

EPISODE 74:
Playing with FIRE, Having a Belief System, and Term Life Insurance

[INTRODUCTION]

[00:00:05] Benjamin Felix: This is 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.

So last week had by far our biggest week of downloads ever. Over 10,000 downloads in a week. Now, for context, in April, we had 10,000 downloads in the month. It's continuously increased after that. But in April, we were ecstatic about having 10,000 downloads in a month, and we had that many downloads in a week last week.

[00:00:35] Cameron Passmore: For real context, when we started this 70 four weeks ago, we said if we get 100 people a week, we're thrilled. Yeah. So Thursday is the day that this drops. It's always the busiest day. But last Thursday was 50% higher than any other Thursday. It's a big jump.

[00:00:50] BF: The Friday last week was higher than most past Thursdays, which is crazy, like the day two after a release. So we're obviously happy that people are listening. But one of the things that made us think about was that there are obviously new people listening to the podcast, which is good, but newer people that haven't gone back to the beginning to listen might not know anything about who we are.

[00:01:12] CP: Have no idea who we are.

[00:01:13] BF: We thought it might be worth mentioning that briefly.

[00:01:16] CP: Yeah. We are portfolio managers at a company called PWL Capital. So we are a wealth management firm based in Ottawa. We record this from Ottawa.

[00:01:24] BF: In Canada, because I know we have a lot of non-Canadian listeners.

[00:01:27] CP: Our team manages a little over a billion dollars in client assets. We solely use low-cost total market index type funds to build portfolios.

[00:01:36] BF: We say index funds, but in some cases within our team here, we're using traditional index funds. But in most cases, we're using funds from Dimensional Fund Advisors, which we talk about every now and then we podcast.

[00:01:47] CP: Safe to say we do not use this as an overt marketing piece. We do not pitch for clients. I don't think we've ever done that. Certainly not our intent. Our intent is to give back and to share information.

[00:01:59] BF: Yeah. Oh, I wanted to mention too, because I this question a lot. We manage assets based on a percentage of the – We charge a fee based on the percentage of the assets that we manage. We don't do fee-only advice. We're not going to take \$5,000 to give you advice on your investments and financial plan. There are firms that do that. We don't. So we're what you'd call a full-service multi-management firm. We do have an investible asset minimum of a million dollars.

I think it's also important to point out that we don't just give people for our clients. We don't just give people advice on their portfolios. I mean, it's kind of like what we talked about in the podcast. It's all the stuff.

[00:02:32] CP: It's all the stuff.

[00:02:33] BF: Retirement planning, insurance, estate planning, tax planning. How to use and think about debt? How mortgage debt fits into asset allocation? When to take government benefits?

[00:02:42] CP: These come up every day in our world and we just keep a list going of items that come up to talk about in the podcast as well as take questions and feedback from listeners.

[00:02:51] BF: But that's kind of how the whole thing started. We're thinking about these stuff all the time, and you and I, Cameron, we're talking about it all the time and still are and we just kind

of had this idea that maybe our clients would appreciate if we get a podcast, because then it would know exactly how we're thinking about all these different issues.

[00:03:05] CP: We're also pretty passionate about following others in the industry, which is where we get all of our guest ideas, and we have amazing guests lined up.

[00:03:13] BF: Yeah. But as much as this started as what we felt was a good idea to communicate with our clients, it's turned into a lot more than that, which is awesome, and we found a whole bunch of different benefits from doing a podcast and excessive communicating with our clients that we didn't necessarily expect.

[00:03:28] CP: All the unintended consequences, right? I mean, it's such a good thing for our team for training, for learning. It's made us better I think as we've done a ton of research. I mean, we're spending hours every week researching and preparing and thinking about this stuff.

[00:03:42] BF: We've had a ton of conversations with people that, I mean, would we have ever talked to otherwise, maybe, but we probably wouldn't have had the same level of conversation with those people. A lot of those conversations are genuinely – Like we talked about annuities is an obvious example.

[00:03:55] CP: They changed us. That conversation with Alexander changed us for sure. Conversation with Dr. Summers, same thing, it changed us.

[00:04:03] BF: Some of those conversations have turned into ongoing business relationships, which again, like that's a benefit of doing the podcast that we never would have really expected. Like you said, it keeps us pretty sharp, because we're doing deep-dives into issues every single week that – I mean, just like the one we talked about in this episode. Is a rental property a good hedge against rising real estate prices?

[00:04:23] CP: Great question.

[00:04:24] BF: I had to think about that. If we weren't doing the podcast, I never would have thought about it.

[00:04:27] CP: No. That's

[00:04:27] BF: Unless a client ask, maybe.

[00:04:28] CP: Want to give some shout outs and thanks to MOne or MOne 2008 for the kind feedback. Slouchy87, and I'm not sure how you pronounce this name, but it's /-:{}.

[00:04:42] BF: These are people who have written reviews on iTunes for the podcast.

[00:04:44] CP: I'm looking forward to listening every week. I'm learning so much. Thank you for producing such an awesome podcast.

[00:04:49] BF: Oh! We hired someone. They got in touch with us after listening to this podcast.

[00:04:51] CP: That's true.

[00:04:53] BF: Just another benefit. Anyway, I guess the point of all that was to express some gratitude to all of the people who are listening to the podcast and sending in questions and interacting with us and with the content. It makes it worthwhile from all of these different perspectives that we just talk about, many of which we didn't expect.

[00:05:08] CP: We got lots of content today. Those questions, some factor funds, insurance and bad advice of the week. Enjoy 74.

[00:05:16] BF: Go to the episode.

[INTERVIEW]

[00:05:24] BF: You watched a documentary that you're pretty excited about, and I haven't watched it yet. But do you want to talk about it?

[00:05:29] CP: No. You will love it. I know that for sure. I follow Mr. Money Mustache, as I think you do on Twitter, and he announced a documentary that came out last week, and it's called

Playing with FIRE. I just find out as well, there's a comedy that was just released with the same name. If you search it, it's not the comedy. It's the one about the financial independent, retire early movement. I guess he was on with Tim Ferriss. I've not heard that interview, I don't think, but he was on Tim Ferriss three years ago and I believe a moviemaker heard that interview and decided to make a movie on the FIRE movement.

I must say, I was blown away by the movie. It's about an hour and 50 minutes long.

[00:06:07] BF: Hold on. Is Mr. Money Mustache involved with that movie?

[00:06:09] CP: He's not involved with the movie. He's in the movie, but he's not involved, I don't think, in the production of it. He's in the movie for sure, and his group of cohorts that lived this way are part of it.

