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Podcast

# *What Would the Robot Do? How to Invest Cash In Volatile Markets*

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Featuring:

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**VO** [00:00:01] Is your wealth strategy supporting your long-term goals? Welcome to *Your Active Wealth* with BNY Mellon Wealth Management, where we offer insights that can help you move closer to your goals. We'll tackle timely topics through the lens of the five pillars that comprise our Active Wealth framework, Invest, Spend, Manage, Borrow and Protect, and provide guidance on navigating the unpredictable, to help you build and sustain wealth.

**Alicia** [00:00:32] Hi everyone and welcome to *Your Active Wealth*. I'm Alicia Levine, and today on our show I'm joined by Jeff Mortimer, director of investment strategy at BNY Mellon Wealth Management. Together we're going to tackle one of the biggest questions investors have today, is this a good time to put cash to work in the market, especially when we've had one of the worst January's in the market ever and we are expecting some volatility going forward? So, Jeff, thank you for joining me for this really timely conversation.

**Jeff** [00:01:06] Pleasure to be here, Alicia.

**Alicia** [00:01:07] So I'm so excited to talk to you about this because, you know, we have client conversations all the time, we've had a very volatile January to start 2022. But let me set the scene a little bit. So, in December, cash in money markets totaled 4.6 trillion dollars, both from individuals and from institutions, which means some of the cash levels out there are the highest ever. Even though we had markets move very high in the last couple of years. At the same time, we have investors who were really looking for a market drop in 2021 to put that cash to work and with the strong markets were reluctant just to jump in when markets were climbing ever higher. Today we have the S&P down around 10%, the NASDAQ down around 18%, rallies are hard to come by, and the Fed surprised everyone with how aggressively it is planning to raise rates this year. So, Jeff, when we think about the cash on the sidelines, what is the big question that you're really getting from investors today?

**Jeff** [00:02:17] It's always an issue with people who have had a liquidity event, had additional cash put into their portfolio for some other reason, inheritance, whatever it may be. And so, people are always asking me, you know, when do I have that money join the rest of the portfolio? You know it seems to me that investors seem to worry when we're making all-time highs because they don't want to invest at all-time highs is the thinking because they were taught to buy low, sell high. So why would they be buying at an all-time high? So that's uncomfortable. But as markets also, when they're in a pullback mode, investors also don't want to put money in because they don't know when the drawdown will end. And so, all of a sudden you find as a human being that whether markets are going up or down, you know, you always seem to have an excuse for not putting money to work. And so, I remind people that, you know, we made 70 new highs last year. I think very good advice is only invest in markets when they are making all-time highs. I mean think about that on January 1st of 2021, the person who only invested when markets made all-time highs invested on the first one and he rode the market up the whole year. The person who didn't invest in all-time highs is still sitting in cash, and while he or she may feel good because of the latest drawdown, remember we were up some 28% last year rough numbers or so on the S&P 500, and we've drawn back only 10% of that, so it's still 18% gain from the beginning of 2021. So, I tell people to try to take the emotion out of the cash dispersion. Use dollar cost averaging, we'll talk about this more, but I think that the cash on the sidelines really shows you that as markets are moving ever higher, people are reluctant to put money in, I think that's really what you're seeing from the last year as markets still rose in levels that cash continued to sit on the sidelines waiting to come in.

**Alicia** [00:04:21] That's right, and of course when we had our recent client call, the most frequent question was not is this the right time to buy the dip, you know, after we've had a pretty notable sell off in January, but the question was, you know, is it better just to get out of the stock market for six months until things calm down? And so, it feels like there should be some discipline around that. You know, investors are taught buy low sell high, so when stocks move higher, there's a reluctance to go against that saying. But talk to me about, you know, how you convince investors and what are what are the stories you tell them to help them get over that fear of jumping in pretty much at any time? Because overall, of course, markets, you know, move higher, and if you're allocated properly, you should have positive returns. How do you help people get around the nervousness?

