EPISODE 44

Interactions with Trolls: Who Should You Listen To?

[INTRODUCTION]

[0:00:05.6] Benjamin Felix: This I the Rational Reminder Podcast, a weekly reality check on sensible investing and financial decision-making for Canadians. We are hosted by me, Benjamin Felix and Cameron Passmore.

[0:00:15.8] Cameron Passmore: Your street club is on. You still haven't screwed up that intro yet, which is quite impressive. Mind if you wouldn't have never known if you did or not?

[0:00:21.4] BF: Wait, what are you talking about? We just screwed it up.

[0:00:22.8] CP: No, you didn't screw it up. We mocked up where we went after you did the intro, but you didn't screw up the intro. I screwed up the coming in. Anyways, this is a pretty good episode. We cover a lot of ground. We talked at length about your interactions online with people commenting on your YouTube video, and a Global Mail article, which is quite incredible. That's a theme for this week. We talked a bit about that.

[0:00:44.0] BF: You could almost call it interactions with trolls, but they're really well-thought trolls. We dive into this in the episode, but we didn't talk about what I'm about to say, that the people who are engaging in these discussions that better – they're disagreeing with our evidence-based approach based on non-evidence. They've got really well-thought-out non-evidence.

[0:01:05.0] CP: They're aggressive about it. I mean, they really are believers.

[0:01:09.0] BF: You have to love the enthusiasm. A couple of people, they put a ton of time into debating with you.

[0:01:14.6] CP: Oh, I signed off on Friday. I wrote one last comment and said, "Thanks for the chat everyone, but I couldn't keep going."

[0:01:20.5] BF: Anyways, it's super interesting to read. Super entertaining for us to see it. Yeah.

[0:01:25.8] CP: One thing that we don't have for this episode that we hoped to have is we filmed two episodes ago when it was just Cameron and I. I mean, not a crazy amount of views, but about 200 people have watched it on YouTube, which tells me that at least some people are watching it. If anyone's disappointed that we don't have a video for this week, we apologize. We had just rented the equipment last time to see if it would work and we haven't actually gotten the stuff that we're going to use to film going forward. That's still something that will happen, just not today.

[0:01:55.7] BF: Right. Anyways have a listen.

[EPISODE]

[0:02:06.7] BF: Welcome to Episode 44 of the Rational Reminder Podcast. It looks like we will probably hit 10,000 downloads for the show across all of the past episodes in the month of April.

[0:02:18.2] CP: It goes up every month. It has every month since we started, which is cool to see.

[0:02:22.2] BF: Yeah. I guess, the point of saying that is just to say thank you to everyone who is listening. We do really appreciate that you are listening. We definitely appreciate when people reach out with comments and suggestions and questions.

[0:02:34.7] CP: It's also interesting to observe where people get advice and who they take advice from. That's a common theme that goes through a few of the stories today, just with the interactions you've had on your article on Globe and Mail, as well as your YouTube channel and who dispenses that advice is also interesting.

[0:02:52.8] BF: Yeah. Well, I know that Dave Ramsey, the guy in the US that has a radio show and a YouTube channel, he took a bunch of flack recently, as did a Suze Orman for giving different advice that would generally be called bad. Dave Ramsey loves promoting actively managed mutual funds and he's got a huge following. It's the weirdest thing ever.

[0:03:15.6] CP: Well, it's a highly rated show in Canada as well. Always way, way above us. I'm sure you must have massive download numbers.

[0:03:21.2] BF: Oh, yeah. His podcast is huge, definitely. Anyway, so sticking with the new format that we rolled out for our non-guest episodes a couple of weeks ago, we're going to follow the same format today. We're going to cover a couple of what we're calling current topics. One of those is a listener question with something that somebody reached out to us with. Then we've got our one portfolio management topic and our one financial planning topic. Then we'll finish off with the worst advice that we heard last week.

[0:03:52.4] CP: Yeah, we got a pretty good one this week, or bad one depending on how you look at it.

[0:03:57.3] BF: The first the first topic we want to talk about is we asked – last time we did an episode, we talked about some of the reasons that somebody might say index funds are not good investments. As part of that discussion, we asked listeners if they had any other reasons that we hadn't thought of, that people used to argue against index funds. We got a bunch of people sent us notes, which was neat to read, but there was one of them that I found the most interesting, I think. That was somebody that said well, an index is created by somebody. People had to make decisions to create an index, which is what an index fund invest in obviously. How is that different from an active fund? He said that if I were an active manager, that's the argument that I would use against indexing.

[0:04:43.9] CP: Yeah, which is really interesting. Why would that necessarily be a bad thing if you're trying to capture capitalism? Is it because they're just blindly picking names?

[0:04:51.8] BF: I think the point is that in either case, you have delegated decisions being made. Why should an index be better than an active fund? That was the point of the person's question. This is something that's not a new thought.

