Ep. 246: Is Going to College Really Worth It? - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management Podcast. This is episode number 246. Your trustee hosts are here, Brendan Mullooly and myself, Tom Mullooly. And welcome to our show.

Brendan M: Welcome to everybody. I think we have a handful of things that we want to cover today. Right?

Tom Mullooly: We do.

Brendan M: What was this first one? You had like a graph that you were sharing with me before we started up here.

Tom Mullooly: It looks better on the color printer then on the black and white printer.

Brendan M: Sure, but we can link to this.

Tom Mullooly: We'll paint the word picture here and we'll link to it in the show notes. Report out recently from MIT that showed the cumulative change in real weekly earnings of working age adults. So these are working age adults. So this is from age 18 through 64 and it covered a period from 1963 to 2017, in some cases going back as far as 55 years.

And they showed what happened to the change in real weekly earnings if you were someone who was a high school graduate, or if you had some college, or a bachelor's degree, or if you had a graduate degree? What impact did that have on your earnings over time? They also included, what if you were a high school dropout? Very interesting using 1963 as zero, their launch point, they showed that there really was no drop off for your income in the 60s.

And actually into the early 70s, there wasn't much drop off between a college graduate or someone with a graduate degree and a high school dropout. But things shifted very quickly after that. In fact, from a peak in 1981 through the late 90s, in the late 90s, you were actually on a dollar for dollar basis earning less than a high school graduate 25 years earlier in the 1960s. And that hasn't really budged all that much.

Now, in the last 25 years where if you're dropping out of high school, you're going to have a tough time making money and your income hasn't increased at all really in the last 30 years, 40 years, 50 years. Now by comparison, we were both looking at this. That was for men who fit those different profiles. Women high school dropouts starting again 1963 as your zero launch point, they've actually had a somewhat steady ride up.

Again, not making much as people who have some college or college degree, but they are moving up and you alluded that to-

Brendan M: I think that could just be fair wages given to women over this time period or more women entering the workforce. This goes back 50 years. A lot has happened over the last 50

years in terms of equal pay. I don't think we're quite there yet, but things have definitely gotten better over this time period and maybe that speaks to equality.

Tom Mullooly: Probably a lot behind this. It's interesting to note that if you have a graduate degree, if you're a male with a graduate degree, pretty much a straight shot up from 1963 into the 1970s, kind of pause there around the late 70s into the early 80s. And from there, moonshot up very nicely. The graph is actually sloped even higher for women who have graduate degrees. Their income doesn't really seem to be stopping.

Brendan M: Right. I don't know what the larger report that this was from says or is about, but what this graph says to me, the people who tell you the solution to all this student loan stuff is to just stop going to college, those people are wrong and that's not a good idea. And additionally, we hear all of these stories about people like Bill Gates who dropped out of college and started making computers and stuff in his garage. That's terrific. That doesn't mean that you should do that either.

And that's not to say that you 100% won't be successful doing that because obviously this is on average. So on average, people with college degree or graduate degree pretty much goes in order by the level of your education. You could basically just match those with earnings. I could name these lines without even looking at the legend on the chart. You know what they are based on how much school they went to.

That has been the message, but people have begun to question that recently because things like student loans have really gotten out of hand. Totally agree with that. It's a problem. Maybe some of those dynamics are suggesting that not as many people should go to these different levels of school that they did. But I don't think the answer is just that college is crap and you should not go. Because I think a lot of people are beginning to suggest that and it has political undertones that I don't care for.

Tom Mullooly: It's really going to hurt people as they get older in life. So the main message I saw in these charts is stay in school.

Brendan M: Right. So on average, staying in school pays. It doesn't mean that it's a guarantee. So you still have to be smart about it. Go to school for something that you think can get you a decent paying job or give you skills to be employable when you leave. You can't just mail it in, but on average, yeah, stay in school.

