Emergency Plans: Coronavirus Edition - Transcript

Tim Mullooly: Welcome back to Living with Money. This is Tim Mullooly. This episode is titled Emergency Plans Coronavirus Edition. The content of this episode is not going to be as severe as the title suggests. I mean, we certainly are in a serious crisis for a lot of people. So now that I have your attention, let's dive in.

So this episode is meant really to serve more as a reminder for those people who actually have a financial plan. It's a reminder of why you got that plan done, the meaning behind it and why you have it in the first place and why it's important to stick with that plan, especially during times like this. And it's a perfect example for those without a financial plan of why having one is so important and hopefully it will serve as a little motivation to go out and get one done and really think about these things once the dust kind of settles here and things calm down.

I think one of the most important things to talk about right now, when we create financial plans for people, there are a lot of hypotheticals and a lot of assumptions and a lot of projections that get factored into the process. I'm going to say it a lot on this episode, but as we all know, no one can predict the future. So building a financial plan obviously is going to have a lot of these hypotheticals and projections built into it. I think one of the best examples of that is the portion of the financial plan that usually would outline how much cash someone should have on hand or the cash reserve that they should have built up or it's usually called in the financial industry, your emergency fund, and people hear about that all the time.

I feel like on a number of different podcasts here, any time you talk with someone who deals with personal finance or financial planning, usually one of the first steps in building the plan is outlining how much cash someone should have on hand for an emergency. If you haven't heard any of those podcasts or anything, I'll quickly go over the rule of thumb here. It's a general rule of thumb in the personal finance industry that everyone should have an emergency fund of somewhere between three to six months of living expenses sitting in the bank. How much money do you need on a monthly basis to live your life, pay your bills, pay your mortgage, pay your rent, buy your food cover insurance costs, everything like that? Discretionary spending, how much you spend going out and having fun and living your life. How much does that cost per month? It's a general rule of thumb to have three to six months of that built up in cash sitting in the bank, not at risk in the market at all. This is for emergencies.

Now when we tell people that or when we explain that concept at the table in a meeting, we get a lot of shaking your head, "Yeah, of course. Yep. That makes sense." On paper it makes sense and everyone agrees that yes, that general rule of thumb, three to six months. Yep. That makes sense. However, in practice we found that it tends to be an area where a lot of people skimp on and it also tends to be an area where people like to take the lower projection. So more towards the three months of expenses as opposed to six. It's personal preference. But I've noticed that people like to have less than more and people sometimes like to do things with their emergency fund. And that is definitely not recommended. That's not what it's for.

Identifying what your money is for is extremely important to having a good financial plan and having something that will stand through tough times like this. Especially when times are good, that's when people tend to skimp on these emergency funds the most. I mean, just looking back on what just ended, we were just in the midst of the longest bull market in history in the stock market. The economy had been chugging along nicely since the last recession, which is now over a decade ago, back in 2008 and 2009. The unemployment rate was, is as low as it's been in a really long time. Things were good until they weren't, and that's usually how it goes. You can't predict anything in the future. You can't predict what's going to happen. If you told people even six weeks ago that we would be where we are right now, people would laugh at you.

No one could've predicted a global pandemic, new virus coming up that we've never seen before. It's an unknown unknown, so it's hard to plan for something like that. But, that really speaks to why you need to have that money sitting safe, not at risk in the market. And that's really the problem with these emergencies for this emergency fund. If we knew when they were going to be and we knew when they were going to hit, they wouldn't actually be real quote unquote emergencies. With businesses, industries, I mean states, cities, everything's shutting down. Things are getting canceled, events everywhere across the country. Plenty of people have seen their hours at work getting significantly reduced or in a lot of cases completely cut. Their source of income is gone. This is the emergency that we've been planning for. It might've seemed like you were foregoing potential stock market gains leaving your cash in the bank, but this is when that decision will pay off.

We have people when times are good, when the market's going up, they don't... You can't see the next problem coming down the road. Well you got questions. Can I take some of that money out of my savings? Should I be putting it into the stock market? The market's going up. I want to take full advantage of those gains. What we're going through right now, this is the exact reason why we often tell people, "No, leave the money in savings." This is what we outlined it for. This time right now, the coronavirus, this is what we've been planning for. Right now it's pretty unclear how long all of this is going to last and for those that have that emergency fund and that security blanket, the peace of mind of knowing that you're covered for at least three to six months, it's not going to last you forever, but just having that little bit of cushion, I mean that peace of mind is enormous for the people that have that benefit.

