Sound Financial Bites 022 - Roy Rasera

Episode Transcription

"Most smart people realize there's a limit to how much they can do."

Hello, this is Cory Shepherd, vice president of Sound Financial Group, and I'm excited to welcome you to Sound Financial Bites where we bring you bite-sized pieces of financial knowledge to help you design and build a good life.

Hello, and welcome to Sound Financial Bites. My name is Paul Adams. I'm the president and CEO of Sound Financial Group, and your host for today's podcast. I'm excited about our topic today. We're going to talk about how being smart about finances could be unwise.

So, today, what we're going to talk about is how people that are really, really smart and really successful with their finances can make tremendous mistakes that actually end up working against them. What works against them is the very success they've had in life so far. We've got a special guest today I'm going to introduce in a moment, but let me just share with guys last couple of podcasts, what we've done is really changed the order in which we're doing things and arranging it by topic.

So what we're going to be doing is we're going to have personal financial philosophy cast like our last one, then the analytical focus one like today, but it will be interesting. Don't turn it off right now. We're going to have personal philosophy that could be somebody who helps people build better marriages, or somebody in fitness, or somebody who's an expert of biohacking may come on the podcast. Then lastly is going to be a career and business philosophy podcast. So you're going to watch those rotate, so that we really get a chance to do everything possible to equip you to design and build a good life.

Now, if you've not yet had a chance to engage with us in our firm, I couldn't encourage you enough, go to our website www.sfgwa.com. You can sign up for a newsletter. You can look at where our live events are. You can certainly listen to the rest of the podcast. If somebody just forwarded you this one, you can download our book. First three chapters right on the website, or you can have it downloaded by Kindle or Amazon could just drop it off with a drone at your house perhaps even before the podcast is over. So, I'd encourage you to stay engaged with us. As Cory mentions, send us a note and make sure that what you do is let us know what you'd like to see covered on these shows, and we'll do our best to accommodate.

So, let me tell you about the guest that we have today. Roy Rasera is one our advisers here at Sound Financial Group. Now, Roy moved up from Portland just a couple of years ago, and has been in the business 13, 14 years. But prior that, had a career at Intel. At Intel, what he did is he was an engineer that kind of piggybacked on his 3 degrees from MIT, and he's also a legitimate member of Mensa. Now, why is all that important and why does it apply to our conversation today?

Well, we find that really smart, really successful people, and Roy be one of them people, they can tend to make decisions that could actually hurt them financially, that somebody without the success and maybe without some of the mental horsepower would have never have thought to make. It's almost like, they got the opportunity to do a better job of making some mistakes because of the horsepower they brought to the table intellectually, when it came to looking at their finances. So Roy, background, Intel, genius I guess technically, if you're a member of Mensa I think that's what they call that. An incredible guy who cares a lot about his family, and cares a ton about his clients is here with us today and we're honored to have you. Welcome Roy.

Thank you very much.

Yeah, you're welcome. So, I think as we launch, Roy and I were talking ahead of time, and one of the things that we talked about is distinguishing was this idea, there's really 3 different levels that

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we decided to name for the podcast today that kind of either helps people be successful or could get them in trouble. We talked about it being clever, being smart, and then having wisdom. I'm going to give you like one quick example, and then we're going through some of the mistakes we've seen people make financially, and what that might mean. So, clever it might be, I really research a decision I make, or I really made one great decision. I would give some examples to that. Smart might be I research the heck about every decision that I make, individually as decisions.

Wisdom is when we seek out the council, when we seek out the help from other people that's really targeted at helping us see how all of those pieces fit together, not just picking one or hoping for one. So, with that, maybe you could give us some examples of, Roy, kind of what, what you've seen, what kind of things you've seen climbs to in terms of either, mistakes, successes, or maybe even a general orientation when they've got that kind of mental horsepower.

Sure, well maybe I should start with some of my background and my experience before I even got into this industry.

Oh, yeah, like Intel, and then your Financial Bites.

"I went through 15 financial advisers in 3 years."

Yeah like kaboom, right? So, one of the things that I found when I was at Intel, and this goes back to late 90s early 2000, is there was a point in time where -- for those that may have been in the tech industry, they probably can relate to this, where there was a lot of money coming into tech fields and a lot of expansion there, stock options, all that type of thing was going on. I was in a position where I didn't know what to do with all these stuff, right? So I was doing all the things that I was told I should do, hold the options because they will always go up and you'll do great, just on the options alone that you'd get from your company, and max out the 401k because you want to retire there someday. Purchase paid and stock registration plan and go do all of these things, okay?

