The Just Word Podcast

Transcript of Episode 18 – Beating The Bank

Pat Bolland 00:01
Larry, welcome to the podcast, a real pleasure to talk to you. But you tell a great story, or at least I read a great story about how you wrote this book and why you wrote this book care to share that with us.

Larry Bates 00:14
Cats. Great to be here, Pat. Thanks. Sure. Well, I was sitting on one of the bank towers downtown. Still working in my main career in the banking business a few years ago, and I got a call from my sister from New Brunswick. And she said to me, " Hey, Larry, all we hear about is how well the stock market's doing. But this, this bank mutual fund that we've had for the last 15 years, really hasn't done very much. And we just don't understand why can you have a look?" So I googled the fund and asked my sister, hey, do you realize you're paying 2.3% in fees, and she said, what we're paying fees? And I said, Yeah, 2.3% a year. That's whether your fund goes up or down, you pay those fees. And she's she said, Oh, you mean 2.3% of our of our returns, and I said no, no 2.3% of your total amount invested, you pay that every year, for 15 years. That means you've you've lost 35 or 40% of your money to fees. And my sister was, she was shocked, she didn't even realize she was paying fees. Many Canadian investors are in the same boat, they don't even realize they're paying. Very few can figure out actually how much they're paying. Anyway, so you know, she was quite upset. Like most Canadians, every penny of her retirement savings is, it was really important to her and that didn't make me feel very good as a participant in the banking / investment industry. This is my industry. And I just, I just don't think that average Canadians are well served by the investment industry. And it's got me kind of fired up and and that's sort of led me to write the book.

Pat Bolland 02:17
Okay so you write the book - you used to work in the banking industry - I would say, obviously, you're retired now, from that, how did your colleagues react?

Larry Bates 02:27
Well, most of my colleagues, were very positive about it. You know, I spent my career in the industry, but I never dealt with individual investors, I was always on the capital market side dealing with large institutions and in companies and governments, etc. So I never, was never on this side of the business. So my colleagues generally are saying, 'Yeah, go, Larry, that's great.' Did I have I received some flack? Yeah. But that's okay. But most people, you know, most of my colleagues from the industry are, you know, they, they're professionals, they know how it works. And they generally, I think, you know, agree with what I'm trying to do.

Pat Bolland 03:13
You know, you think of the Canadian banking system is one that serves and protects Canadians. That ... you're going against that?

Larry Bates 03:25

Well, no, not really, because I think the banks in many ways serve Canadians very well, like you said. You know, for instance, going through the financial crisis, banks, in other parts of the world were failing, collapsing. Canadian banks held up really well. So there are many things that Canadian banks do well, I'm a fan of banks, I like banks, I just think in this particular area, of selling investment products to average Canadians, they take advantage of Canadians' faith in the banking system. And their lack of knowledge and lack of understanding and lack of transparency about the costs, that the banks charge, which by the way, consume about 50%, on average, about 50% of total investor returns over time, which is a catastrophic result. You know, so I, yeah, I criticize the banks in this area, but you know, banks overall, I think, you know, they do lots of good things as well.

Pat Bolland 04:27
But you're suggesting though, and when you're talking about transparency, that they're hiding it or do you think the banks are doing this on purpose? They have a business model after all, their that's their job...

Larry Bates 04:37
Well, look, the industry never presents a proper bill. They'll never really show what ...you have to really dig hard to find out what what you're paying in annual fees, and then on top of that, Pat, you've got the compounding effect of those costs over time, you know, somebody might think, well, I'm paying a 2% annual fee. That doesn't sound like very much. But, you know, just take a simple math example. If you're paying a 2% fee every year for 25 years, what does that add up to? 50%, right? People don't tend to do that math. And I'm oversimplifying it a bit. But that's the impact over time. And they sure ... They sure don't mention that when they're marketing their high cost funds with somebody either way, generally underperform - massively underperform simple index funds.

Pat Bolland 05:41
Yeah. And I will get to that in a second. Because I do want to talk about the mutual fund industry as part of the banking industry. But should somebody like government step up? Do you think Larry and say, and because I know what happens in other countries, there needs to be more transparency, it needs to be simplified. And that has been happening over the last few years. But I don't think it's done enough. What are your thoughts?

Larry Bates 06:04
The regulators have forced some increased transparency, but the the industry keeps fighting and fighting and fighting against us. You know, another example is the regulator's Canadian regulators try to impose a best interest standard that tried to oppose impose a legal standard on the industry to act in the best interest of investors. Well, the industry fought that as well. And ...

Pat Bolland 06:37
Why would they fight that that seems to be logical? Fiduciary responsibility...

Larry Bates 06:41
Of course, it's logical, but it would destroy their high fee business model, because they wouldn't be able to sell punitive high-fee products anymore. Now. So what do the regulators do? They water it down?