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Tom Mullooly: So speaking of average, a headline from CNBC and the last couple of days, the average family has no idea how the new tax law will affect them. Probably good for CPAs.

Brendan M: Good for CPAS, also scratch the new tax law part. Do you think that last year families had a good idea of how income taxes affected them? I think this is just a broader issue is what I'm getting at.

Tom Mullooly: I agree. I think that a lot of folks just kind of look at their check that they get every week or two and say, "Okay, it's kind of what I was expecting." And they just move on without any real understanding of how much comes out for healthcare, how much comes out above the line, below the line, what's being saved for retirement, what's going out the door in taxes. They just don't really understand. We could probably put on a seminar just breaking down someone's paycheck.

Brendan M: I think there's been kind of like a fundamental misunderstanding that people have been discussing over the last month or so now that we're into a tax season with this new law about the difference between what your tax return is and a tax refund.

Tom Mullooly: Yeah.

Brendan M: I've experienced this talking to just friends, people that I know. I think that people have this misunderstanding that how good or bad their accountant is is measured by how much or little they get in a tax refund. And that couldn't be further from the truth. Depending, if you're doing some kind of tax planning with whoever this professional is, then maybe that does fall on them a little bit if they recommended certain withholding rates for you or things to get some deductions and lower your taxable income, things like that.

But if you're literally just going to somebody for tax preparation and then judging them based upon how much you get in a refund, that does not correlate with their skills or intelligence as a tax prep professional or CPA, whatever they are.

Tom Mullooly: It's amazing. I think in making a baseball analogy, you can't tell if a trade between two teams really works for a few years. You can tell if an accountant is good or bad, depending on the amount of letters you get from the IRS.

Brendan M: That's a better proxy than whether or not you get a tax refund. That is entirely a function of whether or not you withhold enough money over the course of the year. That's a conscious choice. So if you got a refund this year and you don't want to refund next year because you view it as an interest free loan to the government, then change your withholdings so that you come in break even or maybe you owe a little bit.

Conversely, if you owe the government money this year and you don't want that in the future, you would rather get a refund, a form of forced savings, then hike up your withholding rates next year for state or federal income taxes, and then you'll get a check back. It doesn't need to be a surprise in April or March whenever you're meeting with your tax professional. Am I going to get a refund? Like I'm going to hold my breath as they punch in a calculator.

Tom Mullooly: It shouldn't be. It should never be.

Brendan M: But this article, a lot of things that it discussed do apply to this year because there were a lot of changes. So it covered things like the new standard deduction, the increased child tax, the tax credit, different aspects of the tax code that did change.

But I guess my initial point was that I don't think people probably had a good understanding of how. Did you know what the standard deduction was last year? It's not like you don't know it because it changed this year. A lot of people just don't know that to begin with.

Tom Mullooly: Yeah. So when we talk about income and income taxes and stuff like that, a conversation often goes back to, well how much income are you bringing in? Whether it's from social security or from a pension or from a bond portfolio, this kind of leads to discussions that we've had with clients, we've had around the office. Do you want to-

Brendan M: Yeah, good segue there. I like that.

Tom Mullooly: Hey man, I worked all day on that one.

Brendan M: So this is a topic that's come up a handful of times before. If somebody has a pension, which we all do in some capacity. If we get social security, that's how that functions. But in addition to that, this often comes up if there's an extra pension.

So if you were a government employee or you happen to work at a corporation that had a pension when you were there or still does, we've heard it suggested before that if you have a pension you can or you should consider that a part of your bond portfolio because it's throwing off a certain amount of income every year.

Tom Mullooly: Guaranteed, fixed amount of income coming in. Right. Do we buy into this?

