Pros and Cons of Commission-Free Trading - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management Podcast. This is episode number 277. I am one of your co-hosts, Tom Mullooly. And alongside me, or I should say across from me, is Brendan Mullooly.

Brendan M.: Ready to talk about commission-free trades?

Tom Mullooly: Everything that's free is good, right?

Brendan M.: I mean, it's definitely not a bad thing for people, I don't think ...

Tom Mullooly: Certainly.

Brendan M.: ... to be paying no money for trades. Do we want to preface this by saying that this week, Charles Schwab and TD Ameritrade both announced that they'll be moving from having a limited list of ETFs and mutual funds; and stock trades, too, I think, were included in both cases; that trade commission-free on their platforms, they are moving to full-on trading is free.

Tom Mullooly: It actually, the dam broke a week ago when Interactive Brokers ... small player, but getting a little more recognition.

Brendan M.: Most people outside the industry don't know who they are.

Tom Mullooly: Probably have not heard of them.

Brendan M.: No.

Tom Mullooly: But they kind of broke the dam and came out and said that they were going to do it. And Schwab quickly responded and said, well, we're going to zero. And it's been a race to zero. I can give everybody the Reader's Digest version on what's happened, but prior to May 1st, 1975, which is known as May Day in the business; prior to that date, commissions were fixed. I still, as a cold calling guy in the '80s, had people that I had called and they said send me your commission schedule. Because from 1975 through the '80s, the commission schedules were different at different places. And I can remember working and having the commission schedule printed out. It was several pages long, stapled together, and it got passed around the office so everybody could say, "Okay, if we buy 2,000 shares at this price, the commission is going to be X."

Brendan M.: And it was a percentage total of what you were buying, correct?

Tom Mullooly: When I got started 30 years ago, it was somewhere between one and two percent of the total transaction. You really didn't want to get into flipping anything for short-term profits because you knew that it was going to be somewhere between two and five percent for a round trip, in and out. In 1975, they allowed commissions to be deregulated. Charles Schwab was the first business to get into the discount brokerage, and pretty much since 1975 it's been a race to zero.

And here we are in 2019. Didn't take really, in the big picture, all that long. It's accelerated, definitely, in the last 10 or so years, as things went from $20 a trade, to $12, to $10. And now we're ... in the last few years, we've been at $5 and $6 a trade. Now we're at zero. Charles Schwab is taking a hit. They estimate that their revenue will be down seven percent going forward. TD Ameritrade announced that their revenue, their net revenue per quarter, will be down by 15 or 16 percent, so-

Brendan M.: This is a positive for people though, because this is more money staying in their accounts as opposed to paying for trading commissions. And we've seen this trend also within the fund space, because mutual funds have gotten cheaper. They used to be more expensive. Some of them are still pretty expensive. ETFs have continually gotten cheaper since they launched, so costs continue to fall for the individual investor.

Tom Mullooly: There were plenty of folks who had a lot to say about this and we'll link to them in the show notes. I think Josh Brown did a quick video in his car about this, and I thought it was terrific. We should definitely link to that in the show notes. I know Colin Roach put together a post on his blog. I know I wrote about it on the Human Advisor, but from kind of a different perspective in the sense that since price is going away now, since the cost of the transaction is going away, what it's really going to come down to is who can give you the best service. It's really hard to define, but I can't think of a better time to be an advisor in this space because the playing field's been leveled, and I think we're going to find out that doing all this stuff on your own, it's a full-time job if you want to do it that way. I think working with an advisor can provide value. Working with the right advisor can provide value. I don't know. What are your thoughts on that?

Brendan M.: Yeah, I mean I look at it more as a win for the individual investor out there. Whether somebody's doing it themselves or they're working through an advisor, they are paying less money to get access to their investments now, which means there's more money for them to spend in the future on the things that they were literally investing for from the get-go.

Tom Mullooly: Right.

Brendan M.: So that's a net positive for people as long as they let it be one. And this has always been the case, so there's no point in owning super cheap investments like ETFs. Talk about ETFs versus mutual funds; you could be in a super expensive mutual fund and if you buy and hold it, you're going to do better than somebody who's flipping in and out of their ETF every day. That has an expense ratio that's cheaper.

Tom Mullooly: Right.

Brendan M.: You need to behave to reap the rewards, so to speak, of these lower costs. And this applies, too, for trading costs. I mean, not paying on your trades is great because you're going to keep your five or six bucks probably; especially for smaller investors, that's important. But if you're going to just constantly trade now because there's no cost, then I don't think you're actually going to, it's not going to be a net positive for you.

