Mullooly Asset Podcast #191: Tim & Tom Take Your Questions - Transcript

Tom Mullooly: Welcome back to the Mullooly Asset Management podcast. This is episode number 191.

Tim Mullooly: This is Tim Mullooly.

Tom Mullooly: And Tom Mullooly.

Tim Mullooly: We're going to keep on going answering those questions that we've been getting from you guys on a weekly basis. Some really great, unique, interesting scenarios and questions about financial planning and investments and pretty much anything that falls under our umbrella of expertise, you could say.

Tom Mullooly: Another podcast that we both listen to would say, "These are all fascinating."

Tim Mullooly: Yes. So, let's jump right into the questions. We have a couple good ones for you today. Yeah.

Tom Mullooly: The first question is about a 401(k) and getting a loan from a 401(k).

Tim Mullooly: Right. The question is, "Will I have to pay back a 401(k) loan with post-tax dollars?"

Tom Mullooly: The short answer is yes, you will have to pay back a 401(k) loan with post-tax dollars. Think about it. If you could pay back a 401(k) loan with pre-tax dollars, why wouldn't everyone have the maximum loan all the time?

Tim Mullooly: Right.

Tom Mullooly: Because they'd just be shoveling pre-tax dollars into their 401(k) plan, as much as they could. So you're always going to be paying back a loan from a 401(k) with post-tax dollars. I think the real question, though, is, he said, "When I retire and start withdrawing the money, will I again be paying taxes on it?"

Tim Mullooly: And that answer is no. Most 401(k)s, when you take a loan and you pay it back with post-tax dollars, that money is tracked. They can tell which money was used to pay back a loan, which is post-tax, which is pre-tax. They should be able to keep track of that so that you're not taxed on the money twice.

Tom Mullooly: Right.

Tim Mullooly: Because otherwise, it would seem very foolish, even more foolish to take a loan from your 401(k) if you have to pay taxes on it twice.

Tom Mullooly: Right. Not every 401(k) plan in the United States has the ability for participants to take loans. Understand that if you happen to be in a plan that permits loans, you're in a pretty sophisticated plan and they have the accounting software to keep track of your pre-tax and your post-tax additions. Paying back a loan will definitely be a post-tax addition to your plan balance. Now, understand that post-tax additions like the money you use to pay back a loan cannot be rolled over into an IRA after you retire. You're just going to get a check for that money.

Tim Mullooly: Right.

Tom Mullooly: Yeah, that's not going anywhere.

Tim Mullooly: I think if your plan offers you the ability to take a loan and you're unsure, a good thing to do would just be to ask the plan if they keep track of that, because they should, and if they're not, you really should think twice about whether or not to take the loan.

Tom Mullooly: One other follow-up question that I think I would say. If you're calling your 401(k) plan administrator, like Tim just mentioned, ask them what happens to the contributions. Do they go into the money market? Do they go into some kind of stable value fund? What happens to the actual dollars that you send in? In theory, that money should go in as you instructed them to allocate your paycheck, your pre-tax contribution. So if you have 50 percent going into some large cap growth fund and 50 percent going into a small cap fund, your post-tax contributions really should do the same thing. But it's a good thing to find out.

Tim Mullooly: Yeah.

Tom Mullooly: Yeah. Let's move on to the next one.

Tim Mullooly: Sure. Second question is, "How cautious should I be of retiring when I still have substantial debt on my plate?"

Tom Mullooly: Okay. Before we even get into the details. Tim, how cautious should you be if you're retiring and you still have some substantial debt?

Tim Mullooly: I would say very cautious. If it's substantial debt, I would think twice about even retiring.

Tom Mullooly: Yeah.

Tim Mullooly: That's a scary thought. You're not working anymore, so you don't have that paycheck coming in and you still have debt on your plate that you have to pay off. Very cautious, would be my answer.

Tom Mullooly: Yeah. Let's go through some of the details.

Tim Mullooly: Sure.

Tom Mullooly: This person writes in and says, "I'm 66 years old with an annual salary of about 100,000. I'm thinking of retiring within a year or less. However, I'm very apprehensive because I still have a mortgage." That's okay, a lot of people retire with a mortgage.

Tim Mullooly: Right.

Tom Mullooly: "But I have a mortgage, two car loans," okay, that's a problem, "couple of credit card bills ..."

