You're Allowed to Buy Lattes - Transcript

Tom Mullooly: Welcome back to the Mullooly Asset Management podcast. This is episode number 269. I am sitting across from one of the top 100 financial advisors in the United States, Brendan Mullooly.

Brendan M.: We did that last week,

Tom Mullooly: I know, but it's ... You know, it's not something that I'm going to let go of.

Brendan M.: Well, thank you.

Tom Mullooly: So first of all, I'm really proud of you and I think it's bears repeating.

Brendan M.: Thanks.

Tom Mullooly: And you're welcome.

Brendan M.: Well, you let me know before we turned on the microphones here that the Mets have already won today and I just want to state for the record that I'm back in. I was out and now I'm back in and I'm ready to be disappointed again. And ....

Tom Mullooly: Ready to have your heart smashed in a million pieces ...

Brendan M.: Yeah.

Tom Mullooly: ... sometime in the next two months.

Brendan M.: Yeah.

Tom Mullooly: So the easy part of the schedule is over and now we find out where the men are made. We have a couple of things that we wanted to bring to our listeners' attention this week.

The first was an article by friend of the firm, Christine Benz from Morningstar, who wrote an article about four worries that you can cross off your list right now. A couple of things-

Brendan M.: For retirees, right? That was the focus or just general investors?

Tom Mullooly: People in general. I don't want to rehash the entire article, but there were a couple of things that jumped off the page at me that I thought we talk about these topics enough that I was nodding my head yes as I was reading this. And the first was talking about estate taxes. It doesn't mean that you should skip out on estate planning.

Brendan M.: Yeah, very different things. Not being subject to estate taxes doesn't mean that you shouldn't have an estate plan.

Tom Mullooly: We've seen lots of train wrecks pass through here and heard of enough horror stories to know that. I forget the exact number, but a large percentage of the American public is walking around without wills, which is insane, in my opinion.

Brendan M.: And I would imagine that some that do have wills have wills that are like printed off the internet or something. So I think that for the average person out there, if you're married, have any kind of dependents, own property jointly with a spouse or anybody really, there's a good reason for you to have at least a basic estate planning package. And from what I've gathered in conversations with attorneys locally here in the Monmouth county area, it's probably going to run you somewhere in the realm of $1,500. And this is something that you can set up and obviously you want to review when you have big life events, like if you have this done before you have children ...

Tom Mullooly: Marry, remarry.

Brendan M.: Yeah, exactly. So there are points where you're going to want to revisit this, but it's well worth the time and the money that you'll pay a professional to do it and do it correctly that your loved ones don't have to deal with the ramifications of not having anything.

And this includes having stuff like power of attorney and medical directives, which can be important while you're still around too. So this isn't just taking care of stuff for after you're gone.

Tom Mullooly: That was something that I was going to mention. You beat me to it. But in addition to having a will, which is basically a plan for after you're gone, if you wind up in the hospital on your way out, you need to have some advanced directives so that your family can follow your wishes and say, "Hey, I don't want to be hooked up to a respirator for a long time."

Brendan M.: Or if you are in that kind of a situation, hey, we need to get money from the bank or from the investments of the person who is now incapable of doing so. And in order to do that you need actual documentation to show to these financial institutions so that they can authorize you to access this money.

Because you could have all the money in the world to take care of yourself God forbid something happens, but if people can't get to those resources and you're incapacitated, that's trouble. That's a big headache for people who are already really worried about you at that point in time I'm sure.

Tom Mullooly: So the reason why Christine said that we don't have to worry much more going forward about estate taxes is because the threshold now for federal estate taxes for an individual is now over $11 million. So for a married couple, it's almost $23 million. It's a lot of money.

Brendan M.: And again, I know the caveat with all of these discussions is that those thresholds have changed dramatically over time. And so they will continue to do so I'm sure.

Tom Mullooly: In both directions, up and down.

Brendan M.: Sure. That's something to continue to pay attention to, but as things exist today, that's not something ... Paying estate tax or doing maneuvers to avoid paying the estate tax are not something that is on the radar of the average everyday American or even people who are doing really well for themselves.

Tom Mullooly: And we've mentioned this in other podcasts, but it's also important to remind folks that in addition to a federal estate tax, you may be subject to state estate tax or an inheritance tax depending on your relationship. And that is certainly the case here in New Jersey. If you are not a direct descendant, there are different classes depending on where, who gets what. That you may be subject to inheritance taxes. So those don't go away. And at the present time, you don't really have to worry about the federal estate taxes. But as Brendan said, these numbers change depending on the political climate more than anything else.

