Important Tips for Filling Out the FAFSA - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 249. Thanks for tuning in. I'm one of your co-hosts, Tom Mullooly, and alongside me is ... Actually, not alongside me, but across from me-

Brendan Mullooly: Yeah. We're normally across the table, but-

Tom Mullooly: That's right.

Brendan Mullooly: I'm here too, Brendan Mullooly.

Tom Mullooly: Brendan Mullooly and Tom Mullooly are here to paint the word picture for you.

Brendan Mullooly: Yes, and I want to start off by discussing an NJ.com article that you recorded pretty extensively. Is that correct?

Tom Mullooly: You are correct sir.

Brendan Mullooly: Alright. So fill us in, this was on the FAFSA, correct?

Tom Mullooly: Yes. We do get a lot of questions from clients asking about the FAFSA and the FAFSA is kind of a moving target. Important to know if you have kids who have gone through the college system already, things have changed.

Brendan Mullooly: So this falls into the college planning bucket when we're looking at a client's situation.

Tom Mullooly: Right.

Brendan Mullooly: Looking at their financial plan.

Tom Mullooly: My advice to the folks who hang around the coffee pot or the water cooler at the office and say, “when my kids went to college this is how we did it”, don't say that anymore because things have changed. One of the big problems with doing the FAFSA each year in the past, if you were filing it, and they usually would tell you in the calendar year file as early as you can because the schools have a limited amount of financial aid. If you can file by January 31st you should or file as soon as you can in January.

Brendan Mullooly: Meaning the FAFSA form?

Tom Mullooly: File the FAFSA.

Brendan Mullooly: And by extension of that your federal income taxes as well, right.

Tom Mullooly: Correct.

Brendan Mullooly: Because they want that information on the FAFSA.

Tom Mullooly: That's right. Let's just go back in time and say its 2013 or 2014 or 2015, you would have to have your taxes complete or pretty much on their way to being completed in January when you go to file the FAFSA so if you didn't have your taxes done they eventually added an option that said “will file” and what would happen is your student's FAFSA form would be accepted but the college would normally send out some kind of financial package award letter in late April or May 1st you would get it and if you hadn't filed your taxes or you had to get an extension they usually got a letter saying “hurry up and get your taxes done so you can update your FAFSA information”. It was a real drag.

Brendan Mullooly: It's tough because while the college or soon to be college student I'm sure wants to make their decision and things like award packages are going to factor into that big time you also want to get that in is what I'm saying. You also don't want to rush something like your federal income taxes because-

Tom Mullooly: Absolutely not.

Brendan Mullooly: You may, and many likely aren't prepared to file taxes in January. That's very early.

Tom Mullooly: Years ago when this business was getting off the ground and you were a student in school I was always getting an extension to file-

Brendan Mullooly: Right.

Tom Mullooly: So that kind of messed with the timing of the award packages. Also,-

Brendan Mullooly: Many people get flustered by this, it's a lot, so it seems like an imperfect trade-off. I'm either going to wait to hear about this college stuff, which is important to me and my child, or I'm going to rush my federal income tax returns which is going to make me stressed.

Tom Mullooly: Yeah.

Brendan Mullooly: Anyway, because we may not even have all the information we need like 1099's and things like that at the time of year you need to do it so what do you do because it seems like it's a rock and a hard place.

Tom Mullooly: Before we get to that I will tell you that I could almost identify perfectly which clients had students in school or about to go to school because they usually called the first few days of January “when am I getting my 1099, because I have to file the FAFSA”.

Brendan Mullooly: In March, my friend.

Tom Mullooly: Yeah, they didn't like that. So FAFSA has changed their terms and now you can use your previous year’s tax return information so that's really good. So if you're filing now we're recording this in March of 2019 most people are now filing the 2018 taxes, you can use your 2017 return.

Brendan Mullooly: Right, and then eventually they'll ask you for the 2018 return. Is that how this works?

Tom Mullooly: No. Everything is based off the previous year, there's a year lag-

Brendan Mullooly: Right.

Tom Mullooly: So your financial aid package will be based for the 2019 and 2020 school year is based on your 2017 return. Always be a year lag.

Brendan Mullooly: Interesting to account for when you're thinking about things you're doing that have tax implications in these years. That could either be advantageous or not depending on ... some people have one off events that may dramatically impact-

Tom Mullooly: Sure.