Brendan M: I do not for a handful of reasons. First, let's just consider how you could think about this. So if you have social security income and a pension that are going to cover, let's say, all of your living expenses for retirement, you need $50,000 a year. In between the two of those, you're going to get 55, you're set. What that's saying-

Tom Mullooly: Wait, wait, wait. That assumes that prices never change, there's no inflation-

Brendan M: Let's just assume that for this example. Let's assume it's inflation adjusted and it's going to take care of things even though that probably isn't the case. So in that scenario, you could choose either to be 100% in stocks, like the suggestion that we've often heard like, oh, I don't need bonds, I have a pension that's covering that income, so I'm not going to have any bonds.

You could make that decision to be 100% in stocks or you could take it to mean the alternate, which means I don't need to take any risk. I am covered. I don't need to grow anything. I could be 100% in bonds.

Tom Mullooly: Right.

Brendan M: So it's ultimately all up to your feelings in that scenario. You've eliminated ... When we talk about risk tolerance with clients, we're talking about their need to take risk as defined by their situation and their financial plan, their desire to take risk, which is what they're comfortable with, and the ability. Is this sensible? Can people afford to take this amount of risk? That fits back into the needs thing, but it's slightly different.

So you've eliminated the needs aspect of that by saying, "I have a pension and social security income that covers all of my income needs." So there is no need. It comes down to your ability and your desire to take risk. If somebody is all on board and they understand that being 100% in stocks means a lot of volatility, as much as you can get a with an investment portfolio, and they think that they can stomach that, that's great.

Like I said, they can afford to be 100% stocks if they want because they don't need to do anything above and beyond what they already have locked up with their income sources. I question whether people can hang with that, especially as account balances grow. I'm not sure that just replacing the income component of a portfolio that bonds would offer with pension income, so to speak, is going to do the trick.

I think that the behavioral aspect of having bonds that lowers the volatility of the account as long as we're talking high quality bonds is probably an important aspect to consider in this.

Tom Mullooly: I think this is really the point that we need to drive home. Instead of looking at this income stream as the cash flow that you'd get from bonds, the real value that bonds bring to an asset allocation is providing that buffer or that bumper which helps deflect some of the volatility away.

Brendan M: Yeah. So I would say that, just rephrasing what you said, you should think of your pension income as cash flow, as income. Like it doesn't enter the asset allocation part of your financial plan.

Tom Mullooly: I'm going to interrupt because if you were working and bringing in a paycheck, you wouldn't consider part of that a bond portfolio because you're bringing in work without having the asset throwing off the cash flow behind you. You are the asset.

Brendan M: I've heard it thrown around before that, especially for young people, you could consider your income a bond because it's hopefully over the course of your 20s, 30s, maybe into your 40s even, growing each year or at a rate that could be higher, especially with bond rates and the ballpark of 2-3% for something high quality these days.

Tom Mullooly: That would really be a step up bond.

Brendan M: I get that you could do that, I just don't think that most people can handle being 100% in stocks even though I know that that is going to help people get the highest possible rate of return. I'm just not sure that somebody can stick with that.

And I think that that's more important than saying, "Well, it would be most optimal to pretend as if your pension income is the bond sleeve in your portfolio." Like if you're getting $30,000 in income from a pension, how much in the aggregate bond index would you have to own to get that?

Tom Mullooly: You'd have to have a million dollars.

Brendan M: Right, exactly. So I get that part of it. So to then take your allocation and say, "Well, now I basically have $1 million worth of bonds, so let's counter that by being all in stocks with the rest of my retirement portfolio." Okay, that makes total sense on paper, but how are you going to feel in the fourth quarter of last year when markets are down 20% in three months? Is that okay then? Probably not.

Tom Mullooly: We saw it in living color.

Brendan M: Right. I just don't think that people are going to be comfortable with that in the moment. I think that saying that your pension is your bond allocation is something that people say during a bull market. It sounds great during a bull market. It's like, oh, well, what the heck would I need bonds-

Tom Mullooly: Why should I have money in bonds?