Tim Mullooly: Bigger problem.

Tom Mullooly: Bigger problem. "... totaling a debt load of about $330,000." Yeah. Big sigh.

Tim Mullooly: Oh boy.

Tom Mullooly: "I expect to have 401(k), pension, and Social Security to rely on as income. What do you suggest I do?" Keep working.

Tim Mullooly: Agreed.

Tom Mullooly: Or plan to sell your house, because I'm going to guess that of the 330,000 that you have in debt, that a large amount of that $330,000 is your mortgage. It's unfortunate, but you've got car loans, you've got a couple of credit cards. I just want to give you some back of the envelope math. Really simple. Let's assume that none of these debts have interest rates, they're all zero. If you want to pay them off over the next 10 years, meaning, by the time you're 76, you need to pay off $33,000 a year. That's almost $3,000 a month, just using simple interest and paying it back over 10 years. Now, of course, all of these have interest rates tied to them, so it's going to be more than $3,000 a month, if you want to pay it off over 10 years.

Tim Mullooly: And that's $3,000 a month just to pay off your debts. When you're retired, you have all of your other living expenses and everything else as well.

Tom Mullooly: Yeah.

Tim Mullooly: So it's $3,000 on bare minimum, definitely more than that. Including living expenses, and you're going to pay for it all with a 401(k), pension, and Social Security. I sincerely hope you're 401(k) is substantial.

Tom Mullooly: Right.

Tim Mullooly: Just like your debt.

Tom Mullooly: The other thing that I'll add, and I'm not trying to be sarcastic, but don't get sick. I mean, having a serious illness is a big problem and should be a big concern for people as they get older. It's very, very expensive, getting sick. Hopefully you're in good health. Sit down with a financial planner at your earliest convenience.

Tim Mullooly: Right. Moving on, next question is, the writer asks, "Is it better to hold a REIT in a taxable account or a Roth IRA?"

Tom Mullooly: Okay, good question. Better to hold a REIT, that's a real estate investment trust, in a taxable account or a Roth? If you own a REIT and let's just say that you're getting four, five, or six percent in dividends, and they're technically not dividends, they're funds from operations. If you're getting a higher yield investment and you're in a taxable account, understand that you're going to have to report and pay income taxes on the distributions that you receive from a real estate investment trust. If you have something that pays a dividend and you're going to hold on to it for a while, then you really ought to think about owning it in a retirement or some kind of tax-deferred account, because you won't have taxes chipping away at your overall return. But there seems to be a twist to this person's question.

Tim Mullooly: Right. It seems like they asked the question after they have already have the REIT in one of their accounts. They write, "I own a REIT in my taxable Vanguard account. I was thinking of moving it to my Vanguard Roth IRA," which on the surface sounds like a good idea. The only thing is, you can't do that.

Tom Mullooly: Right.

Tim Mullooly: Well, it's not as cut and dry as you would think.

Tom Mullooly: You can only add cash to retirement accounts. You can't take a position and move it from your taxable account into a retirement account. If that were the case, then I would take those shares of Coca-Cola that I bought 35 years ago, with all the taxes built up, and I would transfer that into my IRA.

Tim Mullooly: Wouldn't that be nice?

Tom Mullooly: Right. So you can't move positions, investments, into a retirement account. When you're funding a retirement account, you can only move in cash, whether it's a traditional IRA or a Roth.

Tim Mullooly: This person can and should probably, if they're going to own a REIT, should own it in a Roth or some sort of tax-deferred account. But to move it from one account to the other, they would have to sell the REIT in the taxable account, move the cash over to the Roth IRA, and then buy it back.

Tom Mullooly: Right. You've got a couple of extra transactions in there, probably not what you had in mind. Sorry.

Tim Mullooly: I think we're coming up on one of the last questions, here. The writer asks, "What documents do I need to bring to a consultation with a financial advisor, and what should I expect to get out of a consultation?"

Tom Mullooly: We promise we did not write this question ourselves, but this may be one of the best questions that someone could ask. If you're going to meet with a financial planner or an investment advisor, just like if you were interviewing someone to build you a house, you'd probably want to interview more than one. So I'll tell you, Tim and I will share, what you need to bring to a first consultation with Mullooly Asset Management. You don't need to bring anything.