I was expecting a story about how to cut your spending and save more money, kind of garden variety FIRE is what I was expecting, and I did have that, but it followed this couple as they realized that money is a source of a lot of issues in life. Once they realized that they wanted to have freedom to do the things that they loved doing, they realized what they loved to do, and that actually showed them talking this through. They realized that what they were doing in terms of their current lifestyle, which is twin luxury vehicles, very high-cost of living in California was not made them happy. This was the real breakthrough, because we talked about this in the past, where more income doesn't necessarily make you happier, and they talk at length about how money is the root of so many issues in relationships and in society today. There's so much pressure from consumerism and how much signaling comes from the stuff you own.

This is a real struggle over this couple, but realizing what made them happy and the drive to get to a point where they could just live that kind of life really motivated them to make some pretty dramatic decisions in terms of where they lived, how much they spent. It was a huge, huge transition that you got to watch through this show.

[00:07:34] BF: It gives a whole different meaning to FIRE when you think about it that way, as supposed to think about cutting, spending as much as possible so that you don't have to work anymore. It's more about spending on what is most important to you, which results in a reduction in spending.

[00:07:48] CP: One of the quotes was you can't lose if you keep happiness in the forefront, and that was the thing that really triggered with me is that it's not so much about being frugal. It's about realizing what makes you happy, and it's a challenge to think about that, because we're all so busy, like how busy you are with the kids. Career-going, kids. It's a busy lifestyle and you're nowhere I think anywhere near kind of the typical consumers that we could all fall prey to. What's important is the why are you buying this stuff as supposed to just buying the kind of stuff.

Another quote that he said was I can buy this lifestyle or I can buy my life back. And once they had realized that they wanted to buy their life back, that's what enabled them to make these changes.

[00:08:27] BF: For these people, what does that mean? What is their life that they got back?

[00:08:31] CP: They enjoy things like hiking, spending time with their kids, the simpler things. Spending time reading as supposed to all the trappings of the lifestyle that they did have.

[00:08:40] BF: It still sounds like I'd go insane.

[00:08:42] CP: They had the same career. They're doing the same work.

[00:08:44] BF: Oh, they didn't stop working.

[00:08:45] CP: No. They're not at retirement yet, but they got this meter. The meter show — I forgot the number, but years until retirement, whatever it is. 31 years and they show, "Oh, they made these changes." That meter rolls back all of a sudden like 6 years. We really like this part of the lifestyle. So it goes back up at 12. They just show the impact of their decisions as they go through life. They haven't retired yet.

[00:09:10] BF: Do they talk about what they would want to do if they were to retire?

[00:09:13] CP: Yeah, they go through that. You got to watch it. It's really well-done. They talk about how the world would be a better place if we were all rational with our money.

[00:09:19] BF: But hold on, hold on, hold on. Do they like desperately want to get out of their career or they love what they do and financial independence totally separate from retirement?

[00:09:26] CP: It's more about having the ability to choose to not to work and to do the things they really loved doing.

[00:09:31] BF: Interesting.

[00:09:32] CP: The quote at the end of the movie says they thought this was a quest about money, but no. It's actually a quest to get more truth out of your life.

[00:09:40] BF: That sounds like a way more reasonable approach than thinking about it as retire early.

[00:09:45] CP: No. It's about having the ability to spend more time doing the stuff you like doing. That resonated more to me than the typical way that I've interpreted the FIRE movement.

[00:09:53] BF: It reminds me a lot of the discussion we had with the Loonie Doctor recently. Similar philosophical coach.

[00:09:58] CP: Anyways, this is on all the platforms on Amazon. I rented off Google Play. It was like \$4, I think. iTunes has it as well. Rent or you can buy it for 10 bucks. It's well worth watching. I know a lot of listeners would really appreciate it.

[00:10:10] BF: This obviously changed your perception of the whole FIRE ideology.

[00:10:14] CP: It struck me in a way that I thought about this for a while, which is you got to get straight in what's important to you. I spent a lot of time thinking about that, and we're quite conscious about that in the office here. I think it's a better way as supposed to just live frugal just for the sake of living frugally.

[00:10:29] BF: After watching that, you've spent a lot of time thinking about it, I know, because you mentioned this to me a few days ago. Are there takeaways that you'll apply to your own life?

[00:10:37] CP: Oh, absolutely.

[00:10:38] BF: Like what kind of stuff?

[00:10:39] CP: Well, this has been going on already, which is perhaps why it spoke to me so much. Once you realized what you really love doing, like I love spending – I did this yesterday, spend the Sunday afternoon just reading. Reading is basically free. Hiking is basically free. I love doing that. Going to the gym, not expensive. To me, those things are fabulous. Making a good meal at home. A lot of things I love to do are not expensive.

[00:11:02] BF: You know what I started doing recently? Just because you mentioned hiking and exercising. I took my camping pack that I had when I was on the trail on the East Coast and I had a weighted blanket, probably weighs 35 or 40 pounds, and I stuffed it in there and then I put my back that I take to work inside of that and I've been walking to work with my – It's probably a 60-pound pack. That's free.

[00:11:22] CP: That is free. It's probably good for your core too.

[00:11:24] BF: It feels good.

[00:11:25] CP: But once you realize that the expensive stuff, there's lots of stuff you can do for so cheap. Great film. I highly recommend it. You got to watch it.

[00:11:33] BF: Yeah. Well, I've got to watch it too.

[00:11:35] CP: Okay. Some listener questions. Current topic number two.

[00:11:38] BF: I know I've said this before. I don't want to sound like a broken record, but my inbox is often full over the weekend with questions from people that are either listening to the podcast or watching the videos. It's good to get these questions, because it keeps the show going. I mean, when is the last time we worried about what we're going to talk about in the podcast? Never, I don't think, right?

[00:11:57] CP: No. There's so much content.

[00:11:59] BF: Yeah. But the content is largely interestingly listener-generated, because we get so many good questions that, yeah, there's never a shortage of stuff to talk about.

Anyway, so these were the two that stuck out for me recently over the last sort of week. The first one was – And this is my paraphrasing of the question. Is a rental property – So buying a rental property. Is that a good hedge against rising real estate prices to ensure affordability of a bigger house later? You own a house, but you also have some cash.

[00:12:28] CP: Yeah, that's the key. You have to have the cash obviously for the down payment.

[00:12:30] BF: Right. You own a house. You have some cash, but you're not quite ready to go buy the bigger house that you foresee wanting, say, in the next 5 or 10 years. Instead of leaving that cash in high interest savings account or whatever, you go and buy a rental property to park the cash.

[00:12:45] CP: And you're ignoring transaction cost on this?

[00:12:47] BF: No. Well, in my little example that I did, I ignored transaction cost, but you can't. That's a big part of it.

[00:12:52] CP: That's a huge part.