Brendan Mullooly: The kind of aid they're getting if they're showing a lot more income for one calendar year if they took a big distribution from a retirement account or had something abnormal come across the cash flow over the course of the year.

Tom Mullooly: They lost their job or they started a new business and there's no income, a lot less to show that will also skew the numbers as well.

Brendan Mullooly: Yeah, these decisions have ripple effects so it's important to consider these. Not top of mind sometimes when you're making these decisions but you think about this tax year is going to impact this year of the FAFSA and you can kind of map out and maybe consider those ramifications when you're thinking. This is why financial planning is “comprehensive” because these areas all have overlap. Whether it seems like it on the surface or not.

Tom Mullooly: Yeah. Like you said there's a ripple effect all through. Totally off topic but I knew that when I started the business back in 2002, I had worked for Morgan Stanley, I borrowed a lot of money, I was in a situation where my car started falling apart and I had to buy a car and I had to borrow money to get a car. I knew that I had to do it pretty soon because at some point my credit was going to change because of a change in my income and a change in my situation.

Brendan Mullooly: Right.

Tom Mullooly: So you really need to think about this stuff because a job change, a retirement, all these things have far reaching implications and not something that you would immediately think of.

Brendan Mullooly: Also, not something that traditionally people have come to expect an investment advisor, financial planner, it's not something that people come to our office to talk about a lot of times but their surprised at the scope of what we're looking at in terms of their life and finances. This is no longer an industry of call me on the phone so I can sell you something. We're looking at all the areas of a person's life and this can. And this can-

Tom Mullooly: What stock got upgraded at

Brendan Mullooly: Right.

Tom Mullooly: This morning. You know.

Brendan Mullooly: People don't care about that but they do care about stuff like this where you can show them the impact of a decision and why we should not just wing it with stuff like this and try to plan out as best we can. I know life is throwing us curve balls at all moments but-

Tom Mullooly: This is along the same lines of when should you consider the timing of a Roth IRA conversion?

Brendan Mullooly: Yeah.

Tom Mullooly: If you have a situation where you've got a pretty normal amount of income this year, next year there's going to be a big drop off because you're getting a retirement package or something's going on, that may be the window to-

Brendan Mullooly: A one year opportunity to do something that could have far reaching implications on your future. This is future tax free income that is not going to be subject to required minimum distributions so it could impact how much taxable income you're showing in retirement which could impact how much of things like social security is being taxed or what bracket you're in at that point and that in itself affects withdrawal rates and where you wanna take assets from so if you have a chance to do something like that you can plan for it.

Tom Mullooly: So these things do have ripple effects. I like that phrase, we're going to use that some more but these Roth IRA's Brendan they're tricky for some people.

Brendan Mullooly: So I've had an issue recently. My girlfriend has a Roth IRA, has been getting her taxes done this week and the preparer at a very big tax firm that everybody knows, you see their commercials all the time.

Tom Mullooly: Right. We won't say their name but their initials are H&R Block.

Brendan Mullooly: Anyway they have been trying to tell her that she can deduct these contributions that she's been putting into her Roth IRA which of course we know is not true. She knows it's not true and has been sharing this with this guy like, “Hey, I don't think that that's right. I've never deducted these before, I don't think that their deductible since money goes into these accounts after tax. That's not how this works”, and so I put out a tweet last night kind of making fun of the whole situation, we're handling it and it's all fine but one thing that was brought to my attention.

Tom Mullooly: Are you Twitter shaming H&R Block over this? What are you doing-

Brendan Mullooly: I didn't tag them but I did name them in the tweet. Anyway, one thing that a friend brought up, Andrew Miller, who we've discussed on the podcast before-

Tom Mullooly: Friend of the firm.

Brendan Mullooly: Friend of the firm, I did the Alpha Architect March for the Fallen with him, he is really in touch with taxes and knows his stuff and one thing that he replied was, “Is your girlfriend eligible for the retirement savers credit?”.

Tom Mullooly: This is actually a real point.

Brendan Mullooly: This kind of cool which is why we wanted to bring this up.

Tom Mullooly: Yeah.

Brendan Mullooly: I said I don't think so but I'm going to look just to be sure because I'd never heard of this before. So Andrew sent me a link, it's out there on Twitter.

Tom Mullooly: Just follow Brendan.

