Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Ed Butowsky

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Retirement Lifestyle Advocates
961 Four Mile Road, NW
Grand Rapids, MI 49544

Phone: (866) 921-3613
Email: info@plplanners.com
Website: www.RetirementLifestyleAdvocates.com

Dennis Tubbergen:

Welcome back to RLA Radio, I'm your host, Dennis Tubbergen. Joining me on today's program is first-time guest, Mr. Ed Butowsky. Ed is the developer of the Chapwood Index and we have certainly referenced that index here on the program in the past. He is the managing partner at Chapwood Investments and he is the author of Wealth Mismanagement. You can learn more about his work at chapwoodindex.com. And Ed, welcome to the program, very much a pleasure to talk with you and have you on.

Ed Butowsky:

Well, thank you very much.

Dennis Tubbergen:

So Ed, let's just start, explain if you would, what was your motivation in developing the Chapwood Index?

Ed Butowsky:

Yes and I developed it mainly as a result of a conversation I had with my mother. When I got into the investment management business, I didn't know anything about COLA, the Cost Of Living Adjustment. And my mother, when I sat down with her before she passed away, she had revealed to me that my father didn't set up her alimony for COLA. And I sat there and literally was dumbed down because I thought she drank Tab and I didn't know what she meant by COLA. And after she passed away, I started looking into it and realized that this was a major issue that is misinterpreted or misquoted. And it started back in 1983, and 84 when they started to change the way they calculated the CPI. So the cost of living adjustment that the government makes for checks that go out and transfer payments from the government, also has a negative implication to those that are in the private sector whose salary increases are tied to the CPI.

Ed Butowsky:

And so I decided when I met John Williams, who you mentioned you had on the show before. I talked to him once and I said, "Why aren't you breaking this down city by city?" Because every city has a different cost of living increase and it's not the cost of living that's the issue, because everybody knows what the cost of living is, it's the increase that kills people. So when you start looking at these checks that are written for or increases in salaries from the people who are middle-income and lower-income, they get salary increases based on a thumbs up or thumbs down from somebody above them, who decides that they're going to get an increase of 5% or 3% and they usually tie it to the CPI. Well, right now the CPI is almost non-existent, it's almost... What is it? 1% right now?

Dennis Tubbergen:

Yeah, 1.3%, I think is the cost of living adjustment for social security recipients for 2021.

Ed Butowsky:

And, so think about that, that do you really believe your cost of living is only going up by 1.3%? And it's not, it's not at all. So I spoke to John about doing it on a city by city basis and he decided that he had too much work and which he does. He does a lot of good work and focuses on things other than the CPI. Well, not focuses but does things other than the CPI adjustment. So I set out to create a pool of people through Facebook who every twice a year, they go out and get prices for me and we calculate the price increase and I have people in every major city that does this for me.

Dennis Tubbergen:

So let's just... I've got so many questions for you Ed, but let's just take a look at what kind of items are you measuring? So when you've got all your, I'll call them the army of people you have all across the country, when they go out and check prices, what items are they price-checking?

Ed Butowsky:

Well, just about everything. Anything that we use on a day-to-day basis is what they look at. So you're looking at soap, you're looking at toothpaste, you're looking at food, your Starbucks, movie tickets, hairspray, oil changes, car washes, things that you use on a day-to-day basis.

Dennis Tubbergen:

So Ed, when you compare the rate of inflation using the Chapwood Index which by the way, seems like a common sense way to calculate inflation. What did this stuff cost a year ago? What does it cost today? What's the percentage increase? That's the real inflation rate. So when you compare the inflation rate that you are seeing on a rough average versus the 1.3% that the Consumer Price Index calculates the inflation rate to be, what kind of difference are you seeing?

Ed Butowsky:

Well, it depends on the city, but the cities in California are about 13% a year over year because that's when you include your electric bill and your food costs and oil and all of the things that are included, you get to about 13% a year, which is 12% higher than the CPI.

Dennis Tubbergen:

Just out of curiosity, what part of the country? I guess I would guess the Midwest probably is going to be a little more tame, but what is the best city to live in the country as far as measuring the inflation rate?