The one tiny silver lining to all of this, I guess is that hopefully more people will now understand the importance of having that emergency fund and knowing that you can't see these types of things coming, so you have to just have that money ready for whenever or whatever hits. Now, I don't want people who don't have an emergency fund to think that I'm shaming them. By no means is that the case. If you don't have an emergency fund readily available, there are some things that you can still try and do during this time that'll keep your finances under control. Although it should be relatively easy, I think now with a lot of things shutting down, now would be a really good time to reign in that discretionary spending.

So that extra stuff that you would have spent going out to dinner or going to the movies or just spending on things that you didn't really need. Now would be a really good time to just kind of cut back to the necessities and focus on what you need. I mean, if you don't have money coming in or you have less money coming in on a monthly basis, it would be irresponsible I think to just continue to spend frivolously on things that you don't actually need. Scale it back to just the essentials. If you're going to stock up at the grocery store, I mean actually think about what food will last the longest, what can get you the most bang for your buck. Really take those decisions seriously and not just buy whatever you want. If you're working from home right now or you're quarantined in your house with plenty of free time, why not use this time to make yourself a nice budget and track your finances over the last year or so.

I know it doesn't sound like a whole bunch of fun, but if your excuse for not doing that before had been, "Well, I don't have the time. That seems like a pretty tedious activity." Well, guess what? Now you do have the time. So there's no excuse. If you're sitting at home looking for things to do, this would be a perfect thing to do. Figure out where all your money's going I mean... And figure out where you might be able to start building up that cash reserve now or figure it out for when things kind of go back to normal. It's like, "All right, once these restrictions and shutdowns stop and life kind of goes back to normal, how can I get these things back on track?" Now is a really good time to go over things like that.

And I would definitely say, don't let this discourage you from getting your finances on track. I think that's what I meant before when I said I'm not shaming anyone for not having an emergency fund or not having that money to fall back on if your job gets cut or something like that. This is not the time for procrastination either. Use this as that kick in the butt that you needed to get started and to keep yourself as prepared as possible to get through this time and to be even more prepared for the next time. So this is a perfect example of the importance of understanding what your money is for. We oftentimes like to use the visualization of buckets for clients. This money goes into this bucket. This is for saving for the emergency fund. This is for saving for a down payment on a house, this bucket. This is for long-term investing. This is for retirement. This is for my bills on a monthly basis.

Each bucket has a distinct reasoning behind it and it has a goal for that bucket. We get asked by clients if they can invest the cash that they have sitting in the bank or if we think it's a good idea to send more money into their accounts now that the market has taken a dip. So I wanted to take a couple minutes here and address both of those questions one at a time.

The answer to the first question of, can I invest my cash in my savings account? At this point right now it should be pretty obvious. I kind of just went over that, but the answer is no, especially if it's within the context of a financial plan. That cash is there for a reason. We went through these things for a reason. Just for example, imagine having $20,000 initially in savings and then you feel like, "Well, the market's going up. The economy's good. I feel like I'm missing out on making some money on my money. So why don't I take some of that money, some of that $20,000, let's transfer it savings and move it into the market."

Then a new virus sweeps over the globe like what's going on right now, stocks drop 30% and also your hours at work just got cut. You need that income. You needed that cash reserve to kind of keep you afloat for the next few months, but guess what? Since it was invested, since you wanted to try and make more money on top of your money, that $20,000 took a 30% haircut and now you only have $14,000. And you're only going to be able to last two and a half months as opposed to the four or five that you had planned out and those extra couple months there, if things persist, you're going to be in trouble.

The problem is it's kind of hard to get people to take that scenario seriously when things are going well for a really long period of time, which is what we just went through. Like I said before, the bull market and the economy we hadn't had a recession since 2008, 2009. People often forget about what happened during that time or maybe they weren't adults, they didn't have money during that time. So this is the first time that the market is taking a really big hit like that and we might be seeing a slowdown in the economy. So it's kind of hard for them to take those hypotheticals and put it into real term scenarios when they haven't actually lived through it yet. And it's not to their fault, but at the same time, hopefully this will serve as good experience I guess in that sense. Again, another small silver lining to take away from this for next time moving forward.

