

# CONSIDER THIS PROGRAM

EPISODE DATE:

**March 21, 2020 Episode**

ON THIS SHOW:

**Big Joe Clark, CFP®:** Managing Partner and Lead Advisor of Financial Enhancement Group

**Angi Kinser:** Event Coordinator at Financial Enhancement Group

## SHOW NOTES:

### Topics Include:


- Crazy Economic Times
- Low Interest Rates
- I Love Exchange Traded Funds
- 4 Things To Wreck An Early Retirement

### The Stimulus Package

Do you wonder why the government pumps money into the system when things are wrong? We're going to talk about stimulus this morning, what it does for an economy, and why it's important, right here on Consider This Program. We had some questions about a proposed stimulus package. We know this happened before in 2008. It's happened many times before that. The biggest one was probably 2008.

What is the idea behind a stimulus package? You've got two things; you have consumers and companies. There's a belief in the economic world that if prices are cheaper, that I will buy more. I don't agree with that. I'm a demand price person as opposed to a supply price person. Most of the people in the academic world believe that if prices decrease, the supply will be purchased. I believe that things will only be bought when demand rises. What we've watched happen in 2008, is rich people got more things, more money, more assets. They didn't spend it to buy more things cause they didn't need more things. My brokerage account went up, my 401k went up, my business became more valuable and we managed more money.





The real concern is people who live paycheck to paycheck who provide very valuable services for us. I don't like fast food, but I like knowing that McDonald's is open when I need them. The idea of the stimulus is really to protect people on the lower end of the pay scale, much more so on appreciating assets, which is what they tried to do in 2008.

Does that money go directly to taxpayers? The president has made it very clear that this needs to be dealt with immediately. They've even thrown out a fear of a 20% unemployment rate by the end of the year if they don't. In 2008, most was money that was pumped into the system more than you getting a check. That money went to me buying more investments, which pushes stock prices even higher.

Where are we at right now? Are we in a global recession? We will certainly. The National Bureau of Economic Research declares it, and they're almost always tardy. Their typical definition is when you have two quarters of GDP contraction. We are probably in a recession right now, if not, we'll be one in the next week or two weeks. This market has contracted quicker than the Great Depression in 1929, quicker than the crash in 1987. That's because there's so much information that's out there.


How does this impact the banking industry? Is it harder or easier to get loans? The idea behind the stimulus that the Federal Reserve has already put into place is to support the SBA, the Small Business Administration, to be able to help small businesses. When we look at the week prior to this, the S&P 500 was down a little over 9% for the week. Now that's huge. That's painful. Small cap companies were down over 16%, almost 17%. That's because in volatile periods of time, small companies are going to take this harder than big companies. Smaller countries are going to take it harder than big economies.

### **Interest Rates**

Who controls interest rates? What's the purpose of reducing the interest rate? There's two groups that control interest rates. The Federal Reserve has the ability to control some interest rates. It has the ability to control what you're able to borrow. Then there are treasury rates. The government needs to raise money, so what's the least amount you're willing to accept? They have an auction and the person who's willing to receive the least amount of income is the one who wins the auction and gets to buy the bond.

Back in the mid nineties, we actually had this nonsense of a thing called a risk-free money rate, and that was the 10 year US treasury. The US was downgraded back in the 2008-9 debacle. There is no such thing as a risk-free money rate. We use a 10 year US treasury rate. What happens when a corporation or somebody else goes to borrow money? They'll loan me money at a lower interest rate at a bank than what they'll probably loan most people, because I have assets. They're going to charge me a higher interest rate than they're going to charge Apple, because Apple has a lot of cash. That's kind of the spectrum of what's called credit risk.





One of the things that we look for in the marketplace is when the credit risk spread increases. In other words, what a corporation has to pay to borrow money versus what the treasury is able to collect. When that spread widens, something's not right. What's happened with interest rates here lately is they have nosedived and the credit spread has widened severely, meaning people are on alert that there's a problem.

I looked this morning and the average rate on the 30 year fixed is 3.36. That's as of March 17th or 18th of 2020, lowest level in 50 years. If you've got a mortgage that's more than five years out, you want to pay attention to the closing costs. You want to make sure that you've got 20% equity, so you're not paying PMI. But, it may vary. Use this time to turn lemons into lemonade.

If the interest rates are so low, how are they making money? They have a hard time making money, which is why energy is the worst hit sector right now. Materials would probably be next. Financials are probably the third. The lower the rate environment, the tougher it is for them to really make money. The difference between now and 2008 is they are very well capitalized. A lot of the rules were changed. Banks are sitting on a lot of resources. The Federal Reserve has done a lot of what we call "modeling" to make sure that they are prepared for a distortion or disruption, which is what we're having right now.


The rates have been low for a while now. Normally you would try to go for a fixed rate. Do you think it's safe to take any of those variable rates where they're variable for the first three years and then lock into a fixed? It depends on your financial situation. I believe because of the baby boom, you're going to see a huge surprise. It's why I worry about people who buy fixed index annuities and things like that that think they're solving a problem for today. Inflation is not dead. It's in hibernation. It's in hibernation because of the baby boom.

What the baby boomers are doing is very predictable. How we behave when we buy our first home, when we buy our mega home, when we retire, when we buy a second home, when we make major purchases in life, are very predictable things. Individually, we're not very predictable at all. Collectively, we're amazingly predictable. The inflation rate has been very low because there's not a huge amount of demand. That's why you're seeing deflation in the goods area and inflation in the services area. Baby boomers need more and more services all of the time. We will return to an inflationary period of time and that's when this will get out of whack.

