Sound Financial Bites 100 - The Fallacy of Following Financial Entertainers

Episode Transcription

> “Financial entertainers are people whose job it is to keep you engaged and drive ratings. One easy way to think about it is [that] financial entertainers, their customers are advertisers.”

Paul: Hello and welcome to Sound Financial Bites, both on the podcast and on our YouTube channel. We’re so glad to have you. And we’re pretty excited about our conversation we’re going to have today. Let me first introduce Cory Shepherd, President of Sound Financial Group.

Cory Shepherd: Hello, and yes, excited is probably the word. Apprehensive, may be the other one.

Paul: Well, Cory’s apprehensive.

Cory Shepherd: Paul is not at all.

Paul: I’m perfectly happy to just let it go with both barrels. Cory, Cory has a saying about Paul being talked off a ledge, okay. And the subject of today is we’re going to be looking at some of the financial entertainers out there and we’re going to be looking at what they have to say, and this is going to be a new series of ours, looking at what they have to say and whether or not we can find evidence that it’s accurate. And it’s going to be an exercise in accurate thinking the way that we consume information as consumers in several different areas, it’s just that we’re the experts on the financial side. But you can see this is the same kind of thing that would apply to all areas of your life.
Cory, would you please just share with our audience a little bit about this talking Paul off the ledge?

Cory Shepherd: This ledge. Yeah, yeah, yeah.

Paul: Yeah.
Cory Shepherd: The common meaning of that phrase is someone is feeling down and we want to talk them off that ledge like they’re a jumper, like we don’t want them to hurt themselves. Well, Paul, I picture more like Batman perched up on a ledge, ready to jump down-

Paul: Just pounce and take somebody out?

Cory Shepherd: And pounce on someone. So, we’re going to try to keep him off of that ledge but know that as we get into it today, and there’s some fire comes out … and maybe it will be me to, but I know it will be Paul … it’s coming from, only from that sense of care for the consumer and the clients that we work with, and helping them find grounding and intellectual honesty and accurate thinking. So, with that, let’s jump into it.

Paul: Right now, I want to play a clip from, where Jack Nicklaus is on the stand and he’s being interviewed by Tom Cruise, and he’s saying “You want me on that wall!”

Cory Shepherd: We want you on that ledge.

Paul: You guys do want me on that wall.
We want me on the ledge. We don't want me talked off the ledge, because that's when I take out a bad guy.

Alright, so let's talk financial entertainers. Financial entertainers are people whose job it is to keep you engaged and drive ratings. One easy way to think about it is the financial entertainers, their customers are advertisers. You, as a somebody watching their TV show, listening to their radio programs, subscribing to their newsletter, you are the subscriber, the product that they sell to their advertisers. Okay?

> *"You, as somebody watching their TV show, listening to their radio program, subscribing to their newsletter, you are the subscriber, the product they sell to their advertisers."*

So, their product is not financial information to you. You are the product being entertained, being sold to advertisers. Okay, that's not bad. They can be quite entertaining. I certainly grew up listening to a lot of them. Sometimes I will still put them on when I'm driving across the country and all I've got is AM radio if I'm in a vehicle without satellite radio. Here's the thing. That being the case, we need to spend some time talking about accurate thinking as it relates to the financial entertainers.

And one last word before we jump into the first in this series, and that is, two things can simultaneously be true. They can be good people and their advice could fit perfectly well for the average person. The person who has the average net worth and average income in the United States. By the way, both of those are about $40,000 a year. I think the average income may be up to 45. But, if you're things like living within your means, can you afford it, be sure to start saving money … all of those things, perfectly valid. It's when you get into higher income realms and when you start building a significant net worth, and needing to do some real planning, a lot of what the financial entertainers say begins to fall apart.

And this is one example of that. We're going to start with Dave Ramsey. Now Dave Ramsey has a longtime reputation of being somebody who consistently touts a 12% rate of return. And how you can get 12% rate of return, all you need is a good growth mutual fund. And we're going to examine whether or not that holds true here in a minute, but we're just going to listen to a little snippet of the show, pause it on and off. This is all for educational purposes to help you understand how to do accurate thinking when you hear one of these.

Dave Ramsey: "It has averaged around 12% a year. Can you tell me where you get that number from?"