[00:12:54] BF: The real question is, is that a good hedge? So you've got say \$100,000 set aside that you know you want to put toward a house in the future, but not yet. Is it a good idea to put that into a rental property? To hedge against real estate prices going up 20% and then you can't afford the bigger house anymore?

[00:13:09] CP: Presumably, the other direction is also true.

[00:13:12] BF: That's the major downside.

[00:13:14] CP: Well, yes, but housing market goes down, so with your rental property. So you've bought an asset that's got some correlation.

[00:13:21] BF: That's the idea, is you want to buy – I think that's where the listener question came from, is like instead of having this cash that's uncorrelated with real estate prices, does it make sense to park the cash in an asset that's directly correlated with real estate prices?

[00:13:33] CP: The question is does leverage helper hinder this?

[00:13:36] BF: When I started thinking about it, and I had to think about it for a couple of days, but when I'm having trouble thinking about something, I always model it in Excel. What does the numbers actually look like?

[00:13:44] CP: Do you see what listeners questions do to him?

[00:13:46] BF: I put this in Excel, and once I did that, it was obvious that, yes, you get correlation on the asset. But because you're using leverage, like if we're saying that you've got \$100,000 that you're going to put into a rental property. So you buy \$500,000 property, you're using 5X leverage. Yes, it's a correlated asset, but your equity, which is obviously what you own, is correlated, but you've got a 5X dispersion.

[00:14:12] CP: Magnifier.

[00:14:13] BF: Right. When real estate prices change by a percent, your equity, your net asset changes by 5%, which – I mean, great on the upside.

[00:14:26] CP: But it's going to swamp your correlation with the prices though. As it goes up, you're going to make so much more because of your 5X.

[00:14:32] BF: The correlation is still the same time if they both go up at the same time.

[00:14:34] CP: The magnitude of that of the magnification is going to swamp the benefit of the correlation.

[00:14:40] BF: Correct. This maybe – Actually, this is a total digression, but when we're talking about portfolios, like stock and bond portfolios, or whatever asset portfolios. People often talk about wanting uncorrelated assets. So people talk about that with global diversification, like global equity markets are more correlated now. So there's less with benefit to diversifying, but that's not true. Even if you have high correlation but also wide dispersion – So if things move up and down together but at different magnitudes, there's still a diversification benefit, and this we're kind of talking about from the reverse perspective, where you get the correlation, good, but you also get this big wide dispersion.

[00:15:20] CP: Because of the leverage.

[00:15:21] BF: Because of the leverage. So if you're putting cash into a property, no leverage, that's a pretty good hedge, but then you'd have all the cash obviously and you would just buy the bigger house. Anyway, in short, buying real estate to hedge against real estate makes sense. Buying real estate with leverage to hedge against real estate price changes, I don't think that does make sense, because of the amplification from the leverage. Do you agree?

[00:15:43] CP: I agree. Question number two; I have adapted index investing, except for my Canadian bank stocks. Can these banks make money in good times and bad and haven't they had a track record worth hanging on to?

[00:15:56] BF: Yeah. We've had this question. I don't know if we've talked about it in the podcast before, but we've definitely gotten the question.

[00:16:02] CP: Not as much latterly, but boy, over the years, that question comes up all the time.

[00:16:05] BF: I mean, the banks, they have done extremely well. They are good businesses. But I think one of the challenges when we're looking at a stock or a sector, the specific risk, which is a random risk, this shows up obviously just from survivorship. It shows up as a positive. We know the banks have done well. We know that, but that doesn't make them good investments. They've been good investments in the past, but I think –

[00:16:28] CP: Plus if they are this great and this persistent in making money, who doesn't know that? Therefore, why would you have higher expected returns from them?

[00:16:37] BF: That's right. Thinking about this question, there were two things that I thought were important to consider. One is where does stock returns come from? Which relates to what you're just saying, Cameron. Then the other one is how does specific risk affect your outcome? Like you just said, everybody knows that banks are great businesses. That's already priced in. When you buy a bank stock today, you're buying expected future profits discounted at some rate that reflects the riskiness. That discount rate is what drives your returns. The fact that the bank is a great business, that's already in there. That's already in the price.

[00:17:04] CP: That's right, which will drive down the discount rate.

[00:17:07] BF: You're buying those great future profits at some discount rate. If you receive the profits as it expected, your return is having bought those future cash flows at a discount. It's not free. You don't get to buy higher returns with the information that we know today, unless it ends up happening that the bank surprise the market on earnings, which they've done in the past. But whether or not they're going to continue doing that in the future is a big unknown.

[00:17:33] CP: Yeah. Basically, making a focused bet on a single sector that something random to the upside will happen, or they give it a higher expected return.

[00:17:41] BF: Yeah. Well, you buy a bank stock today. You'd expect to earn the returns of stocks with similar characteristics. Say it's large cap Canadian value stocks with robust profitability. You'd expect to earn that all else equal, but that doesn't account for the specific risk of the asset, which it gives you a totally random outcome.

If you want the returns of that asset class, you have to diversify. If you just try and get the returns to that asset class by buying one company, you're going to get the asset class return plus or minus some random error from the specific risk.

[00:18:09] CP: Likely a less reliable outcome.

[00:18:11] BF: It's almost certainly a less reliable outcome, and I think that our perception of how reliable the outcome is is heavily skewed by how well the banks and how consistently well the banks have done in the past, but that shouldn't form our expectations about the future for an individual company. For all Canadian large cap value stocks with robust profitability, we can have an expectation. For one company like, say, RBC, it's really hard to have an expectation.

[00:18:33] CP: Good answer. So let's go into the portfolio topic, and this came from a question that I think you get a fair amount of in your inbox. Questions like what do you think of this factor ETF? Here's where we do a deep-dive into your world of happiness, I would suggest, in terms of how to choose a factor fund, and actually you've gone through and looked at a number of different factor funds that are available in the marketplace today.

[00:18:59] BF: Yeah. I mean, we do get this question a lot, and I know we've talked about this in the podcast in the past about how factor has become this marketing buzzword, and factor can mean a whole bunch of different things and it's not regulated or specifically defined. So you can call anything a factor.

But I think when we're thinking about factors and we're thinking about investment strategies in general, in order to evaluate them, the first thing that you have to have is a belief about markets. If you don't have a belief about markets, you don't have a framework to evaluate any investment strategy or decision. I think that's step one.

[00:19:33] CP: I was thinking about this, like where does that belief – For example, our belief comes from at the basic level that markets are efficient. Price is information in, and efficiency of information comes a risk story, which leads to our framework of deciding on the different factors.

But in reading, for example, this book about renaissance technologies, there's a whole different world of belief system and what they do, and they've had mind-blowing returns, and their belief is that there's all kinds of little patterns, little micro-patterns that they've been able to capture through systematic use of technology and math. But that's just a whole different belief system, which is quite interesting.