### **Mutual Funds**

Mutual funds were created in 1924 and last updated legally in 1940. The concept was very simple in 1924 and there was a huge crash in the market in 1921. By 1923, you were back to new market highs and everybody wanted to be invested in the market.





There were about five or six different exchanges across the country, but there was no CNBC. There was no fax machine. You had to go to Western Southern to be able to wire money, if you could do that at all. Brokers had to keep track of what you bought. It made no sense at all. They created the idea of mutual funds and there were three: closed-end mutual funds that were primarily used in the past, unit investment trusts that were passive (they had no managers, so you knew exactly what you owned, but you owned a bunch of stocks at one time), and then open-ended mutual funds, which were hardly ever used where you put money in. I put money in and there was a manager that would manage the money.

Over the years the open-ended fund took off with the explosion of defined contribution plans after 1980 and that was the big thing. Almost all of the funds that you guys own out there are open end. You put money in, I put money in, it goes. A manager manages that once a quarter. They tell us what the top 10 holdings are. They tell us how many holdings. They don't tell us what the rest of them are. They give us some details and we think we're getting some information, but we all know we go to the bottom of the page to see what the net asset value is and what our return was.

This is why I'm really not concerned about the crisis right now. As a money manager, watching a market be down over 20% is not a fun period of time. I have a thousand families I'm responsible for, we have their entire nest egg. If you don't think the stress and the burden of that is on my shoulders, Adam's, Andrew's and our allocation team, then you don't understand us emotionally and personally. We're humans too. We see pain, we have empathy. It's our money that's in the market as well. I'm feeling this right along with you. Whenever we have a crisis, America comes out stronger.

In 1987 we had this huge crash and it didn't just impact the United States, it impacted everybody. The response in America was not great because people don't change when things look like they are working. It's not natural. Canada had a more reasonable system put together and said, "We can't afford this issue to happen again." They created the first exchange traded fund March 9th back in 1990. The first one in the United States, which is called the spider. The S&P 500 came into play in 1993. The cost of making individual trades was so great that people didn't use exchange traded funds. Why would I want to spend \$300-500 or more to make a stock trade? Today, there is no trading cost if you're working with a Registered Investment Advisor at a reasonable firm. When we buy and sell stock, it costs you nothing. An exchange traded fund trades just like stock, except I'm able to be diversified in a larger sector.


Most importantly though, I know exactly what it is you own. When I look at exchange traded funds, 30 years old, which most consumers are not in, it's a \$6 trillion market, which sounds like a lot of money until you know how much money is in mutual funds.

By the way, the amount of money going into mutual funds is declining. The amount of money going into exchange traded funds is growing exponentially and the largest holder of exchange traded funds are



FINANCIAL  
ENHANCEMENT  
GROUP, LLC





mutual funds themselves. That ought to tell you something. But, they're more transparent. You can see what you own. Their fees are much lower typically than what you're going to find in a mutual fund. There's a tax advantage.

## 5 Things that Can Wreck Your Retirement

There are five things that can wreck an early retirement because the earlier you retire, the longer your money has to last. These are the five things that a Wall Street Journal article says can wreck your retirement, if you retire early.

### 1. Health

Bad health is costly. You have to figure out how to take care of Healthcare Insurance up to the age of Medicare, which is 65 under the current rules. If you're in great health, you're going to live forever. Then, you have to have money that lasts longer than you expect. They go on to mention what steps can be taken to properly plan for a health crisis, which is very timely.

### 2. Budget

Is it true that the cost of living decreases at retirement or is that a myth? Not like people think. When you go to retire you need to maintain 100% of your standard of living. We know people have two parts of their budget, fixed expenses that have to incline over time with inflation and social expenses, which is the discretionary spending. It's the desire to go on vacation. Nationally, discretionary spending peaks at age 65. In our practice, we watched it at age 68. That may be inclining a little bit, but not dramatically. You can watch distributions just begin to decline. When we help people set up their retirement budget, we actually expect fixed expenses to incline, which typically is between 40 and 60% of what somebody needs to retire, and their discretionary spending flatlines. By definition, it becomes a smaller and smaller percentage of your budget.

### 3. Inflation and Purchasing Power

The longer you live, the more impactful it becomes. We're not going to get to all five because you need to know this. You need to understand inflation is in hibernation. It is not dead.

### 4. Becoming a Caregiver (such as taking in an elderly parent)

*Disclaimer: Joseph Clark is a Certified Financial Planner™ and the Managing Partner of Financial Enhancement Group, LLC an SEC Registered Investment Advisor. He is the host of "Consider This" found on WIBC Saturday mornings from 6-7a.m. as well as*



FINANCIAL  
ENHANCEMENT  
GROUP, LLC



*three other Indiana-based radio stations. Joe has served as an Adjunct Assistant Professor at Purdue University where he taught the capstone course for a degree in Financial Counseling and Planning.*

*Financial Enhancement Group is an SEC Registered Investment Advisor.*

*Securities offered through World Equity Group, Inc., member FINRA and SIPC, a Registered Investment Advisor.*

*Investment Advisory services offered through Financial Enhancement Group (FEG) or World Equity Group. FEG is not owned or controlled by World Equity Group.*

*Joseph Clark and World Equity Group, Inc. do not provide tax or legal advice. For tax advice consult with a qualified tax professional. For legal advice consult with an attorney.*



FINANCIAL  
ENHANCEMENT  
GROUP, LLC