Paul: "The market has averaged 12% a year." One of his listeners writing in. "The market has averaged 12% a year. Can you tell me where you got that number from?", is what the question was.

Dave Ramsey: Sure. S&P 500. The Standard & Poor's 500 is probably the most accurate measure of the stock market. [crosstalk 00:05:00]

Cory Shepherd: Yeah, can we pause that?

Paul: Not … Corey?

Cory Shepherd: By the way, "Dave Ramsey Rant" is not our title on the top left of that video. That's from YouTube. So, we're not saying how he is-

Paul: No. That is really his rant. That's how he labels them on his channel.

Cory Shepherd: Right. That's not our title, I mean. We didn't … yeah.

Paul: No, that's his channel's title! He calls it the "Dave Ramsey Rant."

Cory Shepherd: So, the S&P 500 Index is the best indicator we have of how the 500 largest companies in the country are doing.

> *"The S&P 500 Index is the best indicator we have of how the 500 largest companies in the country are doing."*

Paul: Mostly selected growth stocks that are US-based companies.

Cory Shepherd: Not any kind of market as a whole, by any definition.

Paul: Yeah, like, as an example, an academically-allocated, globally-diversified portfolio ought to have about 12,000 different securities in it.

Cory Shepherd: And at least include some from other countries?

Paul: Oh yeah.

Cory Shepherd: And smaller companies. So, yeah. We're already off to a shaky factual start. I-

Paul: Yes.

Dave Ramsey: The S&P 500 is an index. It is the top 500 companies traded on the New York Stock Exchange. That is what we call "the stock market". There are several markets-

Cory Shepherd: Some people call-

Paul: Some people call the stock market. On the news. And financial entertainers.

Dave Ramsey: But that's what people refer to when they say "the stock market." It's a market where stocks are exchanged. The New York Stock Exchange, where we buy and sell. Anyway. The top 500 companies on there in terms of size. If you look at the average of the Standard & Poor and the estimates of what it would have been, had those particular companies been in existence since the stock market's inception, you'll see an 11.5 to 12% rate of return average annual. Now that's average annual. There's different ways to calculate the math on it-

Paul: Ew.

Dave Ramsey: But that's the number that we use and the number that we're quoting all the time when we're talking about it.

Paul: Okay. So the number that we're quoting all the time is 12% average annual. Now, we're going to show you an example of what average annual looks like. And I'm going to do it with a little drawing that I made, because it's real fancy. Here's our very simple little drawing. Okay?

Cory, how would you feel if I told you I got a 25% average annual rate of return fund?

Cory Shepherd: Sign me up. [crosstalk 00:07:28]. Yeah. Do it.

Paul: Okay. Here we go. This is how it's gonna go. Are you ready for this?

Cory Shepherd: Mm-hmm (affirmative).

Paul: You're going to start with $100,000. 100,000 … and the first year, year one, we got good news for you. Killed it! One hundred percent rate of return. We now have 200,000.

Cory Shepherd: That's called, under-promise, over-deliver. Wow.

Paul: You just take me to dinner. You're super happy. Excited. Then comes year two. And we didn't do as well. We did negative 50%.

Cory Shepherd: Whoa. You're killing me here.

Paul: This year, I guess I've got to take you to dinner. I'm real sorry that happened to you, but you're back down to 100,000.

Year three. You know what? Things are looking up. 100% rate of return again.

Cory Shepherd: The boys are back in town!

"It's almost more normal in the media today that people lambaste their critics by criticizing their critics rather than pointing to the evidence that they think."

Paul: That's right. Man we're killing it back up to 200,000 and you know what? You probably couldn't be much happier with me. You're seeing visions of early retirement. Kids going to the best possible colleges. Shoo.

And year four comes around. And we lose 50% again. And we have $100,000 now. Let's calculate our average annual rate of return.

Now the way we calculate an average annual rate of return is we take all of those. We add them together and divide by the amount of years. So that equals 100 … as we add 100 minus 50, 100 minus 50, we have 100. We divide by 20 … or by four and that gives us … that should be an equal sign, I suppose … equals 25%.

Cory Shepherd: I've never been less excited about a 25% rate of return.