In common knowledge, there was too, I know we're going to come back to it. It was like, even though you depended on your income from your place of employment, you also went all-in on any wealth you'd manage to save on your same place of employment. We'll talk about that later, but I just think that if we all think back to the 90s, like that was just normal that people did that.

Yeah, and you know what, it's probably can be normal again sometime in the future. For some people it's normal now depending on what or where their industry is in. So, at certain point, I'd decided I needed help, and as most smart people realize at some point, presuming I'm smart here. They realize that there's a limit to how much they can do timewise, energy-wise, mental capacity in different areas of life. Like, I'm not going to go be a brain surgeon if I need brain surgery I'm not going to be able to figure that out. Someone else had to figure that out over the last couple of centuries, go through schooling, learn how to do that, and there are brain surgeons out there. I'm not going to be able to do that. People don't have that orientation around finance, but at some point many people realize, "You know what, I need a really good banker." A really good bank relationship, I need really good mortgage banker. I need a really good investment -- real estate investment person maybe. I need a good insurance person. So you go through -- I was trying to find the right people for myself because I needed a team to work with. I could only go so far as an individual, and so as I was trying to find that one of the people I engage was a financial adviser. To make a very interestingly long story short, the punchline from the financial plan -- 80 -paged financial plan that I got and it just came across at my garage the other day and it was --

> *"Those reactions to what we hear in the media, those tend to lose you 2-8%."*

Oh you got to bring it here. I want to see it.

I know, it's hysterical. It was basically there I could retire when I was 42, and I was like, this is great. I should've gotten a plan like three years ago.

Yeah, because and all that had happened was everything in the plan, happened just as predicted.

Exactly.

That's all that had happened.

And, so when I went back to them 6 months later, because within 6 months, Intel had changed the way that they were doing their bonus structures, there are more 401k matches, the options had shifted around to different types of structures that are now restricted stocks. Everybody knows all those things and, but my living situation had changed. One of my rental properties had some vacancy rights that I hadn't put into the plan. Gas prices and food prices had gone up faster than I had thought inflation would go. So all of these things around me shifted, and I went back I said, "I don't think this plan is going to work out. You know, what do we do?" And we're like, "Well, for 500 more dollars we can put new assumptions into the plan and print you out a new one." I'm like, "You have got to be kidding me." I can create a really good spreadsheet and change the numbers at the top two and have numbers at the bottom come out different too. Why am I paying for this? So, that was my experience of the financial industry at the time, but I was smart enough to know I needed help, I just didn't realize that a lot of the help that was out there was also quite limited in terms of wisdom.

Yeah, and even that was maybe getting as far as smart. It wasn't necessarily doing a good job of helping you see it at more global picture.

Yeah it was the presumption that the world would enfold exactly as it was, the day that I created the financial plan.

So all had to work out perfectly the way the plan was written that day. So when one thing changed when you walk out the door, it's done. Does it work?

Exactly. Like, what if interest rates are -- I don't know, say zero for a decade, because they weren't when I did that in 2000. What if the market goes down 40% which it did maybe twice since then.

Yeah, and the plan itself. So you told me this journey -- for all of our listeners who don't know about the journey you went on to find competent help after that. Tell them a little bit about that.

Right. So, I went and started interviewing. As I realized that this was a limited static snapshot of a future time that would never happen. It was like there's a consolation, a possible future is out there and they print it out one and handed it to me, and I would never get to that star. I would either be way on one side positive or way on one side negative but I never hit that one.

Which I got to say that when it comes to just that traditional static printed financial plan, whether

we did it because we read it online, or went to an adviser and had it printed for us. I was working with a client who is a CPA, and it was actually where the consults that help build one of state lotteries. When I went through and talked about all the variables that have to be hit just right, and I named off like 10 or 12 variables you have to hit, and he sat back in his chair and said, "Did you realize it's more likely to hit the lottery than hit 12 variables?" And we went right in that moment from that kind of smart, clever, I'll figure it out, we just got to get the variables right, to realizing that it had to be something different. I don't want to take away from this something different you found.

