to action for the week. It's too late to promote the webinar, but you can catch the recording to provide the visuals alongside what Alex is discussing. And in that regard, let's dig into things. So Alex, market volatility. What is that all about? Why is this something we should be thinking about? What is market volatility? Well,

Alex Murguia 05:19
volatility is when when you're doing a financial plan, that's when you put in the standard deviation, effectively, the dispersion of those returns. But from the standpoint of, you know, CNBC and volatility and what's going on around that, that's described as a lot of times periods of significant, unpredictable, unpredictable price movements in the financial markets. Wayne and I wholeheartedly believe a lot of the information that's out there is priced in the markets. Gets digested effectively, instantly, and it's priced within the market. And so there's, quote, unquote, let's say, reasonable bets placed upon that information. But extreme periods of volatility occur when new information is coming out very frequently, and expecting new information coming out, not knowing exactly the signal behind that, leads to a lot of price fluctuations around that. Now, volatile markets can stem from a variety of sources. Wade I mean, it's economic considerations, government policies, global events, and right now, what you're seeing is a bit of a trifecta on all of those things.

Wade Pfau 06:29
So one other thing too is just market volatility works in both directions. Yes, markets are increasing rapidly, that's volatility. But that's not something anyone's complaining about. Really. We're thinking about market volatility when it's particularly showing volatility in the the downward direction,

Alex Murguia 06:46
yeah. But what I would add to that, though, you see a lot of volatility. They're, they're, they're like, grapes right up and down, they they come in bunches. And so the down, the down and up days are very, you know, sometimes closely linked, but I'm not providing strong data behind that right now, but that's, that's what you kind of

Wade Pfau 07:05
see. Yeah, yeah. I mean, some days market fluctuations are maybe point three up point two down, but then you get into periods where suddenly, each day there's more than a 1% movement. And yeah, and that can be concerning. Now,

Alex Murguia 07:18
you said a lot of times Wade, and I'll put it to you what? Because, you know, we do the accumulation stage and the distribution phase. How would you describe market volatility, at least on the a little bit of the downside for for an investor who's in the accumulation phase versus an investors in the distribution phase?

Wade Pfau 07:42
Yeah, I think that's important. I've heard, like, a lot of different slogans. I think one of the most creative ones was, when you're accumulating, it's dollar cost averaging. When you're taking distributions, it's dollar cost ravaging. It's the idea that, if you're saving for retirement, market downturns in the long term can be helpful just because they let you your new savings, get to buy

more shares for the same amount of funds that you're investing. But that kind of idea reverses post retirement, where if you need to take distributions to meet a fixed amount of spending, if there's a market downturn, you have to sell more shares. And that's the whole idea of the sequence of returns risk, where if you have to sell more shares, even if the market subsequently recovers, your portfolio doesn't enjoy that full recovery. So retirees do become more vulnerable to market volatility than pre retirees. Okay, yeah. Now when we talk about volatility, the there's the VIX measure. Could you talk a little bit about what that is and why? I know, even on my computer, I never asked it to tell me VIX, but in the lower corner, it's always giving me updates on what's happening with VIX. I don't know why, but that's your

Alex Murguia 08:56
that's your agreement that you made with Bill Gates and your operating system, I guess so, yeah. But yeah, this is, you hear this a lot, the vix index, the Fear Index. And think about it, if you're, if you're a news station, it's kind of a nice thing to say the Fear Index, because that's gonna, you know, get eyeballs on the screen, right. But effectively, volatility is again, for financial planning purposes. It's measured with metrics like standard deviation. Standard deviation measures of central tendencies, right? How far are you from that central tendency? And that tends to be a standard deviation, but within the financial space, on the floor of the exchanges and things like that, almost like a sentiment tool. Sentiment tool, you see what's known as the volatility index of x, and that's calculated in real time by the Chicago Board of exchange. And what it is, it's trying to give you markets expectations for volatilities over the next 30 days. Right options are. Price. Part of the option pricing model is to include a volatility matter, right? And so, you know, leave it to the Chicago Board of exchange to come up with one. But effectively, it's a market's expectation for volatility up or down over the next 30 days. And it's commonly referred to the Fear Index, because it typically has this inverse relationship with market prices. If you know the Fear Index goes up, that's usually because the market prices have been going down, and when markets go up, there's less of a fear component to it. So you see the index go down, but you see that being talked a lot about, in terms of what's going on it. They're trying to blend, if you will, the actual movements of the market, again, with, you know what's good, what they think is going to happen within the next 30 days from a total price movement. But it's using, to some extent, historical returns to begin to interpolate the next 30 days. And so it's, it's come hand in hand it, it's come in hand with, sort of the investment media, sort of the VIX as this sort of volatility measure from an expectation standpoint, yeah.

