KEEN ON
RETIREMENT

Cut the Jargon: Here's What Some Popular Financial Terms Really Mean

Welcome to Keen on Retirement
With Bill Keen and Steve Sanduski

Steve Sanduski: Hello and welcome back to Keen On Retirement. This is the podcast where we help you thrive before and during your retirement years. I'm your co-host, Steven Sanduski, and we are here today with Bill Keen and Matt Wilson. Hey guys, how are things today?

Bill Keen: We're doing well here at Kansas City, Steve. I hope you're doing well up in your neck of the woods.

Steve Sanduski: Doing just awesome up here. Today we are going to try and demystify some of the acronyms that are frequently thrown around in our industry. Sometimes we tend to make things a little more complicated than they necessarily are. Today we're going to look at some of these acronyms and terms that are often thrown around in the financial industry, and make some sense of them, Bill.

Bill Keen: We've come up with quite a few terms today. There's many, many others, but we've come up with some that appear quite often in our firm, in our practice in the day-to-day operations. I think it'll be a fun episode today as we walk through some of these, Steve.

Steve Sanduski: Yeah, well, should I start you off with a tough one?

Bill Keen: You know, I'd say typically we like to start on a winning streak, but if you have faith in us, and I've also got ... with Matt here on the line with me, I've got some back up and some confidence here.

Steve Sanduski: Okay, well let me start with one that I know you have the answer to, CFP.

Bill Keen: All right, well I know that that stands for Certified Financial Planner, and that is one designation and credential that Matt holds. Matt, would you like to explain a little bit about what you had to go through to get that credential, and what that means?

Matt Wilson: Yeah, it was a rigorous process. There was about a year-long course that I took through the University of Missouri Kansas City here locally, and sat through classes on that, both in person and online. Then studied for a test. Passed the test, became a Certified Financial Planner. There's minimum requirements too. You have to have at least three years experience in the financial services industry to be able to sit for the test and use the designation.

I have it here, among many of the other advisors that we employ at Keen Wealth. Certified Financial Planner is definitely crucial to our organization.

Bill Keen: It sure is. We always say there's two pieces to this, successful financial planning endeavor, and that's having an up-to-date and quality financial plan in place, and then complimented by the engine to the plan, which is actually the investments. Having experts on staff that understand all the dynamics to a financial planning, for us, is a must. Good one to start off with, Steve.

Steve Sanduski: All right. Now we're going to ratchet it up here a little bit.

Matt Wilson: Uh oh.

Steve Sanduski: What is Monte Carlo Simulation?

Matt Wilson: Monte Carlo Simulation, okay. I don't think you're asking us about the roulette game over at the casino, are you?

Steve Sanduski: I am not, but there is some connection a little bit there.

Matt Wilson: There are. Monte Carlo Simulation, we use those in our financial planning process. It's used to model the probability of different outcomes in a process that cannot be easily predicted through the intervention of random variables. That is the true definition of a Monte Carlo Simulation.

Steve Sanduski: Now, Matt can you say that backwards?

Bill Keen: Well, the reason that we use simulation statistical modeling is because we want to come up with reasonable, rational probabilities of success for things that will happen out into the future. That helps us back up into the moment, and the day, and make educated decisions about what we're going to do on the ground, in the trenches, in each of our client's financial plans.

Historically even the folks that have done some financial planning have used what we call Straight Line Interest on their Excel spreadsheets, which says, "You're going to get a certain rate of return each year." We just know that returns don't come in a straight line. Looking at multiple simulations, up to a thousand simulations of a certain data set, and projecting that out, and coming up with some ranges of probabilities, give us a more educated look at what might happen going forward.

It's a very, very powerful tool.

Steve Sanduski: Guys, I'm a bit of a student of history, and there's an interesting history behind Monte Carlo Simulation. It was actually invented by scientists working on the atomic bomb back in the 1940s. The people who were working on it, they named it for the city in Monaco, Matt, you mentioned that, which of course is famed for its casinos and games of chance.

What was happening with those scientists was they were working on these, obviously these physics problems as they were trying to invent this atomic bomb. The models that they had, they had to model things like neutron diffusion that were just too complex for analytical solutions that were available at the time, so they had to come up with something different, and they came up with Monte Carlo Simulation, which was very effective at finding solutions to these problems.

I guess that old saying that necessity is the mother of invention was true when it comes to Monte Carlo Simulation.

Matt Wilson: It is. It reminds me of another acronym, GIGO, G-I-G-O. I learned this is Stack Class in college.