Got it. Well I found that there were basically two models at that time, and I went on a journey of trying to find competent help. As I said I was looking for the banker, the investment, real estate mortgage person, a primary mortgage person, the attorneys, which I find out now. Of course, you need a suite of attorneys, they're state attorneys in your business, your litigation attorney, your real estate attorney, it's like such specialization there. But the financial adviser role is one that I interviewed and used partially some. I went through 15 of them over the next three years. One of the challenge as for me was that they were either a variant on what I'd already seen, which was pay us money, what predict the future that will never happen, or they were a variant of roll-over your accounts, we've got this great asset allocation model either we beat the market or we do great trading, or whatever it was, we do re-balancing, there's tax service, whatever it was, it was focused only around that one component in my finances. So that when I would ask those people, I'm looking at evaluating another real estate deal. Can you help me pencil it out, can you help me figure out what's some of the ripple effects might be from this, are there two or three back-up systems in cases that it didn't pan out the way we think it's going to pan out. It was like deer in the headlights, or they'd say, "Go talk to a real estate person."

Or they'd say just, "Instead of owning real estate, just invest it with us."

Well, that was sometimes there, or hey if this cash flows you can put that into one of the many portfolios we have for you. Another thing that they would come tell me what, "You need to put money in the retirement plan, in the IRA, and all these places. Open a couple of thousand in this, a couple of thousand of that amount and you'll have a big pile of money out here someday. And I said, "Well, let me just walk through something with you. I'm a little concerned that today taxes are historically relatively low income taxes. I think I have the most deductions and likely to have in my entire life." I can write off my mortgage, I can abbreviate properties, I can write off my business expenses. I get a deduction for having kids, I can write off my contributions to retirement plans. So I'm at a point where I'm hopefully going to progress in my careers, so every year hereafter, hopefully my income will be higher. So right now I'm actually at the lowest income, most deduction, lowest income tax environment in hopefully my life, because probably taxes are going to go up, probably to make more money. If I'm successful by the time I get to retirement, maybe the house has paid off. I'm not working in the business anymore, I can't write off my business expenses. I can't write off contributions of 401ks, IRAs because I'm not working, I don't have earned income. Maybe most of my rental properties have depreciated. God willing my kids have moved out. So, I've lost almost all of my deductions right at the time when I think taxes may be higher, and my reverse tax planning my retirement strategy here. Is there something I can do to help offset that, or some things that I might be able to use to relieve some of that tax burden that's going to be forced upon me, when the money from those retirement plans get -- to pushed out to me. The best answer I had at that time was -- well, if you put more money in, there will be more money to pay the higher taxes to that.

Wow! That's out of the 15, that was the best that you -- you were talking about that with them, "Hey, I'm concerned about this." Instead of an exit strategy, instead like, "Hey we understand that it could be a big back and burn on taxes on this. So what you should do is just put more fuel on the fire.

Yeah. Exactly, and not just that, but there was also the question of "If I'm reverse tax planning that part of my world." One of the other things that would came up was, well you know you'll be in a lower tax bracket then, and I said, "Well why would I be in the lower tax bracket?" because you'll need less income. Like, "Why would I want less income?" When I'm 63, 65, whatever, and I'm used to, I don't know, 300, 500, whatever it is, when I'm used to that why would I suddenly not want to still have that? Right at the time that my health care cost are likely to go up. My leisure expenses are likely to go up because now I have all these time.

Yeah. Seven days of weekend.

Yeah. Sure. House is paid off. Great. There's a couple of thousand a month that it maybe I won't need, but that's going to maybe go off to healthcare cost or vacation to see the kids, or the grand kids. All of the things that I would now want to use that money for.

And that someday -- what's so interesting is so as you went out, had these conversations, came up with some of your own, for a lack of better way of seeing it, breakdowns you saw on this usual planning model, and the solutions offered were mostly just work harder at it. But then you met somebody who gave you a different perspective.

Right, and I started seeing that planning our financial strategy design is more important than any particular product or any particular government plan, or any particular asset type. You started thinking about that in all the rest of the world and it's true. It's like, "Do I really care if I have the best possible piston in my car engine?" Or do I want the car engine to work which may or may not have the best possible piston, but its got oil and it's got all these other things in it. It's like I need the engine itself, that whole mechanism, that has to work. I don't need to get overly concerned about a particular spark plug brand. Does it make sense? I started seeing that this was more of an ecosystem design, and an ecosystem that you want to last through your lifetime. So, we need to start looking and what are inputs outputs, how do you stress test an ecosystem to make sure you just didn't blow something up that's going to have ripple effects that's going to destroy the ecosystem over time, or create pollution in your ecosystem over time if you will.

This adviser, rather than it being, we're going to set it, forget it, you're done, we'll talk to you in 15 years because it's going to work out perfectly the way we printed it out on the plan, instead it was a relationship of working together over time.