So that answers the first question. The second question we have been getting the question of, is now a good time to be sending more money into my account because the market has dropped? The answer to that is kind of similar to the first question. The first part of the answer kind of goes back to what I was just talking about, figuring out what that money is for. So if someone asks that question, I'll usually respond with, "Well, are you only going to take that money from your bank and move it into the market just because the market has now gone down and there are better prices for funds and stocks out there?" If that's the only reason behind wanting to move money into the market, then the answer is usually no, that's probably not a good idea.

If this is money that can truly afford to be invested and they still will have that emergency cushion in their bank account and this is kind of just extra money on top of that, then maybe yes, it might be a good idea to send money into your account now that prices have dropped on a lot of things, but I will say just in the day to day of what's going on right now, the market is so volatile. I mean we're seeing massive swings, percentage end points every other day. Last week we had a down 10% day and then followed directly by an up 10% day. We're seeing really, really volatile swings in the market. Right now might not be the exact best time, but maybe when the volatility kind of slows down a little bit and we're not seeing thousand points swings every day or every other day, big percentage point moves every other day.

Once things kind of calm down, then I think it would be a better idea to consider investing at that point. There's kind of multiple layers to both of those questions there. The last thing that I wanted to talk about was actually something that I wasn't planning on bringing up during this episode because I just listened to it today before I was going to come record. It was a conference call with Carl Richards and Jerry Colonna. I wanted to share some takeaways. They're things that all humans can consider during this time and I'll try and tie it into the lens of financial planning and personal finance because that's the point of the show.

So a little bit of background. Carl Richards, he's an author. He's a certified financial planner as well, but he's written books, The One-Page Financial Plan and The Behavior Gap. I would recommend everyone out there read both of those books. He appears weekly in The New York Times since 2010. Jerry Colonna is the founder and CEO of Reboot.io. He's a certified professional coach now. He's had a long career doing a number of different things, but he helps CEOs design a more conscious life and helps people make changes in their careers to improve their performance and overall satisfaction.

So they talked about not necessarily things, like five things to know about the market or how to react to it. They were just having a more human to human conversation about what's going on, how can we get through this? How can we be okay? And it really hit home for me. So I wanted to pass along some of the things to you guys as well. One of the questions that was asked, and they talked about it for a little bit, was what is the point of a plan? What's the point of having a plan in times like this? Is that plan broken?

The answer is no. They went on to say that the point of having a plan, it serves as a mechanism to keep an individual calm and provide a sense of direction when things get off track like they are now. So the only thing that we know for sure about a plan is that that plan is going to be wrong, but having a plan itself is calming and reassuring that you know it's there and it points you back in the right direction when things get off track. Admitting that you have to change your plan is not a failure. That goes for life and that goes for your financial plan. That goes for any other type of plan that you might have. Changing that plan doesn't mean you failed. It's okay to change your plan and it's going to happen.

It might be happening right now for you and it'll probably happen again in the future. It doesn't mean that you failed or that you did something wrong. Like I said before, we can't predict with any certainty what will happen in the future. So changing and being able to adapt to your circumstances is just part of life. This goes directly, I think, to advisors and financial planners, but it really does apply to almost any... Pretty much every relationship that you'll have in life. Trying to deliver 100% certainty really destroys any amount of trust between you and the other person. Since we all know that no one can predict the future with absolute certainty, trying to project 100% certainty that you know what's going to happen in the future just communicates to the other person that they can't trust what you're telling them because at the base level, they know you can't predict the future. I can't predict the future, so he's being dishonest with me. How can I trust what he's saying right now?

That goes especially for financial planners, but that just goes the same thing between a parent and a child, a brother and a sister, between you and a significant other. It really works for any relationship. So kind of piggybacking off that, it's okay to say that you're unsure and nervous about what's going on. That's what we're all feeling. We're all going through this together and it's okay to communicate that, but there's a difference that they noted between being honest about what you're feeling and projecting our anxieties onto others. It's the difference between acknowledging your fears and outright panicking. It's comforting in a sense to hear someone say, "Yeah, it's scary what's going on right now. I feel it. I know you feel it, but here's what we know. Here's what we can do. Where can we go from here? Let's acknowledge that everything is uncomfortable right now and that things are uncertain, but what can we control and how can we be stronger getting through this?"