[00:20:12] BF: It's a different belief system. It's also an outlier, which makes it challenging informing your own belief system. You can look at renaissance technologies and say, "Oh! Their

belief system is pretty good, because look at the results.” But how do you actually apply that? I mean, you can’t. They can and –

[00:20:28] CP: They can.

[00:20:28] BF: Whatever they have.

[00:20:29] CP: All these algorithms.

[00:20:30] BF: Have you finished that book?

[00:20:31] CP: I’m about almost 80% done. The framework is similar to what Dimensional talks, which it has to make sense. I don’t just shove things in for the sake of shoving them in. Obviously, I don’t disclose what they do, but it’s always little – They’ll often do 300,000 trades a day, little micro-trades, although it’s not HFT. It’s not queue jumping on trading. It’s actually using their information from the patterns and capitalizing on what they see.

[00:20:55] BF: Does it talk at all about what they’re doing just that they’re capitalizing on patterns?

[00:21:00] CP: It’s math. They’re mathematical quant brilliant people.

[00:21:03] BF: And there’s a lot of leverage, I’m assuming.

[00:21:05] CP: I don’t believe so. It’s a good question. Someone can correct me, but I don’t believe so. Well, the returns are staggering.

[00:21:11] BF: I know they are.

[00:21:11] CP: They’re brilliant people.

[00:21:13] BF: You raised a good point. Jim Simons would probably not evaluate an investment strategy the same way that we would, or the same way the Fama would, because he has a completely different belief system.

[00:21:24] CP: Sorry to interrupt, but how do you then choose a believe system? Some people can – To go back the dividend one, they believe dividends are better. That's your belief system.

[00:21:32] BF: Yeah. I mean, I guess –

[00:21:33] CP: Banks are better.

[00:21:34] BF: Yeah. I guess it's all about hypothesis testing at the end of the day.

[00:21:39] CP: Well, that's where I'm so comfortable with our belief system. It goes back decades of peer review data.

[00:21:43] BF: Yeah. It's built on things that are theoretically true and robust in the empirical data.

[00:21:50] CP: All right. Let's motor on, otherwise this will be a two-hour podcast. I mean, it's a super interesting discussion.

[00:21:56] BF: I'm glad you brought it up though. So that does speak to where I was going with this, which is you have to have a belief system. When you're evaluating an investment strategy, if you have a belief system, some other strategy that somebody else thinks is smart based on their belief system might look not so smart based on your belief system. Which belief system is better? Like you said, how do you choose one? I don't know.

[00:22:16] CP: What I find is the hardest is you'll often hear of other things that appear to be very good, then you put the framework we have, which is all these robust peer review data and it's like oil and vinegar. They just does not go together. You can't get your head around it.

[00:22:29] BF: Sometimes it doesn't. I think in the case of renaissance technologies, it doesn't. But in other cases, I think that – Well, it doesn't go together, but if one framework can explain what another framework suggests, then if we take the efficient market framework, if there's some other factor model that gives maybe better results of similar results, you could easily say,

“Well, it’s just a repackaging of the risk-based factors.” Now, they could say the same thing on the other side. Their model is better because of whatever reason that they have.

Anyway. So this is why it’s important to have a belief system. Choosing a belief system is not exactly easy. But as listeners know, we tend to use the model of market efficiency to make investment decisions. Within that framework, we have the five-factor model, which is a risk-based framework for how the market price its assets. It’s an equilibrium pricing model.

For us, if we’re evaluating an investment strategy, we’re going to use the Fama French five factor model. I think there are other models that will show – The quality factor I think is a great example, where research will show that quality is a good factor that you should use. It looks better in the back tested data than the Fama French five factors, or then some of them. Like maybe quality on its own looks better than profitability on its own.

But the question you always have to ask is do the factors that are already in the five factor model, not just profitability, but all of them together, do they explain the differences in returns that are observed through something like quality? The answer in that case specifically is yes, you can use the Fama French five factor model to explain the differences in returns that you would observe using quality to sort securities.

I think another part of this whole concept of choosing a framework to think about markets is the idea of Occam’s razor, like the simplest solution is probably the best one. So you take quality again as the example. They’re using ROE, return of equity, leverage, and debt to book, and earnings variability. There’s a whole bunch of different stuff that goes into quality, which makes it harder to calculate, harder to implement, higher turnover in a portfolio that’s using quality, and that’s something that you could have explained using the factors in the five factor model.

[00:24:36] CP: Right. The simpler model would have done a good job explaining it.

[00:24:39] BF: On implementation, when we’re talking about actual live portfolios on implementation using the Fama French five factor models instead of quality is going to give you a lower turnover portfolio. Because there are less variables, the characteristics of securities will change less often.

[00:24:53] CP: Safe to say there's also more product available in the market place for investors to choose from.

[00:24:56] BF: What do you mean?

[00:24:57] CP: Instead of using quality as one of the factors. Using the other mini-size and –

[00:25:01] BF: I would say the opposite. There are a ton of quality products out there.

[00:25:04] CP: Really?

[00:25:04] BF: Yeah. We're going to talk about some of them.

[00:25:07] CP: Let's jump in on the products.

[00:25:08] BF: Yeah. I think so.

[00:25:08] CP: When you went through the products, you wanted to – You had a certain criteria that you used to determine how good they were. You always took a look at what is the factor exposure in the products.

[00:25:20] BF: I want to finish up on quality. There are a couple of things that I didn't touch on that I wanted to. When you take quality, which I mentioned has – Or we leverage debt to book and earnings variability. If you instead take net income, and this is from Robert Novy-Marx, net income instead of return on equity, because return on equity can be affected by one-time expenses. Novy-Marx says you should use net income. Then once you control for the level of profitability, the variability of profitability contains almost no information about future profitability. That's now negated two things that are in the quality metric.

Then for leverage, Fama and French in 1992 showed that once you control for size book to market, leverage contains little information about differences in avid returns. So it's like all these things that are in quality that make quality sound good can all be explained more efficiently by the five factor model. Anyway, I think we already kind of talked about that, but I wanted to make I got the points out explicitly.

[00:26:12] CP: Good points throughout. I'm sure listeners are very happy.

[00:26:15] BF: Yeah, I hope so. Once we get to thinking about evaluating products, we now have our frameworks or we're believing that markets are efficient. We're using the Fama French five factor model to evaluate products. Understanding that pretty well, any other factor that's been documented can be explained by the five factor model, which maybe supports that as a belief system, but anyway.