Paul: Because, your actual rate of return was zero. Now this is an extreme example of the difference between average returns, where your asset manager or somebody watching an index adds up all if the different returns for each year, divides it by the amount of years. But, that's not how money works, clearly illustrated by this because the down years have a greater impact and the up years then have to grow off of a smaller amount of money.

Cory Shepherd: So, when Dave said, just now, and I said "ew," there's a couple different ways to calculate it, what was connecting for me is a distinction I like to make, which is what it did versus what you got.

Paul: Yes.

Cory Shepherd: And so, he's talking and the fact that he said that phrase suggests to me that he has an understanding of this, which is frustrating for me to hear him blatantly ignore … he's talking to people about what they should do to help them with what they're getting. He is really referencing an academic figure that really doesn't relate to anything in anybody's actual life.

"Be a planner or be an entertainer, but when you blur the lines between both you're creating a real danger for the people that are listening."

Paul: Absolutely.
And, let's see what else there is out there that says about it. Well, this is part of the accurate thinking, like, wow. 12% really?
Well. So, I started with doing a Google search. And here we go, the average annual total return for the S&P 500 Index over the past 90 years is 9.8%. Now that goes all the way through 2017 in all fairness, you record this video in 2014. We're going to go deeper into it, but that's good to notice, right there, like, that's a long cry from 12 and we're going to see how big that difference could be in just a minute.
We have another one from Investopedia, just so everyone can see we're willing to pull

from-

Cory Shepherd: Oh, This is through 14. Yeah.

Paul: Separate sources that through 14 it's approximately 10%. So, we're taking the 9.8, or whatever, and we're rolling it up a little bit.
Why don't we go to MarketWatch? And what we're going to look at is average annual rates of return. I want to highlight this for you, specifically. In the middle of the article, he mentions a brief detour … that we're going to take a brief detour because the compounded return over 87 years was 9.8%. But the average was 11.8. And see, the problem is what you get is what the compounded return was. There's fancier ways to say it, which is the arithmetic average, or the arithmetic mean average versus the geometric average, which is the compounding return, the idea of what did you actually get if your money was in in the beginning, and you waited, waited, waited, waited and then you pulled all your money out. That is the real return somebody might receive. You get even more detailed and talk about what if you had actually put in the money every single year, because that's another rate of return entirely. All of them lower, all of them will always be lower than the average annual return that gets quoted by Dave Ramsey, especially over longer periods of time.

Here's the problem. That's not a little difference, the difference between … so, let's stick with his idea of the 9.8% and we'll compare it to 12 over a period of time that most people might normally invest. Now, for this first run at this, I want to do this just based upon, like, a normal person, no tax … we're going to assume that somebody else pays their taxes for them, so we'll start there.

"The biggest hindrance to people's financial wellness is that they don't set enough money aside for assets."

$100,000. Let's start with the 12% that he started with over 30 years. Grows to 2.9 million. So your a 35-year old. You manage to save up $100,000. You feel like $3 million is enough for you. Mic drop. Done. Listen to Dave. I got myself some good growth mutual funds. Probably don't need to plan anymore. I'm going to spend all my money, because I nearly assuredly, because the market does 12 I'm going to arrive there.
And there we go. 2.9 million. No problem. I'm there.

But, let's talk a little bit more in reality. Let's just use this 9.8%. Now, that's over since the beginning of stock market time anyway. We'll just go ahead and use it, despite the fact that we only have a 30 year period to make the point, and now it's 1.6 million. That's half, little, slightly more than half of the amount of money that was previously going to be projected.

So, if people are listening to Dave as a good growth mutual fund story, he, I've never heard him, he may have said it at some point, I've never heard him say, "You know, to be conservative, you should probably project X." It's nearly always him hammering the 12. 12%. 12%. 12%.

We’re going to talk about more about where somebody could actually get that in a minute, or where they could have gotten it, versus what you actually got, but that’s a big difference, and, what if we had that after tax? Like, there’s actually taxes on this money over time, and let’s say taxes took us down to 7.5. Now we’re 875,000. Not anywhere near the 3 million we might have hoped for, or projected for, for ourselves in the future.