Ed Butowsky:

Taos, New Mexico.

Dennis Tubbergen:

So when you go back and take a look, you mentioned Ed in the early to mid 80s, 83, 84 that initially changes were made to make the reported inflation rate look more favorable and obviously as you indicated, many government benefits and payouts are tied to the inflation rate, so there's obviously a vested interest from a cost saving standpoint to make the inflation rate look more favorable. What are some of the key changes that have been made to how the inflation rate or how the CPI is calculated?

Ed Butowsky:

Well, there's three main methods that they adjusted and one of them is taking the product itself and saying that you could have steak but instead of having steak, you'll have a burger. And instead, that's one of the main things that they do, but they also take things out of the basket. There used to be 1,700 items that they calculated every single month and then they changed the way that basket of items was calculated coming into 1983, they made a major change from those 1,700 items. So this way they could make that number lower, so they didn't have to pay out as much money in cost of living increases.

Dennis Tubbergen:

So when you take a look at what the real impact is, let's take a look at someone in California where the real inflation rate is 12% higher than the reported inflation rate-

Ed Butowsky:

That's right.

Dennis Tubbergen:

... that means every six or seven years, their cost of living actually is going to double. That makes it really, really difficult to plan for retirement given that you've got maybe 30 years of retirement, depending on when you retire. So, how does someone actually protect themselves from that or maybe even deal with it in your view? What kind of advice do you give people?

Ed Butowsky:

Well, I'll tell you, it's a really difficult thing because the real conversation is you can't retire. Most people cannot afford to retire and that's why so many people leave the state because I coined a term called taxflation, a number of years ago in an article and taxes are the main culprit, because when a city increases taxes, it trickles down to the end user. And ultimately it trickles down to the people of California and in San Francisco when they increased a tax there, it ultimately is paid for by the citizens of San Francisco.

Ed Butowsky:

And so tell me... You can't tell me that they're not increasing taxes in San Francisco and San Jose and Oakland to pay for all of their programs that they have for the residents. So it has a tremendous ripple effect and these are people who pay their taxes, who can do exactly what they're supposed to do. And their increases are so small that every year they're falling further and further behind. So they might get an increase of, let's say 3% when their real cost of living goes up, let's say 12. Well, over a five-year period, they've lost 45% purchasing power.

Dennis Tubbergen:

Well, if you're just joining us, we're chatting today with Mr. Ed Butowsky. Ed is the author of Wealth Mismanagement. He is the developer of the Chapwood Index and the managing partner at Chapwood Investments. You can learn more about his work at chapwoodindex.com, I'd encourage you to check it out. Ed, when you look at just inflation itself, the Federal Reserve policy now in 2020, more money has been created, I think the fiat money supply has increased by 65% according to Alasdair Mcleod who was on the program last week. When you take a look at all this money printing, that in and of itself is a tax on savers and investors, would you agree?

Ed Butowsky:

Absolutely. It depreciates the value of the dollar and about 60% of what we use in this country comes from outside the US. So when you look at the actual things that you purchase, clothing and autos are probably not as good and idea of that but a lot of food comes from outside the United States. So the value of the dollar depreciating, you have to hope that whatever countries we're buying from, their dollar is depreciating as well or their currency is to match it. But it's definitely a tax on everybody when the cost of the dollar goes down because of the printing of money.

Dennis Tubbergen:

So I'd just be curious, Ed if you have an idea of what this end game might look like because if you take a look around the world now, every central bank is literally creating money, so when you look at the dollar index which measures the purchasing power of the dollar against the major trading partners of the US, you've got this race to the bottom going on as far as currency devaluation, do you have a sense as to how this ends and maybe when, if that's a fair question?

Ed Butowsky:

Well, I'll tell you, it is a race to the bottom. In fact, they just announced this weekend that it looks like they're going to have to print more money and have another quantitative easing, which is not good for anybody. So it is a race to the bottom and I don't know how it ends, but I know it's going to end in an ugly way. That's for sure.

Dennis Tubbergen:

Well, my guest today is Mr. Ed Butowsky. He is the author of Wealth Mismanagement, we'll talk to him about that in the next segment. You can learn more about his work at chapwoodindex.com. Ed and I will be back after these words.