Yes. It was that and it was questions. I see you've got some -- how much more real estate do you want? What's your exit strategy from that? Have you looked at the tax benefits of owning the real estate? Some of those tax benefits are getting eaten up by the interest and dividends that are being created off of your investment portfolio. I'm like, "Wait. You just said real estate and investment portfolio on the same sentence." Nobody has done that before. Let alone potential tax impacts and offsets, and things that could be connected together now in an ecosystem rather than in siloed decisions in separation.

So how long after? So you got a chance to meet with this person that was your adviser. How long

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after realizing there was this different way to look at money? Can it really kind of resonates through why we look at money as a firm now? How long after engaging that, hearing this different way did you say, "I going to no longer work with Intel. I'm leaving technology. I want to do this for other people."

Got it. Actually I had already left Intel at the time I found this guy. So, there was a little bit of exploration, you know, some more real estate acquisition and things after I left Intel, and when I found someone I'd been looking for but I didn't know I was looking for, I went back probably within 2 weeks and I said, "I want to hire you. Actually I'd like to learn more about this because I could help a lot of people with it. How do I work here?" So that was the beginning of my transition to this career.

Right on. Well, one, we've actually had that happened here at his firm, just in the last 4 and a half years where people have engaged, worked these clients and then have that same sort of pull if you will of -- I don't want to be the cog on the wheel of this large corporation where I want to be with families over time making a difference. I always love hearing that story. So let's talk a little bit about -- so we have these folks whose super successful and maybe an executive or the technology company, or they've climbed the corporate ladder at some large institution, or they're maybe a business owner, like that just has done a great job. We're really talking about the kinds of mistakes that people have made when they're expert in some field. They may or may not be Mensa members or even, you know, think about that, but they're probably pretty sharp cookies in their domain, and necessarily when we're really good at something, especially when it's the kind of thing that makes you 3, 4 or 5 hundred thousand million 5 a year of income. It's pretty easy to think that you can figure out most other stuff. The kind of mistakes they get made there -- there was something you said a moment ago Roy that I hadn't thought of that really hit me, center mass, is of course somebody's not going to say "I can go become a brain surgeon tomorrow." Because it's not as if you tinker with the brain when it's little and then you go "Oh it's too big. I can't deal with it now." But with our finances from the very beginning there's nobody there helping us bounce a check book or make our first 401k contribution, so we sort of get like boiled like a frog, and only one day do we wake up and go, "Oh my gosh. I was sort of comfortable handling my investments when they were a hundred thousand, or as comfortable making every decision when I was making 200." But now, with a million of investments and making half a million dollars a year, I need to pause long enough to say "The consequences were a little bigger than I thought," and it's that slow gradation that almost makes us feel like we can do it. Intel -- and unfortunately, a major event happens like somebody's we're going to talk about. I need to apologize to our audience before we go down this topic list. We will not have time in this podcast to hit every solution. We may give you some ideas of resources and ways to think but there just isn't enough time to talk about the solution of each of these things. They might be different for each person but some of these sound, smell, or taste a little bit like something you've done or you might know yourself to maybe do. It might make a lot of sense to engage or coach with our firm or go get some help somewhere. To be able to help you just skin it back and see if these things could be creating any problems for you. So what's the first one, Roy, that you've seen that people do this?

Well, one of them we're talking about clever, smart, and wisdom is a single-based decision around the product. Like, I care about my kids, I want them to have the best education possible, I better start a 529 plan for example, at least put a couple of hundred bucks, a couple of thousand bucks a month into it so that someday they can go to whatever college, university or education system, makes sense, and that's not a bad decision. I mean, it's a decision that's made and it's

something that people think as the right thing to do because it's supporting a value or a value around education and family and all those types of things. But what maybe the smart person would do is...

Right before we go to smart, I just try to think of a phrase that I hear people say when they go down the clever route, almost always, is they'll say something like "Something is better than nothing." Like maybe they're like putting in some out of my -- but they may not be have gone as far as like "How much capital actually do I need?" They literally just throw in some money to bucket and say, "It's better than nothing." They haven't even pulled the mat all the way out of how much has to be in there and how much we'd really have to put in your account.

Right, and by the way there's a tax benefit, so it's going to be the right thing. So, the smart person might actually take that a few steps further, like, well should I get maybe my state's prepaid tuition plan versus a 529 plan, and by the way, what about every other state's plan in the country, and which are the best ones at the lowest cost to the highest rated in. So they'll maybe go in and look at a dozen different options to choose from, and yet there's still stuck in -- I'm in a silo and here's a solution for it. Now, someone with -- on the third level, the wisdom level we're talking about, might say "What are -- I don't know, 10 different ways to send a kid to college? Which is the right one for me?" I know that one of the tools that's out there is a 529 plan. What are the other 9 or 10 or 12 or 58 ways to send a kid to college and which one makes the most sense in my ecosystem, right? Or sometimes we're talking about is a chess game. I'm walking in the middle of somebody's chess game financially and they've been playing for 30 years. Their pieces or whatever they are, and they know how a couple of them move even, but they don't know how to build a strategy of how do you move those pieces over time to create the optimal offense and defense simultaneously?

