MAM Podcast 190: Financial Questions with Tim & Tom - Transcript

Tom Mullooly: Welcome back to the podcast. This is episode 190 of the Mullooly Asset Management podcast.

Tim Mullooly: We're getting close to 200 now. That's a lot.

Tom Mullooly: That's right. Well, we appreciate everybody tuning in. I'm Tom Mullooly.

Tim Mullooly: This is Tim Mullooly.

Tom Mullooly: Together, we answer your questions that come in. We happen to have a slew of interesting questions that have come in, and we want to tackle them, so let's jump right in.

Tim Mullooly: Right on. First question is, "How wary should I be of 401(k) fees through my company's plan?" It goes on to say, "I have been working for a company for over six months and have been offered a 401(k). The vesting period is surprisingly six months and 100% matching. After recently becoming more aware of the hidden fees that these financial companies charge their employees, I asked both my employer and the 401(k) financial company about the fees. They both stated that my employer pays for all the fees. This sounds too good to be true. Is there something I should be aware of or concerned about?"

Tom Mullooly: Well, when it comes to 401(k) fees, should you be wary? I think you should be aware.

Tim Mullooly: Right.

Tom Mullooly: The fees are pretty much negotiated between the company, the employer, and the administrator on the plan. It may sound surprising in 2017 that the vesting period is six months. I'm not surprised. When I worked at a particular brokerage firm, I was not permitted to join the 401(k) plan for the first year that I worked there, and then I was invited to join the 401(k) plan.

Tim Mullooly: Lucky you.

Tom Mullooly: Yeah. The 100% matching, make sure you understand what the terms are with the 100% matching. I can't imagine an employer, if you maxed out your $18,000 contribution that they're going to match it 100%, so I would check the fine print on that. Since it sounds like you've been checking the fine print anyway on hidden fees, there's nothing really hidden too much anymore. It's all out in broad daylight.

Tim Mullooly: Right.

Tom Mullooly: The statement that kind of jumped off the page at me is that the employer and the plan administrator both said that the employer pays for all of the fees. Now, let's just pump the brakes a little bit on this.

They may pay transaction costs and they may pay for any kind of maintenance fees that go on in the plan, but if there are embedded fees in the investments that you own, for instance, if you're going to own a bond ETF in your 401(k) and there's nine basis points built into that, I really doubt that the employer is going to pick that up because there's no way to really bill it.

I wouldn't be very, I wouldn't be a skeptical as the tone sounds from this message, but I would ... It's a good question. It's a good question to ask.

Tim Mullooly: Yeah, and you should definitely be aware of the fees, but when it comes down to being wary about it, there isn't too much one individual can do about the fees in the plan anyway since they're negotiated between the company and the provider, so it's good to be aware. You should always know what the fees are in what you're participating in.

Tom Mullooly: Before we move on to the next question, the fact that you work for a company that has a match at all, it's pretty good.

Tim Mullooly: Yup, agreed. Next question. "How should I invest a large sum of my savings towards my kids future expenses?" It goes on to say, "I have $100,000 sitting in the bank at 1.5%. I would like to invest the money so it starts earning for me. I have a pension and a 457 for retirement. The money would be for my children to help with a house or wedding within a 10-year time frame. What investment would be good for this objective? I'm willing to sacrifice risk for higher returns."

Tom Mullooly: If you're looking for 10 years down the road ... Now, we're not giving out specific investment advice because this person is not sitting here in our office, and we need more information before we can make a specific recommendations, but just talking like two guys sitting at a bar talking about this, I think if you have a pension and a 457 plan for retirement, and this is money that's clearly going to be earmarked for a wedding or a purchase of a home, and it's 10 years in the future, then I would think about it being nearly 100% growth oriented. Do you agree?

Tim Mullooly: Yes, I do. With that amount of time to let it grow, like this person said, they're willing to sacrifice risk for higher returns, and I think that's a smart move given the amount of time they have.

Tom Mullooly: I would almost look at this situation as if someone came in with a six year old son or daughter and said, "I've got $100,000 that I need to put away for college. Here's the 100. How do we get started?" I don't think you're going to be buying bonds.