When I'm looking at products, the easiest thing to do is use U.S. listed funds of U.S. stocks, and the reason for that is the factors for U.S. equity are the most explicit. If you have international equities, some people might treat the definition of international differently. So your factors might not match up exactly with what's in the fund. But for U.S. equity, it's pretty straightforward.

Then the reason for U.S. listed is there's a website called portfoliovisualizer.com that makes this analysis like easier that you could ever imagine. You just put the ticker in and it gives you the full factor regression, but it only works for U.S. listed ETFs.

Fortunately, for every Canadian listed ETF that I've gotten questions about, there is a U.S. listed counterpart. Like in many cases, the Canadian version is just a wrapped version of the U.S. ETF. When I'm looking at products, the things that I want to look for are quantitative implementation. I don't want subjective human active management in there, for I think what should be obvious reasons; broad diversification. I don't want something – The whole conversation we had with Wes Grae from Alpha Architect. Some people might want a highly concentrated portfolio, but that gives you an unreliable outcome.

So when I'm looking at products, I don't want to see that. Low turnover is a big one. It's hard to capture return premiums if your portfolio is turning 50% or 80% every year. Turnover is like how much it changes its holdings each year. 100% turnover would be it got rid of and bought new holdings for the entire portfolio. Low fees are big, and then consistent factor exposure is another big one. If you're buying a factor fund that's not actually giving you statistically significant factor exposure, obviously, you're just paying higher fees for no real good reason.

[00:28:03] CP: Let's jump in. First one you looked at was the Vanguard U.S. Value Factor ETF, VFVA.

[00:28:09] BF: VFVA, yeah.

[00:28:10] CP: It's actually a small fund too.

[00:28:12] BF: I didn't look at the assets –

[00:28:12] CP: Like \$70 million in the U.S. fund, and 70 million the Canadian fund.

[00:28:17] BF: We have, and this is one that I've gotten a lot of questions about, VVL in Canada. SO VFVA, like I said before, the U.S. listed version of the U.S. equity fund. VVL, the one that we have in Canada is a global value. One is U.S., the one that we looked at. VVL is the global value equivalent, but the concepts are all the same. The way that they're implementing the products are the same. They're defining value as a book, value over price. Forward earnings over price and operating cash flow over price. You could argue how you should define value, but they're using three different metrics. That's fine. It's got 750 holdings, which is pretty good, and you'll see why I say it's pretty good when we start seeing some of the other ones. 70% turnover though.

[00:28:57] CP: Super high.

[00:28:57] BF: Pretty aggressive. VFVA, the U.S. listed one has 13 basis point management fee. VVL in Canada is at 40 basis points for the MER. Now, when we get to factor loading, it's actually pretty good for VFVA, and presumably VVL is quite similar, but it's got pretty strong exposure to the value factor and profitability as well, which is good.

[00:29:16] CP: You know there's a but coming. I can tell by the way you're talking, there's a but coming.

[00:29:21] BF: I really want to like both these funds, VFVA and VVL. The problem when you read the investment strategy page on the Vanguard website for these funds, they have this. It's like the last paragraph, the very bottom of the page, but it says the fund that may take

temporary defensive positions that are inconsistent with its normal investment policies and strategies. For instance, by allocating substantial assets to cash equivalent investments or other less volatile instruments in response to adverse or unusual market, economic, political or other conditions. In doing so, the fund may succeed in avoiding losses but may otherwise fail to achieve its investment objective.

[00:29:55] CP: Deathblow.

[00:29:56] BF: It's like, "Come on! It was such a good product.

[00:29:58] CP: There are lots of other product.

[00:30:00] BF: I don't really understand why they're putting that human subjective overlay on top of what otherwise is a pretty good value product. Anyway, there's one. VVL would be the Canadian equivalent, the one we just talked about. I think between YouTube and emails from the podcast, I get a lot of questions about VVL.

[00:30:15] CP: You get lots with the next one, the iShares Edge MSCI USA Value Factor ETF, VLUE.

[00:30:21] BF: Like I'm on recently.

[00:30:22] CP: And XVLU in Canada.

[00:30:25] BF: Yeah. So XVLU is the Canadian wrapped version of VLUE.

[00:30:29] CP: The U.S. fund is huge.

[00:30:30] BF: I don't look at the assets. How big is it?

[00:30:31] CP: 4.5 billion, but the Canadian fund is small, but it's just launched two months ago.

[00:30:37] BF: Yeah. They're using book value to price and 12-month forward earnings to price and dividend yield. Again, a bunch of different value metrics, which it's kind of interesting

actually. If it's a single factor product, so if it's not using all five factors in the Fama French model. Using these alternative or mixing together different metrics for value actually ends up giving you exposure to other factors.

When you control for size, value, profitability and investment, adding in alternative metrics for value doesn't give you anything. But if you're only looking at value, adding in the alternative metrics gives you exposure to maybe a bit of momentum, maybe a bit of profitability. Anyway, interesting side note.

XVLU or VLUE is the one I was looking at. 148 holdings. Now it's pretty concentrated. Not 40 stocks, like Alpha Architect, but still –

[00:31:23] CP: Half the turnover of the last fund, the Vanguard fund, 35%.

[00:31:26] BF: For the year ending July 2019, but I looked at the statements, and in 2016 it turned over 81%.

[00:31:33] CP: That's wild.

[00:31:34] BF: It is wild, and for this fund you're paying 15 basis points in the U.S., but 30 basis points for the Canadian listed version. Now in this case, it has value exposure. Pretty good loading the value, but statistically insignificant. Close, 1.5 t-stat, but not significant with the 95% confidence level, which is kind of like if you're buying a value fund, you'd probably want statistically significant value exposure with a 95% confidence level. The big one for me on this is 148 holdings. That's going to give you an unreliable outcome.

[00:32:02] CP: The iShares Edge MSCI USA quality factor, QUAL and XQLT in Canada. There's a \$14 billion fund in the U.S. It's a new fund in Canada.

[00:32:14] BF: Yeah, they just launched all these. Easier this year they launched them. Did you look?

[00:32:17] CP: I don't remember the date on that one.

[00:32:19] BF: Okay. They're measuring quality as high return on equity, stable year over year earnings growth and low financial leverage.

[00:32:25] CP: 124 holdings.

[00:32:28] BF: 41% turnover, and the fee is similar to VLUE, 15 basis points in the U.S., and XQLT in Canada is at 30 basis points. Now in this one you're seeing pretty good exposure to profitability, which is kind of what you'd expect from a quality fund. That's fine, I guess. Negative exposure to value, which again something that is seeking exposure to quality, which is similar to profitability. You'd expect negative loading to value.

It's actually one of the things that's really interesting when you look at the dimensional funds, because they're going deeper on value. You won't see a big regression coefficient for profitability, even though Dimensional is targeting profitability. But it's like if they were just going after value and not looking at profitability at all, you'd expect a negative loading to profitability.