One of the other areas that she mentioned in her article was gift taxes. And we've spent a lot of time talking about that as well.

Brendan M.: So what was last week? 268, the podcast episode.

Tom Mullooly: That's right.

Brendan M.: Yeah, so we, I'm pretty sure, had a pretty extensive conversation about that similar points to the estate tax here because the threshold is the same. It just tends to be a lot of misunderstanding about how gifting to friends, family members works. And it's definitely something that we're talking to more with our retiree clients who have done a good job saving and investing for themselves over the years. And now part of what they want to do with that money is help out family members, friends, and they're worried that if they give them too much money that the recipient isn't going to get all of it or waiting. It's not true.

Tom Mullooly: Yeah, it's not the case.

Brendan M.: Obviously, again, you want to be cognizant of these thresholds, $11 million per person. So double that for a married couple. It's not going to be on the radar of a lot of people. And so gifting is okay. Maybe you still want to pay attention to that $15,000 a year per person from each individual threshold for the gift tax in terms of filing a return, but-

Tom Mullooly: As we said last week, it's an informational return.

Brendan M.: Exactly. I think that's the best way to to explain it. Informational return, but anything below that, you don't have to fill it out. Anything above that, you do. It doesn't mean that the person is getting anything less than what you were trying to give them or that they're going to have any ramifications to deal with come tax time.

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Tom Mullooly: So I want to move on to a article that we both saw in Forbes, but I have a trivia question for you first.

Brendan M.: Okay.

Tom Mullooly: In the 1980s, one of the biggest number one singles was a song called Fire. Do you know who sang it?

Brendan M.: No idea.

Tom Mullooly: The Pointer Sisters.

Brendan M.: Okay.

Tom Mullooly: Do you know who they are?

Brendan M.: Nope.

Tom Mullooly: Okay. So this trivia question is going nowhere.

Brendan M.: Yeah.

Tom Mullooly: The interesting part of that was ... Well, two parts of it. The best interpretation of that song I ever heard was someone doing it in Elmer Fudd's voice. It's hilarious. You got to find it.

Brendan M.: Okay.

Tom Mullooly: You can Google that and find it. But the writer of the song for The Pointer Sisters' big hit was Bruce Springsteen. So the article in Forbes, five myths about FIRE.

Brendan M.: Ah, I get the time. Okay.

Tom Mullooly: That five myths about FIRE that won't die. So FIRE is Financially Independent Retired Early. They had five points that they say they just, for some people, they just don't believe them or they won't go away. And I'll run through them real quick and then we can discuss.

So the first one was that if you want to be considered a FIRE person, that you must save 50% of your income. The second thing is that early retirement means never going back to work again. The third thing is FIRE is only for young people. The fourth thing is the next bear market will snuff out all of these FIRE people. And the last one was if you're FIRE, Financially Independent Retired Early, that means that you're going to say no to lattes forever.

Brendan M.: The article was basically trying to defend these people. Whether you do some of these things or not or you consider yourself to be FIRE or not, you hear about it often and then you hear about people who are, for lack of a better word, just like haters on it. And I don't see any reason why because basically the gist of what these people are trying to do is save to an extent and lead a lifestyle that allows them to hang it up from the regular corporate job or the regular nine to five, and lead a life that they enjoy more. And maybe that means they're frugal, obviously that word's relative, but they lead a frugal lifestyle and maybe have some kind of a small business of their own that they do to bring in some money and then they also rely upon investments to throw off the money that they need.

And this is feasible for some people and for others it's not.

Tom Mullooly: Right. I think most of these fire people that you read about, they're extremely goal oriented and they got started early on saving, but they have lower thresholds than a lot of people would have for saving for retirement. Most times when you talk to someone about saving for retirement, you ask them how much did you have in mind or how much do you want to have for retirement? Very few people have a specific number, unless they're a year away from retirement and they're like, "I want to have $1 million." But most people in their 30s, 40s, and even into their 50s are like, "I just want to save as much as I can for retirement." They don't actually have a goal.

And so you meet or read some of these FIRE folks and they're like, "Hey, you know what? I saved 50% of my income or some big percentage of it from the time I started working out of college at 21 or 22 and I had enough money to live on when I was 37. And so I stopped my job and I started doing what I want to do." Now a lot of these folks, they stopped doing their "job" and then started doing what they wanted because they would prefer to do something more fun or ...