Wade Pfau 11:05
And just to kind of clarify the point that you made, like with these alerts that I mentioned, it shows me for different market indices and for the VIX. And usually green means, well, green means up, red means down. So usually you like to see green on those market alerts, but the VIX, if you see green, like up 8% that means all those indices are probably going down because of that fear index, when the VIX is up,

Alex Murguia 11:28
probably markets funny way, because if you're south of the equator, it's the opposite,

Wade Pfau 11:34
right, right? But if you see the VIX is red down 8% you might Oh, no, the market's 90% no, that probably means the market's going up. So,

Alex Murguia 11:43
yeah, it shows you how little we actually follow it. I personally don't. I mean, I look at it just to kind of know from the standpoint of where what our clients may be being exposed to. But I'm not, like, religious about it or anything

Wade Pfau 11:56
like that. And like I was saying, the only reason I know is for whatever reason, I get these alerts on the corner of my screen, I could probably turn them off, but that sounds too complicated. That's

Alex Murguia 12:05
because you're messing around with a new AI imaging fool. Yeah, it's down to that right now.

Wade Pfau 12:11
Yeah. So as you're preparing for that webinar, you uncovered some interesting data from the Dow Jones Industrial Average, which I know you've talked in past episodes, really is not a meaningful index to understand. Market movements, but nonetheless, it has the data. So

Alex Murguia 12:26
yeah, there's data's there and and it's presented. And so I'm trying to put myself into the standpoint of the individual consumer, you know, the individual investor, right? And so you just get bombarded with the Dow Jones, and so in line with the VIX, which is this Fear Index, I think people right now, especially, they're probably looking at the markets on a daily basis for multiple times a day kind of thing. And I want to point out the, you know, is there any signal to be had? Because it's very easy to look at it last week and think, oh, okay, the market's doing well today. All right, I can now shake my day accordingly. Oh, the market's doing poor today. Okay, I can now worry more accordingly, right? And so is that I want to kind of give this convey the sense of, is that worth the calories? Is it worth the mental calories? And I think everyone can already know where we're going with this, that it's not but I just want to add to this, because I think it's quite interesting. So we took over a 10 year period from 2015 to 2025 right right now. We right now being when we're recording this, probably a few days ago. We're recording this on the 27th so I think I did this on 25th All right? The Dow Jones has returned january 2015 to 2025 24,467 points, right? Roughly speaking, through point to eight at the end. But 24,467 points. It's gone up since that period of time. And think about everything we've gone through in that period as well. But for that return, what we also did is we wanted to look at the absolute number of points. It, it, it transfer, it traversed, to be able to achieve that 24,000 points. So for instance, if it, if it goes up 300 points today, that's 300 points if it goes down 300 points tomorrow, that's 300 points, right? And so that's 600 total points for net of zero, all right. So I wanted to see if it if it's worth following what happens if we follow the up days and the down days and the sort of the emotional roller coaster that that entails. So to get to that 24,000 roughly 24,500 points, the Dow Jones needed to move 491,000 points. So think about that, 24,500 points net, you know, you needed to move. 491,000 points. So said another way, for every point that the Dow Jones moved up, you needed to go through 20 at points. In absolute terms, it's a waste of time, and it's just an aggravation to try to find signal. And so there's plenty of people that are like, Oh, it's been up three days. Okay, that's gonna portend good things over the long term. Because, you know, we had a run of bad returns. Now it's been up three or four days. We're good. And you see this all the time on CNBC, oh, the markets has a string of six weeks of positive returns. Are we gonna break that street? I mean, the answer is, who cares? Ultimately, it doesn't mean

anything. Remember, for every one point that goes up, it goes down accordingly, right? In fact, you need to get 20 total points to net up one. It's just a waste of time. I mean, what are your thoughts around that? Wade, well,

Wade Pfau 15:59
yeah, yeah, it just speaks to the whole idea of you don't need to watch daily market fluctuations. And then that usually gets accompanied with the idea that people are loss averse. And so the pain of seeing the downturns more than exceeds the happiness of seeing the upswings. And so when you have to endure that much volatility to see each positive upward movement, there's going to be a lot of aggravation, for sure, exactly you

Alex Murguia 16:25
really talk about, like a high maintenance relationship, you have to go through 20 points of highs and lows to net one point. You're better off just sticking to the NCAA double A tournament and calling it a day at that point. Wait, but that's, that's, that's kind of an interesting thing there. I'm sorry, what about that