**Jeff** [00:05:16] Oh, I love that question. Thank you for asking it. You know, I start with this one. I've looked at the past through complete rigor, removing as much emotion as I could. And I usually start out with a statement like this. A robot would put all the money in the market tomorrow, right? That's what a robot would do. Because you know, that robot, that A.I. robot would look at the past and say well, markets tend to go up more than down. And so, by having money outside of the market at any point in time is not a good thing to do because the tendency of markets to go higher just exists as a sort of in a permanent state. Now I know it's ups and there's downs and there is rollercoastering and all that kind of stuff happens. But in general right, the path is from, you know, the page looks like when you look at a long-term S&P chart, it goes from the lower left to the upper right. And so, the robot will look at that and say well, you know, I don't know where you are on that page, but I probably I'd want to be in. And so, then I tell them that basically, if you removed all emotion, the right answer historically would be to move into the market. And then I tell them, OK, so try to be as much like the robot as you can, try to remove emotion and start to dollar cost average. You know, in a way, I say for some people, it's three months. For others, it might be three years, but do something to be more like the robot. And what I say to people also to convince them is that, you know, you can be missing out on new all-time highs. I mean, as I mentioned before, 70 all-time highs were made last year. You know, be greedy. Think about the opportunity cost of cash and cash again is really a negative, real yielding asset. It is coming with a toll. I mean sitting outside in cash is actually losing money because you're losing purchasing power. I know the value doesn't move, but what it can buy does. And that continues to decline daily, especially under these short periods of time of higher inflation. You know, I also tell people that it's extremely difficult to time markets, extremely difficult. And so, thinking that you have information that puts you at an advantage over others, right, a lot of hubris in that. And so, I tell people, humility is important. And to know that markets can move in both directions quite quickly. And that again, like dollar cost averaging, which is the fixed dollar amount put into the market at even time intervals. Just because it is a fixed dollar amount, remember what that is doing, it's skewing you to, if markets are relatively low, you're buying more units, and if they're relatively high, you're buying relatively few units. Now you don't know, relatively low or relatively high as you're going through your dollar cost averaging program. But just by the fact that you're doing a you know, a stable dollar amount, favors you know skews the performance in your favor because of that. You know, I also talk to him about the unluckiest investor. You know, you look at an investor over the last 10 or 20 years and say that he has the worst luck and in every calendar year he puts all of his money in that year at the all-time high of that year. So, whatever the highest point of that year, that was the day he invested. We've actually done some research on that. And believe it or not, that person, I think over the last decade still is very close to the person who had much better timing prowess. In other words, because we were in such a bull run and market size, we've mentioned, go up over time, that even that person who is the most if you call them unlucky or unskilled, he didn't face that much deterioration in his overall return, and that really gets to the point that it is being in the market is much more important than the timing of your decisions of when to enter, especially if it's just a smaller portion of your overall asset allocation. If you have $10 million in the stock market and are just dollar cost averaging with another $500,000, you know, please understand that that 500 is just the tail of your other investment plan. It really doesn't matter that much to your overall wellbeing over time, and it may as well just joined right its brethren almost again as quickly as possible may be using, as we mentioned earlier, some dollar cost averaging.

**Alicia** [00:09:40] So, Jeff, help us understand one thing could you explain what dollar cost averaging means in this situation?

**Jeff** [00:9:47] A dollar cost averaging, the definition really is, the practice of systematically investing equal amounts of money spaced out over regular intervals, regardless of price. In other words, you can invest at the end of every month one third of your total capital, right, so you're putting in a fixed amount at a fixed time period, regardless of what the price is doing. Some dollar cost averaging programs are more sophisticated and can move up if price moves down. If you're buying in, you could accelerate them. If price moves up, you can delay them. But the basic answer is, of course, a fixed dollar of money at regular intervals, regardless of price.

**Alicia** [00:10:30] Interesting because it definitely seems like a risk mitigation tool by doing that.

**Jeff** [00:10:34] It certainly is because as I was saying, you are buying less when prices are high and you're buying more shares when prices are relatively low because you are doing a fixed amount of money. You don't know whether it's high or low as you're going through it, but as you look back on your dollar cost averaging program, you will find that you did do that. You bought more at low prices and less at higher prices.