The thing that occurs to me is going back to the chess game, if I listen to somebody on the radio, and the person on the radio is saying "Hey this is what you should do." They don't even know if I'm playing chess -- they hope, maybe I have a chess board, but I might have like grab the wrong game board and I'm way off, and I hear somebody's advice on the radio that is clever. I researched the heck out of what they said, and it seems like a good idea and I execute.

Usually research means Google.

So that's mistake number two, is the what do we call it, the web search versus research, that I go online and Google it. Give me an example what I might Google that could lead them astray.

What's the best mutual fund to buy? That might be something for an example, or what's the best 529 plan from -- period. Or which state has the lowest cost 529 plan? What's the lowest cost mutual fund? What's the best way to invest in real estate? How much money do I need to retire? You going to Google all these stuff and stuff shows up.

Millions and millions and millions of results.

And it doesn't mean it's right for you. It means that it's the topic that got the most clicks around the globe that may or may not be relevant to you at all.

From some of those stuff we've seen and and we actually have done events where we pick up parts some of the -- not pick a part in a bad way but like, let's actually test and see if the thing

that this person said online was even accurate. It's amazing how often, even the mathematics can be off, because many times the person writing the article isn't even somebody who has the responsibilities that come along with licensure that an adviser does. So they can make claims that they don't have to substantiate or prove.

There you go.

Part of what we do, we do at our offices, we educate people and we help walk through the math and the stress testing of the ecosystem and the strategies and how does one connection and another connection lead to better outcomes under higher taxes, lower taxes. Higher returns in the market, lower returns in the market which gameboard setup puts you in the better offensive and defensive position simultaneously.

Always moving from where your board already is when you're walking with the coach. Next is this idea of you could be great with your investments. Like you might have even make really good decisions and be a great investor with your 401k, or with your other assets and you did good.

Or with your real estate.

Or with your real estate. And yet, share a little bit about being smart or clever about that could create losses people don't understand.

Or with business. Alright. So, there are a number of people that I worked with. I'm just thinking of two in particular, really sharp, great business owners, and developed the business from the ground up, sold it, and then started another one. Started another one, started another one. So they're doing two, three. So one business owner might think because "Hey, I'm a highly skilled trained in the industry. I've got a PhD in this that and the other thing. I've been able to build and run a business that I also know everything there is to know about real estate, insurance, investments." And yet, walking through some of the decisions that they made where they had to then -- because their game board wasn't set up effectively. They then have to liquidate properties in a loss, because if they can see rates and things like that they just -- even though they could fund it out in cash like, "Now I'm done and don't want to be the -- fixing all the stuff and I don't want to hire the property." Anyway, it's all that. They take losses that have profound ripple effects across their balance sheet over time, or they make some decisions to cancel and liquidate investments. It happened to be that it was in the 2008, 2009 time frame, because they had to do that at the same time as well. So, just even a couple hundred thousand dollar loss that you then manifest on your game board, means that you've just lost the queen and how are you going to play the rest of the game is you will play it. You will play the game. The game will still unfold, but you're hobbled in the moves you can make. But you don't see it perhaps because that little bump in the road actually turned into a pothole that then turned into a crater that then turned into a chasm, that you now have accepted into your life path. Does it make sense?

Absolutely. It's very factual to what I was doing. I just ran a quick calculation on my computer because I think you're right, we don't think about the impact. The other thing that some of you may see, I think we're going to be able to put it on the podcast but it's definitely going to be on the YouTube channel in the next week or so, is the 4 reasons why humans tend to make financial mistakes. Like why we're not equipped as human beings to make good financial decisions. One of them is, after we get through the painful event, we no longer really keep track of the loss of that event in the future. In a certain way, it would be very difficult to live with, but I just did a quick bit

of math, and that's what I love about this being the analytical podcast, they can actually run some calculations and tell people about it. $300,000 loss on your balance sheet, which if you have some decent net worth in 2008, is probably pretty low of what disappeared off your balance sheet, due to not having decisions coordinated and not having optimal financial balance. If it's just 5%, a 35-year-old that had that 300,000 dollar mistake over 30 years, that's just age 65, is almost 1.3 million, 1,296,000 of loss. Now added to that if it was 50 years like they lived to age 85, because the loss doesn't stop compounding against you, it's 65 of 3.4 million.