Bill Keen: Is that Geico? Is that the insurance company you're talking about?

Matt Wilson: Well, there's another one there. GIGO stands for Garbage In, Garbage Out. If we're putting garbage into our simulations, we're going to have garbage on the outcome, so we want to make sure we're not putting garbage in, but we're being realistic and coming up with those probabilities as Bill mentioned.

Steve Sanduski: All right.

Bill Keen: That's right.

Steve Sanduski: Well guys, here's another one for you, DCA.

Bill Keen: Dollar, Cost, Averaging.

Steve Sanduski: Bingo.

Bill Keen: "Dollar, Cost, Averaging," what does that mean if you just try to think that through? Let me explain. If you're putting in a fixed amount of money over any time period. It can be a dollar amount or a percentage, when prices are higher, you will buy less shares, and when prices are lower, you will buy more shares.

Matt Wilson: Yeah, it's great because what it does is it takes ... This is essentially what anyone's doing when they're contributing to their 401K on a pay period basis. You take the decision making out of it, so you put it on an automatic and systematic process. Then it takes all the emotion out of it. It just happens for you automatically.

Bill Keen: That's right.

Steve Sanduski: All right, well maybe along those lines, how about rebalancing?

Bill Keen: Well you kind of teed that one up, in the right order there.

If you had two things that you put 50% of your investment in, and one of those things went up, and the other one went down, and you had to ... your goal was to rebalance those things, you would be having to sell a little bit of what went up and move it over into the thing that went down, which would now bring those two investments back into balance.

Rebalancing says you set up a portfolio with a certain allocation that you've thought through, and the risk tolerance and parameter is in line with the specific portfolio and this client situation, and you say that when they get out of balance to some extent, then you simply pull those back into balance by doing what I just described.

Now, a portfolio, I think we looked at yesterday, is it 20 asset classes that we operate in our portfolios, Matt, here at Keen Wealth? Is it 20?

Matt Wilson: That's correct, 20 asset classes.

Bill Keen: Yeah, so some people say stocks and bonds. Those are two asset classes. Well, there's a lot of different variations of stocks and bonds, and other asset classes as well. The concept is, it's not just as simple as just two asset classes being rebalanced, it actually can be many, many asset classes, thought through, identified, allocated, and then as things happen, you harness the cycles, the cyclicality of the markets, because we do know one thing. Everything is cyclical.

By rebalancing, you're harnessing those cycles instead of being whipsawed by them emotionally or otherwise. Rebalancing is a key thing if it's employed properly.

Matt Wilson: I think to summarize, basically it's buy low, sell high? That's what rebalancing is, right?

Bill Keen: That's an interesting concept, yes. Actually it is though. That is correct.

Matt Wilson: That's what it is.

Bill Keen: Again, easier said than done though. There's a lot of other factors out there, so a lot of this, people hire professionals to help them take the emotion out of the investment process. Some of these things are very, very impactful, easy to talk about, hard to do for most individuals.

Steve Sanduski: All right. Well, since we were on an R there, let's do another R. How about RMD?

Bill Keen: Well, Matt talks about these a lot when we're doing our end of year meetings with everybody. Matt?

Matt Wilson: Yeah. RMD, I use this term a lot, and I get a lot of what does that mean? RMD, and this comes up as many of our clients approach age 70 and a half. It's a rule that requires a distribution from an Individual Retirement Account. RMD stands for Required Minimum Distribution. It's a formula based on a table that the IRS publishes, and there's a couple of them based on the age of your beneficiary.

It determines how much do you have to distribute from your Individual Retirement Account on a calendar year basis? It is a fixed dollar amount because it's based on the closing value of the previous year, and so we know what the amount is every year, but it is something that we have to be very conscious of because if you fail to take your Required Minimum Distribution, the penalty is 50% of what you were supposed to have taken out. The IRS is very serious about making sure you take your RMD each year.

Bill Keen: Just to make that a little bit more confusing. I've seen that listed, Matt, as a MRD in several financial firms research and statements, which is simply Minimum Required Distribution. Why the flip flop the letters, I'm not sure, but anyway, same thing.

Matt Wilson: Mm-hmm (affirmative).

Steve Sanduski: We do that. We do that purposely because we're trying to confuse consumers, right?

Bill Keen: Well, it makes you think.

Matt Wilson: Yeah, I think the IRS is trying to make sure you get that 50% penalty put into them.

Steve Sanduski: Yeah.

Bill Keen: Yes. Yes.