**Alicia** [00:11:02] So I love that you've actually studied the hypothetical case of the unlucky investor who invested only at the top of particular market cycles because I think we all know everybody who has a story like this. Of course, I won't mention anyone I know personally, but you know it's a familiar thing to buy at the top, and I think it's so important what you say that even if you do that over time, you are still better off. And the point about cash, so important, it is a depreciating asset. You know, it's not safe in the way that people think of it as safe because it is depreciating. Purchasing power decreases over time. And so having so much of your assets in cash really does not feel like the best decision for an overall allocation. But let me ask you this question. I touched on this in the beginning. We've had one of the most volatile January's in market history. Do you ever personally feel just like running out when you see stocks, you know, have 4 or 4.5% reversal in the middle of the day? Overnight markets are up 2%, by the open they're down 1%. Do you ever feel just that the emotions are too much? And how do you get around it? Like, what do you tell yourself?

**Jeff** [00:12:20] On those types of days when markets are, price discovery is sort of extremely volatile, there's information in that, and I'm always looking for the potential for weak hands to strong hands. You know on capitulation days where sellers are indiscriminate in their selling, therefore, don't care about what price they are getting, just want to release the stock from their portfolio. Sometimes they're doing that because they want to, and sometimes they're doing that because they have to, margin calls creep up and when drawdowns get to certain levels. So, I'm always watchful. I have long ago learnt to remove my emotion from my decisions, and I always look at, you know, when we look back on this, you know, 5 or 10 years from now, it will turn out to be a very good buying opportunity. That's just what history teaches me. And so, I always try to utilize them to my advantage. I've said to people, please let the volatility work for you because if not, you will work for it. And so, I think it's imperative that people understand that this is also the price of equity admission. The price of admission is volatility, that's why equity returns are higher than most, if not all other asset classes, right, especially that offer the liquidity that public equities do. And so, while it never an easy price to pay, understand that history teaches that these drawdowns turn out to be buying opportunities. I also remind people of one simple fact, that if drawdowns are not associated with ultimately a recession, so markets drawdown frequently more frequently than we go into economic recession, you know the joke about the stock market is it's famous for predicting 10 of the last two recessions. So those other eight were buying opportunities. And you and I are students of the economy. We work with Shamik Dhar, our chief economist. We look to what will economic growth be going forward, and I continue to think the consumer is in very good shape. I think the consumer maybe is in too good a shape. The issue with inflation is we can't supply enough goods to them. You know, it's amazing, it's not a good problem to have, but it's not that demand is weak. And so, I still think, you know, we have the potential to have a very strong decade of growth as people begin to eventually celebrate the end of COVID-19. And certainly, history teaches that in the 1920s, they were celebrating, of course, the end of World War One and the end of the pandemic and went on to really have a very good time. You know, in the 1920s, as consumerism and good inventions and innovation back then as well continue to push our country forward. So, I know that's a long-winded answer, but that's how I try to get around emotionally, you know, the volatility within the marketplace, how can I make this work for me, knowing that the right decision is probably to buy dips as long as we don't see recession out the windshield.

**Alicia** [00:15:30] That's right. Well, I don't know about you, but I'm definitely ready for the 20s to be fabulous. With no more variants coming from left field, that would be terrific. So, let me ask you, can we get some free advice from you? You know, there's some talk that we're in a new regime here, with the Fed raising rates and perhaps tighter than what the market had expected just a few months ago. So how would you position a portfolio today, you know, if you had free rein over, well you do actually, free reign over portfolios, you know, what would you be doing to position for the new regime that we're in?

**Jeff** [00:16:04] You know, the new regime might be a bit a bit higher inflation. We've certainly over the last decade have had a 0-2% inflationary regime and that is has been supportive of high PE multiples, of growth stocks. They've had a wonderful run against value. And so, as we enter the potential of a new regime going forward, maybe 2-4% or even a 3-4% inflationary environment, you know, what might that mean for stocks? And I have good news here, and that is that most of my career, I've been doing this for over 30 years now, just over 30.

