JG Primer

SPEAKERS
Pat Bolland, James Gauthier

Pat Bolland 00:06
Welcome back. Today we're going to be joined by James Gauthier. He's the Chief Investment Officer at Justwealth Financial, and we're going to talk about the nuances of investments ... investments themselves, for sure, but financial planning as well as trading ... James, great to see you again.

James Gauthier 00:27
Hi. Pat, good to see you as well.

Pat Bolland 00:27
Okay, James, let's start with the broader brush, if you will. When do you consider investments and how do you look at them?

James Gauthier 00:27
Okay, probably easy to start with an example of what investing is. So let's say you and I are sitting together in a bar, and you say to me,

Pat Bolland 00:27
we've done that.

James Gauthier 00:27
I've got this. Yeah, it's true. So you say to me, James, I've got this, this great idea. I want to produce these wonderful new products that I think are going to make tons and tons of money. Problem is, is I need to build a factory, and I don't have any money. Well, I can say to you, Well, Pat, I've got all this money under my mattress, and I don't know what to do with it. How about I give you that money? You can build your factory in an exchange. You know, we'll split the profits 5050 does that sound like a deal?

Pat Bolland 01:48
Sure, I came up with the idea I'm building it, but it's still 5050 okay, I'm no judgment unfair here. But yes, okay, go on with your argument.

James Gauthier 01:58
Okay, well, that is basically the same thing as buying shares in Apple. I'm exchanging capital for a return of sharing profits in the company. In the future, I'm taking an ownership stake, and that is an investment. I'm doing something with idle capital. I'm giving it to someone who needs capital in return for a share of profits. That's just like buying common stock equity,

Pat Bolland 02:26
Except that you now have to deal with the stock market. In the case of Apple, for instance, people would look at that investment and your co ownership is the way you're just describing it, and then they'll say, Okay, how does the value get surfaced in Apple? How do you value what's there?

James Gauthier 02:48
That has become the evolution of investing. So, yeah, working with a friend, as opposed to buying stocks on the market, it's a little bit different. It's bigger scale. So Apple doesn't have one co owner. They've got millions, so there is a process behind investing and valuing stocks, but we didn't talk about the other type of arrangement that we could have. So let's say I wasn't quite so keen to take a risk, because your company, despite your great ideas, it might never make profits, it might go bankrupt, it might never make a cent, and I would lose all of my money that I gave to you. So what we could do is strike a different type of arrangement, where I could say, Well, Pat, I'm willing to give you money, but I want it back in two years time. And in exchange, I'm going to give you $100,000 but when you pay me back in two years time, I want $110,000 and in the meantime, hopefully you have all great success and everything works out. That is the same thing as buying a bond, where you're given a fixed rate of return and your money back at the end of a specified time period. So for those people that aren't willing to take quite as much risk, there's the option to invest in bonds.

Pat Bolland 04:02
Okay, so now we've covered stocks, commonly called equities and bonds or fixed income. So you've got both ends of the spectrum. When you look at your investments, though, and let's just stick with stocks for the time being. How do you look at them? Do you look at things like earnings or ... and that would be a quote, unquote fundamental investor, somebody that's looking and focused on earnings and those kinds of valuations. Or do you look at just the price? You look at the prices going up, the price is going down, and that ...and many people would call that Technical Investing, because you're just looking at the charts. How do you go about it?

James Gauthier 04:43
Yeah, so what you're describing is, is, you know, standard reading for any course in finance, it's fundamental analysis or technical analysis. Everybody who becomes an investment professional has to learn about those things. I don't look at either of them. Both of those schools of thought imply that you can somehow use formulas or algorithms or other types of, you know, methods to be able to try and make money better than what the market can make. I tend to look at what has evolved to be known as Evidence Based Investing, which says neither of those things work. Nobody can use those processes to be able to add value to what the market itself delivers. So empirical evidence, academic evidence, both say fundamental investing doesn't work. Technical analysis does not work, so I don't look at either of them.

Pat Bolland 05:46
Okay, what is Evidence Based Investing?

James Gauthier 05:50

Well, you interviewed Robin Powell on the podcast. I want to say a year and a half, two years ago, he gave a full explanation of what it so it's basically taking, here's a look at what people say. People say a lot of things. They claim a lot of things. You can create formulas. You can say whatever you want without having to provide facts, because it's not regulated, but evidence based. Investing takes a look at empirical results. What has happened, not what you think is going to happen, what has happened, and if you take a look at you know how fund, as an example, how mutual funds compared to the performance of an index over long periods of time, more than 90% of mutual funds do not beat the standard benchmark index. A lot of that has to do with fees, but it's just a proof statement that says fundamental or technical analysis, whichever one they're using, it does not work, and that's evidence to say it's proof.