So Carl brought up at one point, he said, "It's always true, but especially right now it's more important to focus on what we know than what we don't know and I think that that's so true because what we don't know right now is changing literally by the minute." And trying to focus on everything that's changing around you and the things that you don't know, it's a super easy way to become very overwhelmed and paralyzed by your thoughts. The thing to do right now working off of that is to ask yourself, what do you know? And if you're working with a financial professional in that sense in that relationship, pairing what you know with what they know makes everything stronger and you guys can work together from there.

Morgan Housel actually wrote a post about this topic this morning. It was titled Two Things We Know With High Confidence, I'll link to it in the show notes, but the two things that Morgan says we know with high confidence right now or that he knows is number one, necessity is the mother of invention. So our willingness to solve problems is about to surge. I'll say that again. Necessity is the mother of invention, so our willingness to solve problems is about to surge. And he looked back on a number of different times in history when things got extremely difficult and it looked like the world was ending around us and things... Everyone went through some great significant pain both physically, emotionally and financially. He looked back to The Great Depression. He looked back to World War II. Both of those two times were extremely difficult for the world, but it also led to some of the most incredible inventions and innovation that we've seen in human history.

I'll link to it in the show notes, but he lists off the amount of things that were created during those tough times. The second thing that he wrote about that he knows with high confidence is that worry will exceed actual harm, which is both tragic and in a way comforting. More people are going to worry about getting seriously ill and dying than will actually get very ill and die. And like he said, that's both tragic and comforting in a way that we all have to go through that, but it's comforting to know more people will worry about it than actually have it happen to them.

There were a couple more points from Jerry in their conversation that I wanted to touch on really quick. The first being, don't isolate yourself by thinking that you're the only one going through this and that you need to have it all figured out. Like I've said before, we're all going through this together. You're not the only one and you don't have to have it all figured out. He also made a note to try and remain as productive as possible. If you're quarantined or stuck at home, working from home, there are a lot of things that you can be doing to keep yourself busy and it's important to remain productive.

The last point that Jerry made was about the fact that we all get to be human together, so for God's sake, take care of each other. We're all human. We're all experiencing this together. Everybody needs help in some way, shape, or form. So we need to be empathetic. We need to be helpful, but don't be afraid to ask for help. We're going to get through this and we're going to be stronger for it afterwards, but that doesn't mean that you're not allowed to be vulnerable. It doesn't mean that you're not allowed to ask for help.

Like I just said, you're not the only one going through this. Everyone is. So we just need to band together and help each other as much as we can. So if you guys have any questions about your finances or anything else really in general or getting through this time, please don't hesitate to reach out. I don't always bridge the gap between living with money and the content that we put out for Mullooly Asset Management, but last week, Brendan and Tom did one of my favorite podcasts for the Mullooly Asset Podcast. They answered some questions about, what would you say to worried investors during this tough time in the market? So I'm going to finish this episode with a quick clip of what they talked about.

Tom: Okay. Brendan, let's begin. What do you say to the person who's got in the market and they're worried?

Brendan: I think that it's totally normal to be worried. I don't see how you could watch what's going on in the market these days and not be worried or nervous to some extent, scared. I think those are all normal reactions, but I also know that when we're putting together investments for clients, any money that is needed or even could be needed, possibly be needed over the next one to three years is not at risk in the market. It's in stuff like bonds, it's in cash. It's there and ready for them because those are the type of investments that will hold their value right now while the stock part of the portfolio does the scary stuff, but we also know that if we give the stock part of the portfolio three plus years, the odds of us being in pretty decent shape are good, but they're good if you hang tight.

If you freak out and do something rash in the heat of the moment like this, you don't earn the average long-term returns from stocks that we all hear about.

Tom: Why? Why is that?