Brendan Mullooly: We'll link to the IRS page in the show notes too. Basically the way that this works is you can contribute to a host of retirement plans, whether this is an IRA, Roth IRA, your 401k at work, you can do 457, 403b, a whole host, basically all of them but there's a strict list on the IRS website you can reference. So how this works, this savers credit, for retirement savers credit is that if you are age 18 or older, you are not a full-time student, no one else is claiming you as a dependent on their tax return you may be eligible to get a tax credit, not a tax deduction, for your retirement plan contributions and the rate at which you get this credit is between 10 and 50% of whatever your contributions were with a $2000 maximum for the credit. So that's the max that you're going to get. This is all based on your adjusted gross income.

Tom Mullooly: So the most you could get would be-

Brendan Mullooly: A $2,000 credit. If you make, obviously the credit is out there to help people with lower incomes, but if you fit into these specifications, just as an example you could, if you had a 30, if you're a single person and you had a $30,000 adjusted gross income and you put $3,000 into your Roth IRA over the course of the year, you could get a $300 tax credit for your contributions to a Roth IRA where you're going to get tax free income in the future, no tax deduction but you're getting a dollar for dollar reduction $300 off of the income tax that you owe for that year. I did now know about this. It's out there for people and specifically I think it could be something that younger people want to pay attention to and these are often the kind of people who are using a Roth IRA.

Tom Mullooly: Sure. If you're a teenager and you've got money like this you're probably going to qualify on thresholds and you'll get a tax credit. You can't be claimed as a dependent on your parents return.

Brendan Mullooly: Got to be over 18.

Tom Mullooly: Yeah, you got to be over 18, 19, 20 but like-

Brendan Mullooly: Right.

Tom Mullooly: These college students who are working and doing a responsible thing or somebody who's just out of school working on that starter salary.

Brendan Mullooly: Chuck it into a Roth.

Tom Mullooly: Yeah, if you do that you can get a credit and most people will tell you that at tax credit is more valuable than a deduction that you're going to get.

Brendan Mullooly: I thought this was a pretty cool wrinkle, not something that I was aware of. Didn't fix our problem with H&R Block but pretty cool and something that I learned on Twitter that I thought was worth sharing and so we'll have a link to more details on this in terms of how the AGI breaks down for the IRS. Obviously, check with your tax professional who I hope is a reputable professional or your investment advisor, preferably both, before you think about doing stuff like this but its worth checking out. Pretty cool stuff.

Tom Mullooly: I guess you should also find out if your tax preparer is on Twitter.
Brendan Mullooly: Yeah.

Tom Mullooly: What's your Twitter handle? I'm going to follow you for a few days before I let you at my return.

Brendan Mullooly: Yeah, seriously.

Tom Mullooly: So I have a question, when are we getting Ptak on the podcast?

Brendan Mullooly: I would love to have Jeff Ptak of Morningstar on this podcast or Tim's Living with Money podcast. We've had his colleague at Morningstar, Christine Benz on-

Tom Mullooly: That's right.

Brendan Mullooly: Tim's show and we mentioned their work, both of them, respectively.

Tom Mullooly: I think we've cited Jeff's work at least 3 or 4 times in just the last couple of months.

Brendan Mullooly: Basically Jeff puts out a new article and it's almost always something that I wanna bring to the table to discuss on the podcast with you and so that is the case today. New article out from Jeff this morning and we read it and wanted to come share some details.

Tom Mullooly: Don't ditch that bad penny.

Brendan Mullooly: Yeah. Right. The title on this post is "Think Twice Before You Ditch That Laggard Fund in Your Portfolio" which is oftentimes exactly what people want to do.

Tom Mullooly: Sure.

Brendan Mullooly: I wanna chuck this thing, it hasn't been working.

Tom Mullooly: Everything else is up.

Brendan Mullooly: Right.

Tom Mullooly: This thing is way behind.

Brendan Mullooly: Yeah.

Tom Mullooly: Let's just get rid of it and we'll move the money somewhere else.

Brendan Mullooly: Right.

Tom Mullooly: That's music to a brokers ears.

Brendan Mullooly: Yeah, because it's a transaction, it makes perfect sense. I'm not going to say that this is always not the right move and that's certainly not what Jeff is suggesting either but what he is saying is that past performance doesn't equal future results and no matter how many times we say that phrase is our industry we all nod our heads and then we still just look at past performance when we're trying to select a new investment.

Tom Mullooly: Right.