**Alicia** [00:16:38] No way, no way.

**Jeff** [00:16:42] The first 20 years of my career, inflation was between 2 and 4%. And I will tell you that equities perform incredibly well under that environment. Actually, 2% inflation or under 2% inflation can be difficult to manage a company, you can't really raise price, you can't give pay raises. Money is tight, right? Because inflation, there's no price movement. Naturally I call it a lubricant. Inflation is a lubricant to the system. You can give pay raises. You can raise prices. Remember that earnings are in nominal dollars, not in real ones. And so slightly higher inflation can lead to slightly higher earnings. And of course, you then put a multiple on that, and all of a sudden you see the stock markets really don't mind a bit of higher inflation. Even if it were to go to 2-4%, if we were to go higher than 4% or higher than 6%, especially higher than 6%, markets begin to take notice. Then you have more difficult periods of time in which you sometimes get into wage price spirals. And the Fed has to act more aggressively to bring that under control and could bring on a short recession. So, we have to make sure and that's I think where the market is struggling today is where will that new regime be? And perhaps last year it was thinking 2-4%, but is now thinking, boy, what does the Fed know that we don't? And will the Fed have to move more than we originally thought? And so, I think that's why you're seeing that price volatility. Our base case is that we moved to a 2-4% percent inflation. If that is true, then perhaps not most, but some of this market potentially has overreacted. And so, to me, I would, if you were a 60-40 investor, or a 50 50 investor, I would find myself getting pretty close to those actual levels in my portfolio if I were drawing it up from scratch. I would not be underweight. I would not wait to get better entry points. I would quickly move about to my base, you know, sort of my base allocation. You know, we have investment policy statements. When clients join us, we try to have our clients behave like institutions as best they can. Institutions are wonderful at this because they tend to be committees, not individual people, and it's not individual money. They have a fiduciary responsibility for the moneys that they manage. And I wish people would deem their own wealth as having a fiduciary responsibility to do it well. And I think that may help them remove emotion. And if they were fiduciaries of their asset and looked at history, I think they would share sort of that view that this dip may be a wonderful time. If you were again a new client to quickly get to or more quickly get to your target allocation.

**Alicia** [00:19:19] Yeah, it's such an interesting point when you talk about the emotion of it, because look, I've been in markets 25 years myself, hard to believe, and yet each time you get volatility like this, it feels as bad this time as it did the first time, and you would think you get used to it. But actually, you don't. And it's a good indication that having a plan, you know, having an advisor or having an allocation plan is really very important because you do have to take the emotions out of it. Very difficult to do when you have these enormous reversals in the middle of the day, which is, I think, something that is very unusual for us. But let me ask you this, when you talk about individuals investing as if their institutions, besides having a plan, what else does that mean to you?

**Jeff** [00:20:08] You know, I thought a lot about some of our, what are our best clients like, you know, what traits do they have that have allowed them to be successful not only in a perhaps a business that they sold or wealth that they created, but also as they've made the transition from entrepreneur to investor? And that can be difficult for a lot of people to do, especially the volatility as you've mentioned, recent volatility sometimes during the day, in the morning or up by the afternoon you're down, overnight you're up, by the close of business you're down, right. These things, if you owned a business, your business might be volatile if somebody were to offer, you know, a dollar value for that every day. But you don't see that offer every day if you own a private company. You do see that in your portfolio here. So, I think our best clients, they rely on us as co-pilot. Fidelity did a wonderful study, and they looked at what accounts at Fidelity performed the best over, I don't know, the last 10 or 20 years or something like that. And they found that it was the accounts of people who had passed away, or that people had forgot they had the account at all. And what that tells you of course, is just leave it alone for the most part that we sometimes get in our own way. And that's what I'm talking about a client sort of handing over the reins to us. Certainly, it's their money. They can talk to us about cash needs and objectives for that money, of course, but then sort of leaving it to us to allow us to do our best work again as a fiduciary on their behalf. They come up with the asset allocation, they come up with the initial risk tolerance, right? All that is theirs. But then once they've sort of set it, that they allow us to then help them navigate through market and economic cycles. And so, I think that's sort of the best thing you can do. We rely on experts in other areas of our life right, be medical or design, right? Everything else we go to someone and then ask them to sort of help us. If you were in my shoes, what would you do? We ask them. And then we build up trust and rapport over time. And I think that's, you know, that's sort of the best answer that I can give. And I've seen clients run the gamut from wanting to keep almost full control to those that have given away most of it to us, keeping a close eye on us, of course. But that seems to me to be, and again the Fidelity study, really sort of backing that up as well.