Wade Pfau 16:46
local sports team? Yeah, exactly. Okay, so markets have been exhibiting some volatility, and not necessarily one of the biggest swings. We did hit historical highs mid February. We're still, at this point, international markets are up about 8% for the year, but US markets are down the S, p5, 100, and the ballpark at 3% down. The broader total US market little more than that be three and a half percent down. What's causing that, like, what? What is the news that we're getting that's leading to this kind of volatility? Yeah,

Alex Murguia 17:20
and and again, this is what we're going to talk about. Is not because we have an opinion one way or the other. I mean, we all have personal opinions, but I mean from a professional standpoint, being a McLean Asset Management is based effectively in greater DC. We we become experts at being like politically agnostic ninjas, if you will, or Shinobi Wade, you spend time in Japan, right? And so from that standpoint, I, you know, I don't want anyone to read what we're going to say has some political inclination, one way or the other. All we're going to all we're trying to do here is define the terms that are, that are happening, right? Just because, again, we think that helps level set what's going on, all right? I think there are effectively Four Horsemen right now that are leading the way towards this market uncertainty, because you're seeing news coming in every day, and people and people are having trouble knowing what's going to be the next day's news cycle, right? But effectively you see tariff wars, inflation, the tech sector, the the mag seven or whatever, they're having their their comeuppance a little bit. And policy, government spending, as you know, the current president is implementing policies, if you will, or trying to implement policies if you will. The first one being like, we can take the tariff wars, right? And in general, some of you may know this, and we're not each of these can be podcast art, so we realize we're not giving each one its treatment, but we just want to kind of do the Wikipedia version, if you will. You know, in terms of tariffs, you have what is a tariff? Tariff is effectively a duty or tax imposed by the government of a country on imported or exported goods. The purpose is they want to regulate trade balance. If you are right, it the US being a consumer driven nation in which we're actually net importers of things, because our consumption is so high, you know, we you know, and you know, what we export maybe tariffed A little bit more than what we import. There's this desire to maybe balance that out a little bit, right, and in

addition, maybe able to generate revenues. Now, effectively, it's not just a clean slate of, oh, generate revenues, and why not? Right? More revenues is better than no revenue, right? But there are impacts that that has. Effectively, if you, if you impose a duty where you bring something over and you're gonna, today came out that Trump yesterday announced I was gonna be at 25 Tariff on automobiles, right? Well, Mercedes, are they going to eat those 25 that 25% increase? Most likely not. Most likely they're going to pass it on to consumers, if

Wade Pfau 20:10
you will. That's an important point that back in the days when I taught introductory economics, we talk about the economic incidence of the tax versus the legal incidence of the tax. And so legally, whoever the actor is, it has to play the tariff. Well, they pay the tariff, but economic incidence gets into like, who's really paying, and that depends on the elasticity of supply and demand. It's just who's the most sensitive to price fluctuations. You really have to look on a case by case basis. But the point you just made, yes, in many cases, though, technically, the producer, or whoever the actor is, it has to pay the tariff. Well, if they just adjust the price upward that they charge, because they know they can pass that cost on, they don't have the economic incidence of the tariff. It's if I increase the price by the amount of the tariff, it's the consumer who ends up paying for the tariff, and that's where we do just have to tease out in each particular case, it's not obvious just on face value, who's really paying for the tariffs.

Bob French 21:15
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Alex Murguia 21:36
Yeah, and I'll add to that. I mean, I made a broad statement, saying that we're, we're generally net importers because of our consumption, right? But some industries we may not be. We aren't. You know, you know. You take it industry by industry, it may hurt certain industries more than not, such as the agriculture industry, the semiconductor industry, the consumer goods industry, if there's broad blanket tariffs, some industries may benefit. Some industries may not. The consumers in the US may may get hurt more than a consumer in another country for a particular type of industry. So it's a little bit of a balancing act there. Like I said, this would be its own arc in and of itself, but that's really, generally what you're seeing. And ultimately, you know, I would there was something as I was gearing up for the webinar, I didn't realize this way, but, you know, tariffs were a huge revenue source for the US. This is before World War Two, even, you know, kind of thing I had no idea. Now, I think it's like 2%

Wade Pfau 22:40
we now have income taxes that income taxes did not exist for much I think, what amendment was it around the 1910 period that we if