Brendan Mullooly: For whatever reason I don't think it's ever going to go away but the idea for this post came because back in 2008 there was a pretty good study that showed institutions, institutional investors were pretty bad in terms of hiring and firing their own managers and this is the behemoths of the investment world. They're making poorly timed decisions in terms of when they fire a manager and hire a new one from that moment forward the fired manager goes onto perform better than the one that they hired.

Tom Mullooly: There's a similar analogy. I guess S&P now manages the Dow members when they kick a company out of the Dow the next 12 months the one that got dropped tends to outperform the names that got added.

Brendan Mullooly: Yeah. Mean reversion and obviously not something that you can bank on, not going to work 100% of the time but it does shed some light on maybe decisions that have been made that were not made for the right reasons.

Tom Mullooly: But you think about it, when would you ditch a mutual fund? Probably after a period of underperformance.

Brendan Mullooly: Right. You're probably not selling your winner.

Tom Mullooly: In most cases you're piling more money into the winner.

Brendan Mullooly: If you're reinvesting dividends or if you're taking proceeds from a loser you're probably piling into a winner or if not something that you own that was a winner something outside of your portfolio that has recently done really well because it's just human nature. I don't think people are out there, there not looking for “Wow, wow, let me find the worst performing mutual fund I could find”.

Tom Mullooly: I know that mutual funds are going to be diversified and they're going to be a certain extent balanced within their universe-

Brendan Mullooly: Style box.

Tom Mullooly: Yeah, in their style box, but if you believe in rebalancing your portfolio, and let's just say you have a portfolio of stocks. If you subscribe to the idea that you rebalance you're going to peel some money off of the winners and add to the things that have not been performing very well so you're buying at lower levels. Here is what we often refer to in the industry as the smart money doing just the opposite.

Brendan Mullooly: Yup.

Tom Mullooly: They're hanging onto the long terms winners, OK, but they're ditching the losers.

Brendan Mullooly: Yeah, and so what Jeff wanted to look at was since the institutions are doing this one would presume that individual investors are certainly doing something similar and that seems to be the case based upon the data.

Tom Mullooly: Yeah.

Brendan Mullooly: So everybody's doing this. It's not the smart money being stupid its, well it is, but it's all of us being stupid, across the board.

Tom Mullooly: Wouldn't it be great if we could just say, “Hey, this fund really underperformed last year. Let's watch it for the next 12-18 months and if it recovers then we'll move on”.

Brendan Mullooly: Well then you've missed-

Tom Mullooly: Right.

Brendan Mullooly: You've missed the thing. That sounds great.

Tom Mullooly: Sounds great.

Brendan Mullooly: Sounds like perfect market timing to me. I don't think that's how it works though.

Tom Mullooly: Yeah.

Brendan Mullooly: If you've missed the recovery then you've missed the recovery.

Tom Mullooly: No, I'm saying if you owned a fund and it went down and you didn't sell it and you're thinking about selling it now.

Brendan Mullooly: Oh, OK.

Tom Mullooly: Instead of selling this today, we're going to write this down March in, a year from now, March of 2020.

Brendan Mullooly: I love this idea actually just write down all the reasons why this fund sucks.

Tom Mullooly: Exactly.

Brendan Mullooly: Say why you wanna get out, why it stinks and then don't do anything.

Tom Mullooly: And then don't do anything.

Brendan Mullooly: And look at it again in 6 months.

Tom Mullooly: 6, 12, 18.

Brendan Mullooly: Whatever it is, this is something I had my blog launched last week and Michael Batnick basically explained this is how he combats what he calls his internal liar which is all of us have this bias where we rewrite history to fit our narratives so the way that Michael says that he combats this is he would write down all these thoughts that he had about why he was doing certain things, certain trades that he was doing and now being able to look back on that, the chronicles of that in hindsight just convinced him that, “I need to do way, way less of this because oh my God, look at this garbage that I wrote”.

Tom Mullooly: Yeah.

Brendan Mullooly: “What was I doing?” If you don't write it down, if you don't write “Here are all the reasons I wanted to bail on this fund” and you decide to sell it or you decide to hang on you’re going to rewrite it. If you don't sell it you're going to be like, “I knew all along that it was a temporary blip and that I should just hang in there”, but in reality you wanted, with every fiber of your being to drop that thing-

Tom Mullooly: Get out of that thing.

Brendan Mullooly: A year ago and it can be reinforcing to read that kind of stuff and it maybe will guide you to not act on your impulses in the future.