Brendan M.: More fun or flexible and maybe it means a lower salary, but it doesn't mean no salary. And that was one of the points in here is that you're doing something maybe that's more enjoyable, but you don't get paid as much for. Supplementing that with what you've managed to save when you were earning a higher salary. I mean that kind of sounds like the notion of just regular old retirement for some people who are getting to that point in their lives now, whether they're doing so because their investments aren't enough to support where they're at right now in terms of covering all of the costs they have, or because they've reached retirement age and they were tired of what they were doing or were just ready to move on. But that doesn't mean that they want to sit around on the couch all day.

Tom Mullooly: That's right.

Brendan M.: They maybe want to have something going on a couple of days a week or four. Maybe it's full time, but it's just different.

Tom Mullooly: I think you're also going to find that the point that they raised that the next bear market will snuff a lot of these FIRE folks out. I don't truly believe that. It would have to be a really prolonged 10-year bear market to ring some people out completely. But I think that you're going to find that a lot of folks that follow the FIRE approach would probably also be subscribers to Bogleheads. And that they truly believe that they are buying hold, take a longterm approach, continually suck money away, even from a part time job when they're not working on a full time basis. And they just believe in that mindset that they should have money working for them instead of them working for the money.

Brendan M.: Also I think, and everybody's approach is going to be different, but when you're living on your investments, you can take the same approach with it no matter what age you are. So we have this conversation a lot when people are approaching traditional retirement age because it's a logical discussion to have them. But when you're going to be relying on your investments as a source of income, you want to position them in such a way so that if we do have a bear market and it does last two, three, four, five years, you just want to ... We talk about the buckets of somebody's portfolio. And so it's not as if these people are out there living off their portfolios with them 100% in stocks, and then that portfolio is going to get cut in half and they're just going to throw their hands up and say, "Ah, it's over."

Tom Mullooly: Time to go back to work.

Brendan M.: I mean, I'd hope not. Maybe some of them are, but I would imagine that if they're taking distributions from an account, they've got to have some kind of portion of it in money market or short term stuff, and then some intermediate term bonds too, and then longer term stuff that's providing some growth. And so if there's a bear market and they have three, four years of their living expenses that they were expecting to take from the portfolio in stuff that has held up, then what has the bear market really done for them?

Psychologically, you still feel the hurt of ...

Tom Mullooly: ... of ripping over your statements and seeing-

Brendan M.: ... your portfolio being valued down. It's being down so that may be scary, and maybe that means you pull a different lever like all right, we're going to spend less, or okay, I'm going to ramp it back up and work a little more again. But I don't know what it means in the sense of like the bear market's just going to wash them out. Does that mean they go back to work more? Like is that a total failure if they dialed back work a little and they have to dial it back up again or live on less? I don't know.

Tom Mullooly: It seems like an offhanded statement almost. I mean the first time I heard this was when I read the article.

Brendan M.: People say the same thing about index funds. As if index funds are going to disappear in the next bear market, cut it out.

Tom Mullooly: How could that be?

Brendan M.: No.

Tom Mullooly: How could that be? They've been-

Brendan M.: I don't understand that. I mean they weren't ... Index funds and now ETFs, which get lumped together often, index funds weren't like a big thing until let's say the '90s, is that correct?

Tom Mullooly: Yeah, right.

Brendan M.: Right? ETFs' not until after 2000 really. I mean there were some ETFs cropping up in the late '90s but none of them were huge.

Tom Mullooly: They didn't really get any kind of scale until 15 years ago.

Brendan M.: Right. But both of them, in some context, went through 2000 to 2002 and then '07 to '09, and basically that was an entire decade of a bear market, if you want to talk in secular terms. So did that not count as the test?

Tom Mullooly: Yeah. I think a lot of that comes from folks that just don't understand the ideas behind index funds and more specific to ETFs. They don't understand how ETFs work. And I'd love to ... I mean, you know, we can run circles around some people when they throw us these arguments about why ETFs are bad or there's problems with ETFs.

Brendan M.: Like everything. That's it. Like everything's up when the next bear market happens. I'm just, I'm not sure about that because there have been bear markets forever. And whether people are going to sell their individual stocks or their crummy active mutual funds that costs one and a half percent a year or their index funds and ETFs, they're going to sell them. And the market has dealt with that since the dawn of time, and it will continue to do so into the future when we have different vehicles that we can't even imagine today because that's just the way the world works. But depending on people's incentive, I think they try to poke holes in stuff other people are doing. So whether it's FIRE, when people have disagreements about whether that is worthwhile or not, or ETFs, or index funds. They use the next bear market as when they'll be vindicated.