Alex Murguia 22:51
I wasn't aware of the tariff, how am I going to know what amendment? But, but the point is, you know, it's kind of it's not this brand new tool. Now, if you ask, you know, just on a personal standpoint, it seems to be, it seems to be more of a negotiating tool to try to balance out, if you will, the trading between partners. And frankly, when you're looking when you're staring down a

multiple trillion dollar deficit, you know, it's very easy to say, hey, why don't we begin to use this arrow in the quiver? But again, there are significant knock on effects, such as, is this particular industry within the US? Whether, you know, are they able to weather the economic disruption caused by the tariff? And frankly, if there's all this, all of a sudden, there's a slowdown in imports that are needed to produce things here. Does that affect the supply chain, right? Is there a domestic resource available that we can use instead that nets positive for us, you know, and it is a short term thing, or is it a long term thing? Is it a long term thing? Well, what's the adaptability for us to really, you know, create these supply chain efficiencies within our own country that we're not necessitating, you know, things to come in. If you other there's a whole, there's a whole set of knock on effects. But ultimately, what you get down to it, you know it, you know, if you talk about a schoolyard kind of thing as a negotiating play, it's like if Wade and I get into a fist fight, which happens on occasion, no, if Wayne and I get into a fist fight. And way, you know, Wade wins, right? But he has a black eye and a broken nose, and his wife asks him, Hey, what the heck just happened to you? And Wade says, I got in the fight, but you should see Alex. I won. You should see Alex. You know, kind of thing, right? It's one of those things where you're going to get bludgeoned. You may win, but what's the net here? Right? Wait, what do you think of that analogy? Did you learn that in economics,

Wade Pfau 24:51
both sides get hurt? Yeah, both

Alex Murguia 24:53
sides get hurt. Ultimately, I think Trump is banking on like we're a consumption driven. A country more than anything, and they need us more than we need them. And that may be true in aggregate, but industries may suffer because it's industries and not. They're not all equally weighted within the US in terms of net importer, exporter,

Wade Pfau 25:12
winners and losers for any kind of tax and and yes, the income tax was rather the 16th Amendment ratified in 1913 and so tariffs since then haven't really been used as big revenue generators for the federal government, but and for that, it was one of the primary, oh,

Alex Murguia 25:31
my God. And so that's what you're hearing in the news, tariffs. Now, why tariffs? Who cares? Well, that could lead to stagflation, and in its common in its basic sense, it's effectively economic growth is down. Inflation is still high. For us, on a historical basis, inflation is still high. So if you have slower economic growth, inflation is high. Slow economic growth may lead to higher unemployment. That's a recipe for stagflation, you know, which is effectively high inflation and slow receding or stagnant economic growth, and you get the triple whammy of high employment. That's really the concern that the markets are saying. And they're trying to price that right now. They're trying to price that, and it's a difficult thing to price because there's new news on the tariffs, because I think it's a negotiation ploy. So they're like changing the lines in the sand on a every other day basis right now. And so I think that's enough about tariffs right way. There are enough that we want to get into for the purposes of this. Yeah,

Wade Pfau 26:32
yeah. Let's move on to inflation. I think that was your next horse, yeah. And

Alex Murguia 26:36
why don't you talk a little about inflation, since this is something that you know, we're coming off of Retirement Income Challenge, where we did the we did a financial planning, we did a lot of funded ratios for folks, and inflation was kind of like front and center, since that tends to be our discounting tool on that.

Wade Pfau 26:52
Yeah, yes. So we well it over the for quite a while, we had low inflation that we talked about, like the Fed, Federal Reserve, targeting somewhere in the ballpark of a 2% annual inflation rate. We had been below that for quite a while, and then going into 2021 2022 we did see inflation picking up, hitting that 789, percent range, and then since then, coming back down again. I think it was 2.9% was the finalized number for inflation in 2024 it's still each month we get the new, updated annual number that just takes the the old the last month from the beginning of the year, cuts that out, adds a new month in. Think we're still, now, at this point, somewhere around 3% as an annual inflation rate over the previous 12 months. That's the general rise in prices for a basket of goods purchased by the typical American consumer. And the government does like to have some positive inflation just to create more flexibility with managing real wages and things. Deflation can be very harmful when price levels are actually decreasing. So we do want to see positive inflation, but certainly, once it starts getting above that two to 3% range, it creates a lot of concern, and the Federal Reserve is very focused on managing monetary policy to keep the inflation rate under control and as close to that 2% target as they can so.