Pat Bolland 06:53
Okay, so what you're describing to me is, instead of looking forward with your investments, future earnings, future price movements. You look backward, what's it done already?

James Gauthier 07:07
Nope. Looking backward is technical analysis, right? That's when we're looking at prices and trying but if I look back,

Pat Bolland 07:13
I can look back on earnings, and the earnings have been growing at 5% a year, for instance, or pick any number. And that's my backward look. I'm not saying they're going to continue to grow into the future at 5% a year. Or am I?

James Gauthier 07:26
I think you are, you're, you're, you're saying, Here's what it's done. So that's what I should expect. So you're, you're taking the past and naively saying the same thing about the future. And of course, you know any any performance disclosure you read about, whether people are posting fund returns or an individual company's returns, it'll say past performance is no guarantee of future performance. That's a regulator, so there's a reason for that. It's because what has happened is not what's guaranteed to happen in the future.

Pat Bolland 08:00
Okay? So then, with your approach, what kind of a timeline do you recommend when people are looking at investing

James Gauthier 08:11
so everybody's got their own timeline, I would say the timeline is individual based. There is no universal. You need to look at 10 years or 20 years. Everybody is going to have their timeline for their purpose. So whether it's retirement, whether you're saving for a house in 10 years or a car in two years, that becomes your timeline. So everybody's going to be different. And you know, as as a portfolio manager, I have to talk to these people and understand what their timeline is, and then we can, you know, plan their investments accordingly.

Pat Bolland 08:43
Yeah, what do you find with most of the people that you're talking to? Are they planning two years down the road and being and I don't care whether you're buying a car or a house, or are they taking into consideration that the more important investment might be 30 years down the road in your retirement?

James Gauthier 09:01
Yeah, it all depends on their individual objectives. So for those people that are looking at, you know, a purchase of a big item, whether it's a car or a cottage or a house or whatever, they tend to be shorter term in nature. People don't plan 30 years for that. But for somebody who's talking about retirement, who's earlier in their work career, they can be planning a long term time horizon. And we would always tell anybody, no matter what your objective is, what you're trying to save up for, always focus on the end of when you want to accomplish that, whether it's retirement and you have to eventually decumulate or buying a house in five years, your time horizon then becomes five years. You always extend your time horizon to the end of your goal.

Pat Bolland 09:47
Okay, so that seems to naturally move. If you're looking at personalization of investments, it moves into the whole concept of financial planning. What are your thoughts?

James Gauthier 10:00
Yes, that's that the perfect word. I mean financial planning is an evolution of investing. So investing is, you know, how do I get a return on my idle capital? How can I how can I grow it? Versus financial planning, which is about, how do I make sure I have enough money to pay for what I need in the future. So you go from a smaller concept, how do I make money on my capital to how do I make my capital last for the rest of my life? So there is a distinction between the two. It's very different ways to evaluate how to accomplish the objective, but one is a natural extension of the other.

Pat Bolland 10:43
Yeah, it's almost like financial planning sets the table and investing is actually sitting down at the table.

James Gauthier 10:52
Yeah, yeah, very much. So they're related,

Pat Bolland 10:54
Yeah, no kidding. How do you lay out? What do you recommend to people, I guess, is the real question. When they're doing financial planning, do you ask them to make a list of what their objectives might be down the road, or do you take a different approach?

James Gauthier 11:11
So financial planning is, is all encompassing. It's investing is very you know, focused on the investment you're talking about, versus financial planning is all of your cash flows and incomes, including pensions and other factors that are not considered with an individual investment. So there's a lot more input into the the analysis that you do so age is obviously important. You have to make some assumptions. You know, when you expect to die when you expect to retire, what kind of lifestyle you want in retirement?

So are you going to spend 80% of what you're currently spending when you're have a mortgage and you're at a different point in life, savings for kids, education, whatever? So there's a lot more analysis over time that you have to think about when it comes to financial planning, and it all goes into basically, you know, a big spreadsheet. And the the analysis is all mathematical. How do things flow over time? And ultimately, you ask the question, Am I going to run out of money before I die or not?

Pat Bolland 12:16
Yeah, no kidding. The thing about financial planning, quite frankly, is every time I've looked at it or been involved in it, the end result was a budget. You know, you got to save this much money, you got to do this, you got to do that. So my question is, how flexible is financial planning? Because I'm not really good at budgets, to be honest, and a lot of people are not. How flexible is financial planning?