Tom Mullooly: I will say that, before we move on from this, that I've heard more people than ever during my career, talk about planning the timing of their retirement, and worrying about the sequence of returns in the market since 2008. This has really become a topic that a lot of people want to talk about. And my only inclination is to think that a lot of these folks are over invested in riskier type things than they ought to be. And maybe it's because they want to catch up, maybe it's just because they're greedy. I don't know. But more and more people have talked about this than any other point in my career, where people are really concerned about, I'm afraid that I'm going to retire. And within the year before my retirement or the year, immediately after my retirement, the market's going to fall out of bed and I'm going to be in trouble.

And it's sad to hear that. We've always preached that you don't go to retirement and slam on the brakes. It's a process more than an event. If folks are feeling that way, they need to sit down with a financial planner or their investment manager.

Brendan M.: And see how the numbers would work.

Tom Mullooly: Right.

Brendan M.: I think having a plan is the best way to deal with that psychologically. But it's interesting you say that, that's occurring now because I think probably the worst 10-year period for someone to decide to retire and was like the turn till this millennium. So like 2000, but did anyone have any idea at that point that that was the worst time to retire?

Tom Mullooly: No.

Brendan M.: We can only say so with hindsight now. And so I think it's a case of something that investors, all of us do all the time is you're fighting the last war. And so whatever was the worst case last time is what we plan for next time. But of course next time is not the same as last time. It's always some different variation of crisis du jour. It's going to sound different, similar qualities, but you can't plan for it in advance.

Tom Mullooly: No.

Brendan M.: But sequence of returns, it's obviously something that should be discussed when you're planning retirement and you want to look at it in terms of a stress test. And a lot of programs will allow you to do this kind of thing where you, we look at, all right, we're planning for a retirement and obviously we're assuming some kind of rate of return. But what if getting that rate of return involves the first three years losing half of the stock side of the portfolio, then what happens?

And so if the plan doesn't hold up to stress test like that, then like you said, maybe the allocation that you have needs to be tweaked a little bit or you need to be willing to be flexible with the distributions you take from the account in terms of maybe I'm going to take a percentage of my portfolio rather than a dollar amount because that's going to yield very different outcomes.

Tom Mullooly: I want to talk about this latte thing. So do you drink lattes?

Brendan M.: I don't. Just coffee.

Tom Mullooly: I do not. Yeah. And so what is the big deal with lattes? Ramit Sethi was talking about it. Sallie Krawcheck, she's actually now selling coffee mugs saying, "Buy the damn latte" or, "Buy the effing latte."

Brendan M.: Yeah.

Tom Mullooly: And of course Suze Orman talks about if you're spending $5 a day or whatever it is on a latte, you're basically pouring money down a toilet. She said it a little more ...

Brendan M.: She yells and ...

Tom Mullooly: Denied!

Brendan M.: ... slams the table.

Tom Mullooly: I don't understand the whole idea. I kind of tune into what Ramit Sethi says. He has that-

Brendan M.: What's his line? I love it. It's like-

Tom Mullooly: "I will teach you to be rich." And that's his website and his book.

Brendan M.: His line about this is like, "Stop asking $30 questions and start asking like $30,000 questions." And so I've heard that and the variation on that. I've heard it from a lot of people and I subscribed to this, I think Ben Carlson has written about it a lot, is that you want to get the big expenses in your life correct. Like you need to right size those and set your finances up in such a way where like if you want to get a $5 cup of coffee or a latte from Starbucks or Rook, if you're local to the area, then then so what?

Tom Mullooly: So Dr. Wayne Dyer used to talk about this in all of his talks. He would have those, you've seen this because it's all over the interwebs now, where you have these materials all over the table and a bucket, and he calls people up, and he's like, all right, pour the sand in, pour the pebbles in, pour the water in, pour the rocks in and it never works. The only way it works is if you put the big rocks in first and then the pebbles around it, then the sand on top of that, and then the water. You have to put the big rocks in first. That's such a big deal in terms of getting things right in your life. Get a good job, pay down your debt, then talk about finding a place to live, getting married, starting a family. A lot of people do these things out of order and their life is different.

Brendan M.: Life is messy. I think that the things that I would focus on, right sizing are where you live, which is not always easy because rent or mortgage is a lot higher in different parts of the country. I mean I know here in New Jersey especially, it's expensive. And so you've got to find something that's based upon what you earn, that it's reasonable.

Tom Mullooly: Right.