Brendan M: What would I need bonds for? And if you're going to stick with that and you have the temperament to, then great. But if you're going to be 100% in stocks and say, "I have fixed income with my pension," and then freak out and panic sell when the market goes down, you would have been better off in a balanced portfolio that you could just stay in instead of just freaking out at the extremes of the market.

Tom Mullooly: I know it'll sound harsh, but my response to someone who's in that position where they have told us that they're considering their income stream, pension, social security, as cash flow from a bond portfolio, my answer would be, "You signed up for this. You signed up for all this volatility."

Brendan M: Should be discussing this during the planning process. We should definitely be planning around pension income. I'm just not necessarily sure that it enters the discussion during ... It doesn't come in like, oh, X dollars of pension income equals X percentage less in your bond allocation. That is not part of the equation.

Tom Mullooly: It doesn't work that way.

Brendan M: You want to consider it, obviously. That's fundamental building blocks of a financial planner looking at sources of income like that that are going to work in conjunction with whatever the portfolio's throwing off. But I don't think they necessarily are even in the same realm when you're discussing these decisions.

Tom Mullooly: And I want to go back to something you said very early on in this part of the discussion where you said, "Hey, this really is a question of choice." If you have enough income from different sources, maybe you have a pension, maybe you have social security, maybe you have rental income coming from a property, and you're generating enough cash flow to meet all of your needs and then some. You raise an interesting point that a lot of people don't think of. Now I don't have to take any risk.

Brendan M: Right. So it's another discussion. You could be at the extreme poles here and I don't think you should be at either of them in most cases. If I had to throw a blanket over it, I don't think you should be 100% stocks because I don't really believe that most people can stick with that. And on the other hand, sure, could be 100% bonds because you don't need to take any risk. I think you should probably find some kind of balance between the two that is going to speak to the emotional aspect of it.

So you want to have some skin in the game so that when the market's going up, you participate in that a little bit because you're going to be envious if you're 100% in bonds and the market has a great year. I think, as long as you're watching it. If you're not, then good for you. If you made your decision, then you don't need to watch what happens after. But yeah, this discussion, I get the logic behind it. I just don't agree.

Tom Mullooly: I don't buy that.

Brendan M: I think my response to the question initially is just that Ron Burgundy gif, the Will Ferrell one where he's like, "I don't believe you," because I don't. I do not believe you, that you're going to take that as your bond allocation and sit tight through market corrections.

Tom Mullooly: It's not going to work. The people who have 100% stock portfolios all the time, they write books about them. Charlie Ellis, Warren Buffet. Even he's got bonds.

Brendan M: I don't know. Look, there are some people out there that can have 100% stock portfolio.

Tom Mullooly: They have to not need the money.

Brendan M: Yeah.

Tom Mullooly: At least in the next couple of years.

Brendan M: Right. Maybe you can separate it out. Maybe you could do some mental accounting and say like, "Alright, well let's look at this million dollar portfolio. How much of it do I want to keep in something safe just in case I do need something above and beyond my pension?" And we'll put that into a low growth portfolio. And the rest of this, I want to see it grow and maybe it's generational money.

So maybe you just put it in two separate accounts because I think mentally separating that is easier than looking at the one account and saying, "Ah yes, some of this is for me and the rest of

it is for my heirs." I don't know. And mental accounting is never sensible. It never makes logical sense, but I think it can make perfect sense from the standpoint of just helping yourself stick to whatever you're putting in.

Tom Mullooly: Mental accounting seems to work one day out of the month, the day after you open your statement and you call your advisor and he says, "Hey, that represents your bond portfolio, the pension income."

Brendan M: Right. Yeah, you can do mental accounting however you want. I suppose the pension as your bonds is a form of mental accounting too. So I don't buy that version of it, but maybe I subscribe to other versions of it.

Tom Mullooly: Not a buyer. Well, thanks for tuning in to episode 246. We hope you appreciate what we're covering. If you've got a topic that you'd like us to talk about, get in touch with us. Thanks for listening and we'll catch you on the next episode.