James Gauthier 12:39
It's pretty flexible. I mean, it's, it's, we would say to everyone, you should revisit your financial plan every few years, because you are making a lot of assumptions. You're assuming that you're going to stick to your budget, for example, and if you don't, you know you're going to go off plan. But other things will come up as well. So, you know, maybe you figure I'm going to retire five years earlier than I thought before, or my investment gains have done really well because I invested with Justwealth, and now I can retire earlier. There's all kinds of inflation is way higher than what we expected. So things never go perfectly according to plan, and that's why you need to come back to it every few years and make adjustments. You know, I'm going to retire earlier. What does that mean? Do I need to save more now? Do I need to spend less in retirement? You know, any, any one of those scenarios you can isolate and figure out what that means from a saving perspective right now.

James Gauthier 13:39
Yeah, figure it backwards that way. You know, I asked about flexibility, because a lot of people think about investments as trading, getting into the stock market, getting out of the stock market, and doing that kind of stuff. And as a professional, I guess you you kind of do that. But by the same token, there is a downside to taking that approach, isn't there?

James Gauthier 14:00
Well, I yeah, when you, when you think of trading, mean trading can mean a lot of different things, but trading, you know, when we talk about, you know, I'm a professional trader. Traders are if, if financial planning is the evolution of investing, trading is the devolution of investing. So it takes things the opposite way. It focuses away from longer term objectives becoming to more like, how can I make money? How do I make money now? How do I how can I get rich quick? What can I do to make make a buck right now? It takes the short the focus to be very, very short term, and it effectively becomes the exact same thing as gambling. And we all know who wins in gambling in the long run, it's the house investors will eventually get ruined. So trading is not the way you want to go, and it's there's so many people out there that believe that they can make money. Me, you know, I've got this I've got this method, I've got this process. It can't fail. Eventually it will fail.

Pat Bolland 15:05

There's a school of thought in the investment world on active investing. The whole mutual fund industry was founded on active investing. In other words, somebody knows better than you how to invest. And as you pointed at the very beginning, mutual funds traditionally have not done as good as the or at least most mutual funds have not done as well as the indices out there. Active investing is parallel, in my mind, to trading. In other words, they are going to move their assets around. And maybe it's not on a day to day basis, maybe it's on a month to month basis. Am I correct in making that assumption?

James Gauthier 15:41
Yeah, absolutely. So the way that you know active investing, it involves making bets against the market. You're always trying to figure out, how can I be better than the market? Well, to be better than the market, you have to be different than the market. And whether you're being really different or a little bit different, or moving around really fast or moving around really slow, based on whatever theory it is that you have that's going to be better than the market in the long run, the Evidence Based Investing clearly proves it's not going to work. So part of it has to do with the fact that, I mean, the market is just too efficient. There are so many people, so many smart people, so many companies, so much money involved with the market. For any one person or one company to think we're going to be smarter than everybody else. Everybody thinks that, and they can't be on on average. They have to be average, which is the market. So, I mean, it's, it's a, it's a fallacy that you can try and add value. But the other angle is, because you're human, you're going to make mistakes. There is a field of investing called behavioral finance, or a field of finance that's, that's more about, you know, how do investors make mistakes? Why do investors continually make mistakes in trading? You know, when you extract it that way, that's where you see the most mistakes. And so I got a little quote from Terrence odean, who was a behavioral finance professor, very well known. He created a study a few years ago and wrote a paper on it, and this explains, it summarizes the behavior of an individual investors, so I'm just going to read it. The conclusion in theory, investors hold well diversified portfolios and trade infrequently so as to minimize taxes and other investment costs. In practice, investors behave differently. They trade frequently and have perverse stock selection ability, incurring unnecessary investment costs and return losses. They tend to sell their winners and hold their losers generating unnecessary tax liabilities. Many hold poorly diversified portfolios, resulting in unnecessarily high levels of diversifiable risk, and many are unduly influenced by media and past experience. Individual investors who ignore the prescriptive advice to buy and hold low fee diversified portfolios generally do so to their detriment. So that's a pretty strong proof statement by a person who has no incentive to tell you otherwise, he's presenting findings it's unbiased, as opposed to marketing material which you come across, which is biased, and they're the ones that say our active management will add value.

Pat Bolland 18:39
So in summary, then James, come up with a financial plan. Do your investments that way ... avoid the temptation of trading.

James Gauthier 18:49
Perfect advice.

Pat Bolland 18:51
Let's leave it there. James, great to talk again.

James Gauthier 18:54
Likewise. Pat, thank you. James Gauthier, Chief Investment Officer, Justwealth Financial