Alex Murguia 28:18
So effectively, tariffs, right? The attorney on tariffs, inflation is still high on a relative basis, right? Relative to, you know, what we have. And there's some areas where that are quite expensive, you know, it always makes the news, right? What was it? Eggs last month? You know, there's always things that you're like, oh my goodness, right. So you have that, then you have this, the weak technology sector returns being that third horseman, if you will. And currently remember, technology is, you know, it's almost not even a sector soon enough, because it's just all encompassing across all industries. But the high level technology stocks that we think in our head, they represent about 30% of the index. And right now, you know, only about 30 out of nine 100 of those holdings are in the positive year to date. I believe as of the 24th they were down seven and a half percent, you know, which brought down the entire like S, P as of the 24th at negative two, and change in the low range, 2.1 or something like that, and so that's just gonna drag down the folks. That's just gonna drag down the the market right now. So again, tariffs inflation still on the higher side, and technology is kind of waning a little bit. Now we talked about this when we did our quarterly review in the last podcast about international investing. The good news is international stocks are up 6.6% year to date as of the 24th I don't know what it is today, whatnot, so again, I'm throwing that out there from a diversification step, right, highlighting the importance of diversification. But nonetheless, the text, if there is being a significant drag, as much as it was a. A great return on the upside. It's a significant drag right now, yeah.

Wade Pfau 30:04
And if you have a globally diversified portfolio, year to date, you might not even see losses. Yes, depends what it does Monday before the episode airs, but the recording date, you're probably up for the year 100%

Alex Murguia 30:19
now. The other Well, the last Horseman is that government spending and budget cuts, right leading to volatility. So you think of what we did before, and I guess char tariffs is related to this, because it's a government policy, but not government spending. And I'm specifically relating to the government budget cuts where, again, they're trying to address the deficit right here wrongly. I'm not here to make a position in regards to that, I'm just kind of like trying to drag it, dragging that, this, and say, just the facts, right? And, okay, we talked about the issue of tariffs, why they're used. What's the idea, beyond, behind the government spending and budget cuts? Again, it's reducing the deficit right now, multiple trillion dollar deficit in which, you know where they're. So they're drawing a line in the sand, saying, Okay, we're going to address this come hell or high water. And effectively, they're, they're taking a look internally and making significant guts to government services right now. And ultimately, I'm in greater DC. So the reality is, there's a lot of folks that I'm like one degree of separation with that are, you know, selling their houses now, because effectively, they don't, you know, they've been told, you know, they're not gonna have a job in a week and so forth. So there's a lot of anecdotal stuff, but that's just in this area, in Northern Virginia. But what you're seeing a lot of is, there's a lot of government contractors. There's a lot of, you know, knock on effects, where people have 123, degrees of separation from some sort of government agency that's being significantly affected. I mean, the news came out last week about Accenture, right? And so there's this, who's next on the chopping blocks uncertainty and and what? Ultimately, you start seeing this reduction in consumer spending, and not only that, cuts in social programs may disproportionately affect a more most common denominator household, reducing overall demand, if you will, wait,

Wade Pfau 32:18
yeah, yeah, just with a households that tend to spend a higher percentage of their income are gonna if their income goes down exactly less, so, yeah, less consumer demand exactly

Alex Murguia 32:27
on a proportionate basis. If you're, if you know government spending is cut, and you're, and that's part of your you know, a higher proportion of your income that comes from that, then obviously it's gonna have knock on effects on how you spend that money, such as the corner grocery store, etc, etc, now. So, just to put it quickly, in perspective, you have this volatility right now because of the uncertainty around the tariff wars. High inflation is not an uncertainty. It's just a thing that you see right now, and we're still trying to, you know, bring it down, right? But Tara force, what's going on with the technology sector and this monetary policy and government spending? You have news coming out almost on a daily basis on those things, and the news isn't trending one way or the other. It's just, it's either course correct. U turn left, turn right, turn straight ahead. You know, that kind of thing. And so it's hard for the for the markets to digest all of that and feel confident that they've got a beat on this from one day to the next. And so you see that. Now what you have to ask yourself, is this new? Does this happen all the time? And the reality is, this is the risk you take for investing. Like people say, investing in the market, it's risky. It's not risky from a standard deviation standpoint, but it's risky from, I don't know what's going to happen standpoint, because, I mean, let's take, let's start in the you know, you have this all the time. I mean, in the 70s, you had the Arab oil embargos in the early 80s. Remember, inflation was 13 and a half percent. 1987 you had Black Monday, I think, was the single biggest drop in the market on a percentage basis. 23% you had the Iraq invades Kuwait. You had, effectively, the Russian and Asian crisis is right around the internet bubble, right around there. I don't know if people remember, but remember y 2k I don't know how old y 2k was. Like, things

were gonna fall out of the air, because we, you know, the one, the one in zero binary codes, we're gonna, like, you know, cause this huge rigmarole, if you will.