Tim Mullooly: No. Wouldn't make much sense, especially if they're looking to have this money grow over time.

Tom Mullooly: Everyone's situation is different, and again, we're not making specific recommendations to this person who wrote in with the question, but understand that we are happy to talk in general terms about what you should do. This person clearly has money that's earmarked for retirement, so we don't feel too hesitant about saying they should be skewed towards growth.

Now, what the ultimate allocation winds up being is going to be based on how comfortable they feel about risk.

Tim Mullooly: Right. Next question. "Is now a good time to put money into a Roth IRA?"

Tom Mullooly: I'm going to put my broker hat back on. I was a broker for the first 15 years of my career, and whenever I hear the phrase, "Is now a good time," of course, it is.

Tim Mullooly: Yeah.

Tom Mullooly: Of course, it is. The old saying, and we've used this a couple of times in this podcast. When's the best time to plant a tree?

Tim Mullooly: Twenty years ago.

Tom Mullooly: Right. What's the second best time to plant a tree?

Tim Mullooly: Right now.

Tom Mullooly: Right now. Is now a good time to put money into a Roth IRA?

Tim Mullooly: The summary goes on to say, "My wife and I both have employer-sponsored retirement plans we contribute to in which the employers match. Right now, we have $10,000 sitting in a savings account, which pays virtually zero percent. I was thinking about 5,500 into a Roth IRA spread across numerous vanguard funds and ETFs since we qualify with a combined income less than $180,000."

Tom Mullooly: All right, I'm going to stop you right there because a couple of things got my attention right away. Let's work from the bottom up.

They have a combined income less than 180,000. This doesn't really apply to this person who wrote in with this question, but it just kind of, it's kind of like nails on a blackboard when I see people say, "Well, my wife and I make more than 180,000, so we don't qualify for an IRA." It is modified adjusted gross income. It is not your gross income.

Tim Mullooly: I think majority of people completely miss that point because a lot of times, people come in here and ask about Roth IRAs and what the limit is, and we give them the number, and they say, "Oh, we make more than that." It's like, that’s great, but--

Tom Mullooly: Yeah, then we have that discussion about, well, wait a minute, do you have any, do you have exemptions?

Tim Mullooly: Right.

Tom Mullooly: I mean, you have to go through and actually figure it out. It is the modified adjusted gross income. If you want to get a better idea, if you don't even know what modified adjusted gross income is, Tim will put a link to it in the show notes-

Tim Mullooly: Yup.

Tom Mullooly: ... but just knowing the difference between your gross income and your adjusted gross income, you're going to be halfway home. The adjusted gross income is going to be at the bottom of page one of your tax return. That is your adjusted gross income. There's a few things that you have to add back in. They're little things, in many cases, to get you to the modified adjusted gross income.

The other thing is that when it comes to putting money into a Roth IRA, I think a lot of folks are ... It's great to be aware of fees and expenses and costs and things like that, but I think sometimes people are just focusing on the cost and the expenses, and they're not necessarily thinking clearly about where this money is going to be. If you're putting money into a Roth IRA, it is ... IRA stands for Individual Retirement Account. This is money that you really should be putting away for retirement. Can you touch this money? Yes. Does it come with a couple of strings? Yes. A big yes. You need to know that. There are specific details regarding when you can take the money out of the plan without it being a problem.

What bothers me about this particular scenario is that they have money that is in an employee-sponsored retirement plan, and the employer matches. That's great. But then they say, "We have $10,000 sitting in a savings account paying virtually zero." What is your safety net? Where are the three to six months of fixed and variable expenses? We talked about that on the last podcast. Where is that? That money needs to be available tomorrow.

Tim Mullooly: It sometimes sounds like we're broken records on here, but it's really important stuff that people need to have drilled into their heads. Take care of present you first, and then worry about future you.

Tom Mullooly: Good point.

Tim Mullooly: These people with $10,000 sitting in savings, unless they have very little monthly expenses, I doubt that that's enough of a safety net for them to feel comfortable.