Now they're moving forward slowly and slowly, but really hasn't. It really hasn't improved the transparency for the average investor. Now what - There, there have been improvements out there for the average investor, great improvements. They've come from new product developments, like low cost index ETFs, like robo-advisors, etc. And if you figure out the basics, the same banks that want to charge you, super high fees, will provide a great level of service for very, very low cost, great service for very low cost, if you figure out how to do it.

Pat Bolland 07:39
Yeah, to get around to ... another area, that I don't understand why it hasn't done, or growen more is performance fees. So if you're a bank, or mutual fund, or anybody else, and does very well, you charge more, and if you don't do very well, you don't charge as much. And again, it seems to make sense, why isn't the industry doing it?

Larry Bates 08:01
Well, because one reason is the industry generally doesn't outperform the indexes, so it would not work for their business model. You know, unfortunately, the way the industry is set up, they're, they're addicted to these high fees. They've got huge numbers of advisors across the country. They've got, you know, got sales teams, marketing teams, compliance there. It's, it's a very expensive model to run. So they're addicted to these high fees, they wouldn't be able to survive on performance fees, they wouldn't ...the industry would collapse.

Pat Bolland 08:45
Yeah, but as I say, other countries have advisors out there, they have mutual, similar to mutual fund companies, and they're doing fine.

Larry Bates 08:57
There's some of that out there, but not a lot. And you know, some of them have performance fees, there are some funds that are performance fees on top of base fees, that so you know, I guess there are some out there Pat, but it's not prevalent among retail, the retail investment world around the globe,

Pat Bolland 09:18
You've made the point twice now that mutual funds tend to underperform the indices that they're supposed to be beating. Why is there an easy answer, or is it quite complicated?

Larry Bates 09:29
No, there's a very easy answer, that the managers of those funds just are not able consistently to overcome the impact of those high fees. So you know, let me give you an example. If I mentioned earlier, you know, a 2% annual fee on a mutual fund over 25 years, consumes about 50% of the total return of that fund? So if you take that one step further, that means that a fund manager managing that mutual fund would have to generate double the total return over 25 years of the index to match it on an after fee basis. Can't, you know, that's just not, that's just mathematically not going to happen. Now\, you know, there's 1000s of funds out there ... will a small number of funds, potentially achieve that. Yeah. But the problem is, you can't predict which ones. So you know, 90 - all the stats show this Pat - 80, 90, 95, 99% of funds, depending on the timeframe, underperform the simple stock index, largely

because of the fees they charge. And, you know, they say they charge high fees, because they're going to outperform it doesn't happen. I mean, this is part of the you know, the marketing of the industry, which is in which is not, they're not being straight with with investors.

Pat Bolland 11:18
Okay, but you've come up with a way to combat that, if you will, a concept that you called T-Rex, I assume it's named after the dinosaur? Walk me through, what do you mean by T Rex?

Larry Bates 11:32
T Rex? Well, yeah, it's, it's an acronym. It stands for 'total return efficiency index'. So I had to come up with a little macro acronym for. It's just a little tool, it's on my website, #Larrybates.ca and it just shows the impact of fees over time, and anybody can go on there and do their little calculation, if you know what you're paying in fees, if you know, you're what you're being charged, and most people don't. But if you can find that out, you can use that little calculator to look and see what the impact of those fees that you're paying will be on your investment experience over time. But, you know, in the book, I really, it's based on three basic principles. First, take a little bit of time to learn investment basics. You know, the industry will say, look, hey, this investment stuff, it's it's way too complicated and dangerous. Just trust me. Take a bit of time to learn the basics, you don't have to be an expert. Investing can be very simple. And the more that you know, the better off you're going to be even if you stay with your high cost mutual funds. Getting a bit of knowledge is power it gives you makes you a better informed consumer. Warren Buffett said, the best investment you can make is in yourself. So number one principle, invest a bit of time in yourself, learn some investment basics, it'll serve you well over time. Second point is - be a long term investor don't focus on the market day to day, that's just a bunch of noise, you know, being a being a long term investor of owning businesses through the stock market in the long term. That's what makes billionaires are rich, it's what makes pension funds ... gives pension funds the return to pay their members etc. Richard Thaler, the Nobel Prize winner, once said, Rip Van Winkle would make a great investor, he'd invest before his nap, and 20 years later, when he woke up, he'd be happy. And you know, that's long term investing. And that's what the benefit of the stock market is. And then the third principle of the book is, minimize your costs. Costs are where Canadians get killed in their investment returns, and make sure investments - all investment services cost money - But you know, understand them and only pay for what you need. And if you follow those three principles, you can make a big, big difference at the end of the day and a bigger retirement fund means means lots more smiles.

Pat Bolland 14:18
Yeah, no kidding. Okay, so we start with educate yourself. We go into take a long term approach, and then we talk about low cost, but suppose I'm brand new in the saving field. Where do I find low cost? What do you recommend these days?