Tom Mullooly: I also think that that kind of is a reminder. When we talk with folks about what the expected band may be, hey this fund might be working in a certain collar, it's going to be, if the markets down this could be down more or if the market's up this could be up more. I don't wanna get into specifics like if it's down more than 5% we're going to sell it but you get the idea how these things stream. Some things are just not going to correlate with the rest of your portfolio, forget about the market, they're just not going to correlate with the rest of your portfolio.

Tom Mullooly: So there's going to be some things, we need a name for this, let's call it the Jay Bruce Effect. At the end of the season Jay Bruce has 30 home runs, OK, the problem is he hits 11 in April, 0 in May, 7 in June, you get the idea. Then he'll hit 1 in July, 14 in August, he's on the cover of some magazine. The returns as you like to say “are lumpy” depending on where you're drawing the line - hey in this calendar year this fund really did terrible. Is it really a reason to get out of this thing? This could be the secret sauce that actually next year could give your portfolio a nice kick.

Brendan Mullooly: It's always tough to answer the question of when and how or if things are going to mean revert and I think that the way that I try to look at it is the broader your thinking I think the more you can lean on a concept like mean reversion but even then it's squishy and it's never going to work on the timeframe that you want but if you're thinking of asset classes, like stocks and bonds or like U.S. stocks and international stocks or large cap and small cap stocks, we're getting a little more specific here but those kind of things really do tend to ebb and flow. If you're talking about an individual stock I think there's a stat out there that 60% of individual stocks underperform the rate of T-Bills over a stretch of time.

Tom Mullooly: Sure.

Brendan Mullooly: So waiting for mean reversion in individual stock names I think is a bad idea.

Tom Mullooly: Yeah. Have a lot of popcorn.

Brendan Mullooly: Right. You could be waiting a long time.

Tom Mullooly: A long time.

Brendan Mullooly: Or forever. Just to circle back to some of the stuff that Jeff was talking about in terms of stats. He looked from 1996 to 2018 at over 15,000 share classes of active U.S. equity mutual funds across all style and size boxes, later parsed it out by their groupings specifically, but he looked at fund performance and fund flows to determine the hired versus fired criteria and he looked at these funds versus out performance versus their benchmark versus their peers to determine the hired funds, they had flows and how did they perform versus these benchmarks. Across both criteria whether measured against the benchmark or their peers you saw the same effect where before, it was a before and after. So before the hired funds out performed, so they displayed this out performance and then after they are hired they display under performance. This even was accounted for, he did one iteration of this where he removed the dead funds because some of the fired funds were accounting for survivorship bias by not including funds that were dead as failures which they were because they were closed.

Tom Mullooly: Right.

Brendan Mullooly: Even when you threw those in the hired funds still under performed even this group of funds that included a bunch that were dead-

Tom Mullooly: Liquidated.

Brendan Mullooly: Or merged out of existence or whatever it may be. Past performance, as Jeff says, is insufficient evidence on a standalone basis to make these kind of decision but people do it all the time. People, not just meaning individual investors, because everybody likes to say how silly they are but also professionals in our space and as we eluded to the original study looked at institutional investors so this is-

Tom Mullooly: That's crazy.

Brendan Mullooly: This is prevalent across the board no matter how experienced you are as an investor. I think maybe it's something innate in our human being that tells us we need to just buy what's worked and sell what hasn't recently and, like I said, not always going to be a poor decision but I would think twice and as Jeff's suggests use some additional criteria when you're trying to make these decisions.

Tom Mullooly: Good advice.

Brendan Mullooly: Wise man Jeff Ptak.

Tom Mullooly: He will, I guess we should just say he will be a future guest on the podcast. Brendan Mullooly: We'll have to go out to their conference this summer in Chicago and meet him in person. Maybe we'll twist his arm there.

Tom Mullooly: Maybe.

Brendan Mullooly: Yeah.

Tom Mullooly: Picking up some Gino's pizza, some of those other names I'm drawing a blank on.

Brendan Mullooly: Check out the loop.

Tom Mullooly: Yeah. Good times.

Brendan Mullooly: My birthplace, Chicago.

Tom Mullooly: That's right. Brendan hails from Chicago, ILL.

Brendan Mullooly: It's true.

Tom Mullooly: Found him on a corner. Thanks for listening to episode 249 and we will catch you on the next episode which will be 250. Make sure you're wearing a party hat and streamers when you tune in. Big party. Talk to you then.