Tom Mullooly: I think, Tim, part of the situation is everybody wants to feel smart, that they're being smart about their investments, and they see money, any money sitting there earning zero, and they feel stupid, like, "Oh, I should be doing something with this money." Sometimes, doing nothing is the right thing. Warren Buffett has 100 billion dollars, with a B, sitting in cash.

Tim Mullooly: That's a lot.

Tom Mullooly: He's just waiting for the right opportunity. He wants to have that money liquid. You're going to need an emergency fund, a safety net, and it will always come at the worst possible time. Have it available. Some of the worst phone calls we get, Monday morning, 8:00, somebody calls. "We need to get $25,000 right now out of our account. Something happened." Don't let that happen.

Tim Mullooly: Moving on. Next question is, "Should I max out my Roth IRA contributions before investing in another vehicle?"

Tom Mullooly: Short answer? Yes, but I think you have some more details.

Tim Mullooly: Right. It goes on to say, "I started a Roth IRA about a year ago. I'm really ambitious to save as much as I can over the next 15 years. Besides the Roth IRA, I want to invest another $10,000 into some other long-term vehicle. What would you recommend? I really want to be smart about this. Should I max out my Roth contributions first before going with a new investment vehicle?"

Tom Mullooly: There's that phrase again, "I really want to be smart about this." It's great that people are sensitive to fees and what things cost, but let's pump the brakes and let's talk about this.

In my opinion, it makes sense if you're doing this for the next 15 years, maybe you're over 50, you can put away $6,500 per year. If you're not over 50, you can do $5,500, and that's great. What this person with the question didn't address is safety net.

Tim Mullooly: Yup. Same thing as the last question.

Tom Mullooly: Yeah.

Tim Mullooly: I feel like a lot of people ... It's great, like you said, it's great that they're even thinking about retirement because there's a lot of people out there that have nothing saved for retirement, and that's another issue, but just the fact ... We need to make sure that this person is okay at the moment and have that important safety net.

Tom Mullooly: I don't want to go too far off in a tangent, but some of the most uncomfortable conversations that I've had over 30 years have been with people who are, for lack of a better term, betting the rent. They don't have a safety net, and the money in the stock market really is their safety.

Tim Mullooly: That's scary, in my opinion.

Tom Mullooly: That's scary, but it happens every day.

Tim Mullooly: Yup.

Tom Mullooly: There's people out there who are betting the rent, and they're buying the Inverse VIX or the triple-leverage gas thing, Gasland, or they're just taking huge, huge risks, I mean, they've basically-

Tim Mullooly: Reckless.

Tom Mullooly: ... put the rent money or their mortgage money into some kind of Vegas slot machine.

Tim Mullooly: Put it on black.

Tom Mullooly: Right. We're betting it all on red. I've seen it happen over a long career where the people who can least afford to take risks are taking the risks, and then you know what happens, is that they're distraught, and when the market goes down, they become emotional. They wind up having a car accident or something really bad because they're really counting on this money.

So please, public service announcement, have money in a safety net.

Tim Mullooly: It might seem like the wrong thing to do for people who don't know any better having those other, that last question said, "Oh, it's earning zero percent," but it might be earning zero percent, but it's giving you that peace of mind that you know that you're okay if something happens.

Tom Mullooly: If something happens.

Tim Mullooly: I think that's a better return than anything you can get in the stock market.

Tom Mullooly: Totally agree. You need that safety net first before you can really think about investing.

Tim Mullooly: Yup. The next question is, "Is a fiduciary or a broker better for planning and investing assets?

Tim Mullooly: You think you would be able to guess our answer for that question, but I think Tom has a little bit of a different answer than what you might expect.

Tom Mullooly: We're a fee-only investment advisory firm that makes us a fiduciary, but is it better to work with a broker or work with an investment advisor? There's not a right answer. It's going to depend on you, and it's also going to depend on you knowing what to expect with each of them. With a broker, you need to understand that that person gets paid by commission. If you find yourself with a really good broker, but they make a lot of transactions, that may not be in your best interest.

On the other hand, there are thousands of great brokers out there who will buy good companies at the right price, and you hold them forever or for a very long period of time, and you do great. Then there's other people that work with an advisor, and they lay out all the details, and this is how the fees work, and we're going to go in for some very properly-managed investments, and it works out great for them. Both are great. You just have to understand what to expect in each situation. No right answer there.