And it's from one situation that they didn't have the capacity or the liquidity to deal with.

I want to do one that just happened to me the other day. Great gentlemen, executive with large company. One of our advisers asked me to consult with him and on this client, money had grown significantly. This person has been saving incredibly well and it's all in retirement plans. All of it. All of it is in specifically tax deductible, going to be tax to the future retirement plans, and doing, according to common knowledge, the really really smart thing. The problem is, same thing you talked about Roy, he's going to have his house paid off, schedule too. Kids have moved out, they're doing great. I asked this person and I said, "What were we making 10 years ago?" which is of course a fraction of what he's making today. What do you think you'd be making right before you retire? And it's much more than what he is making today. So even if you retire on the same amount of income, then you're making it right now. You're going to be paying more in taxes. Really good, single set financial decision, but with no awareness that literally a large chunk of those retirement plans is actually owned by the IRS.

Right, and you know you can also always go back and say, "Well, what if?" because we can play the what if on the other side? What if I had or moved a lot of money into the market for example in 2008? Just think how far ahead I'd be.Those types of second guessings of actions like, when I talked about the pothole turns into crater it's like, that happens and it exist, but we can't dwell on it because it's unchangeable now. What we can do is prevent it from happening again so that you don't incur that chasm in the future again, and design strategies to prevent that.

It is not that one.

Right. There's going to be the next one that we can see.

That's different.

Yes. You're operating the way -- it's one of the great things for having a coach is it gives us a chance to actually maybe see blind spots we'd have. Tell me about -- somebody that goes like robo-adviser. Like, that's one, it's very vogue right now. People say I'm going to do robo-adviser, I'm going to call some mutual fund company and just by indexes, and usually what you hear is, "I'm going to go as low cost as possible, that's how I'm going to win."

Right. low cost as possible. They rebalance, they might do tax IRS-ing , whatever it is, and it's all automated. By the way, all that is great, and that's not the problem. The way I see it there are two problems with that. One of them is you now have one of the pieces on your chest board automated. You don't have it coordinated with the other pieces on your chest board. So, if and when and how you want to make another move shift money in and out, decide, you know, I need to move these other pieces on my financial chessboard, my retirement account, my real estate, my mortgage structure, my whatever, how is that one piece that's now off on the sideline is doing

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it's thing. How is that integrated into it? So they don't come with robo-advisers, don't come with a robo-financial adviser that actually will advise you on your finances. They will robo your investments, but that's just a piece on the sideline like the spark plug in your engine. Spark plug works. I have no idea if my engine's going to work but that spark plug works. So that's one, the other piece that is less obvious, I think, is what we see in the industry all the time through our Dalbar study. The Dalbar study every year has tracked that kind of 30 years of average investor return, and so we'll need to get to what is average for it, right? So, average investor return underperforms the market, depending on which 10 or 20 year slice you look at, somewhere between 2 to 8% of underperformance.

Of underperformance.

Underperformance. So the average investor is getting a 2 to 8% underperformance of what the market got when you look at 10 to 20 year periods. What Dalbar indicates is the primary cost, not the only cost but the overwhelming majority of it is people's reactions emotionally to market movement. Now meaning...

Something you say, you said "Market movement not market downturn, not stock market drop." Why movement and not drop?

Well, because it happens both ways. There's fear and greed involved when you look at your portfolio. So if all of the media and all of the things you hear on the radio are doom and gloom, and the market's down 20%, the SMP is down 30%. Oh my gosh, we're entering a new recession, and then you started seeing "Oh, bonds are the place to be," or "We need to all hold cash and there's this sort of communal media like "What's going to attract the attention of everybody is a doomsday scenario." So everyone will tune in into the doomsday scenario and it might actually make you go through your robo-adviser and change your portfolio to be much more conservative.

To which they say, "Okay".

And they say "Yup. Sure. Sounds good. Click here. Acknowledge this." Yes, and so now you've shifted your portfolio to more conservative which means by the way, you've just broke in your strategy around what your investment portfolio was supposed to be doing as a piece on your chessboard. The other thing, I said movement, is because you can also see here the flip side, which was in the 90s where I'm up 30%. The market's up 30% as some piece gone through the roof. It's a new economy, the old way doesn't work anymore. Everybody is getting rich.

This time it's different.