Even a small positive loading when you're going deep on value is – I don't know what you call it, impressive. I don't know if impressive is the right word. But all else equal, you'd expect if you go deep on value to have a negative loading profitability.

[00:33:23] CP: Right.

[00:33:23] BF: But by looking at both things together, you can get –

[00:33:25] CP: They actually pull the profitability up.

[00:33:27] BF: That's right. Anyway, in this case, because the iShares fund is only looking at quality, you do get negative exposure to value. If you're a multi-fund, you might not see that. I know the turnover is high. Again, concentrated. I wouldn't feel comfortable investing or telling someone to invest in a fund that has a couple of hundred holdings.

[00:33:44] CP: Okay. Let's look at a couple of fidelity funds. Fidelity quality factory, the FQAL and the FCUQ in Canada. U.S. fund is about 150 million. The Canadian one is about 100 million.

[00:33:57] BF: For this one, the thing that – I mean, it's called a factor fund. You're paying 39 basis points to own this thing. When you look at the regression coefficients, they're all small and statistically insignificant. I was like, "What are you paying 40 basis points for?"

[00:34:12] CP: There's no factors loaded.

[00:34:14] BF: Not in a way that is statistically significant. Actually in this one, so it's a quality fund and it's actually got negative loading to everything, including profitability. In this case, maybe I just don't understand their fund at all, but – Well, they said that they're looking for companies with strong balance sheets and more stable cash flows than the broader U.S. equity market.

[00:34:33] CP: 129 holdings, 29% turnover, but no real factor. No factor exposure in this –

[00:34:39] BF: I think this is the tricky thing about someone calling something a factor fund. It's like what is under the hood? What shows up in a regression? I think we can jump over ahead a low volatility one that I don't know if we need to talk about.

[00:34:49] CP: Going to Fidelity high dividend ETF, the VDFF. VCUD in Canada, \$450 million fund in the U.S. 127 million in Canada. Definition of factor is high-quality U.S. dividend paying companies.

[00:35:01] BF: I thought that was interesting, like you're taking quality and then overlaying a screen for dividends, which as everyone knows –

[00:35:09] CP: Don't start in the dividends. Okay. What was the factor loading on this like?

[00:35:14] BF: I mean, nothing crazy. It had a – You know what? Actually, it is interesting when you think about it. It had a pretty strong and statistically significant loading to the investment factor. That's companies that invest conservatively. If a company is investing conservatively, you would expect it to be paying a higher dividend. So it kind of makes sense that they back out exposure to the investment factor. But I don't know if that's a good thing, especially when we're talking about these are probably I didn't look at, but they're probably SMB zero. So it's about

market cap. I was going to say, it was probably larger companies, but it has market cap weighting of size.

[00:35:47] CP: No value loading.

[00:35:49] BF: Yeah, nothing economically or statistically meaningful. But the investment exposure is interesting, because, theoretically, that matters. But empirically, investment is really tricky to pin down. Dimensional, they've known about it for a long time. They've only recently started looking at implementing it in portfolios. The reason is differences in investment are not predictive for larger companies, but for smaller companies with weak profitability that invest conservatively. It does explain differences in returns, but I think using investment as a filter in a fund like this when we're talking about total market and not just looking at small cap growth companies. I don't know how meaningful the investment factor is going to be.

[00:36:30] CP: Okay. So the main takeaway to me of all of these is there's more to an ETF or a fund than the name it might reveal. Having this framework of the factor loading makes a lot of sense. You want to watch for turnover and you want to watch the number of holdings to increase your liability. That's kind of the main takeaways that I think people should –

[00:36:48] BF: Yeah. I mean, you really have to read. You can't just look at the title and say, "Oh! It's a factor fund." VVL I think is the biggest example where it is an actively managed fund.

[00:36:57] CP: Even if you read it, you still wouldn't know what the factor loading is, unless you want to use that site you mentioned.

[00:37:01] BF: Yeah, you can use portfoliovisualizer.com, but that's one piece of it. It's also what is the strategy of the fund. What are they actually doing on implementation? That's one that blows my mind for Vanguard, is that it's a value factor ETF. Great! But then you read the actual investment strategy page and it's an actively managed fund. It's like, "What? What happened?"

[00:37:17] CP: I want factors.

[00:37:18] BF: Yeah, but that's the thing.

[00:37:19] CP: Key consistent exposure to the factors.

[00:37:20] BF: People hear us talking about factors, so they go and Google factor ETF. Great! Global value factor ETF, and it's pretty cheap, but it's an actively managed fund.

[00:37:27] CP: Okay. On to the next topic.

[00:37:29] BF: Yup.

[00:37:29] CP: Okay. So the planning topic this week is going back to our discussion two weeks ago about life insurance. How much life insurance do you actually need? Because we made a comment about a study that showed that most people don't have any or near the amount of life insurance they should have in place. I think you had a question, "How much should I get?"

[00:37:47] BF: Right.

[00:37:49] CP: We thought we'd help kind of frame that discussion, that decision, but how much insurance you should get? Today we're talking about insurance from a risk management standpoint. There may be reasons why you want some sort of permanent insurance. It might be a state planning reasons, or tax reasons. But today we're talking about basically income replacement.

[00:38:08] BF: On what you were saying there, I'm getting more and more interested overtime in the concept of using permanent insurance in asset allocation as part of the fixed income component for tax reasons. We can come back to that in a future episode.

[00:38:18] CP: Come back to that in another episode. I agree. But today we're talking about income replacement, risk management for your family and how do you decide how much insurance to get.

[00:38:26] BF: Right. It's going to be term insurance.

[00:38:28] CP: It will be term insurance.

[00:38:30] BF: The amount of times that I've seen people with this type of need, an income replacement need who have a permanent policy. It's like, "Man!"

[00:38:37] CP: Especially when term insurance is so cheap, it's so affordable. If you're young and healthy. Basically, if something happened to you, you passed away, you want to make sure your family is taken care of to the lifestyle that the surviving family would want. The amount of insurance I believe on you is actually up to your wife, not you, because she's the one in your situation that's left behind to take care of things.

A lot of people make kind of glib jokes, "He'd be fine, or she'll be fine." No. It's not up to you to make that judgment call. It's up to them to make that call.

[00:39:05] BF: Yeah. I think in thinking about preparing for talking about this, I'd split it up into two different possible buckets where you and your spouse can decide to either plan to maintain current lifestyle, which has implications in the amount of insurance that you would need, or you can plan the change lifestyle on death of a spouse.