**Alicia** [00:22:47] It's actually very funny when you think about it.

**Jeff** [00:22:50] Yes, it is.

**Alicia** [00:22:51] Your portfolio is better off if you're dead. Because you can't do anything.

**Jeff** [00:22:58] You can't do anything about it. You can't do anything about it.

**Alicia** [00:23:00] You can't do anything as ludicrous as trying to time the market. I mean look, I can tell you that some of the mistakes I've made in my investing career is trying to time the market. And I think if any of us scratch the surface, it's true. And you know, as I like to tell people, you know, people in our business tend to be pretty good at sussing out when we're going to have a sell off and getting out. But then it becomes really difficult to make a correct decision about timing of when to get back in. And once you go to cash, very hard to get back in. And so, to try to time the market is virtually impossible, even if you get the first part of it right. Because it's a two-part decision. And so, you know, we think about that $4.6 trillion sitting on the sidelines. You know it's compelling in that it's clear that the emotions are keeping it there and not really a thorough analysis of the opportunity cost of doing so, and particularly in a slightly higher inflationary environment where the purchasing power will decrease at the rate of inflation. So just a really interesting point. But let me ask you, in the last few weeks, you must have had clients calling you, what are some of the more interesting things that you're hearing from them in this time of volatility?

**Jeff** [00:24:26] You know, I've been doing a lot of handholding, as you can imagine, and I would really classify most of those conversations as being more similar than you can imagine. I remind people that we're all humans. We all feel the same emotion. We all feel when volatility comes and the influence it may have on our portfolio and the fact that we sort of can't control markets as they move through these bouts of volatility. And even if we prepare you in advance, which we did, we talked about a much more highly volatile market in 2022 is one of our themes for the year as we went into it, we were talking about that long before the January 5th sort of earthquake of the Fed minutes. And I just want to help people understand that this too shall pass. Some of their questions are, they're listening for historical perspective, they're listening for, help me make it more rational. Help me from my self, right? Are a lot of these conversations. And so, although I am a strategist and have studied my whole life to sit in this chair. I do think, Alicia, and I know you bring this to the table as well, we're both in the media. We're both talking to clients directly. I think I'm half strategist and half therapist. I mean, I really think a lot of my job is to help people in times of volatility within the markets. And I take that very seriously. And an old mentor of mine said, you know, investing is like flying an airplane. It's 90% boredom and 10% sheer terror. And I've never forgotten that line. And he'd said that to me, of course, with a twinkle in his eye, and he's since passed away. But it's these single lines that sort of stick with you. And we're really paid for that 10 percent of the time. We really are here to help clients navigate to these periods of higher volatility. And they come up, you know last year, we do conference calls and Alicia and I present together and pre call, we always guess, we estimate how many people we think will dial in, and we know that with higher volatility comes higher attendance. And we did our first call in January of this year, and we were already at double the levels. So, you can see that the need for that emotional or that rational reasoning is there, whenever markets sort of turn down and people are looking for answers. So, we're here for those periods, that's where we, you know, I've often said, you know, if this were easy, I wouldn't be needed. So, I'm here for people. And also, that we are fiduciaries that we stand for them to represent and if we thought recession were coming, our advice might be very different than sort of where we sit today, but it's not always, yeah you know, weather the storm. It is if that will turn out to be the right answer, which we think it will this time around as well.

**Alicia** [00:27:32] Yeah, I love your analogy to being a therapist for a lot of the time because it really is about thinking through what the risk profile is and how to manage it when it's under stress as it happens to have been in the last four weeks. I think the issue of being, you know, risk tolerant and, you know, are people in the right asset class for their level of risk acceptance is really important also. So, when you speak to clients, I mean how do you figure out where their risk level is so as to help them build overall allocations and overall portfolios that fit with their risk profile? Like how do you assess that out?