Wade Pfau 34:38
Yeah, the dates were only two years. And so all the computers are gonna think it's 1900 again or so. Yeah,

Alex Murguia 34:44
exactly. You know, should we have flights in the air at that point? You had the 911 attacks, you had the.com crash, and then the whole Enron corporate malfeasance thing, you can go on and on. I mean, in a way, during the subprime mortgage crisis, the market that. The US market dropped 46% you know, you had just, I can go on and on, in terms of the specifics, we haven't even touched upon COVID and how the US was shut down for two years. And so, in the grand scheme of things, what's happening right now? I think it's a walk in the park. Frankly, me, personally, you know, on a relevant basis, based on the stuff that we just gone over, Wade, what do you think if you're

Bob French 35:28
looking for more personal advice, take a look at this episode sponsor, McLean asset management. You can learn more at McLean am.com that's m, c, L, E, A, n, a, m.com McLean Asset Management is there to help you on your path to the retirement that you deserve. And don't forget to check the show notes to get your free ebook on retirement income planning. Yeah, well,

Wade Pfau 35:57
you may not even have a loss for the year at this point. Yeah. Exactly,

Alex Murguia 36:01
exactly, and so that I'm not minimizing what's happening right now. I'm just trying to put it in perspective relative to investing in the market is about uncertainty. And I'm not even saying you should, like, suck it up buttercup and remain invested. I'm just sort of saying this is par for the course when it comes to markets and investing in the markets. And if you can't get beyond this, then the answer isn't suck at a buttercup. The answer is find a strategy that you frankly, feel comfortable with, which is the whole reason that we had the RESA. Remember, retirement income planning isn't about total return and making making someone deal, you know, be, you know, take a sustainable withdrawal rate and you know what? Suck it up if markets are tough. No, it's really about finding, finding how you want to source retirement income in a manner that suits your preference. Wade, do you have anything to add around that? Well,

Wade Pfau 36:53
yeah. I mean, that's the recent great, great summary. But yeah, that's the whole idea investments are going to have a role to play in any retirement income strategy, if your total return you're like this whole idea of just stay the course, hopefully that resonates better with you if and the way to make that resonate better for you if you have a different style, is to just make sure you have sufficient reliable income so that you know your essentials are always going to be covered. That can make it easier to then endure the market volatility that the investment piece creates in the short run to hopefully then see those greater long term returns.

Alex Murguia 37:32
Yeah. And so now someone can say, Yeah, but look, if I can kind of I get over the long term, we'll be fine. But you know what, there's trading opportunities here. Let me jump in on this. I would say not so fast, simply because you know it there. There's charts that are out there, right? And you see this all time. And this is where there's kind of a cute phrase that says it's not about timing. The market investment success is about time in the market. You get it. Wade,

Wade Pfau 38:00
so yeah, we did there. Let's do all those cliches,

Alex Murguia 38:03
yeah, no, you see that all the time, right? And, and so if you take, like, the World Index, the world this the world, global market, Morgan Stanley, blah, blah, blah, blah, blah, world market, you know, from 2001 to 2024 but full period returned six and a half percent if you missed the best 100 days of that time period, which is about I just did 250 times 25 years because I didn't want to like count effectively, if you missed the best 100 Days, it's six and a half percent down. You're down six and a half percent annualized. Yeah, annualized. I'm sorry if you missed the same rewards. If you missed the the best 50 days, you're down still one about one and a half percent. If you missed the best 15 days, you're up 2.8% if you missed the best, the best five days, you're up for, you know, 5% if I can 4.9% so annualized, that's a lot over 25 year, you know. And so you want to get the full, the full rack of six and a half percent, and you do that by just being invested. You don't miss out. Right. Now, someone can say, naturally, what happens if you miss the worst day, right? What happens if you miss the five worst days because you were out of it? Look at the end of the day, it nets positive. So you're better off just getting the whole, the whole the whole menu of items, right? You're better off capturing the entirety of the return, because if you really think about it, there are about 6500 days in that period. How in the hell are you gonna pick, knowingly, the five worst days to miss the you have to be beyond lucky. Right from that standpoint, you're not smart enough to do it. You're really not. You may think you are, but you're not. No one is to, you know, no one is able to do that. And I think you need that humility to recognize that, and the humility to recognize that comes in the stamp comes from the standpoint of, I'm just going to capture the market rates of return. When you think you can time this, you're really doing yourself a disservice, because you cannot wait.