[0:05:06.4] CP: A great question. I'm not trying to offend our listener here.

[0:05:10.5] BF: It comes up a lot absolutely. We didn't think of it last time.

[0:05:13.0] CP: Yeah, it's not a new thought. There was somebody actually in Canada that wrote a paper about this. There's a paper called Passive in Name Only, delegated management and index investing. Here's just a quote from the beginning of her paper. She says, “Rather than being passive in any meaningful sense, index investing simply represents a form of delegated management, instead of being truly passive. Tracking an index almost always implies choosing a managed portfolio. Not only are these indexes managed portfolios in the strictly financial sense, by their construction they imply a substantial amount of delegated decision-making authority.” She's basically saying indexes are just actively managed funds.

[0:05:52.5] BF: I think it's safe to say they’re within tighter rules perhaps.

[0:05:56.4] CP: Yeah. I think with an index fund, you're getting low costs and broad diversification, which is probably a good thing.

[0:06:03.9] BF: There is decision-making going on behind the scenes, be it S&P 500, be at any of the other indexes. There is some committee that is choosing what is in and what's not in.

[0:06:13.8] CP: Well, it depends on the index. Some indexes are committee-based. Like the S&P 500 is the most well-known committee-based index. I actually pulled a couple of sentences describing the S&P 500 and how the committee works. This is a quote. The index committees mission in maintaining the S&P 500 is to represent the US equity market with a focus on the large cap segment.

The committee is not trying to pick stocks to beat the market, rather we use guidelines for stock selection, size liquidity, minimum float, profitability and balance with respect to the market to assure that the index is an accurate picture of the stock market. They're trying to make a representation of the US market, but there are a whole bunch of different screens that go into picking the stocks that go into the index to be that representation.

[0:07:01.5] BF: By the way, it's delivered very nice returns. You can get that for virtually no cost.

[0:07:05.9] CP: I think that's the biggest thing. It's a diversification and the low cost. Yes, in either case, you're choosing – you're delegating the decision-making of what goes into your portfolio, but with the index fund, you're getting diversification and you're getting low costs.

[0:07:19.0] BF: You picked up some cool rules and some issues that have come up with some of the indexes that might explain why they're different.

[0:07:25.4] CP: Well, yeah. I mean, so that's the – we were talking about committee-based indexes and that's an obvious comparison to active management. Even when you have rules-based indexes, which are as it sounds, they're based on rules, not based on any human decision-making. Even rules-based indexes can have differences. If you're investing in a FTSE Canadian index, versus an S&P Canadian index, the methodology is to create those indexes can be materially different, which can obviously lead to a different –

[0:07:55.3] BF: I didn't know about the telecom weighting that was so different. I hadn't realized that before.

[0:07:59.5] CP: Yeah, so well the FTSE Canada all cap index, which is what VCN tracks, they've got a foreign ownership restriction for security weightings, where they'll use that instead of free float to weight securities. What that plays out – how that plays out in the Canadian market with the FTSE Canada all cap is that you end up with a lower weight in telecoms, because of the foreign ownership restrictions.

[0:08:27.4] BF: Which isn't necessarily bad, but it could mean tracking error, or performance that is different from a broad index you might see posted.

[0:08:34.6] CP: That's the thing. Ex ante, like before things happen. Looking at it now, there's no way to reliably say, well this weighting methodology is going to be better or worse. You're going to get, or you might get – you would be expected to get even a different result randomly. It's the same thing with – I looked at the Russell 3000 versus the CRSP US total market, they're both US total market indexes, but the Russell cuts off at 30 million market cap. Whereas, CRSP US total market cuts off at 15.

[0:09:03.9] BF: Yeah, it's not a formal rule that it cuts off. That's just where the 3000th largest stock cuts off, right? It's not a rule at 15 or 30 million. It's just that's where it happens to be, right? Because the Russell 3000 peels off the largest 3,000 stocks, which has a cap rating 98% of the index right over the market.

[0:09:22.8] CP: Small differences in construction, but it can have differences impacts in multiple basis points. I looked at the 12-month return for VUN and XUU, which are both US total market. Over 12 months, it had a 43 basis point difference in returns, a tracking error between the two. If you're just an investor holding this asset forever, it doesn't matter because it’s a random tracking error. Where it starts to get interesting is if you're talking about tax loss selling, like you think about tax loss selling, you have to buy – can't member the tax term. Different –

[0:09:57.2] CP: A substantially different asset.

[0:09:58.8] BF: Yeah. It can't be this – Yeah. It can be the same – non-identical properties.

[0:10:04.1] CP: That's the term. You can't repurchase an identical property within 30 days, 31 days of triggering a loss, which means you've got to go and buy something tracking a different index, because CRA quite a while ago had a decision or a guidance, whatever they call it, saying that two different index funds tracking the same index are identical properties. The interesting thing about the tracking error is that you introduced this random risk of one index performing different from the other, which has to be a consideration when you're doing tax law selling.