**Jeff** [00:28:16] So while you and I sit at the strategic level and don't deal directly with clients, I have talked to portfolio managers here for long periods of time, been here for a decade. And what I find, I think a lot of them that do this very well on behalf of their clients, put it in dollars and cents. You know, it's one thing to talk at 20% drawdown, but it's another thing to talk about a $10 million portfolio, which would go to $8 million. You know, how would you feel if that happened?

**Alicia** [00:28:45] Probably pretty bad.

**Jeff** [00:28:47] Yes, but I think 20% drawdown people, you know, I don't know if they know what that means. And so, I think the best portfolio managers put that in dollar terms and say, how would you feel if that were to happen? You know, would you call up and want to remove everything? Or would you wish you had more money to buy that dip right? And so, you start to get what about a $1 million drawdown? What about a $500,000? And then you start to say, well that would, you know, move to an allocation or that would represent an allocation historically of 30/70 or 40/60? And then let's see if with that allocation, we can meet your objectives. So, it's always a push me, pull you about what are your objectives for the money. How quickly would you like to grow it? What number do you have in mind? What are you hoping to accomplish? Well, that always has you take the most risk possible, but then that drawdown is always, but wait a minute, that ride may be so bumpy that you will not be able to realize it, right? That somewhere along the line, that drawdown will be so destructive to you that you will have to pull out of the market and therefore you're right now you've reversed, you're not meeting your long-term objectives because the roller coaster ride was too, it was too much for you. And so, I think our best portfolio managers in the field talking with clients directly really assess that push me, pull you very well. And then once you describe what that drawdown could be in advance and that the client is OK with that, I think then once you're in it, you can say, OK here comes one, we're prepared for it right? We're playing a little bit with the house's money, right? You can talk anything you can do to remove emotion from this, right? We had a wonderful year last year; we probably pulled a little bit forward. We're giving a little bit back, but you know, all these things, you're still up from inception, whatever you can say to someone to just sort of let them ride through bumps. I also think wonderful thing that has been done is people that bucket their money, that have a bucket of money, they've subdivided their total portfolio into a into a liquidity bucket or a, we live off this money bucket, and then another longer-term bucket is for the children or grandchildren. And it has a 30-year life. And so, all of a sudden, the bucket for their grandchildren, although it's volatile, they're like well that's 30 years from now. We don't really need to worry about it. It's another way again of taking emotion out of the decision making just by a bucketing of the assets themselves.

**Alicia** [00:31:17] So I think that's really fascinating what you just said about buckets, because actually it comes back to institutional like investing, because that's exactly what foundation institutions do. They have different buckets of liquidity and time horizons and therefore tend to be fairly well allocated across the risk spectrum. And so, I love that idea that you just put out there that, you know, individuals and families should really think about it with different durations and different buckets in that way. I think that's fascinating. I don't think I've heard a lot of people speak of that in that way, openly about this, it's not just where's the stock market and can I time the market, but it's also about overall allocation and overall portfolio construction and what are my buckets? I love that, Jeff. That was great, very insightful. And by the way, you are very soothing. I have to say, you know, you are very, you know, very soothing about markets. So, thank you, thank you for all of us in this business. It's terrific.

**Jeff** [00:32:23] It's my pleasure.

**Alicia** [00:32:25] So I think, look, you know, when we opened this conversation, we talked about this January being one of the worst Januarys in terms of performance in the stock market. But I think it's important, as Jeff has said over and over again, that it's important to be in the market and not to time the market because timing the market is virtually impossible and probably detrimental to your overall returns. And there are ways of investing even during volatile times with the help of a wealth manager or a financial advisor who can work with you to develop a sound plan and then to keep to the plan. Because again, it's the emotions around it that stop us all from really executing what perhaps our analysis would tell us. Thanks everyone for joining us today and see you on the next episode of *Your Active Wealth*.

**VO** [00:33:19] Thank you for listening to this episode of *Your Active Wealth*. Be sure to subscribe to this podcast on Apple Podcasts, Spotify, Google Podcasts or Stitcher and visit bnymellonwealth.com to view the latest insights on the subjects that matter most to you.

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