Wade Pfau 40:26
I mean, that's absolutely right, and like you were saying before, too, not that this is any predictive power, but often the biggest gains happen shortly after the biggest losses. And so if those losses scare you, then you've completely missed out on the where those gains might tend to more likely happen. Not that that's anything predictive there, but, yeah, no,

Alex Murguia 40:47
no, no. But you kind of see that because, you know, the VIX is high, you know, that's when things go up and down. But look, another way of doing this is you want to give yourself a chance of, you know what's going on, right? Let's just look at the probability of returns right? In any given year, the markets have gone up 53% and gone down. And, you know, the markets can go, you know, have gone up 53% of the time. That means they've gone down, you know, 44% of the time, right? You know, that kind of thing. But over time, if you give yourself sort of, this, this sort of, you know time you know, what about every three years? What about every five years? What about every 10 years? What you find is that you know your market over a 10 year

period. You know, the best return was 16.8% the worst return was five negative 5% over a 10 year period, but through time diversification, again, over a 20 year period, the best 20 year periods was 14, 14.4% you have to be lucky to get in that. The worst was negative 1.9% right? You can play your odds. But the point is that this version of the returns tend to kind of close over the longer term, over the longer time period. And you're most likely to have a higher return than a less than a than a negative return the longer you're invested.

Wade Pfau 42:09
Yeah, over a year, the stocks historically have gone up. Maybe it's over 70% of the time over one year periods. But yeah,

Alex Murguia 42:18
yeah. I said it the wrong way, actually. Yeah, yeah. The best one year return was 53% the worst one year return was 44% My bad. Yeah. And

Wade Pfau 42:26
so would you plus 70% plus? But then as you look at longer horizons, the probability of having, historically speaking, higher positive returns over longer holding periods goes up and will eventually get to 100% historically, yeah. And so what

Alex Murguia 42:42
you want to do in moments like this, what I find myself, my go to thing is you take a little page out of psychology, right? And you know what? How do you deal with stressful moments and making decisions during stressful moments? And ultimately, you want to ask yourself, you know, a few questions, and it's really four questions, wait. And this way you use a concept of your future self, and I'll ask it for you, wait, getting out of the market now, a good decision based on the next 10 minutes, 10 minutes from now, will I regret this decision? Getting out of the market? It not, not 11 minutes. I mean 10 minutes. You're gonna die in 10 minutes, you know, kind of thing would it have been a good decision to just get out of the

Wade Pfau 43:27
market? And, well, I don't understand the question, all right, in 10 minutes, should I get out of the market before?

Alex Murguia 43:33
No, no, like, like, 10 minutes from now, will you have regretted getting out of the

Wade Pfau 43:36
market? Probably depends on what the market, yeah,

Alex Murguia 43:39
maybe, maybe not. Who knows, right? Will you ever get at getting out of the market? Out of the markets? You know, 10 minutes from now it's gonna be the answer is, man, maybe, maybe not. Would you ever get it getting out of the market 10 days from now?

Wade Pfau 43:52
Oh, yeah, yeah. I mean, as we look at longer horizons, you're gonna increasingly probably regret things. Yeah. Are you

Alex Murguia 43:57
gonna regret this 10 months from now? Are you ready 10 years from now? Almost

Wade Pfau 44:05
surely? Yeah, yeah.

Alex Murguia 44:06
And, and it's not a and it's a cop out if somebody is listening and telling themselves No, but I'll get back in before then. Wade wants to keep this podcast rated PG, so I won't say that's, that's, you know what? I mean, the reality is, you're even ruining your odds for success doing that, because you have to be right getting out, and you have to be right getting in. And let's say at best, it's a 50% chance. You know, each time, so puny, you're giving yourself a 25% chance to make the right decision. Why in the hell would you do that to yourself? You're not smart enough to be able to do that. I'm not. No one is when I say you're not. I mean, like knowing it, you know. So why would you give yourself that

Wade Pfau 44:48
kind of thing? And it's not intelligence, it's just we don't know. Yeah, exactly, all the information we have is priced in. So it's randomness of what happens next that's going to Yeah, exactly.

Alex Murguia 44:58
The other piece is. Yeah, but wait, Alex, everyone knows the market will tank. Look at the sentiment indexes. You know, they're companies that that ask investors, how good do you feel about the market? Are you bearish or bullish? And CNBC does this all the time. You know, these sent market sentiments. Now, if you if you divide sentiment analysis in quartiles, like the most bearish the most bullish, right? Wait, when do you think you see the most positive returns, as in greater than 20% the market returns greater than 20% when do you kind of see that when people are the most bearish or when people are the most bullish?