[0:10:35.3] BF: Next topic?

[0:10:35.8] CP: Yeah, next topic. I get a kick out of this I actually, just watching you interact with some of the people that follow you and comment on your article and YouTube.

[0:10:45.2] BF: The current topic is who should you listen to? Really maybe one would say, look at a lot of these comments that these people engage with you. It makes me wonder where people get advice and where does all this passion come from. You wrote an article last week on dividend and investing that man, you had a lot of interactions. What was it up to?

[0:11:04.0] CP: I checked before we started talking here and it was 311 comments.

[0:11:08.0] BF: 311 comments so far. You try to engage with as many as you. Boy, took a lot of time just to read them, let alone for you to engage on that. Also last week, I came across an

article written by Morgan Housel. This one made me think about this. He wrote this article that talked about how when you desperately need a solution, you will try anything and you'll believe almost anything to have that outcome happen. He said, “Nothing is more true than in the world of investing.”
If you're way behind, for example in your retirement savings, you will believe in lotteries, you'll believe in Hail Mary type investment strategies. I just thought that was really interesting. Then I linked back to some of the comments on your chats that were going on and so many people are so fervent believers in their own experience, but they are out there trying to promote it.

[0:11:59.3] CP: Yeah. I mean, yeah. Morgan Housel in the article that you were talking about, he said – I'm paraphrasing here, but he said if there's a 1% chance that some advice, no matter how ridiculous the advice seems, will change your life. Then it's not crazy for you to pay attention just in case. A tiny probability that it's going to actually help you. Even if there's a tiny probability that it's going to change your life, then you're not crazy for paying attention to it.

I think that in investing, I listened to a Sam Harris podcast a while ago and I think it was Sam Harris. He was just talking about the amount of information that is out there today and that we can't possibly absorb all of it. People end up following what I think he called tribal leaders. Once you have a tribal leader and beliefs that follow that, it's really hard to change your mind, and you'll be very willing to ignore good information.

[0:12:52.1] BF: Well, one of the quotes in Housel’s article was wanting and needing something messes with one's ability to gauge the likelihood of outcome, because in all those comments, no one's talking about the probability of success. You say all along, even a bad strategy can have a good outcome.

[0:13:06.9] CP: That's the thing. The thing about decision theory, you can't base a future decision on past outcome if there’s no theoretical underpinning for that outcome. That's one of the things that I kept coming back to in those discussions, was you can show me whatever you want, you can show me whatever past result that you want, but if there's no theoretical underpinning for why that is happening, you've got no reason to expect it to continue happening in the future.

[0:13:27.4] BF: Yeah, and in this conversation reminded each of us of the article that – article. Article that Josh Brown wrote, right?

[0:13:34.3] CP: It was a blogpost. Yeah.

[0:13:35.3] BF: Blogpost called The Crucible, where he says, "I don't think I would ever invest money with someone who isn't on Twitter," which sounds was really interesting to think about that, where for you to grow to make the comments and write the article that you did, I mean, you had to put a line in the sand, do your homework and put something that was a very thoughtful. I don't think was terribly controversial out there, but you knew it was going to poke the bear. I think The Globe even told you that, right?

[0:14:00.6] CP: You're saying you didn't think it would be controversial. The Globe warned me, we may not want to post this because you're just going to get blast in the comments, because I guess that The Globe in general has people who are believers in dividend investing. I didn't actually know this, but John Heinzl who's a columnist for The Globe, he is a strong believer in dividend investing. I didn't know that.

In dividend investing, he is one of those tribal leaders where people – not that he's wrong. I'm not saying that, but people will just believe whatever John Heinzl says. As soon as somebody says something different, which is what I did –

[0:14:33.7] BF: The tribe sure turned.

[0:14:35.3] CP: That's right. That's right. Despite the fact that I'm showing data and evidence, people don't want to believe in that, because they already have their entrenched beliefs about dividend investing being the smartest thing ever.

[0:14:47.4] BF: Were you surprised at how mean some of the comments were?

[0:14:50.1] CP: No. I mean, I do this on YouTube every day. Pretty basic stuff at this point.

[0:14:54.4] BF: I don’t know. I mean, some of the comments were made were just downright mean, as opposed to trying to understand some of the points you were making. Because in our world, a lot of – the points are not that from an academic standpoint, controversial.

[0:15:05.5] CP: No. The fact that when I published that article, I don't get to choose the title, but the title that they chose was I can't remember exactly, but they called me a contrarian. It was like, a contrarian argues against dividend investing. For me, to be the contrarian, when if you look at the academic literature, I'm not. I'm not the contrarian.

[0:15:24.8] BF: One of the people wrote, you deal in theories, I work with facts. What do you do with that?