Right. This time it's different, and so you're like "Well, shoot, I only got 20%." They said they got 30% or the SMP did 28, and I only got whatever?"

And then that funded 300% in a single year?

So I'm going to go change my portfolio from the portfolio that I had to the portfolio that is "more aggressive" which means now more exposed to loss. I clicked that button and the robo-adviser says "Okay. Great. Acknowledge here." Now, positioning and shifting your portfolio back and forth means that what you're doing is you are shifting your acceptance of the potential loss that will happen. You just don't get to pick when. So, when you shift your portfolio down to be more

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conservative, you've missed the upside when it happens because now you're conservative.

And you took the downside.

You took the downside, right, you went down 20%. I mean might at least miss that next 5 or 10, but you took a 20% loss and then you shifted to conservative. So when the market moves in, it moves quickly and unpredictably back up. By the time you get back in and you shift it back up, you missed most of the gain. So, emotionally, those reactions to what we hear in the media or our own self-talk, or what our buddy down the street did, those tend to lose you 2 to 8 percent over 10, 20, 30 year periods.

You know, I can help because the thing when you talked about the 90s, and people shifting to like the big fund, and the one that tech or NASDAQ, or whatever that they chased and they get hammered was nothing compared to the people who in the 2000s had a disciplined portfolio. In 2006, in 2007, they see their friend just killing it in real estate and they came to their adviser and said "Listen, I need to cash us $200,000 out because I'm going to go by -- because $200,000 down, right now, I can acquire $2 million of the real estate and they did at 10% down and they had them rented out, and they didn't lose the 200, they went like, I had people I knew who did that. One of them said to me it was just amazing and probably one of the most pointed I've ever seen was to say, "I knew I could go bankrupt at zero." But I had no idea I could go screaming past zero. So people went beyond because they got distracted on the upside, the market movement. It doesn't just have to be the market of investments, it could be the market that's the market, like every market. They can distract people, they chase it and then they just get hammered because they just -- not bad, but they didn't really rebuild a whole new strategy because they're smart, they're driven, they're successful in their career, they're like "I got this" and they go after it.

How many of those things that we go after do we actually have control over? We can only control our actions, not the things in the market forces that are occurring around us.

Speaking of market forces, you alluded to the averages.

Yes.

You know, we talk sometimes about the idea that you contribute to an average when you invest.

Yeah, you contribute to the average span size in America of being, you know, 42 or whatever it is, but man if I were that, whew! Bad situation.

Is it really 42?

I don't know. I just made that up.

That's probably true. If you're listening to this, please Google that, not while you're driving, and then email me. I would love to know what the average span size is in America, and have that show up like a month from now that some listener listen, Googled it, send it to us.

That actually, that Google search maybe relevant, and it may actually be accurate because enough of the whole U.S. and world may have actually contributed to that. That click on Google search.

So right, we contribute but we don't participate. So one of the things I think about is finding a -- you may have listened to the podcast we did where me and some other entrepreneurs in the Seattle area did SealFit. I was older than a lot of these young guys doing SealFit, and these guys got out of their cars. Some of them were Marines, I'm like we're going to get killed, and you know, we all trained pretty hard and we thought we're ready but we saw this we're like, "Oh man!" So I contributed to the average age at the SealFit 24 hour absolute punish fest that I went through. But I didn't get any younger because those guys were -- so we'll look at markets and people who are smart, successful. They go looking like here's the average rate of return has been, and the average rate of return is something you participate in or you contribute to but you do not get to participate in. It doesn't matter what the market average is. At the end of the day, your investments will be what your investment is.

At MIT, there was a class, the first semester, that man, I tanked on the midterm. It was horrible, and I was so determined that that wasn't me, I'm not somebody who tanks on something that I spent the next two months really learning it and working it and all that stuff getting coached effectively and doing practice so that I aced the final. So, did I get the average or that was a contributor to that average bell curve?

You always get to be on the bell curve.

You're always on bell curve, you just don't get the average per se.

You don't get to pick where. Yeah. Kind of our last one, we alluded to it earlier the idea of the fact that people, like you had your stock options when you were with Intel. Sometimes a business owner will have a great deal of net worth, it's where he drives his income and it's where he owns all his stocks. So whether you're an executive that has a lot of company stock, and it's where you drive your income, or you're a business owner and you own a bunch of company stock in your company and it's where you drive your income. Talk a little bit about the asset allocation around where your income comes from and where your investments are, and how you've seen that affect people.

