Bull Markets, Asset Allocations, Cash Cushions, & More!

Tim Mullooly: Welcome back to the podcast. This is episode number 202 of the Mullooly Asset Management podcast. This is Tim Mullooly.

Brendan Mullooly: This is Brendan Mullooly. I passed the test.

Tim Mullooly: Yeah. Back for a second episode. We had Brendan on a couple episodes ago. If you remember our millennial themed episode, all the questions had sort of a younger feel to it. It was appropriate with me and Brendan here in the office.

Brendan Mullooly: Right. They used the first round draft pick on me and I'm going to be starting center field for Mullooly Asset Management.

Tim Mullooly: Here we go. Just throwing him to the wolves. No time in the minors, just stepping right up to the plate.

Brendan Mullooly: We'll see if I'm ready.

Tim Mullooly: Yeah we're going to give Tom a break. Every once in a while, we'll have Brendan here with us, but we're going to keep the same format for the podcast as we've been doing with Tom. We get questions into, we call it, our mailbag.

Readers, listeners to our blog posts and podcasts, and videos; they write these questions into us, into the website. We do our best to answer them. We just want you to know that it's nothing specific here in terms of individual specific recommendations or advice. We don't have much information on these people. We're just working with what we're given. Again, it's just general broad advice, so keep that in mind when we're answering these questions.

Brendan Mullooly: Right. We're just broadly discussing. Just two guys sitting at a table, doing what they love; talking about investments and finance for people, but no specific advice here. Really just spit balling, so to speak.

Tim Mullooly: Right. I mean if you hear a question that applies to you and you want some more specific advice, feel free to get in touch with us. We'd be happy to have a meeting with you in person.

Brendan Mullooly: Yeah, that's what we do.

Tim Mullooly: Right.

Brendan Mullooly: We do that for a living, but we need a tangible person here in order to dispense actual investment advice.

Tim Mullooly: Right. So I wouldn't take anything we say here, specifically, to heart to you unless you come in here and talk to us on a more personal basis, so we can get to know you a little bit better first.

So with that, we're going to jump in. We got just a handful of questions here today. The first questions asks, **"Should I continue to contribute towards my retirement or pay off my debt in a bull market?"** The summary says, "I'm contributing a small amount towards my retirement, $2,500 annually, even though it could go towards paying off my debt. Now that we are in a bull market, should I continue retirement contributions or stop until we hit a bear market? Even though paying more principal on my debt will help, my retirement accounts only have to earn 4.78% to offset the 17% interest on my debt."

So Bren, what's your initial thought on this question? What do you think this person should or shouldn't do? Or the important points to take home.

Brendan Mullooly: Right. I understand where they're coming from, because they're being rewarded for putting money in the stock market right now. Basically, they want to know, "Should I keep doing that as long as it continues," which is a good question. I wish I had the answer to how long will a bull market continue for? Everybody wishes they knew that. I think one point, specifically, that stands out to me is talk of sending money in while it's a bull market and then flipping to paying down debt in a bear market. I think that it's probably even more important to continue saving regularly. Continue with your regular investment plan in a bear market than it is a bull market. What you're doing is dollar cost averaging and the benefit of dollar cost averaging comes from buying as the market goes down.

Tim Mullooly: Right. So buying during a bear market is ultimately going to help if your dollar cost averaging in. It's going to help you.

Brendan Mullooly: It's more advantageous than buying during a bull market.

Tim Mullooly: Right.

Another point that I picked out was saying that, "My retirement accounts only have to earn 4.78% to offset the 17% interest on my debt."

Brendan Mullooly: That is oddly specific, but I'm not sure where the logic is behind it. Again, we may be missing information, so this person could be entirely correct in that assumption, but normally I would think that the debt is-

Tim Mullooly: There's two numbers here, but they're different numbers in a sense that 17% interest on your debt is fixed.

Brendan Mullooly: Right. That was the word I was searching for. That's perfect.

Tim Mullooly: You're going to be paying 17. That's not changing. You're paying 17% interest on that debt. You have to earn at least 4.78% in your retirement accounts in the market. As we all know, the stock market, nothing is guaranteed. There's no guarantee that every year you're going to earn at least 4.78% to offset that interest payment.