[0:15:29.8] CP: It also raises the whole – when we're talking about taking advice or getting information from someone, if it hasn't gone through this review process – it's like a peer review process and then I could have any journal, but way meaner on the internet. If you're taking advice from someone who has not published that advice online and left it open to criticism from other people, how can you possibly trust that advice?

[0:15:54.9] BF: I agree. I'm just reading some of the comments here that people have said. Even a theoretical underpinning. I'm guessing you're a single guy.

[0:16:03.0] CP: Yeah, I didn't understand that one.

[0:16:04.7] BF: I quite know how the –

[0:16:05.3] CP: It’s that because it's not rational to be married? I didn't get that.

[0:16:07.3] BF: I don't know.

[0:16:08.8] CP: Even the one, the basics, like a dividend reduces the value of a stock.

[0:16:13.7] BF: Oh, that's –

[0:16:14.5] CP: That's tautology. That's not debatable.

[0:16:17.4] BF: That is one of the biggest points that they'd be –

[0:16:19.1] CP: They were living with you.

[0:16:20.1] BF: Oh, furious.

[0:16:21.3] CP: You can't tell me the share price has to go down when it pays a dividend. Well, you're saying mathematically it must. Otherwise, you'd be arbitrage to wait forever.

[0:16:28.6] BF: Well, I think that we can actually – let's maybe end that discussion on whatever we were just talking about, tribalism and who to listen to online. I guess, we didn't answer the question, who should you listen to?

[0:16:39.5] CP: Our point is we just tried to explain the rational arguments for investing based on academic evidence. None of those debates you had were based on any peer-reviewed data.

[0:16:49.2] BF: No. Someone actually and this is on YouTube, I had another very lively discussion on the YouTube video that I posted on Saturday, along similar lines though. Somebody over there, they made the argument for dividend investing based on the anecdotal example of them having bought Disney 20 years ago, or something like that. Again, it's like okay, you're justifying a strategy with the past outcome of something that has no theoretical underpinning. This stock did well. Therefore, dividend growth investing makes sense.

[0:17:23.5] CP: You've said all along, you could have great outcomes from less than great strategies.

[0:17:26.9] BF: Who should you listen to? Yeah. Well, like you said, I think that we were very strong believers that everything that we do and say has to be backed by not just empirical evidence, but also a theoretical backbone that explains the empirical outcome, because without those two things combined, you don't really have anything.

[0:17:47.9] CP: None of these people would ever change their mind, I think it's safe to say.

[0:17:51.1] BF: No. No. There they were even – within the comments in that discussion, there were even people rallying around other people, saying that they go and disagree with what I've said based on –

[0:18:02.4] CP: Of course, no one's using their real name. It's all aliases. You have no idea who these people are.

[0:18:05.9] BF: Yeah, it doesn't matter. You haven't spent enough time in the internet.

[0:18:09.8] CP: Perhaps. Maybe I don't have thick enough skin yet.

[0:18:12.3] BF: Yeah.

[0:18:13.1] CP: Do you want to talk about that article?

[0:18:14.7] BF: Well yeah. Let's transition into our portfolio topic for today. I still don't feel we answered the question of who you should listen to.

[0:18:20.4] CP: I think we did.

[0:18:21.3] BF: Someone who's basing what they're saying on –

[0:18:23.0] CP: On evidence.

[0:18:23.5] BF: Evidence and –

[0:18:24.4] CP: Make it understandable, which is what we're trying to do.

[0:18:27.4] BF: Yeah. Yeah, that's fair. Yeah, it's true. Because I guess the alternative is people just saying – just go and saying stuff.

[0:18:33.5] CP: Yeah. You can get facts to show great outcomes. We said earlier, people want to take a long shot on those things all the time.

[0:18:40.6] BF: You sent me a one of the articles for our show today that was Barry Ritholtz had written.

[0:18:46.6] CP: He was talking about Suze Orman's advice to stop buying $4 lattes or something like that. She calls it the million dollar mistake or something. Barry goes in, looks at the numbers and says, “Okay.” I think Suze Orman says, $4 a day for 40 years, you'd have a million dollars and that's why it's a million dollar error, not by buying, spending money on coffee at Starbucks or whatever.

Barry goes and looks at the math and she uses a 12% rate of return to come to the million dollar number. It’s the same thing. She's just saying things. There's no reason to believe that a 12% rate of return is the right number to use.

[0:19:22.7] BF: He says that latte idea is ruining your long-term prosperity. You got bigger issues than that latte a day.

[0:19:27.7] CP: Yeah.

[0:19:28.2] BF: Okay, so anyway. I think that's enough on that. The next topic that we wanted to talk about ties in with what we were just saying, or at least it's a good segue. The portfolio topic for today is dividend growth investing, which is a highly, highly controversial topic. Even though it shouldn't be, it still is. I did a YouTube video on this a while ago and yeah, highly controversial. Plus The Globe article that we just did, highly controversial. People are very, very passionate about it.