[00:39:23] CP: I've even seen some people said, "Look, I would presume within, say, 5 years or 10 years, you'd meet someone else and carry on in the next chapter of your life." That's a rational decision. Some people want to fully fund their retirement. Some people want to pay off all the debt. It's a very personal decision.

[00:39:39] BF: I think at the bear minimum, and this is just maintaining lifestyle. But I agree, it's all very personal decision. But if we just say the bear minimum is to maintain lifestyle, you want to be able to replace the amount of your income that is currently going toward household expenses and savings.

[00:39:53] CP: For a certain amount of time, and it could be for life. Then it becomes a discount cashflow calculation. Get the present value of that.

[00:40:00] BF: If you take a household that has, say, equal incomes, both spouses working. Maybe the child in daycare, and total expenses are 10,000 per month between the two, between the family as a whole or across the family as a whole. Each spouse is covering an equal 50%. If one spouse dies, you need to be able to replace the 5,000 per month for, like you said,

some specified period of time. That might be until the kids are independent, maybe. It might be until you expect to reach financial independence. I'd say a think about life insurance planning is like all of it is built on top of an overall financial planning.

[00:40:32] CP: Has to be. There's far too many rules of thumb as well, like what's mentioned in that study. You may end up with a rule of thumb, but there are so many different phases. Let's say you're young now, you don't have kids. Does that phase between now and you might have kids than the 20 years when you do have kids and over 25 years. Then there's a phase post-children. Again, it's up to the surviving spouse to decide how much protection they want for each of those time periods.

[00:40:54] BF: Yeah. I probably would include, like when we're talking about replacing whatever amount of income. I would include whatever amount was going into savings. Say, if we're saying one spouse is covering 5,000 or household expenses but a thousand of that is going into retirement savings. You got to replace that too. Otherwise, the whole financial planning is thrown off. Why are we doing life insurance? To ensure the financial plan. To make sure that things work out on death.

[00:41:17] CP: You could also choose to have it pay off the mortgage, which is often the case. Therefore, reduces the amount of cash flow you need to maintain your lifestyle.

[00:41:24] BF: I think that's a sensible way to think about it. Instead of including the mortgage payment in the \$5,000 cash flow figure, I would eliminate the mortgage payment and have enough insurance to pay off the mortgage in full.

[00:41:34] CP: This is also why we believe you should do your insurance planning as part of your financial plan and not part of the mortgage application and not have the insurance coverage as a tick box when you apply for your mortgage at the bank.

[00:41:44] BF: Yeah, I mean there are a lot of reason for that, like when they end it right and how they end it right.

[00:41:48] CP: The banning fees.

[00:41:49] BF: Separate discussion.

[00:41:51] CP: Separate discussion. If for example you want to replace 5,000 a month for 20 years, so your half of the household expenses just kind of by 2%. That's \$980,000.

[00:42:01] BF: 2%, that's a real 2%. That's 5,000 adjusted for inflation. If we're assuming 2% inflation, that's a 4% expected return, which I think is pretty conservative.

[00:42:09] CP: Yes, that's for 20 years. You might decide when it comes time to choose the policy, a part of that in a term 10 policy and part in term 20. So you lock in the second 10 year term rates. You might let the term 10 drop after 10 years.

[00:42:25] BF: Why wouldn't you do all t-20? Because it's roughly twice as expensive.

[00:42:28] CP: Yeah, you're paying more for the first part of the 10 – The first 10 year period.

[00:42:32] BF: Again, we come back to this concept of the insurance has to tie in with the overall financial plan, because you have to know that 10 years from now, whatever portion you're going to do as t-20 is going to be sufficient.

[00:42:43] CP: Yeah.

[00:42:43] BF: But you wouldn't know that unless you had some sense of what the overall financial plan looks like. Did you say the amount?

[00:42:48] CP: Yeah, \$980,000. You round it up to a million. The cost is irrelevant, frankly. There's going to be all kinds of upfront expenses. You may bring family to town. May have a donation you want to make.

[00:43:00] BF: On death.

[00:43:01] CP: On death. Yeah. So you may want to donate to a university or something, your alma mater.

[00:43:06] BF: Start an endowment kind of thing.

[00:43:06] CP: I've seen people set up endowments in the past that want to donate, say, a quarter million dollars to be able to pay out a certain amount of money per year for –

[00:43:13] BF: Would you do that with a term policy? I would think about that as a permanent planning –

[00:43:17] CP: You can do it as a permanent for sure. I'm saying, just as you go down the list of what you need money for, because I've had a number of situations where this has happened unfortunately with clients, and I call tell you the money flies when this happens.

[00:43:28] BF: Oh, yeah. I can imagine.

[00:43:29] CP: Just when there's the funeral, and I don't mean to be creepy about this, but there's a funeral, there's bringing family to town. They're setting up the endowment. There's always different things that you do right out of the gate.

I tell people, "Let's get the number and then round up. It doesn't cost a lot to round up."

[00:43:44] BF: It doesn't cost a lot. When we do this, like when we're sitting down with clients doing this as we continuously allude to when we're talking here, it all stems from the plan. We figure out what it the overall financial plan look like in terms of savings and expected retirement date and even asset allocation and things like that. Then we work backwards from that to figure out if someone died today, how much life insurance would you need? Then we use money Monte Carlo simulation to make sure that the result is robust.

Most people don't have that, but I think just like the little calculation that you mentioned using a really conservative discount rate to find the present value of those future liabilities, that's an easy way to approach it. I guess if you're sitting down buying insurance, the agent should have some method to calculate the amount.

[00:44:24] CP: Yeah. There's all kinds of tools online as well. The reality is you meet so many people that will say, "Oh, I got a work policy. It's a couple of hundred thousand. We'll be fine." It's like that's not going to do anything to replace any income.

[00:44:33] BF: Yeah. The other big decision that we haven't talked about it yet in calculating that need is if a spouse dies, the surviving spouse, maybe they don't want to keep working because they're devastated. Maybe they're worried about the kids. That's a whole other aspect of the planning. It's like you said, it's talking to the spouse. If I die, does my wife – My wife doesn't work. But if you're working, if I die –

[00:44:55] CP: Your wife works very hard.

[00:44:56] BF: She doesn't have –

[00:44:59] CP: I'm not trying to set you up, but man!

[00:44:59] BF: You're going to get me in trouble.

[00:45:02] CP: Your wife is a trooper.

[00:45:03] BF: Yes, she works very hard.

[00:45:05] CP: But it's a good example also. Something happened to her, a lot of people say, "I'll just keep on working." Yes, but it will cost something to replace what your wife does do. You need a lot of homecare, for sure.

[00:45:14] BF: Yeah. But then that's the same like, "Would I want to continue working?" I probably would, because I really like working. But who knows?

[00:45:21] CP: Might be half time.