Cory Shepherd: Now, I’ll give Dave that his target audience is folks who are at a low end of the tax bracket. Because, average income, low … so, I’ll give him the low-end one, maybe, but the difference between that 9.8 and 12, that is what it did versus what you got. And so, if we’re thinking about what we did, it’s a 50% pay cut. Absolutely.

Dave Ramsey: 12%. People get all twerked out and upset about this stuff, but that’s what it’s done. And I own several mutual funds, that have averaged well over 12% in the scope of their lifetime. And many of them are very, very old.

Cory Shepherd: What it’s done.

Cory Shepherd: Can … Can I … Can I make a comment there?

Paul: Yeah, please, while I find my spot again.

Cory Shepherd: I saw this and I said, okay, one of the things I’ve noticed is Dave, I don’t know if I’ve ever heard him name a mutual fund ticker symbol in any of his videos. So, I just went digging, cause I was dubious that they even existed. Well, he’s not wrong. There are some that exist, at least according to Investopedia, there’s an article I found, long list, we’ll put it in the show notes, and it found one fund from 1934 when it started there, average 12% a year. I was able to find all the data on Morningstar Online.

Paul: What’s funny is, is that that fund does exist, at least at the time of our recording, the time of the writing of that article, and it is the American Funds Investment Company of America. Okay? So you can go find it. What you would also find with that, is for most of the life of that fund, and I think maybe even still today, it has a front-end load of 5.5%, meaning that even if you dropped in your money all the way back then, after paying the cost of having to acquire the fund, you might not actually have that now. We don’t know.

Cory Shepherd: We don’t know.

Paul: But we found one fund, let’s say, with some additional searching, let’s say that there’s five. There’s been 54,000 funds in existence by the time he recorded this video, 23,000 of which were closed by the mutual fund companies because they didn’t perform. So, yes, let’s say theirs five out of 54,000. That’s not even 1% of all mutual funds that could have achieved that outcome. And the S&P 500 itself a zero-cost, like, academic number. The S&P 500 performance, still in actual compounded rates of return didn't achieve that.

Cory Shepherd: So, I would … and Dave wasn't alive in 1934 to buy that fund, so, and many of his listeners weren't. So, I think a theme I'm coming back to is, was he dead wrong? No. Was he complete? Absolutely not.

Paul: Yes. Yes.

Dave Ramsey: Now, that is not 12% compounded. There is a difference. People criticize me for not laying out that difference. That's fine.

Cory Shepherd: There we go.

Paul: I criticize. A little. I'm not criticizing him, just his thinking.

Dave Ramsey: [crosstalk 00:18:18] This is, this is what we've based everything we're doing on. It's this mentality. The recent piece of research said that the number one reason-

Paul: Incidentally, notice he said, "research". Once again, no ticker symbols and no citing of the research, like, it was done by this school, at this time and it found these things. Now what he's about to say next, I don't think he's inaccurate about. What he's about to talk about is that indeed, people don't save enough money. That's something you hear us talk about on the podcast, you see us talk about on the YouTube channel and in our books, no question. People don't save enough money.

But what I want you to hear next, is what happens when someone who, what they choose to do is lambast their critics, rather than answer their critics with facts. We see it happen all the time in media. In fact, it's almost more normal, in the media today, that people lambast their critics by criticizing their critic, rather than pointing to the evidence for the way that they think.

Dave Ramsey: that people don't have money at retirement, is not because of their poor rate of return. It's because they never invest. Let me tell you what your rate of return is, the quality of your assets on money you never invest. Zero. Zero.

Paul: He's right. There.

Dave Ramsey: The number one problem in retirement readiness in America today, the number one reason 401K plans are failing at your workplace, management team, is not because you don't offer good mutual fund options in the 401K, it's because people don't put any freaking money in the funds.

Cory Shepherd: And I would submit that even if someone followed Dave's plan and didn't get 12, they're better off than having done nothing for sure. But, the problem would be, if they're following those calculations and they say, "Oh, well, at this point, if I'm going to get 12, here's where I'm going to be, like the numbers that you said. And I'm done."

Paul: Well, and think about how many people, the reason that they don't save enough is that they've been getting told, in the media, that they're going to get 12 and it's like, "I never get 12," and "Gosh bless the stock market's fixed, I'm not putting my money in there anymore." And that's more likely to happen, frankly, at the income levels he's really appealing to, which I think is the problematic part.