The concept of dividend growth investors is that if you can find and understand really strong, good quality businesses that have historically increased their dividends over time, you can invest in those and you'll have a very reliable, safe, good outcome.

[0:20:18.3] CP: That sounds very sensible and very appealing and very understandable. There's a whole lot of people believe in it, so it becomes a very strong tribe, which can lead to great behavior, which is what the point you were trying to make, which is if you believe it this much, that's probably what's causing great performance.

[0:20:34.5] BF: That's the point I made in the YouTube video. Yeah.

[0:20:36.1] CP: Behaving well.

[0:20:36.9] BF: There's merit to that. Really there is.

[0:20:39.5] CP: Yeah. The reality is it leads to weaker diversification.

[0:20:42.3] BF: Yeah. I made a few points in The Globe and Mail article and I thought we could just talk through here. Inherently, dividend investing leads to poor diversification, or at least reduced diversification. There's about 60% of the stocks in the US and about 40% globally. Call it half the stocks in the world, do not pay a dividend.

[0:21:04.9] CP: At least. More and more doing stock buybacks.

[0:21:08.1] BF: Yeah. If you're deciding to constrain your investment opportunity set by dividend versus no dividend, you're cutting out half the opportunity set. We know one of the things that's super important in investing, at least in – this is one of the things that I was thinking about too that's really interesting. There's a big difference between an optimal investment strategy. Well, optimal is hard to define. You might get a better outcome picking dividend stocks, than you would with index funds. You're giving yourself that opportunity by picking dividend stocks.

The challenges that you're increasing the dispersion of outcomes. If you go and pick 30 dividend stocks, you'll be expected to have a much wider dispersion of outcomes. You might get a much better result, you might get a much worse result. Now we know statistically that you're more likely to get a worse result, but that's beside the point. With index funds, you're going to have a much tighter dispersion of outcomes.

Now when we're talking about limiting half of the opportunity set, automatically just by cutting on half the stocks in the market, you're going to have a wider dispersion of outcomes. The way that I would frame that is a less reliable outcome. That's one of the things I kept coming back to and that whole internet debate was why would you not want the most reliable outcome possible? Clearly, some people don't see it that way.

The next one is that picking dividend, paying stocks is unlikely to lead to investing success. Which I mean, picking any stock, regardless of whether it pays a dividend or not, picking any stock has a – it's got a negative expected outcome, because most stocks underperform the market.

[0:22:36.4] CP: I can just hear the dividend lovers exploding.

[0:22:39.2] BF: These are facts. Come back to efficient markets. If a business is great and is going to continue doing well over time, that is already included in today's price. It has to do better than current expectations to beat the market. This is grade one efficient market hypothesis.

[0:22:55.8] CP: Right. This goes back to the early 60s.

[0:22:57.8] BF: How that gets missed, I don't understand. That part of dividend investing is it hinges on markets being inefficient, because the idea that you can pick an undervalued company, buy a great business at a great price or whatever they say.

[0:23:11.1] CP: They're not looking to pick an undervalued company. They like to pick a great company that just says, "Increasing dividends."

[0:23:15.0] BF: At a good price. That's part of it, at a good price.

[0:23:17.4] CP: Yeah. That's what they did say.

[0:23:19.4] BF: Dividend growth investors are not going to overpay for a stock. Come on now. They want to find a good deal.

[0:23:24.9] CP: I was being facetious there. Right. Then your other points were the dividends, or a you're arguing against as the dividends are guaranteed source of returns, which they're not.

[0:23:32.9] BF: Yeah, so I'm saying that's false.

[0:23:33.8] CP: They're going to contain it's false.

[0:23:35.5] BF: That's not true.

[0:23:36.3] CP: The most popular one by far is dividends protect you in a down market, yet paid to wait, which I know you hear Kevin O'Leary say all the time, why he loves dividend paying stocks.

[0:23:44.2] BF: If we think about our dividends identifiers of strongest stable companies, no, the answer is no. When I did the – I can't remember the data points, but when I did the video for this, I looked at all of the companies that have done – or they're doing share buybacks versus dividends. If I remember correctly, it was a pretty even split of companies doing buybacks versus companies paying dividends. Those are two different ways of returning capital to shareholders. Why would a company that pays a dividend, versus a company that is doing buybacks be a better investment? Then the answer is that there is no –

[0:24:14.4] CP: Doesn't. I don't understand why.

[0:24:15.5] BF: There is no reason. Just identifying companies based on the fact they're paying a dividend, it doesn't really tell you anything. Well, maybe it does tell you something. Maybe it does tell you it's a good business. That doesn't mean that a company that's not paying a dividend can't be a good business, which just comes back to that whole idea of limiting the opportunity set.