[00:45:22] BF: If I didn't want to do that, that is something that we would need to plan for and the amount of insurance that we're going to buy for my wife. Maybe it's not just enough for

childcare. Maybe it's enough for childcare and for me to take significant time off. So that all goes into the calculation.

[00:45:34] CP: Anything else to add to that?

[00:45:34] BF: One of the things that I was thinking about on the topic of life insurance is how it relates to asset mix. It's more about how do you treat your existing assets when you're figuring out how much life insurance covers that you need. So the way that I was thinking about it is that if you – Say we decided or you decided that you need a million dollars of coverage, but you've got half million dollars in investments. Do you exclude the portfolio or do you include the portfolio as part of the insurance calculation?

If you have half millions in a portfolio, maybe you decide you only need half million of coverage. You need a million to fund –

[00:46:02] CP: The portfolio presumably is for the long-term retirement.

[00:46:04] BF: This is where it gets tricky, is that if we assume that the half million dollar portfolio reduces your insurance need, but the portfolio is aggressively invested in 100% equities, can you really count on that to be there?

[00:46:14] CP: In 30 years, yes?

[00:46:16] BF: In 30 years, yeah. But if you died tomorrow?

[00:46:18] CP: I'm talking for the surviving spouse though.

[00:46:20] BF: Right. But if we're saying that you need a million dollars of liquidity to fund lifestyle today on death and there's half million dollars in a portfolio, invested in 100% stocks. Do you buy enough insurance to cover the full million dollar liquidity need or do you rely partially on the portfolio?

[00:46:36] CP: Well, I'm assuming the portfolio was there for long-term needs, not for short-term needs. You have to make sure your portfolio is lined up to what the timeframe is for the needs.

[00:46:44] BF: You would ignore the portfolio.

[00:46:45] CP: I think so, in most situation.

[00:46:48] BF: But it's tricky, right? Because the closer you are to financial independence, the more of your human capital is in your financial capital.

[00:46:53] CP: Which means the less insurance you do need though as you get older.

[00:46:55] BF: I know. It's what I'm saying. The portfolio does interact with the amount of insurance. But my question is how does it interact? Is it one for one?

[00:47:03] CP: Unless you are applying market collapse at time a death insurance?

[00:47:06] BF: No. I'm just talking about planning for assuming that you might not have the full amount of your existing investments at the time of death when you're figuring out how much life insurance –

[00:47:14] CP: Yeah, but you would consider that in your Monte Carlo analysis. Anyways, it's part of your plan.

[00:47:18] BF: We would have, but if someone's thinking about how much insurance they need on their own. I'm just thinking if you have existing assets that are invested aggressively, it might make sense to discount them when you're figuring out how much insurance you need.

[00:47:29] CP: Interesting. I hadn't thought of that. Frankly, for most people, to buy more term, it's so cheap. Just buy more. Literally, it's so cheap.

[00:47:38] BF: It is, yeah. It is not expensive. Yeah, when I was thinking about this exact thing, I looked at – If you include the half million dollars of portfolio in the insurance calculation,

meaning you only buy 500,000, and I compared that too if you discounted it 50% of its value assuming the market tanks at the time of death. So you're buying 750. The difference in cost was \$20 a month.

[00:47:58] CP: There you go. On to bad advice of the week.

[00:48:01] BF: Yup.

[00:48:02] CP: This one, I got permission from a client to share this story. I'll generalize it so it's not too specific, but as a good example and I appreciate him allowing me to share this story. He's a regular listener. Client was in. His mom who is in her 80s has a portfolio and is living off this portfolio, but there's not enough money in the portfolio to last as long as she's expected to live.

She's in her 80s and her mom lived to 104. He just asked us for some feedback in the situation. The portfolio was full of mainly equity, mainly active, all active equity mutual funds. Anyway, that was our – Now it had done well. So knock on wood. It turned out okay. He decided, "Okay. Well –" She wants to stay at the bank. She's with two banks right now. I'm going to visit them and try to clean up the portfolio and get a better portfolio, a better asset allocation and lower the fees. So that was his mission, to go and help her.

Went to bank number one, and to the bank's credit, they had been wanting to talk to them to reduce the risk of the portfolio, which is admirable. When the son asked about lower fee options such as ETFs or index funds, he said the branch representative was not at all interested in discussing index funds.

[00:49:19] BF: Not interested. Like just said, "No. I'm not interested in talking about it."

[00:49:20] CP: No. They said they could add in a bond index fund and have three other active equity funds. In the end he said they were very nice. Again, they're very nice and they decided on some sort of 30-70, so 30 stocks, 70 bond portfolios as a much more sensible asset allocation. The fees came out at 1.47%, which is much lower than the average fees. You could have gone cheaper with ETF, but still, it's better than it was and more suitable than it was.

He then went to the other bank, and when he framed it the same way, which is want to lower fee options, ETFs, indexing. They basically said, “Well, you better set up an account online and go –” and I quote, “buy your ETFs.” But why would you do that? They said when the funds you have have done so well.

[00:50:02] BF: Good question.

[00:50:03] CP: Anyway, so I had a good chat with him. He called to see if we could help him out in what they should do. Given our recent conversations, like the one on reverse mortgage, because she’s still in her home, and annuities. I said the biggest risk here is that she lives risk. Let’s hope she lives long as her mom did to 104. The money she has now will last another 7 years. He wanted to make it to her age 90. That’s another potentially 14 years after that.

We actually work through some of the math we talked about a few weeks ago on her first mortgage. For now, they’re not going to do that, because they don’t need a lot of money to make up the short fall, but they can take the money she has now, buy an annuity. They’ll make up roughly two-thirds of her short fall. So she’s short one-third. She has lots of equity in her house. She could easily go get a simple line of credit now at Prime PLUS 1 or something, which is a little bit lower than the reverse mortgage rate.

[00:50:56] BF: But she couldn’t get a line of credit, could she?

[00:50:58] CP: She actually has one now. She has a secured line of credit right now. There’s a risk of it being called, at which point I said, “At that point, you look at a reverse mortgage.” But these kinds of planning decisions, discussion, didn’t happen at the two banks. It was basically nicely said that we can’t really help you with what you wanted to do, but what should have happened is what we ended up talking about. They’re super happy. He was super happy with the discussion, but it’s interesting how our recent research and work on reverses and annuities has helped a lot.

[00:51:28] BF: That is interesting.

[00:51:29] CP: Again, thanks for the input and I appreciate it very much. Anything else on your mind?

[00:51:34] BF: Nope. I think I'm good.

[00:51:36] CP: Good. Well, thanks for listening, and we'll see you next week.

[END]

The ideas, opinions, and recommendations contained in this document are those of the authors and do not necessarily represent the views of PWL Capital