Tim Mullooly: That answer seems to surprise people a lot. People ask, should I bring papers, statements, what should I bring?

Tom Mullooly: Should I bring tax returns?

Tim Mullooly: Right.

Tom Mullooly: Should I bring my insurance policies?

Tim Mullooly: If it's an initial consultation, just bring yourself.

Tom Mullooly: That's right. Just show up. What we do, and not every firm does this, is we have what's considered a fit meeting as our first meeting. That is strictly getting to know you. We invite you to come into the office and sit down and meet our team. We want to learn about you. We want to learn about your situation. We want to learn about your experience with investments, with advisors. We want to know as much as we can know before we dig into any kind of paperwork and numbers. We want to know about you.

Tim Mullooly: The other side, you are going to want to know about us, and that's the flip side of that. We're going to tell you how we work with our clients and the services that we provide. Then once both sides have exchanged initial information, we see if it's a good fit on both sides.

Tom Mullooly: Right, right.

Tim Mullooly: Because our feeling is, both sides need to want to work together for it to work as best as possible.

Tom Mullooly: Yeah. When I was a broker, I don't know if, Tim, I've ever shared this with you, but when I was a broker, they used to have this thing in the branch offices called Broker of the Day. Back in the 80s, they actually used to call it Man of the Day, which they can't do anymore. But when you were the Broker of the Day, when someone called up the main number for the office and they said, "I want to talk to a broker," you would get that call. It rotated every day. Everyone got a turn. Occasionally, someone would come in and say, "I want to talk to a broker," and you would meet that person. A lot of times, people would be ticked off at their broker, whose office was right across the street. They would get mad, upset, whatever, and they would march across the street, or drive across the street, and say, "I want to talk to a broker."

Understand, it took me a couple of years to figure this out, but there were some clients that just lived for Broker of the Day. Because it was like, hey, if I get two or three new clients a month, then I'm going to keep my branch manager off my back and I'll probably get some new revenue and that's great. New assets, new revenue, that's what they want me to do, so I'll just be Man of the Day. Understand that you're inheriting someone who is having a problem or has some kind of complication or they're just a handful to work with. Is that really what you want?

Tim Mullooly: It's not an ideal client.

Tom Mullooly: It's not. So what we do is we have this fit meeting and we invite people who want to ask questions, want to find out about what we do, we want to find out about them. We come in and we get to know each other over 30 to 60 minutes, talking with each other, and then we decide, sometimes it's at that meeting but most times it's over the next day or two, we don't want them to make any kind of commitment on the spot. We will decide if it's a good match for us and let the potential client know if it's a good match ... They can decide, we can decide.

Tim Mullooly: Right. It's a big decision, picking an advisor or deciding to work with someone.

Tom Mullooly: Right.

Tim Mullooly: We feel that we don't want to put anyone on the spot. It's good to let people leave and let it marinate for a day or so. Our belief is, if you're enthusiastic about working with us during the fit meeting, if it really is a good fit, you're going to be just as enthusiastic the next day or the day after that.

Tom Mullooly: Right.

Tim Mullooly: Then we'll give you a call, we'll schedule another meeting to come in, and then we'll really dig into the paperwork and the numbers. But that's our approach. People are usually surprised when they call in for an initial consultation and we tell them, "You don't need to bring anything." But every advisor's different. That's just our own personal process.

Tom Mullooly: It tends to work pretty well for us, especially when we want to talk to these potential clients and let them know that our approach and the way that we do business as a fee-only advisor and financial planner, is probably not something that they've seen at other firms. We have a lot of comments that we get from people who say, "I thought you were going to sell me something today." Sorry, we're all out of Dodge Caravans today.

Tim Mullooly: A lot of places, you can drive up and down the road here and four out of five people are going to try and sell you something.

Tom Mullooly: Yeah.

Tim Mullooly: So it is a little different when you come here.

Tom Mullooly: You could be the square peg, but they're going to try and fit you into a round hole.

Tim Mullooly: Right.

Tom Mullooly: And it's not always a good fit. Great question, and remember, if you've got questions, you're probably not the only one who's thinking about these kind of topics so by all means, get in touch with us. We'd be happy to answer your question and you may even hear it on a future podcast. So thanks for listening to episode 191 and...

Tim Mullooly: We'll see you guys on 192. Thanks for listening.