[0:24:30.5] CP: The biggest one.

[0:24:31.6] BF: Well, you just said it, I think. I cut you off. The biggest one I think is that dividends are guaranteed, or at least a safe source of returns. When you receive a dividend, you've gained nothing. Now the heads are exploding. Now the dividend growth heads are exploding here and we say that.

[0:24:48.2] CP: It can't be. We said this so many times. If there was an opportunity, the market would arbitrage that away. If you get the dividend, buy the stock, get the dividend, sell the stock at the same price, you would do that all day long. Just do it every quarter and leverage like crazy.

[0:25:02.8] BF: The value of a company is its book value, plus the present value of future cash flows. When a company pays cash out, its value is decreasing by the amount of cash that has been distributed to shareholders. The challenge, the reason this is so hard for people, I think is that you don't see that reflected. The dividend gets paid, but then a thousand other variables affect the price of the stock. You don't necessarily see a dollar-for-dollar drop when the dividend is paid out.

Dividend investors are people who believe in that. They think, “Well, no. The value of the company doesn't drop.” Just because the price doesn't change dollar-for-dollar with the dividend. The fact is like, valuation theory 101, dividend is paid, the value of the company decreases. You as the investor, you receive the dividend, but you've got correspondingly less capital. You are net zero before taxes.

[0:25:54.5] CP: Okay, so that's enough about dividends.

[0:25:56.0] BF: Yeah, I guess so.

[0:25:57.1] CP: That’s enough. People get it.

[0:25:59.4] BF: Well, it's worth mentioning that the whole idea of dividends protecting you in down markets, what I just said, if the stock price is down 10% and then it pays a dividend for 2%, you're going to lose another 2%. It's the same thing as if you sold off an additional 2%.

[0:26:15.3] CP: Yeah. You have the 2% dividend, but yeah, the price has to go down.

[0:26:19.2] BF: You got the cash. You've got much less capital and now you’ve got the cash, the same thing as selling. Plus companies can cut their dividends. If you're using dividends as your spending rule, which I think is what dividend investors do. They don't use the 4% rule, or whatever, which we're also going to talk about today. They use whatever the dividends are. Now you're letting corporate policy dictate what your retirement spending rule is.

[0:26:41.6] CP: Okay. Now I'm pulling you over the planning topic.

[0:26:43.4] BF: Well, wait.

[0:26:44.2] CP: We're going to keep this rolling. Now let it go. Let it go.
[0:26:47.0] BF: The last one is the most important point.

[0:26:48.8] CP: Okay, fire away.

[0:26:49.4] BF: One of the biggest challenges for dividend investors is that when you look at dividend stocks, like if you look at the dividend aristocrats index, which is an index of stocks that have grown to dividends over, I can't remember, 25 years or something, it's beaten the S&P TSX or the S&P 500. Why is that? We're saying dividends don't matter.

[0:27:06.9] CP: Random chance?

[0:27:07.9] BF: No, it's not.

[0:27:08.9] CP: Value?

[0:27:09.6] BF: Exactly. Dividend stocks tend to have, or at least have historically had exposure to mainly two of the factors that explain differences returns between diversified portfolios. If you take a dividend growth portfolio, it will have a value tilt.

[0:27:26.0] CP: Profitability.

[0:27:26.4] BF: Will probably have a profitability tilt, which is it's actually really interesting, because maybe you can actually get a value in profitability till using a dividend index. You're still limiting your opportunity set, I guess.

[0:27:36.9] CP: Don't let the dividend be the driver. Let the profitability and value be the driver. That's your point.

[0:27:40.8] BF: Exactly.

[0:27:41.8] CP: Be dividend blind.

[0:27:43.0] BF: Exactly. There's no reason to favor dividends, because the advantage of dividend stocks is explained by value and is explained by profitability. All right, I'm done.
[0:27:51.1] CP: Last week, we were driving out to record an upcoming podcast on the used car market, which as a slide was a fascinating interview. We were in the car and we decided to listen to a Tim Ferriss show, where he interviewed Mr. Money Mustache. Boy, we're not intending to be hard on the FIRE movement, the Financially Independent Retire Early movement, but there are some things were said on that podcast that really made us scratch our heads.

[0:28:16.8] BF: We should be very explicit that today, we're not being critical at all of FIRE. We've heard from listeners – I mean, in some cases, almost pleaded with us to take it easy on FIRE.

[0:28:26.5] CP: In fact, if someone knows a great FIRE representative, we'd love to have one on the show.

[0:28:31.3] BF: I think we should get Mr. Money Mustache.

[0:28:32.7] CP: He'd be great. He's a connection to Ottawa too.

[0:28:35.3] BF: Yeah. It was a very interesting podcast. It's just the math, that 4% rule. In today's day and age, just seem to be a little – well, it doesn't seem to be. These are these facts.