Tim Mullooly: It's all about doing your homework and just making sure you're educated on the pros and cons of both and deciding what's best for you.

Tom Mullooly: Right.

Tim Mullooly: Next up is, "Is it possible to spread out the taxes after closing out a guaranteed annuity?"

Tom Mullooly: Big sigh. I specifically wanted to go through this one for a couple of reasons. Why don't you give us a little more background on this, Tim.

Tim Mullooly: Sure. The question goes on to say, "I have a relatively small guaranteed annuity under $100,000 and would like to close it out so I can make a cash payment for a mobile home in a retirement park."

Tom Mullooly: Okay, let's stop right there. We'll just take this step by step. If you have what they called a small annuity under $100,000 and they want to cash it out, I am going to assume that they don't understand that your principle, what you started with, is not taxed. If this person started with $60,000 and it's grown to a hundred, 40,000 of it is taxable.

Tim Mullooly: Right.

Tom Mullooly: I just get, and maybe it's just the tone of the question, but the tone seems to imply that, "I'm going to take this annuity out, and it's going to be 100% taxable to me." Do you get that?

Tim Mullooly: Yeah. That's the sense you get just reading, just what the question says. That's all the information we have at this point.

Tom Mullooly: Let's go on a little further, and see what else they have to say.

Tim Mullooly: Right. It says, "I will have them withhold 10% federal taxes and receive the balance. Next year, when the income taxes on this along with my social security income is due, is it possible to spread the tax out so I do not have to pay at all in the first year?"

Tom Mullooly: This is a person that has an annuity for little less than $100,000. They want to cash it out, but they want to be prepared for the taxes that are owed on it.

The first thing we need to determine is, what is your cost basis in this? Is it 40,000, 50,000, 60,000, is it 70,000, and just 30,000 is taxable? We don't know. Understand that the whole thing will not be taxable.

In terms of spreading it out, the income taxes are due for the tax year that you receive the money. If you spread the money out, I know this doesn't work for your plan, but if you were to spread it out over five years and say, "Give me 20% of my annuity spread over five years," then you're going to have a tax bill spread over five years with different amounts in each year because it's all income first, principle last.

Tim Mullooly: Right.

Tom Mullooly: I just don't, I'm ... Again, this is kind of my soapbox about annuities. A lot of people understand going in, "Hey, I'm not getting a 1099," "Hey, it's safe," "Hey, I'm earning more than I can at the bank," but they don't ask enough questions about what happens when money needs to come out of these things. They just don't ask because they don't know to ask. That is not the problem of the investor, it's the problem of the person who sold this thing to them. They didn't explain it well, and that is my beef with the industry.

Tim Mullooly: Right. They just need to disclose all of this information upfront, but you understand why a salesman wouldn't say that because it makes it harder to sell if they know all the strings attached to try and get the money out of the annuity.

Tom Mullooly: Yeah, and if you knew all the strings attached to it, you may have second thoughts.

Tim Mullooly: Right, exactly.

Tom Mullooly: It may not seem so appealing. In this person's case, let's just say, back in the envelop numbers, say they started with $65,000, and it's grown to 100,000, and they want to cash it out. How much is taxable?

Tim Mullooly: Forty.

Tom Mullooly: Well, I said 65-

Tim Mullooly: Oh, okay.

Tom Mullooly: ... so it'd be-

Tim Mullooly: Right, 35.

Tom Mullooly: ... 35,000. That's going to be taxed as ordinary income, not capital gains, it's going to be taxed as ordinary income. If someone is in the 20% tax bracket, how much are they going to owe in federal taxes if they take it all out in one year?

Tim Mullooly: About 7,000.

Tom Mullooly: Right, out of $100,000 investment. It's not the end of the world.

Tim Mullooly: Right.

Tom Mullooly: It's not great, but it's not the end of the world.

Tim Mullooly: Yup.

Tom Mullooly: Okay.