Brendan: Because if you sell now, you're taking unrealized losses that aren't locked in yet, making them permanent. And then also putting the weight on yourself of having to decide later when it makes sense to get back in. I got to tell you, it's not going to feel any better when the market does find the bottom because we don't know when the bottom is. We can only see it in hindsight and the news is never all rosy. We're not going to wake up one morning and just be like, "Oh guess what? We're 20% higher in a day."

It's a process and it's not going to feel like it's getting better. And then before you know it, it is. And you probably missed out on a bunch of the recovery. So I get it. It would probably feel great to dump some investments during a week like this and just put the money in something safer, but if that money has a horizon longer than a year or two, you're actually putting it in something more risky because you're putting it in cash and that's risking the future dollars that you need to spend down the road. Five, 10, 15 years from now, they won't be growing anymore.

Tom: But Brendan, what if somebody were to say, "Well look, things are really volatile right now. I think I'm just going to sit this out. And then when it looks like the market's getting better, yeah, I'm not going to get the exact bottom, but I'll get back in." Why isn't that a game plan?

Brendan: Because I don't think they will get back in.

Tom: I think that's a big part that never gets discussed in any of the financial media is that if you're at the point where you feel like you need to rip up the script right now so that you'll feel better about being out of the way of a tornado, just explain to me how a few weeks from now or a few months from now you're going to feel differently that, yeah, now I feel better and it's okay to get back in. I don't see that happening.

Brendan: Right. And nobody in the history of investing has shown a reliable ability to get out and in of stocks into stocks on a consistent basis. Some people might guess and get it right a couple of times. Nobody can reliably do this time after time and all you're doing then if you're getting in and out is probably costing yourself some of a recovery in between where you had to sit out until your feelings got you back into the market.

Tom: So we've had a couple of quotes. In fact, I just wrote this morning about Ben Graham and some of the things that he's said. One of the things that he said and I actually put it in the blog post was that as an investor you need to become accustomed to the idea that your investment is going to fall by 33% or more at least once every five years.

Brendan: I think it's important to consider though that for most people that means the stock portion of their portfolio and I think something that's important right now for people who are nervous or who are scared is to try as best we can to remember the feelings now when stuff is really going poorly so that when we do see stocks recover and portfolio balances get back towards where they were before all of this, you can make some adjustments if you decide, "Hey, I was able to ride that out, but man, that really made me sick. That was a little too much for me." And you can put that into the context of your financial plan. What are you going to need from your portfolio? And maybe now after going through something like this, you have a better idea of what you can stand in your portfolio.

I wouldn't let it scare you too far in the other direction, but at the same time, I do think that these kinds of markets teach people what their real risk tolerance is and we try as best we can to simulate that and to have discussions with clients about it, but there's no substitute for experience. And if you've experienced something that just was unbearable to you, I would say that if you can resist the urge, now is not the time to be making these course corrections, but when we do arrive at a better time to do so, to try to remember these feelings because these are real lessons and sometimes it's really hard to remember how you felt in the moment. I think you can learn a lot from this about how much risk you're taking and what you're truly comfortable with.

Tom: Charlie Munger also had a similar kind of quote, I think he was kicking around the number of 50% draw downs.

Brendan: Right? He talks about this all the time, as does Buffett who are both some of the biggest names who will tell you what I said before, that nobody can reliably jump in and out of stocks over time. Anyone who says they can is full of crap and he said that you need to be all right with your holdings getting cut in half. And that he and Warren buffet have seen this in their own portfolios multiple times over the course of their investment history as partners. And that's kind of the price of admission is more or less the gist of what he has to say in that topic. And I think everybody nods their head and says, "That sounds great." When they're just reading quotes like that.

But then when it's happening in real time, they're like, "Oh no-"

Tom: Like, "I can't handle this."

Brendan: "This is what it meant? Like, "Oh, I thought it meant something else." We're not even close to those kind of levels yet of what Munger's talking about, but I think these percentages that we're talking about here and the regularity at which they occur, it's important to stress that that's for the stock side of your portfolio.

Tom: So let's-

Brendan: So you can't handle your entire portfolio going down 50%, then you shouldn't be 100% in stocks.

Tim Mullooly: All right. I hope you guys enjoyed that last clip from the Mullooly Asset Podcast. I'll link in the show notes if you want to go listen to the entire thing, but thanks for tuning into this episode of Living With Money. Hang in there and we'll see you next week.