Brendan Mullooly: Yeah, that could end up being your long-term average after 20, 30 years. Let's say 5, 5%. Maybe you did earn 5% annually after 20, 30 years of investing, but that doesn't mean that every single year, like clockwork, you put your 5% in the bank, because if it were that easy, quite frankly, people might not need our help.

Tim Mullooly: Exactly.

Brendan Mullooly: I wish it were that easy for everybody, but that's not how it works. The market doesn't go in straight lines. We're working under the assumption that that math is correct, that that's all it would take, that 4.78%, to offset the 17% interest on the debt. I don't totally buy, but maybe it's right. Tim is correct in his advice there, that you don't want to take market returns as something that is concrete or locked in; where the debt is. You're paying that 17% on the debt regardless.

Tim Mullooly: Right. You can make 0% or negative in a year in the market. You're still going to have to pay that 17% interest. Your interest doesn't care how your portfolios did that year in the market.

Brendan Mullooly: Right. I mean going back to just the main part of the question was, "Should I contribute towards my retirement or pay off my debt in a bull market?" I would just drop the end of that sentence, "In a bull market," and if you got debt that is at something kind of high interest rate, like 17%, I think it's a no brainer to get rid of that before you save for retirement. Maybe even before or in conjunction with saving for something like an emergency fund. That debt is negatively compounding your net worth and it will continue forever and ever. It will eat you alive if you don't take care of it.

Tim Mullooly: Right. Instead of letting the interest accrue every year and only paying down what you have to offset the interest, you could just ... Also from a mentality standpoint, why would you want to ... If you have the ability to stop contributing towards your retirement for a year or so, use that extra cash to pay off the debt. Then you don't have that black cloud of debt hanging over your shoulder every day when you're walking around. At the end of the day you don't have that looming in the back of your mind like, "Oh I still have to pay off this debt."

Brendan Mullooly: Right. Whatever money you swing towards the debt to pay that off ... A great habit would be at the end of that, when the debt is paid off, then you do probably want to flip that to going into your retirement account or whatever kind of vehicle you're using to save for your future, because it's somewhat painless. That money has already been gone out the door every month when you get your paycheck. That's been paying down the debt and now you're doing something very positive for yourself, flipping that into some kind of a savings plan.

Tim Mullooly: With that debt gone, you know that it is a positive for you. You won't have to answer that question, "Am I doing the right thing by saving for retirement when I have this debt," because the debt will be gone.

Brendan Mullooly: Right.

Tim Mullooly: So let's move on. The second question we have here today asks, **"When should I switch my very aggressive asset allocation to a moderate one?"**

The summary says, "In my 403(b), I've accumulated 150,000 and still contributing and have an all equity fund allocation. I'm currently 47 years old and thinking of changing my allocation to a moderate one 10 years from retirement and then to a conservative one in retirement. Is that a sound plan or too risky of one?"

Brendan Mullooly: Okay, well I like that the changes in asset allocation seem to be based more on a specific life event in the future, like retirement, and they're not asking, "Can I change my aggressive allocation to moderate before the next crash?"

Tim Mullooly: Right. They're not asking, "Hey the market's up 20% this year, can I get more aggressive?"

Brendan Mullooly: Or, "Should we get more moderate, because I'm nervous that it's going to go down eventually or going to continue upwards?"

Tim Mullooly: Exactly.

Brendan Mullooly: So not based on market movements, which is like phase one of what we discuss with clients when we're getting an idea of what they're risk tolerance may me. That makes me happy.

Tim Mullooly: Me too. Risk tolerance isn't something that you want to be swinging back and forth with every up and down turn in the market.

Brendan Mullooly: Exactly.

Tim Mullooly: One thing that this person does need to consider though, is when you ... They're talking about going from aggressive, to moderate, and then to conservative over time, but with some planning help, they can really map out how long they need this money to last. It would help them determine when to kind of pull back on the risk in their allocation, when that would be appropriate to do. They might need to live on this money and whether they're retired or not, if they need this money to continue to grow so they don't outlive their money, they might still need to have a little bit of risk in that account to let it grow. You can't get too conservative, because then you're slowing down the amount of returns that you're going to get in your account. You'll have ultimately, most likely less money to live on in retirement.