Larry Bates 14:38
Yeah, there are three, three or four different ways. First way is first gain that, get some investment knowledge. And the first method would be actually do it yourself. Choose your own stocks and bonds. Open up a discount brokerage at one of the banks or one of the other providers and pick your own

stocks. Now, I would suggest, Pat, that that's probably appropriate for maybe 5 or 10% of investors out there who have some knowledge and experience,

Pat Bolland 15:11
Larry, you realize you're not recommending people go to those discount brokers that are owned by the banks?

Larry Bates 15:18
Well, that's fine. The banks provide a great service to their discount brokers. Look, the banks, the big Canadian banks, they're smart, okay, they, they want to charge the highest fees, they can, but if investors figure it out, and go and want to go through a low to a lower fee service, they'll provide that too. So in order to beat the bank, you don't necessarily have to leave the bank. Now, look, there are some great other providers, too, you should check them out. But the banks will provide that service if that's what you want. A second method, I call it, assemble it yourself using low cost, index ETFs. To where you don't have to ever choose a stock or bond. But you can have a very effective portfolio that serves you well over decades using just two or three, or four, index ETFs. Fantastic, fantastic products. And the third way would be to, to use a robo advisor, if you're not quite ready to help choose your own ETFs. Or you don't want to do what you're doing yourself, you can choose an online advisor, nicknamed robo advisors, that can be a fantastic alternative for those that are a little hesitant and don't want to do it themselves. And that's totally understandable. Because not it's not right, not for everybody to do it themselves. But robo advisors, they charge more than, you know, index ETS, but way, way less than than the mutual funds. And you benefit, most of that saving stays in your pocket, or stays in your account and gets to compound over time. So those are three methods. And there are some other, there's some other low cost methods as well.

Pat Bolland 17:05
Yeah, I, it's interesting, you're talking about ETFs. And we, you and I, use that term interchangeable. And people know what it is, you know, an ETF A lot of people don't realize that an ETF is just a different kind of mutual fund. That's really just low cost mutual fund. But what you're saying about exchange traded funds being the terminology for an ETF, but what you're saying is the robo advisors provide a level of professional asset management, right?

Larry Bates 17:34
They do. And I think one of the criticisms of robo advisors is their sort of cookie cutter portfolio, they provide cookie cutter portfolios, You know, most Canadians, you know, everybody's different. Everybody has different circumstances. But most Canadians, their circumstances are not exceptional. They. So, a robo advisor that offers you know, a dozen, or some offer more, different portfolio mixes, that's probably just fine for 95% of Canadians. Get a bit of advice, remember, robo advisor, answer a bunch of questions, they'll recommend a portfolio that that is designed to suit your timeframe, your your comfort level, your willingness to accept risk or or not. And, you know, for most investors, certainly most people that currently go to the bank branch for their insurance advisor, whatever, and buy these expensive mutual funds ... massively better.

Pat Bolland 18:47

You know, full disclosure, and I'm into transparency, JustWealth sponsors this podcast, and they've got 60 or 70 portfolios, so you've got a lot of flexibility within the products that they offer as an example, as opposed to a bucket of five or six different kinds of funds. Right.

Larry Bates 19:08
Yeah, I mean, I think, you know, having that array of different options is great. I think, you know, for most people, they probably don't need to go to the 60th option, you know, because as I said most for most Canadians, it's pretty straightforward. In terms of choosing an asset mix, it's basically down to look, do you want to take a level of risk where you have 80% stocks in your portfolio and 20% bonds or, or is it 60-40 or 20?Whatever the ratio is, that's probably the most important question. But anyway, robo advisors generally are worth checking-out definitely be checked out by Canadians, whether you've got a few $1,000, or even a few million dollars, if you're currently paying on mutual funds, you're likely to be much better off going that route or one of the other routes I mentioned.

Pat Bolland 20:19
Okay, again, back to somebody just getting started with money. You're talking about robo advisors asking you questions about where you want to put your money and what your portfolio should look like. But what are the questions, as an investor, I should ask?

Larry Bates 20:34
Well, I think what's the purpose of your investment? What is it for? Is it for coming up with a down payment for for a home that you hope to, to act on in a couple of years? Is it for retirement? Is it for some other purpose that's in what's the timeframe in retirement? If you're, if you're 30 years old, and you're thinking it's retirement that you're saving for? Well, you know, if you put the money in most of the money, for example, in the stock market? Well, it's not going to matter what happens to the market day to day market tanks next week or next year. What happened? What's more important is what happens over decades. So maybe, and stocks over decades tend to outperform everything else. So you might be more aggressive there. But if you're saving for a down payment that you plan to act on a couple of years, well, you know, a two year timeframe in the stock market, there's a lot more risk, so maybe you want to be much more conservative. So those are some of the questions like that, Pat, and I talk about talk about that a lot in the book.

Pat Bolland 21:49
I was just gonna say people should pick up a copy of 'Beat the Bank - the Canadian Guide to Simply Successful Investing. So Larry, it was a great read and a great chat. Thank you.

Larry Bates 22:01
My pleasure. Thank you very much. Larry Bates, author of Beat the Bank, the Canadian guide to simply successful investing.