Dennis Tubbergen:

I'm Dennis Tubbergen and you are listening to RLA Radio. My guest today is Mr. Ed Butowsky. Ed is the author of Wealth Mismanagement. He is the developer of the Chapwood Index, which is widely used now measure of inflation and he is also a managing partner at Chapwood Investments. The website to learn more about Ed and his work is chapwoodindex.com. And Ed, just out of curiosity, I didn't ask you this, but how many years ago did you develop the Chapwood Index?

Ed Butowsky:

I started it back in 2004.

Dennis Tubbergen:

Okay. Well, it is widely used and widely quoted by many of the newsletter authors that I interview, so quite an accomplishment. So let's shift gears a minute here and talk a bit about your book, Wealth Mismanagement. Tell us a little bit about the premise of the book?

Ed Butowsky:

Well, the idea is that I've been a financial advisor for 33 years, which is unbelievable. But I realized that most firms and most financial advisors are building investment portfolios for their clients that are inefficient and are not what people need. And they have a very difficult time interpreting what this collection of investments that they get from their financial advisor is all about. We oftentimes in our field talk in a language that most people don't understand and they just trust you and those days should be long gone. They should be held accountable for what it is that they're giving to their clients. So one of the issues I found was that people were not willing to accept the volatility that they get in a portfolio. And the other major issue was the cost of living increase that people were being built portfolios that did not get them the kind of rate of return they needed after they subtracted taxes and expenses and their cost of living adjustment.

Ed Butowsky:

And I purposely didn't use CPI because CPI is not a good measure of your real cost of living adjustment. So the Wealth Mismanagement is a little bit about how I got there. The first couple of chapters are the history of how I got into this business and my view of it and always feeling uncomfortable that we were pushing products and investment that the firms wanted us to represent. But when you look at the portfolios that you had and the compliance people's job was to overlook what the portfolios that you put together look like and did they make sense for the client. Most people in the compliance areas didn't have any idea on how to interpret what it is that we were doing for our clients. They just looked and said, "Okay, you have stocks and you have bonds and this is the person's age." But that's not how the business works and I wrote this book, Wealth Mismanagement to highlight the fallacy of people who work at a well-named firm like Morgan Stanley or Goldman Sachs or Merrill Lynch or UBS and thinking that because they work at those firms, there's this oversight where they're going to have a portfolio that's appropriate for them. And that's really why I did it, it's really my way of getting back at my industry even though I love my industry, but getting back to my industry, we're not training people properly.

Dennis Tubbergen:

Ed, when you were talking, you used the term volatility and I think so many people when they're approaching retirement, they just do what they did in their 401(k) all these years without compensating or making allowances for potential volatility. And earlier this year in 2020, it's a perfect example when the market declines 35%, it takes about 51%, 52% gain to get back to even. So, that's a big risk that a lot of people face and a lot of times that is not accounted for in a portfolio.

Ed Butowsky:

No, and if you were to ask most people this question, I encourage anyone listening to do this with their current financial advisor. Ask them if they had a portfolio with a historical rate of return of 10, what should your standard deviation be? And in our business, standard deviation is the same thing as volatility. And the answer should be eight or lower. And if your advisor answers that question properly, then you can actually go on the Chapwood site and put in your current holdings and figure out exactly what the historical volatility is. And I guarantee you that most portfolios have historical standard deviations that are about 150% of their historical rate of return, meaning that if they had a rate of return of 10, their standard deviation is about 15, which is significantly higher than 80% of your historical rate of return. It's a real problem and most people in my industry don't understand how to manage risk although they look their client right in the eye and tell them that they care about them, they care about the risk that they're taking, but they don't do it in practice.

Dennis Tubbergen:

So Ed, for our listeners that are not familiar with standard deviation and what a standard deviation of eight versus 15 is, can you give them a quick standard deviation at a basic level as far as an explanation goes?