Brendan M.: And if that means having a roommate for a little while while you're younger, okay. You figure that out. Or basically just living in a place that you can actually afford. And I think that a good target in terms of percentage is that it shouldn't cost more than roughly a third of what you're bringing home each month. I think I would be worried if my rent or mortgage payment were costing me more than that. Because think about then you have the other two thirds to cover all the other stuff. And we haven't even talked about paying your bills, like your utilities, things like that.

Tom Mullooly: Well, this is actually kind of leads into an interesting point and something that ... We also saw an article headlined in CBS Market Watch about students pledging their future income as a way to pay their student debt. And the article went on to say that that's an open license for discriminatory financing. I also think it's a stupid idea. That's just my opinion.

Brendan M.: I don't know about that. I guess it depends.

Tom Mullooly: I guess it does depend.

Brendan M.: Right? I mean what's the difference between offerings or assigning a deal that says ... I think that whoever gives you the money has to be more invested in giving you the money than somebody who gives out a student loan. Like the federal government, they barely even care who gets these things. They'll give them to basically anybody who needs it and can show that. But if somebody's going to give you a deal where they say, for 10 years after your graduation or whatever the terms would be, I don't know, obviously some terms would be better than others. But let's say for 10 years after your graduation, we're entitled to 10% of your salary and we're going to cover all of the costs of your education.

Tom Mullooly: That'll be a great deal.

Brendan M.: Yeah. And the numbers obviously changing would make that good or bad dependent. Just like a student loan, but a student loan is, all right, you're taking out this lump sum of money and then you're going to have a fixed dollar payment regardless of what you're making after. And so I think that depending on where this funding comes from, there are places doing this now, like the Lambda School does it with coding.

Tom Mullooly: That's right.

Brendan M.: And so I think that they have more of an incentive to make sure that the students who go into their program are completing it and that they're accepting the sort of people they're willing to bet on. Because if somebody gets out of school and you're entitled to 10% and they have no job, then you're getting 10% of nothing.

Tom Mullooly: Nothing. Right.

Brendan M.: Or 10% of a low salary. So you want to make sure that not only they're going to graduate, but they're going to do it on time, and that they're going to find a good paying job so that you win the bet basically. Because if they make six figures within that 10-year period, then you're entitled to a slice of that.

Tom Mullooly: I'm curious, as an employer in a business field, would we want to look at a history major or an English major or ...

Brendan M.: I don't know.

Tom Mullooly: Would we be closing doors to potential employees because we say, you know, we're really only interested in hiring people who come out of major schools with finance degrees or economics?

Brendan M.: I don't know. I don't think we would be the ones funding that people going to school. I don't know necessarily how this all works. I didn't really look into that. I know Lambda School is the school and they're the ones with the incentives to help their students learn to code and then go find a job afterwards, but I don't know. I think it would more be like the university is doing this than the employers, but I also think that shutting doors on people based on what they majored in college is ...

Tom Mullooly: Is crazy.

Brendan M.: ... is foolish because nobody knows what they ... Hardly anybody knows what they actually want to do when they go away to college. And so I think it's kind of ridiculous to say that major x is better than major y. I think that's ridiculous.

Tom Mullooly: I'm going to repeat my campaign stump idea. Instead of canceling student debt or forgiving debt that we should just make student loan payments pretax. If you make a $400 a month student loan payment, you pay $4,800 a year to your student loans. Then you get a $4,800 write off on top line. It all comes out pretax. You're not to tax on the income.

Brendan M.: As if it went to medical benefits.

Tom Mullooly: Like if it went to a 401(k). Right or medical benefits. It lowers people's income so they're going to be paying less taxes and it gives them an incentive to continue making payments while they can.

Brendan M.: Yeah. I don't ... Obviously some people ... if the payment in dollar terms is what's really smothering them, this would only help marginally because as you said, maybe it lowers your taxable income so they have a little extra breathing room from it rather than just writing off the interest on the loans as things are constructed now. I don't see any reason not to, aside from that it lowers current tax revenue, which is always a ...

Tom Mullooly: Then I think government's not getting that much money from people who are 22 or 23 or 24 coming out of school anyway.

Brendan M.: Yeah, but why give a tax cut to them either? Because most of those people aren't turning out to vote. They give the tax cuts to the corporations because those are the ones who care.

Tom Mullooly: I was going to say those are millions of potential voters out there.

Brendan M.: Yeah, no, I think it's a good idea. I'm just, I'm skeptical that they'll go through with something like that.

Tom Mullooly: Yeah. Well, it remains to be seen what our politicians will give away. So thanks for listening to episode 269 and we will catch up with you next week.