[0:28:45.7] CP: I went back to his old website and even – there's a quote on there that says, a shockingly simple math behind early retirement. You can almost see, it's shockingly wrong now.

[0:28:53.5] BF: Well, it is. It is shockingly wrong. Now he does have some, I don't know, what you'd call them, caveats that being flexible spending and being able to work a little bit. For him, I mean, come on. I'm sure he's making decent money from his –

[0:29:08.7] CP: Because what was his spending budget? It was not a lot.

[0:29:10.9] BF: 24,000 a year or something like that.

[0:29:12.6] CP: A year.

[0:29:14.3] BF: He has a nine-year-old child, I think. A couple of nine-year-old child. He has other sources of income. He even said in his website, he's got rental income, his portfolio, his government benefits. He could reduce the spending. He could pick up some side work. He does have a bunch of escape hatches if things don't go well.

[0:29:34.8] CP: The thing that I really wanted to hit on was the 4% rule, because I think that – I almost feel like I have a public service duty to tell people how irresponsible it is to use the 4% rule as a spending rule for your retirement goals. To me, it's completely insane. When you think about –

[0:29:50.9] BF: The younger you are, the worse it is.

[0:29:52.7] CP: That's the problem. Where did the 4% rule come from? It came from a guy named William Bengen. He wanted to figure out how to responsibly coach his clients on spending money from their portfolio. He did something that was really neat that nobody had done at the time and he went and did historical analysis using data. This is like I said, at the time that he did this, it had not been done.

He took a hypothetical portfolio using S&P 500 50% and US intermediate term government bonds 50%. 50% stocks, 50% bonds using US, S&P 500 data. He looked at rolling 30-year periods starting in 1926 ending with 1992. That's 1926 through 1955, followed by 1927 through 1956. 30 years, 30 years, 30 years moving forward each 30-year period one year, with the last year being, or the last 30-year period being 1963 through 1992.

What he was looking for was what was the maximum safe withdrawal rate in the worst 30-year period in US history? That is where the 4% rule comes from. The worst 30-year period – I didn't write down which 30-year period it was, but in that worst 30-year period you could have spent 4% without running out of money. Boom, there it is. 4% rule is born. It's become now this massive thing.

[0:31:14.7] BF: Okay, so what's the problem with that analysis?

[0:31:17.3] CP: Okay. Number one, he's using S&P 500 data. We know now ex-post that the S&P 500 has been the best performing index in history, market cap index. I'm sure there are better niche indexes, but anyway. If you repeat this exercise, the 4% rule analysis, the 30-year rolling period analysis, if you repeat that with global stocks still using historical, you get 3.5% as a safe withdrawal rate.

[0:31:46.6] BF: How do fees factor into this?

[0:31:49.7] CP: This is all no fees. Now with ETFs, fees are almost negligible.

[0:31:55.3] BF: Okay, but for an adviser charging 1% and 1.5%?

[0:31:58.5] CP: Well, yeah. I mean, it doesn't work at all.

[0:32:00.5] BF: Or really, complete demolishes the 4% rule.

[0:32:03.0] CP: Which is why FIRE people would never use an advisor. They also might run out of the money if they're using the 4% rule. Sorry, I'm really –

[0:32:09.5] BF: He was using actual data, actual performance from actual years. There was no going back and doing any Monte Carlo randomization of returns.

[0:32:17.3] CP: No. The analysis is done for the 4% rule initially was historical analysis, not Monte Carlo. That's one of the other things that you can do. Before we get there, I think that the big thing that's important to understand with the 4% rule is that 30-year period. It's a rolling 30-year periods. If you change that to using the same data, US data, 50% intermediate bonds, 50% S&P 500. If we go 40-year periods instead of 30, the failure rate at a 4% withdrawal rate is 15%.

[0:32:52.2] BF: This is using real data?

[0:32:53.3] CP: Yeah.

[0:32:54.2] BF: Wow.

[0:32:55.1] CP: You just extend out by 10 years. 15% of the time, you run into money spending 4%.
[0:33:00.2] BF: That's the real issue for the FIRE people, because they're retired longer than 30 years.

[0:33:04.4] CP: That's correct.

[0:33:05.1] BF: They retired like 50 years, or even more.

[0:33:07.6] CP: If you go 50 years, that was looked at as well. If you extend out to 50 years, the failure rate increases to 30%.

[0:33:14.2] BF: Crazy.

[0:33:14.9] CP: It’s now in 30% of historical periods spending 4% over a 50-year retirement period.

[0:33:19.5] BF: This is actual failure, let alone any Monte Carlo looking forward with any assumptions failure.

[0:33:25.3] CP: This is historical actual failure. Yeah.

[0:33:27.1] BF: Wow.