Tim Mullooly: This next question is a doozy. "Should I stay with a 403(b) annuity or roll it back into my 401(k)?" We need a little more information to fully understand this situation this person's in. It goes on to say, "A few months back, I decided to roll my 401(k) from a previous employer to a 403(b) account with my present employer. I did not quite understand that I was investing in an annuity. Annuity contracts and so many rules worry me. Can I roll it back into a 401(k)? Should I keep it? I have another nine years before I am eligible to begin withdrawing."

Tom Mullooly: There's a couple of questions here. The first one that we'll tackle is, "Can I roll it back into a 401(k)?"

Tim Mullooly: You can't roll it back into the 401(k) that you took it out of.

Tom Mullooly: You don't work there anymore.

Tim Mullooly: You don't work there anymore.

Tom Mullooly: So-

Tim Mullooly: So that, that option's out.

Tom Mullooly: That option's out.

Tim Mullooly: The next question, "Should I keep it?" meaning the annuity inside the 403(b) that they rolled it into initially. Should they keep it?

Tom Mullooly: Well, they may not have a choice.

Tim Mullooly: Right.

Tom Mullooly: Because-

Tim Mullooly: That's my first instinct as well is-

Tom Mullooly: ... the money's there.

Tim Mullooly: ... you might have to keep it.

Tom Mullooly: Let's back up a second here, and let's just talk about when you leave a company. You can leave the money in your old 401(k) plan, and now with the Department of Labor regulations that just got pushed back another 18 months, with the Department of Labor changes that they'd like to see, you could potentially leave your money in the old 401(k) forever, but you're under no obligation to take the money out of your old 401(k), so it can stay there, but suppose you don't want to leave it there.

Before you go rolling into your new company plan, there's a vehicle called the Rollover IRA. This is different from a traditional IRA where you make your contributions, $5,500, or a Roth IRA. This is a Rollover IRA, and the Rollover IRA is created specifically for someone who leaves a company, takes their 401(k), not sure where they want to go with the money after that. Maybe they want to check out their new employer and their retirement plan, but before they do that, they need to park it or it's going to become taxable.

You can put the money into a Rollover IRA with the, you can't make contributions to that account, with the intention that in a short period of time, that money is going to bounce out of there and into your new company plan.

Now, what this person did was they left it in the old 401(k), and then they went straight into their new retirement plan at work, which is an annuity, and now they're discovering this annuity may not be such a hot deal.

Tim Mullooly: Right. My initial thought is, I mean, it would've been a good idea to do a little bit of homework before moving directly into the 403(b) into the annuity. Without knowing any details about the annuity itself, they might be stuck in it, unfortunately.

Tom Mullooly: Yeah. You've got high fees, you've got surrender charges.

Tim Mullooly: It could be more hassle than it's worth to get the money out of it now, so they might actually be stuck in there, unfortunately.

Tom Mullooly: That may be the ultimate outcome. At this point, I don't think that it would hurt to write a letter to the insurance company that manages the plan, not to your broker on the plan, and certainly not to your employer, but write to the insurance company. The address is on the statement that you get from the plan, and explain to them that you got into this thing. You didn't realize it's an annuity. You don't want an annuity. Anything's possible, but we could certainly not guarantee that you'll get your money out.

Tim Mullooly: It's worth a shot.

Tom Mullooly: Right. Doesn't hurt.

Tim Mullooly: Right.

Tom Mullooly: It's a tough spot.

Tim Mullooly: Yeah.

Tom Mullooly: Look before you leap.

Tim Mullooly: Always. We have a couple more questions left for this episode, about one or two depending on how much time we have. Next question is, "How can I dig myself out of debt after losing my job?" There's a pretty big explanation for this, so I'm going to, I'll read the whole thing, so bear with me, and then we'll wrap it up after this.

The question, again, is, "How can I dig myself out of debt after losing my job?" The summaries goes on to say, "I have recently been hospitalized, placed on disability, my income slashed in half, and lost my job in the meantime. I'm working with an employment attorney about that matter, but my question for you is how best to handle the now overwhelming debt that, while daunting, was at least manageable before the loss of income."