Brendan Mullooly: Right. You don't want to completely flip the switch from a stock heavy allocation to a bond heavy allocation or whatever the conservative one is going to look like, just because you retire. Like Tim said, you want to have plan that maps out how long the money is going to have to last for and in what amounts you're going to need it and when. That's really going to dictate more what the asset allocation needs to be to accomplish those things.

We're talking about goal driven investment planning here. This is something we do for our clients because we think it's more valuable than trying to guess what the allocation should look like based on the market environment. We need to accomplish something for a client, "We need to accomplish X. How are we going to get there?" That's really what you want to dig into, more so than just saying, "I'm retired. I need to get conservative," or, "The market is doing this. Let's get aggressive," or conservative, or whatever it may be.

Tim Mullooly: Right. There's sometimes two different dates in a person's life. It could be when they retire is one date and then when they start withdrawing money from the account is another date. Some people may not, depending on the accounts and their money situation, they might not be withdrawing funds from a certain account for five or maybe even ten years, or longer. You never know.

Brendan Mullooly: Right. This person, just as a good example, says that this is a 403(b). A lot of times, just to Tim's point, those end up being for teachers. This is a person that may be collecting a pension and may not need the 40#B money right away to supplement their living. You want to make sure that ... For some people, retirement and beginning to withdraw money it aligns, it's the same date, but sometimes it's not.

Tim Mullooly: Right. All things to consider here in that situation. Definitely a good question. At least this person is thinking about their portfolios and getting closer to retirement. It's good that that topic is on the top of their minds, but there are some things that they need to consider moving forward.

So the next question that we have here is somewhat similar to the first question, but has a little bit of a different details to it. The question asks, **"Should I invest or pay off my debt?"** Seems very broad, just on the surface here, but there's a few details in here that'll help us get more granular with this situation. The summary says, "I have around $35,000 in mutual funds, but more than twice that in student loans. Should I use my mutual funds to pay down my loan or should I keep my funds as investments and grow them?"

Brendan Mullooly: About $35,000 in mutual funds and twice that. I mean we're talking about like $70,000 roughly in student loans. I would be interested to know what interest rate that debt is at. Sometimes student loans, depending on where they came from, have somewhat low interest rates. We'll see. This is one of the things on the table in the new tax proposal, but you do get to deduct some student loan interest that you get every year. I think you can deduct up to $2,500 of that on your tax return. There isn't really great debt, but it is a little advantageous to have some student loan debt. It's not a necessity to completely pay it off, but that is a big amount. I think that taking into account the interest rates, it may be a kind of situation where yeah it would make sense to get rid of some of those. It wouldn't necessarily help their personal balance sheet. It would feel worse to use that investment capital to pay down debt, but it would improve their overall financial picture, to have half of the debt that they had the day before they pay it down.

Tim Mullooly: You said, "Overall financial picture," and that got me thinking. Like we said in the beginning, we don't have all the details here on these people. It's hard to truly answer the question that they're asking without knowing everything else. We don't know what kind of cash flow this person has on a monthly basis and whether or not the debt is accruing, because of the interest, at an outrageous rate that they can't pay off or can't handle on a monthly basis. If they're managing the debt and it's not out of control, maybe it would be okay to leave the money in the mutual funds.

Brendan Mullooly: One thing that popped into my head when you were speaking was that we don't know, "How did this $35,000 in mutual fund investments accrue?" If that is a regular savings plan and the student loan debts are, let's say, being paid at the minimum every month, you're going to send in $1,000 a month or something, towards the student loan debt, could be the kind of situation where instead of what it seems like they're suggesting, taking the lump sum to pay down student loan debt, maybe instead of that you could swing the cash flow that you're sending towards the investments, also to just add a layer on top of whatever you're already paying towards the student loan so that they get paid down quicker, but you keep that lump sum in the investments and continue letting it grow for your future.

Again, probably need more information to make a better assessment of the situation, but these are the kind of things that are popping into our heads as we're reading this kind of a question.

Tim Mullooly: Right. There's definitely more to this one, but as we've said over and over again, we would just need more information.