Steve Sanduski: All right. How about ARM, A-R-M?

Bill Keen: Now, is this have anything to do with leg?

Steve Sanduski: I'm not talking about the appendage that we all have.

Matt Wilson: Okay.

Bill Keen: Okay, well I think what he's referring to, Matt, is the Adjustable Rate Mortgage. We always like to talk to folks about having debt as they go into retirement. We talked on our last episode just about the responsible use of debt, and trying to avoid having money on credit cards for kids, grandkids, and for everybody.

I think everybody typically has a mortgage at some point in their life as they try to start to build equity in a home. The thing that we always caution people is to make sure that that mortgage, unless you really understand what you're getting into, doesn't have the letters A-R-M in it somewhere.

That means Adjustable Rate Mortgage, again. That means that your mortgage is more than likely tied to some sort of base interest rate. Either the prime rating in the US, or LIBOR. There's a couple of other acronyms that we could explain as well. LIBOR, the London Interbank Rate. Right, Matt?

Matt Wilson: That's right. London Interbank Offered Rate.

Bill Keen: Okay, so there's another acronym that they might tie your ARM to. We see why people get vastly confused here, but we want to make sure that we are able to reduce the things that might come up and bite us, so if we're working, and we understand what an ARM means, it means that hey your interest rate could go up as rates rise.

In retirement, one thing we talk about too is carrying a mortgage in retirement isn't all bad. It could be okay as long as that mortgage be fixed. We know that's not a variable that we have to look for surprises. We always say, "Eliminate surprises in retirement." Try to avoid Adjustable Rate Mortgages, if at all possible.

In this interest rate environment as well, we believe that if you have an Adjustable Rate Mortgage, it's probably going to be going higher here pretty soon.

Matt Wilson: Yeah, and the reason someone might say, "Well, why would anyone ever choose an Adjustable Rate Mortgage?" They generally or typically have lower rates charged than a 15-year fixed or a 30 year fixed mortgage. That's why people sometime get enticed into those loans because the rates are lower.

Bill Keen: I know I had one at one point because I knew I was going to be refinancing anyway for a specific reason on a property, and that particular one had a five year ARM, which means it was fixed for the first five years, so I was able to lock in quite a bit lower rate by having a five year ARM, and I knew I was going to be out of it anyway before the five years was up, so there are reasons to use those, but we've just got to be educated going in on the front end so it's not a surprise, takes us off track later on.

Steve Sanduski: Okay, well guys, I've got a couple here that are related, so I'm going to give you both of them, and you can work in the definition of the two together. The first one is EPS, and the second one is PE. What are those, and how are they related?

Matt Wilson: PE stand for Physical Education.

Steve Sanduski: You're so right.

Bill Keen: Well that does go into staying active and thriving in retirement, right? We want to be active. Is that what you're talking about, Steve, or is that wrong?

Steve Sanduski: I don't think that's quite what we were thinking here on today's show.

Matt Wilson: Yeah. EPS stands for Earnings Per Share, and this is a widely-followed acronym, in the investing world is because we look at companies, and we take the earnings that the company makes, and we divide it by the number of shares outstanding to determine what's the Earnings Per Share for that company.

Bill Keen: You've heard me talk about, both of you and all our listeners, over the course of long periods of time, the stock market, the valuations over time have always traded back to the underlying earnings of the company.

All the crazy speculation we see of the day in the news, and the headlines, the markets have always traded back to their underlying earnings. This is an important metric to just be conscious of. What are companies making per share that they have outstanding? That rolls right into the Price to Earnings Ratio.

"What's the PE ratio, and what does that mean?" Well, it's the price of a security on the top, and the denominator would be this Earnings Per Share that we just talked about. The price divided by the Earnings Per Share. Let me give you an example, a simple example.

If you had made an investment of one dollar. Your P, your numerator, is a dollar. That was for one share. In the very first year, your earnings on that dollar were a dollar. Your denominator is now a dollar. You invested a dollar, and within one year you made a dollar. Your Price to Earnings Ratio would be one. That would be a pretty good investment. You got your money back essentially in the first year, and you still own the investment.

The way we look at this is the lower, typically, the PE Ratio, the better. If you had to pay $10 for one dollar of earnings next year, now you have a 10 PE. If you had to pay $100 for a dollar of earnings, now you have 100 PE. Back in the dot com bubble, people were paying large amounts for the price, and the companies had no earnings, so how do you do that calculation? There is no PE Ratio at that point.