Got it. So, this actually has happened a lot. I mean, you can point to the spectacular fails of Qualcomm, or WorldCom, or any of those where a person's job, income, insurance, stock options, net worth, retirement plan, matching pension. All were at one company and that company is no more. The spectacular fail is not frequent, but it gets publicized a lot. It's a cautionary tale to those that do have all of their income asset based, et cetera, in one place or tied to one place is that, I think anyone would realize that you will either be a spectacular success by doing that or perhaps a spectacular or a mediocre fail by doing that. You don't get to choose. It's the market forces that choose for you.

There's people living up here in the Seattle area, there's always couples, everybody knows somebody that was like, less than employing number 50 at Microsoft and that person has a slamming house. They killed it. As a survivor, it looks like a great example of how to do it. Everybody knows. Everybody knows a business owner like that. They got bought out because some user companies had to come into that market and the thing is we don't see all the -- I didn't even think about the spectacular fails we sort of hear about. We don't know those people because when it happened those people they weren't really around talking about it anymore.

But then the mediocre fails, like the person that continue to think their company stock was going to do well and it just never did. Like I don't know, say Intel. Not that I know from experience but someone who has half a million dollars in Intel stock that then suddenly doesn't and decides to leave Intel. That for me, I mean that's -- I wouldn't say a spectacular fail, but if you look at it conceptually that could be a spectacular fail too.

When we hear about the companies that fail out but the times when it happens to an individual, it's never big enough. That is not the mediocre fail like you just did okay. That is the epic fail that nobody ever saw.

And no one will talk about it.

Yeah, and one last one that I thought was an interesting clever one that we'll talk more about on a future podcast, around future behavior but it's one that Roy and I were talking about idly before, and that's this idea that when the market falls and then there's somebody has a big win or clever in one area, they'll keep talking about it forever.

Right. I'm sure everyone has seen this or experienced this where, maybe they or a friend went to Vegas for example. They come back and say "How'd you do?" and they will talk about the great win they had that one day at that one table and they were on fire. The great thing that happened. They may or may not then tell you that, well, but overall I kind of lost $15,000, but I gained $15,000 so it was a wash. Or, overall, I lost $15,000 and my one winning day is what brought me back up to that 15 because I was down 20. So they'll talk about the exciting success they had because everyone wants to hear that and everyone's also excited to talk about that. Very rarely, people are excited to talk about the mistakes they made or the losses that they had. So it's effectively a survivorship bias through a mental screen, if you will. We see some -- survivorship bias and we talked about this before where you see companies around in strip malls and big companies. So people think, "Oh I could go start a company and really -- the odds are stacked against you. The only ones you see, you're still in existence because they made it through an incredible amount of statistical possibility to even still exist. So a survivorship bias because we see something or we hear something we think it's more likely to happen or be doable, and yet, if all we hear is the people who talked about their successes and not their failures, we think we could be a success too in that realm doing that thing. Statistically, it's just -- that's lunacy.

The one that I think -- I'll just give a fun one to end this, to all here listening to this podcast that the -- you might want to do to somebody. If they threw out the -- well, I sold everything right before it fell apart back in September of '08. Now, we don't do this to people at our firm when client say that because, periodically, they do. We're much more gentle. But if what you wanted to do was just give that person a little bit of a jab, just kind of have fun with them. Just ask "When did you put it all back in?" "When did you put it all back in?" Because that's what had to happen actually benefit from the drop, you actually had to put it all back in, and pretty quick in 2008, to actually benefit from that big drop. You had to be all back in by April of 2009. I think it was the bottom in April. So it literally meant, you remember what April of 2009 felt like? Those were the doom and gloom, there was the -- everybody is dialing down their robo-advisers to the conservative portfolio because gosh I can't take anymore hemorrhaging.

We're no longer the world -- you know, reserve currency and this is going to happen and that's going to happen and what end up happening was the market went back up. So to have benefited and avoided a 40% drop, you had to put all your chips back on the table really quickly and nobody

is doing that. And yet, even the very person who did it, who knows all the facts, doesn't realize that they still live with, they killed it, made an awesome financial decision. They feel clever and smart but in closing, they may not have the wisdom. So Roy, thank you for being able to be here and be able to share your time and take the energy to do this. If somebody wants to reach you, what is your email address, they can get you at?

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I'd encourage you, you can see more about how to contact Roy in our show notes. So don't forget to engage us at sfgwa.com. If you have any questions or any show notes, things that you'd want to share or see us address in the future, don't hesitate to email us at info@sfgwa.com or on Facebook, or email Roy and tell him what you thought of the podcast. I look forward to seeing you guys again back on this podcast too.

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2016-24590 Exp 6/18

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