With that, we're going to move on to our final question of the episode, which asks, **"Should I stop contributing to my 401K and build up my cash?"**

I know what you're thinking. "This kind of sounds like the other questions as well”

Brendan Mullooly: This one's a little more nuanced though.

Tim Mullooly: Yes. There's a few more details in this one than the other questions.

The summary says, "I am 55 years old and losing my job in six months. My wife and I have zero debt, $38,000 in cash, $14,000 in mutual funds and $1.4 million in our IRA's. I want to accumulate a large cash cushion. Should I stop contributing to my 401K and just bank that money?"

My initial reaction to that is if this person wants to build a large cash cushion, then build a large cash cushion.

Brendan Mullooly: Yeah and you're going to want that liquidity, meaning like you don't want it in a retirement account.

Tim Mullooly: Exactly. Yeah, you want it in cash. You don't want it tied up in mutual funds or IRA's, like they have, or a 401K. So that is my Cliffs Notes answer to that question is, "If you want to build up cash, build up cash."

Brendan Mullooly: Keep it liquid.

Tim Mullooly: Stop contributing to that 401K, but there is more to it that we could dive into.

Brendan Mullooly: Yeah. Things that would be very helpful, in terms of giving a more specific answer, would be what are their expenses like, because they have some cash. They have, it says, "$38,000 in cash." It would be nice to know on a monthly basis ... How many months is that expected? Is that going to cover them after the job is lost in six months?

Tim Mullooly: Right, because as me and Tom have said on many, many questions, on many podcasts here ... General rule of thumb that we like to tell people is at least six months of expenses is what you want to have in cash, liquid, in the bank, just in case something happens. Like this person said, they're losing their job in six months.

Brendan Mullooly: Yeah and they have little bit of advanced notice. If you have the ability to swing money that had been going into a 401K and put it in the bank instead to build up and extra ... Maybe that is six months of expenses for them, maybe. In the event that you're losing your job you may want even more than that, just to have some flexibility.

Obviously we don't know what the plan is. Maybe this person is going to find a job afterward. Not sure. Is 55 going to be like early retirement? Is that how they're looking at this? Or will there be another job?

One thing that I don't want to dive too far into the weeds on, but seems worth bringing up in this scenario given all the money they have in IRAs, is the ability to access that before age 59 1/2 without a 10% penalty. They could take something called substantially equal periodic payments. There are a lot of details that go in to this, so it's probably something to discuss with, not only a financial advisor, but somebody who's either a CPA or very in touch with taxes. You have to take these payments, periodic payments, it's an equal amount that you have to take for a minimum of 5 years or until you turn 59 1/2. So for somebody who's 55, this could be something to help bridge the gap until then. Where they can avoid a 10% penalty and get money from those, pretty substantial $1.4 million, in IRA money. They could get into that if need be, in case they end up draining that $38,000 in cash, $14,000 in mutual funds and whatever else they're able to sack away over six months before this person loses their job. Substantially equal periodic payments.

It's an option. There are three methods to determine what that equal amount is going to be that needs to come out every year for a minimum of five years, but again I don't want to dive too far into the weeds with this one. That is an option for them to keep in their back pocket, in terms of maybe the job search doesn't go as quickly as planned and they're running through the savings that they have outside of the IRA's. There is a way around the 10% penalty. Obviously, any money that comes out will be taxable as ordinary income, because it's from an

IRA. They have a nice lump sum of money built up there, so it would be a shame to not access that in the event of an emergency. That is there for them as an option.

Tim Mullooly: This person, you know you have options. Like I said, if you ... You know you have six months left at this job. If you want to build up cash, it seems like an okay idea to stop contributing to that 401K and just build up the cash, at least for the next six months. Then go from there.

Brendan Mullooly: They could put it in a storage unit, like Walter White, and go sit on top of their piles of cash.

Tim Mullooly: Exactly.

So that's going to do it for this episode of the Mullooly Asset Management podcast. Want to thank Brendan for coming on here again. We'll be having him on more and more often, just to change things up a bit. So thanks for coming on Bren.

Brendan Mullooly: Thanks for having and hopefully I can continue to impress in future episodes.

Tim Mullooly: Yeah.

Brendan Mullooly: Earn myself more playing time.

Tim Mullooly: Yes. So thanks again for listening and we will see you on the next episode.