Understanding these metrics at least gives folks a bit of understanding, a little bit about what we're looking at in some of these financial metrics that frankly most of the people we work with, Matt, they're expecting us to be paying attention to these things aren't they? That's the reason they have us is because they don't want to have to pay attention to most of these issues, but it's still good to have a baseline understanding of what they are.

Matt Wilson: That's right. We do like to help people understand these concepts, but many times people tell us, "Hey, that's what I have you guys for."

Steve Sanduski: Good.

Bill Keen: That's right.

Steve Sanduski: All right. Well, here's another one. RIA.

Bill Keen: Registered Investment Advisor is what RIA stands for.

A lot of people get that term confused with IRA. We take the same letters, and we mix them up, and we come up with something that means something totally different. An IRA account is an Individual Retirement Account. Completely different from RIA, but that is simply the accounts that folks open to save for retirement. Those came on the scene a number of years ago, decades ago, to allow people to put money in accounts that had some sort of tax preference going forward.

One thing I might mention there too is in the IRA accounts, those are called Individual Retirement Accounts, so they're always titled in the name of the person that owns that asset. If there's a husband and wife, typically, not always, but typically the spouse is the beneficiary of that account.

Steve Sanduski: All right. We've got a handful more here if you guys are up for it. How about, I'm going to give you three here together because these are also so much similar. 403B, 401K, and 457. Lots of numbers here.

Matt Wilson: Yeah, lots of numbers on that one

Steve Sanduski: It sounds like maybe we've thrown some of these things into the Monte Carlo Simulator and come up with new things here.

Matt Wilson: Yeah.

Bill Keen: They're not just randomized. They might seem like it.

Matt Wilson: A 401K is a retirement savings plan that's established by an employer. You're able to make pre-tax and after-tax contributions into that. Then with the advent of the Roth IRA, there's also been a Roth 401K added to the mix here. A 403B and the 457 are both available to public schools, colleges, universities, charities, state governments, local governments, and other tax exempt entities. Those organizations have the ability to open up a 403B or a 457.

Steve Sanduski: All right. Well, guys, I've got a couple more here, but I'm just going to throw it open here. Do you have any other terms off the top of your head that you want to go through?

Bill Keen: Well, since we just were talking about the random nature of all these acronyms, and the concept that it looks like Wall Street, in a good portion of the cases, was designed to confuse the consumer as opposed to provide clarity and transparency. I've got BS as one of my acronyms, Steve.

Steve Sanduski: Okay, well I have an idea what that might be, but I don't think it's what you have in mind.

Matt Wilson: Is this going to be an explicit episode today?

Bill Keen: Oh my goodness gracious. I see where you guys' minds are. Absolutely not. One of the things we're most interested in when we sit down with clients is their Belief Systems. We want to make sure that we understand their innate Belief Systems.

We ask a lot about family history, family tree. What was it like growing up for you? Did you have any bad experiences with financial people? Did you have anything happen in your life that you can say was a turning point for anything good or bad with respect to how you handled your financial affairs?

For us, Belief Systems are a big deal to understand when we're about to advise our clients.

Steve Sanduski: Bill, I want to go a little deeper with that. Tell me from a practical standpoint, you ask some questions, you get their Belief System, you get some of their history, some of their experiences, then how do you take what you hear, and how does that apply to a portfolio that you develop, or how you might work with them in the following years to make sure that they're sticking to the plan?

Bill Keen: The first thing that comes to mind when you ask that question, is finding out from folks how they've responded in prior market corrections.

Going back to the 2001, 2002, we had the largest attack on our nation at that point. The market was in free fall.

How did you react and respond during that period of time? Most of the clients that we do work with were invested to some extent back then. A lot of good portion of them were working. We had some people that were retired back then already, but did you, at some point, sell out all your investments and go to cash? Were you afraid and feeling like that was the best thing you could do for yourself to, in essence, preserve what you had left at that point, if you will?

Or, did you perceive that as normal, cyclical, volatility and comparing that to what happened in '73, '74, or going back to some of the other corrections that have occurred over a lifetime or lifetimes, and did you stay the course, and did you add more to your 401K and look at that as an opportunity?

How people responded to those events, even though that's 17 years ago, or 15 years ago, or as recently as the '08, '09. How did you respond to that when the news was telling you the world was coming to an end, banks were failing, it did not look good out there> Everybody had used their homes as ATM machines.

There was mortgage fraud that was occurring, and it was a scary time. Did you sell out your investments at that point, or did you look at that as an opportunity or at least something not to run from? Is your mind, is your Belief System telling you that I'm going to be okay waiting this out as long as I don't need any of this money in the next few years?