Ed Butowsky:

Sure, a standard deviation has to do with how much volatility or how much variance you have from the historical rate of return. So if you had a rate of return of 10 and a standard deviation of 15, you're looking at a range of returns between plus 40 and minus 20, which means that you're willing to accept anything between minus 20 and plus 40 at any given time even though it averaged 10%. So you could have years where you had a minus 18, a minus 17 in succession, that's too big a volatility. So you want that volatility to be lower, you want it to be, let's say 0.8% or 80% of your historical rate of return. So your return is between plus 26 and minus six. That's much more palatable than having the 10 and 15.

Dennis Tubbergen:

So when you take a look at hedging for inflation or investing in such a way as to attempt to keep pace with inflation, when you take a look at the investment options that people who are retiring today have, it wasn't that many years ago we can both remember when you could get 6%, 7%, 8% on a very safe investment like a CD, those days are gone. So what kind of advice are you giving people these days?

Ed Butowsky:

Well, it's difficult because the education is the most important part, because most people need to have alternatives in their portfolio. When I say alternatives, I'm talking about hedge funds, I'm talking about having gold and silver and even diamonds in their portfolio. And now, it used to be that these were reserved for the wealthiest people and for institutions and foundations but now most people can gain access to investments very similar to them without having to go into a hedge fund. There's hedge fund replications that they can go into and there's ETFs that replicates managed futures for instance and long short equity.

Ed Butowsky:

So they can get into these but it's mathematically impossible to have an efficient portfolio without having alternatives in your portfolio. And the days that you could get 6% on a CD, one of the things that's interesting to note is that the reason you could get 6% was because the stated CPI was around 5%. So there was very little difference between the CPI and what you could get on a short-term CD. The reason you could get a nice rate of return on a short-term CD was because the government's inflation rate was that high.

Dennis Tubbergen:

Well, we are chatting today with Mr Ed Butowsky. He is the founder or developer of the Chapwood Index. He's the managing partner at Chapwood Investments and the author of Wealth Mismanagement. You can learn more about Ed and his work at chapwoodindex.com. So Ed, when you take a look at Fed policy today, do you see that the actual inflation rate moving ahead using the Chapwood Index is going to have to go higher?

Ed Butowsky:

Well, it should but they continue to manipulate it, so it stays lower. And this is a... I can't underscore how horrible this is for middle-income and lower-income individuals which represent a huge part of our population because most of their salaries are adjusted for the CPI. And as long as the government keeps that rate lower, then people are going to get salary increases that are far lower than what they need in order to keep and maintain their standard of living. It's devastating, so the Fed policy is one where they continue to print money, which they'll continue to do and do even moreso over the next couple of years given the new administration that's coming in. And because of that, you're going to see this in real inflation go higher but it's going to be tampered down by the manipulation of the CPI.

Dennis Tubbergen:

So you have these cities in California now that are double digit inflation when you look at your basket of 500 items, how high do you see that going potentially, care to make a prediction?

Ed Butowsky:

I would hate to, it's scary and it's scary for all the people that live in those cities. And it's not just there, it's also New York and Chicago. You have a number of cities where inflation is or the cost of living increases far greater. In Chicago, five-year average is 11.1, New York is 11.9, Philadelphia is 11 and these are real numbers. These are numbers that everybody needs to be aware of and this is why if you live in those cities, why every day you feel like you're getting further behind even though you're paying your bills, you're paying your taxes and doing everything right. But this is why people, I always kid that when people get older, the Christmas gifts they give get worse. And I remember very well that there was a year where I would get a $100 from my parents and then it was $50 and then I just got a card.

Ed Butowsky:

And it's because of this and this is a huge reason why we see us borrowing so much more money than we used to and why people lend, it's because there's so many programs that are needed out there to keep people being able to feed them. But we're talking about the core reason why there's so much depression and so many problems with people making ends meet as they get older.

Dennis Tubbergen:

Well, the clock tells me Ed, we're going to have to leave it there. My guest today has been Mr. Ed Butowsky. He is the author of Wealth Mismanagement, available at Amazon. He is the developer of the Chapwood Index and managing partner at Chapwood Investments. Ed, very much enjoyed our conversation today. Love to have you back down the road.

Ed Butowsky:

I would love to. Thank you very much.

Dennis Tubbergen:

We will return after these words.