Coming up next is him answering his critics. We're not going to go all the way through this video. I would actually encourage people to watch the rest of this video. And you start to see what you want to watch out for in any financial entertainer, not that they're not entertaining all the time, not that Dave Ramsey might not help you shift your mindset to spend and live more within your means, which is great. But when it comes to deep financial advice, we just did some of these calculations based upon 100,000. If you're watching this, and you have a couple of million dollars to invest, all of the problems created by the misinformation compound at a drastic rate.

Dave Ramsey: And then you have a zero percent rate of return. And you can discuss real rate of return, post-inflation. You can discuss all these freaking mathematical theories that some of you financial nerds just sit around and crunch your numbers all the time and do nothing to help people.

Paul: Alright. Financial nerd 1, financial nerd 2.

Cory Shepherd: Can you give it, like another 10 seconds, because he's gonna-

Paul: Yeah.

Dave Ramsey: What we do, is we get people to actually invest. Are they gonna get 12%. No. They might get 14. Are they gonna get 14? No, they might get 18. Last year it wouldn't have been that unusual to get 18 in that year. Do I project that as an average annual going forward? No, I don't. But do I believe this crap that you people put out there that the market's only going to average six percent when it's averaged almost double that? Because all you do is sit and you beat your gums, some of you in the financial world-

Cory Shepherd: Right here.

Dave Ramsey: and run your freaking mouth and you don't do anything except talk people into being negative about this stuff because you're such nerds and you get caught up in the think tank aspect of the business instead of understanding there are human beings on the other side of this that get a 0% rate of return 100% of the time when they don't invest.

Paul: Let me know when you're ready.

Cory Shepherd: We can pause it.

Paul: I can't take it anymore.
Cory Shepherd: Yeah I know.

Paul: They have to stop there.

Cory Shepherd: I got it. There were some numbers that he was going to throw out in a second. I'll be ready when it happens. But, let's chat.

Paul: So here's … so what we hear there is … it's him lambasting his critics. Because there's a lot of critics out there online about "where's Dave Ramsey's 12% rate of return? There's a bunch of them. We're just trying to teach you guys to critically think about things that you hear. It's like, make sure that it's true. And, in this case, he's even said, "I don't think people are going to get 12. They might get 14. What? Like, maybe. I'm not saying it couldn't happen.

Cory Shepherd: Well, and in any one year, it absolutely does happen.

Paul: And yet, what he's wanting to do is to diminish … like, later in this video he talks about somebody who has invested the time, effort and energy and diligence to get a CFP as a Certified Financial Pharisee?

Cory Shepherd: Now, to be fair, he does separate those into, maybe you're doing really good, maybe you're not. So-

Paul: All the same, it's like, if anybody has anything negative to say about me, they're not helping enough people, by his measure, whatever that is. And all I'm … I'm okay. Cory, I'm okay.

Cory Shepherd: Go ahead. Off the ledge.

Paul: But what I will say is that this is hurting people whose expectations are getting off, or worse yet, their projections, somebody literally could go from sufficiency, be on track for sufficiency, and people would save more money! If they're doing their calculation at home and they're thinking they're going to get 12 because of his talk over and over again, talking about 12, this person that wrote this letter in, if they took his response seriously, what are they projecting now for the future? They're not projecting seven. I would much rather project and work towards seven and be super happy that I got ten than to have projected 12 and got ten. Very different ball game.

Oh, by the way. Guess what licensed professionals could not possibly say you getting his long-term rate of return? More than 12. 12 is literally the highest a licensed professional could help somebody project about their earnings on their investments for the future.
Cory Shepherd: And you better bet we're not going to do that, but if we were, the reams of paper of notes substantiating why that level of risk was okay for that person, and why-

Paul: Yes.

Cory Shepherd: Yeah.

Paul: Okay.

Dave Ramsey: And that's the number one reason people's retirement program is failing. It's because they don't put freaking money in. Not because they put it into a mutual fund that made 11.25 instead of 11.75.