What someone has done in the past has a large part to do with how we recommend they invest going forward. We do not want to set somebody up for failure.

Can you think of any other examples about Belief Systems, Matt? I mean there's other ones around having debt in retirement, when to take Social Security, those kinds of things.

Matt Wilson: That's right. Those were the two that just popped into my head as you mentioned this was debt. There's some that want to carry the longest, biggest mortgage they can into retirement. As we mentioned, as long as it's a fixed rate mortgage, and we can control it and account for it within the retirement plan, hey, we're all for it, and the rates are reasonable.

Then others don't want to have any debt. If they're heading into retirement, and they want to pay off their mortgage, well one, what are the tax ramifications. It may not break the plan, but it might cost you a lot of taxes, so let's just be aware of what that's going to do.

Then others who don't have any debt, and don't believe in any debt, we're not going to recommend that they go take on some debt in retirement because we know that's going to fly against their Belief System. We're going to be aware of that. When it comes to Social Security as well, very similar concepts with hey, what do we feel? We ask people all the time, "What are your thoughts and beliefs on Social Security, and the future of the trust funds, and how well do you think Congress is going to make sure this is there for you?"

We want to be aware of that too because we can show them a financial plan that mathematically says, "Yes, you'd be better off waiting," but if they're going to struggle with that concept, then we're going to maybe shift some of our recommendations, just in light of what that means for the plan. We're not going to recommend a plan that doesn't work, but we're going to take that Belief System into context when we make our recommendations.

Bill Keen: For sure, and you know clients come to us for us to advise them what we think they should do. That's why they come to see us. They wanted to delegate some of these decisions, and they respect our opinion and our experience. It's interesting when we ask folks, "What do you think about the Social Security plan?"

We sat down with someone recently and instantly they said, "We're going to wait until 70. We've looked at the numbers. We're going to wait until 70. We're in good health. We believe we're going to have long life, although nothing's guaranteed," and they got that, but they said, "In our minds, we're going to maximize it, and that's our plan."

Then we've had other people say, "We're spooked by this whole system right now. We don't think the funds, trust funds, are going to be there. We're going to take it as soon as we can." Neither of those will determine what we tell the client we think is the best option for them because they're hiring us and coming to see us for us to give them advice. Knowing what they believe about it helps us in communicating with them.

There's not necessarily a right or wrong answer on Social Security, right, Matt? You don't know until you've passed away, how long you lived, which was the right answer. I think helping people make educated decisions and getting aware of the numbers, the breakeven points, where we stand, what the variables are, and making educated decisions.

That's the mantra around Keen Wealth.

Steve Sanduski: Well guys. I think you have single-handedly cleared up all the fog that has existed since the beginning of time in the financial industry with today's show. Thank you.

Bill Keen: Well, Steve, you're so kind. You told me to look at some financial acronyms here, and I'm seeing another 1,700 of them that we could cover.

Steve Sanduski: We'll save that for the next 100 episodes, how's that?

Bill Keen: All right. All right.

Steve Sanduski: Yeah, I think we'll exhaust our listener's patience long before we get through that list.

Bill Keen: Okay. All right. That's fair.

Steve Sanduski: Well, hey guys, let's wrap it up for today. Any final thoughts from either one of you guys?

Bill Keen: Steve, we always have a fun time doing our episodes. I think we're up to somewhere in the mid-40s now that are out there online for our listeners to go back and look at. A lot of these topics, they're timely, based on what was happening around the time that they were recorded. We've been doing these since 2015 now, but a lot of them are wisdom that could be repeated and listened to over and again.

We have a fun time with this, but it is a very serious topic, and we're committed to putting the resources and the time into, I consider it, making an investment back into our clients, and making an investment back into our friends of Keen Wealth to try to be a resource for people, and share the information that we are every day going over any way in the firm.

We've gotten some wonderful feedback. We now have many, many financial advisors across the country, reaching out to me, letting me know that they're listening to our podcast. We're sharing information, comparing notes, and it's just been really very positive thing for us here at Keen Wealth. You're a big part of that, Steve. We're grateful to have you as a part of our program, and look forward to many, many more episodes to come down the road, sir.

Steve Sanduski: Sounds great. Bill, Matt, as always, a pleasure. Thank you, and we'll look forward to the next episode.

Bill Keen: All right. You've got it.

Matt Wilson: All right. Thanks, Steve.