Goes on to say, "I know I've dug my own hole, made bad decisions, and have been robbing Peter to pay Paul, didn't have an emergency fund, et cetera, so I'm not asking for anything to tell me that I'm wrong. I am. I'm here in the hopes that someone can advise me the best way to overcome this potentially insurmountable problem. I've looked and even qualified for the National Debt Relief program, but after much thought, decided against it. I've contact only a few of my creditors regarding lowering my interest rates and haven't had great luck there just yet. I understand debt consolidation loans are capped at

$35,000, and the ones I've reviewed don't offer better interest rates than the bulk of my debt, so that wouldn't be wise. I have not yet contacted a nonprofit debt management group, and I'm also wondering if bankruptcy is the way to go. I honestly hate the notion of wiping away debt I knowing accrued. I made my bed. I'm not afraid to lie in it, but due to these circumstances, I wonder if crawling out will ever be possible. What can I do?"

Tom Mullooly: Well, the first thing that we want to say is we hope that your health improves-

Tim Mullooly: Certainly.

Tom Mullooly: ... and your situation improves because we feel bad hearing about this, and we hope that you recover quickly.

Tim Mullooly: Definitely an unfortunate situation this person is in.

Tom Mullooly: What they didn't mention in their notes is that they didn't say that this debt was accruing was because of hospital bills. They said that they had debt already, and now they've lost half of their income because they're on disability. This is debt that already existed. I think it's important to consider your options. You've done a good job of laying this out.

Bankruptcy, definitely an option. I, personally, don't believe in it. If I took on a debt, it's an obligation. I fully understand that I, and I have every ... I believe that I'm going to do whatever I can to carry out the debt, the terms of the debt.

Tim Mullooly: Seems like this person feels the same.

Tom Mullooly: Right, but understand that it is an option.

What I would do is I would write to every creditor that you have with the details that you just outlined. Now, one thing that we need to stress is that if there is a silver lining in this, is that it's 2017, not 2007.

Tim Mullooly: Right.

Tom Mullooly: Ten years ago in 2007 or 2008, you may not have gotten much sympathy because everybody was skipping out on paying their debts, and so your situation sounds a little more unique right now than 10 years ago.

Tim Mullooly: The odds of creditors feeling more sympathetic or compassionate towards your situation, definitely a lot better odds now than it was, so worth a shot to contact them and explain the details of what's going on.

Tom Mullooly: One of the things that you need to remember is that it's important to send something in every month on a debt. Don't just not pay. Just, "I'm not going to, I'm going skip this one this month," or, "I'm not going to pay this car payment," or, "I'm not going to make this payment over here." Make some kind of effort to make some kind of payment every month. That will help you. Just merely skipping without an explanation or without any kind of contact can hurt, and it can hurt you badly.

Tim Mullooly: It's going to decrease the odds of the company wanting to help you out because you're putting forth no effort. I mean, even if you're not making the minimum payments, any amount of money to show, "Hey, I just don't have the money right now, but at least I'm trying." It would go a long way for you.

Tom Mullooly: Something that we don't know from the original question is, are these secured or unsecured debts? What's a secured debt? That's something that is tied to an asset. If you borrow money to finance a car, you don't make the car payments, guess what happens to the car?

Tim Mullooly: They take it away.

Tom Mullooly: It disappears in the middle of the night. It's gone.

Tim Mullooly: Right.

Tom Mullooly: If you have credit card debt, unsecured. Unsecured. There's nothing they can do. They can't take anything back. It's ... There really is no asset for them to go after, and the banks do not want to own assets like cars, houses. They don't want to be in that business-

Tim Mullooly: No way.

Tom Mullooly: ... and they certainly don't want to be in a situation where they have someone who's out of work not making any payments at all on an unsecured debt. It's probably going to impact your ability to get additional credit in the future.

Tim Mullooly: Absolutely.

Tom Mullooly: That's the way it is, but continue to make some kind of payments and reach out to these companies in writing to let them know of your situation.

Tim Mullooly: Definitely. Hopefully, that person can figure out a way to make it all work out for them.

That is going to do it for episode 190. I wanted to thank everyone who's listening, and if you have any questions that you want us to talk about, feel free to contact us. We'd be happy to answer, talk about any questions that you might have on a future podcast. Thanks again for listening to episode 190. We'll see you next time on episode 191.