Cory Shepherd: Oh, can you pause there for a second? That's what I was waiting for. We were so close. I just felt like, doing the math, if you had a million bucks over 20 years, the difference between 11.25 and 11.75 is actually, like, close to $800,000. So, and, and you probably didn't get that, cause you may have had to pay taxes. Or, maybe, because, we know, and if you watch some of our other videos you'll see that these active managers do not beat the market, on average, over time, but some do. We just don't know who they are in advance. So, somebody might have. And, in this case, we found maybe as many as five mutual funds that actually performed over 12 since the beginning of time. And yet, every bit of academic study, shows us that even those funds, even if they did it at 30 years, there is zero evidence that they can repeat that performance in future years, after that period of time.

I'd like to give Dave a rebuttal, for him. Like let him rebut, like, he said something in a video and I'm being a little bit nitpicky, 11.2, 11.7, oh, actually Dave, it's eight. And that's what he's really frustrated with, except, when he's being that cavalier, throwing numbers out everywhere, on a show where people are supposedly building their financial plans. So, be a planner or be an entertainer, but when you blur the line between both, you're creating real danger for the people that are listening.

Paul: Yes, and so far, just notice what we've done. A little bit of Google. Is that accurate? Is it real? And then bring it back to the laboratory and test it, which is what Cory did in analyzing those rates of return. Okay? That's it. Are we good? We don't need to go any further in this one. He just kind of continues running.

Cory Shepherd: Yeah. Yeah.

Paul: So, join us again. We're going to go deep into some other financial entertainers. We're going to be looking at Suze Orman. We're going to continue to look at Dave Ramsey. We're going to have lot of fun with Jim Cramer. And, one of our favorites, that I think that when we poke him with a stick we might get some ... I don't know if we're ... we may have a Twitter war. Cory doesn't want that. Cory wants me to stay on the ledge.

Cory Shepherd: I certainly don't expect that to happen.

Paul: But, what I will say is that there is going to be some other bloggers out there that just as similarly, without the licensure, without the liability or responsibility are choosing to go out and offer advice. And here's the problem for all these people. Similarly, you, if I were to say, "Hey, you might want to consider eating on this diet. You might ... It might work for you." I would suggest that you not listen to me as a final authority. I'm not a physician. I'm not a dietician. I don't have a single certificate that says I know what I'm talking about in that realm. Now, it's not that I ... I might be right with my advice. It doesn't mean I'm not. I might be able to change your mindset and help you be healthier than you would have been otherwise. Those are all possible. But what you don't want to do is make a decision that could change your life forever.

And here's the problem when it comes to money. And this is where we're going to close, is that with money it's a unique part of your life. Like, if I get hungry for a bunch of Thai food and ice cream this weekend, and I just eat my toes off. Like, I just eat a ton of food, and it's like I'll gain a few pounds over the weekend, but it doesn't ruin my life. It's not going to kill me.

But there are people, and there are many, many, many recorded times when people make a significant error, often times because of hype, media, entertainment or fraud fueled by all of those others, where people make a mistake and when you make a mistake with your money, especially when you make it later on in life when you have some substantial assets, let me tell you. You can't rebuild it. It's not like making a mistake and eating too much food over the weekend. In fact, it might upset and destroy all the work you've done up to this point.

So, what we're going to do with this series ... we're not going to make fun of these people, although, sometimes it would be easy to. We're not going to talk down to them, although periodically they may deserve it. What we're going to do is we're going to continue to dig in and show you how to see through some of the entertainment down to the facts, and, for the sake of this video, I think Cory and I both agree, Dave is right. The biggest hindrance to people's financial wellness is that they don't set aside enough money into assets. What we just want to make sure, is that people understand how those assets will work for them in simple things like the returns they may get, what they may need to expect, and how they may plan for the future.

Cory, any other closing comments?

Cory Shepherd: I would, if I can close us out, I want to say I have a big relief. That went better than I thought. We didn't have to talk you down off the ledge. We just kind of hung around up there, and if you want to find out more info, @sfgwa is how you can reach us if you'd like to have a one-on-one conversation. Our website sfgwa.com can find some other white papers and podcasts.

Paul: Twitter. Twitter. Can find us @soundfinancial1-
Cory Shepherd: And on Facebook-

Paul: Numeric one. And on Facebook. Yeah, so reach out to us.

Cory Shepherd: Glad you could join us. Look for the next one soon.

Paul: We hope this has been a contribution to you being able to design and build a good life.

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