[0:33:28.1] CP: Now the next step is because this is also using historical data, expected returns now are maybe lower than they've been in the past, so the next thing that you can do is start looking at Monte Carlo. It doesn't actually change that much when you start looking at Monte Carlo, but we did look at a 55-year retirement period using Monte Carlo and found the safe withdraw rate was just over 2% for 50 years. Now this is all assuming you never work again, that you fully withdraw from your portfolio, whatever the percentage is every year regardless of –

[0:34:00.3] BF: Yeah, and then you’re spending in a bad year, which I think a lot of people would do.

[0:34:03.3] CP: Yeah. Once you start factoring that stuff in, I think the 4% rule could be a fine starting point. You've got to understand that that's what it is, a starting point.

[0:34:11.3] BF: 4% knowing you have to go down to maybe 2% or 2.5% in a bad year.

[0:34:15.4] CP: You can't get to the point where you can spend 4% and you're good. That's not how it works. That's not how it has worked in the past anyway. Maybe the future is going to be different. You start talking about other sources of income and of course, that's why do you think so many people who are big FIRE advocates are also big FIRE bloggers? It's an alternative source of income, which is fine and I'm not saying anything negative about the FIRE movement. 4% rule, not so much. Maybe 3.5% for a 30-year retirement. Maybe less for a longer retirement.

[0:34:45.1] BF: Worst advice from last week, there’s an article in The Globe and Mail that we – that caught our eye, called When Mutual Funds Make More Sense Than ETFs. My first comment, what drives me crazy is that people equate active management with mutual funds. I hear this all the time. New people come in to meet us, “I don't want mutual funds.” Well, it's not about mutual funds. There's nothing wrong with the mutual fund structure. It's a great structure for all kinds of reasons.

[0:35:12.4] CP: We talked about this with Rob Carrick, where he wrote an article saying the exact same thing. The TDE series mutual funds are fantastic low-cost index funds, but they’re mutual funds, but that doesn't mean you need to be scared of them.

[0:35:22.0] BF: Yes. Mutual fund is a structure, it’s not a strategy. It gets right of the gate that rubs me the wrong way. Then they go and I mean, it's all about he gets the fact that the ETF now have greater net sales and mutual funds, even though mutual fund assets in Canada are least eight to 10 times larger than ETFs. They go around interviewing a bunch of different advisors to get their feedback on this.

Some of these quotes – I mean, get this one, in later stage markets, a good actively managed mutual fund can maximize returns and limit volatility more than ETF can and alleviate the emotional ride for investors on the downside. You just love that one, don't you?

[0:36:00.6] CP: This article was insane. Then that same advisor was quoted again as saying, clients don't mind paying a little bit extra in fees if they feel their portfolio was being manned actively, particularly when markets are more turbulent.

[0:36:14.1] BF: We know how much Ben likes the word feel.

[0:36:16.8] CP: Yeah, feelings are important.

[0:36:18.9] BF: You can summarize it as in some cases, actively managed mutual funds are better, in some cases being times where markets are potentially going to drop. It's actually good timing for this discussion, because we just posted a YouTube video on Saturday talking about this exact same thing, about what – the arguments against index funds. The same stuff that they were saying in this article, that mutual funds – actively managed mutual funds are going to protect you in bear markets, because skilled active managers can whatever, whatever they can do.

In the video, we showed all of the data explaining why that is not the case, and you're still going to have a much more reliable outcome using the diversified index funds, compared to an active fund.

[0:36:58.6] CP: Don't forget another quote here. ETFs don't rebalance on their own, which means investors need to stay on top of the trades to get their portfolio balanced.

[0:37:07.2] BF: I guess, they haven't heard of V Grow.

[0:37:08.6] CP: They go by V Grow or V Bell and it's all done for you, whatever. 18 or 20 basis points.

[0:37:13.8] BF: It's crazy to me that information like this still gets published. It's crazy that people still eat it up. I think, the craziest part about all of it is that people don't just eat it up. If you look at the investment fund assets in Canada, almost 90% of them are still in actively managed funds.

[0:37:29.6] CP: I'd love them with the weighted MERs of it.
[0:37:31.8] BF: The morning I started looked at it I think a couple years ago and it was 2.02%. It's coming down. It's coming down a bit.

[0:37:36.8] CP: Yeah, be 20%, 30%, which is better. Anyways, that's their bad advice of the week.

[0:37:43.8] BF: Yup. Worst advice from the week was that mutual funds make sense sometimes. Well, sorry. I'm being the bad guy. Actively managed mutual funds make sense sometimes. Our feedback on that is that no. No, they do not.

[0:37:55.5] CP: Anything else on your mind?

[0:37:56.5] BF: Nope. I think that's it. You?

[0:37:57.8] CP: No. Great guest next week, Dr. Barbara Summers is up next week.

[0:38:01.4] BF: Yeah, it would be good episode. It was a good episode.

[0:38:02.7] CP: It's very good.

[END]