Wade Pfau 45:32
Well, I'm looking at the chart, but I could have predicted this that, yeah, it's when the market, when sentiment is most bearish that that's ultimately because of the recency bias. Returns may have been bad recently, leading to that bearishness, but then that's when returns will tend to be better subsequently, and conversely, people are probably most bullish after the market's been doing really well. And things can't just go up forever. So that would tend to be the time that you may see lower subsequent what you see is, and this

Alex Murguia 46:01
is from 1987 to 2004 24 when, when people were the most bearish, on a quartile basis, the market return greater than 20% 36% of the time. When people were the most bullish, the market returned greater than 20% 17% of the time. And it's a linear decrease, you know, dividing this into quartiles, right when people, when you see this all the time, and so it's one of those that you want to make sure that you kind of disabuse yourself from listening to that kind of stuff. It's the same

Wade Pfau 46:35
kind of plot as that old Dunning Kruger effect of, yeah,

Alex Murguia 46:38
100% you're 100% correct. I mean, I don't want to say what and but there's a flip side to this. I don't want people to think, oh, but when people are the most bullish, we should get out of the market, right? Because there's still a positive return. When the people are the most bullish, based on quartile, the market still returns about six and a half percent.

Wade Pfau 46:56
Yeah, and going to the the other end of that distribution too, like when people are the most bearish, 20% of the time, subsequently, market returns are negative when people are most bullish constant, subsequently, 25% of the time markets had negative returns. So it's not that big a difference, but it's there. The markets tend to have the least likelihood to fall when people are most bearish, yeah. And so difference, but, but still, it is. It's yeah in that regard. And

Alex Murguia 47:29
so here for me, it's, it's the focusing on what you can control. Look, we're not going to be able to control right now, the Four Horsemen that we set, the tariffs, the inflation, what's going on with the tech sector and and the like, we just it's, it's, it's, it's a bit of a tougher and monetary policy and government spending, you know, the spending cuts, we can't control it. But what can we control? Way when it comes to investing, you know, accumulate from the accumulation side and from the retirement distribution

Wade Pfau 47:59
side, you can control your your asset allocation choice, the strategic asset allocation, cost of your investments, time horizon that those investments before you you need them to spend. You're managing emotions around that using tax efficient distribution, so managing the tax side of things, and just taking valuations into consideration, yeah, from

Alex Murguia 48:24
maybe the strategic allocation cost, right? But, yeah, expect that we focus on when you can control the risk you're bearing, the cost that you're spending for, for implementing the strategy, the time, the emotional energy spent through this and taxes. I mean, at the end of the day, it seems maybe try, but it's the truth doesn't make it any less right? And so we wanted to take a moment to just review this and level set. Listen, this is what's happening, not because we're making forecasts around it, because, but we, I do feel, from my experience, just discussing what's happening in a manner that's not politically charged, or as least emotionally charged as possible. I mean, helps people just simply understand, oh, okay, I see the concepts that are effectively influencing the market right now. Where are those concepts? What could happen? What could not happen? Just just because I think knowledge is power in that sense. But then take a step back. We've seen things like this before at significantly greater scales. And at the end of the day, what happens to the market? What happens to the markets? Bad days, good days, what's the net on those, etc, and what can we do about and there it is. Way, if you want to see this in greater detail, we will be talking about this in greater detail in a webinar. It'll be recorded in the show notes. Feel free to knock yourself out, but wait, we have a Q, a you said,

Wade Pfau 49:53
yeah, yeah. Now this question I pulled out for the week is somewhat lengthy, and. Yeah, unfortunately, I do have a hard stop coming up here on the recording time. But let me just let me

pull the last part of the question, and then we could consider it's actually a multi question question. So I'm just going to take one of these for now, and we'll leave the rest for another time. This is on the topic of doing Roth conversions. And the scenario here is, you've got your IRA, your tax deferred account, and you have your Roth account, and you're thinking about covering your spending needs, you're thinking about doing Roth conversions. So again, there were multi parts to this question, but let me just ask the last one, because it's a pretty quick one. Does the math ever work out to cover your spending from the Roth in order to do more Roth conversions, or is that just taking from one pocket and moving to the other? And the answer to that is you had the right intuition there, that that would just be taking from one top pocket to move into the other, if, like, if you're going to do, if you're going to meet your spending through Roth distributions so that you can Roth convert more money into the Roth you haven't done anything different than if you just had covered your spending through the the tax deferred account. So no, in this context, you would not cover your spending goals through Roth distributions to make it possible to do more Roth conversions that that wouldn't impact the overall amounts you had in your IRA and your Roth. Ira in that scenario,

Alex Murguia 51:30
to Roth or not to Roth or

Wade Pfau 51:32
not to Roth. And there were more parts of that question, but we'll we'll save those for another time, and we'll thank everyone for listening and catch everyone next week for another episode of retire with style. Bye everyone. Wade

Bob French 51:46
and Alex are both principals in McLean Asset Management and retirement researcher. Both are SEC registered investment advisors located in Tysons, 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 risk, including Risk of Loss past performance does not guarantee future results you