Tom Mullooly: I think the, I agree with you. I think the barre had already been lowered to the point where you could do trades for $4.95 or $6.95 or seven bucks, which is pretty low compared to when I got started in the business. There's less friction now with trading costs. There's zero potentially now, but that like you said, it doesn't really create an incentive, hopefully not, for people to begin overtrading in their account. What's the difference? It doesn't cost me anything. I can move in and out of this. You're right. It's still going to come down to investor behavior.

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Brendan M.: So have you ever gone on the Social Security website and pulled up your estimates? I know they used to mail these things out, but you have to go on the website now.

Tom Mullooly: Right. We used to get this thing once a year in the mail that would tell you basically, hey, if you've worked for 20, 25, 30 years, they would actually do a printout of how much you made each year and what your estimated Social Security benefit will be at retirement.

Brendan M.: You can still get the very same sheet and I can get one, too. It doesn't matter how many ... You have to have been working for at least five years or 10 years, or something like that for them to even bother running it for you. But I've gone on and done it, too, and it looks exactly the same as ones they used to mail out to everybody. So, same format.

Tom Mullooly: So the quick form, and I think before I even get to that, I think part of the reason why they stopped mailing these out is because you're sending out someone's income history in the mail.

Brendan M.: It's also a waste of the money now.

Tom Mullooly: Well, that's part of it too.

Brendan M.: I'm pretty sure it was a cost cut.

Tom Mullooly: I think the government's pretty good at wasting money in a million different directions. But that's also something I just thought of; was, hey, you're putting stuff in the mail, and people move and ... But the shortcut when you go on the website is you can just go to this quick calculator and do a quick number without putting in your information, your Social Security number. You can just put in your age and what you made last year, and it'll give you in three seconds an estimate of what your Social Security benefit will be at retirement. Have you ever done that?

Brendan M.: Yeah. So the other ones, the same thing.

Tom Mullooly: It's on the same site.

Brendan M.: It's still an estimate. So I think the thing that I wanted to bring up was that even this one that they used to mail out, there's a lot of misconception that that surrounds this number, and a lot of people worry that if they stop working later in their career, but before they begin collecting, that it's going to lower their benefit. And it's not actually going to lower your benefit. It's that the estimate that they're providing you might be wrong.

Tom Mullooly: Yeah.

Brendan M.: Because the estimate, whether we're talking about the quick one or the full scale one that they used to mail out that you can still access online, it's taking the highest of your 30 years' wage history. And so if you have a bunch of years at the end; let's say, from 60 to 65; you're not working, but you're drawing on your investments, and so you're not adding any more wages to your wage base, or maybe you're working part-time and it's just not as high an income as it used to be. You're not lowering your future Social Security benefit because if it's not in your highest 30 earning years, it doesn't matter. It just gets chucked out. It's not affecting it. It's not like a pension, where they're taking an average of your last five years or something like that.

Tom Mullooly: That's a question that came up that you had shared with me recently, that someone said if we go and work part-time for a couple of years, is this going to affect my numbers?

Brendan M.: It's not going to affect your numbers, but the way that it's estimated on the website, it will mean that you will probably knock out what your estimate says because baked into the estimate in both cases, no matter how you're calculating it, is they take your most recent year's earning, whatever you earned, and they extrapolate that as if you're going to earn that until you begin collecting. And then it gives you your numbers at 62 full retirement age, and 70. So it just assumes that you're going to earn, if you're making $100,000, that you're going to do that for the next five or six years. It's kind of tough to wrap your head around, but the estimate is what changes, not what you actually stand to collect.

Tom Mullooly: Not the actual number, right?

Brendan M.: Right. And so it's just important to understand how the estimate is calculated so that if you do plan to have a change in how you're working between today and retirement, you understand how that might impact the estimate. But it's not the kind of thing where you should not work part-time because it's going to lower your ... it's not going to lower your benefit. And if you want to work part-time, then that's fine.

Tom Mullooly: Then go ahead.

Brendan M.: Yeah.

Tom Mullooly: Yeah, it's worth it.

Brendan M.: Right.

Tom Mullooly: This is a discussion that we have a lot with folks, especially as they're approaching retirement. We start going through these numbers with them. So I think there's a lot of misunderstanding when it comes to Social Security. There's lots of questions about this.

Brendan M.: Right.

Tom Mullooly: And I know that there are folks in our line of work who make a full-time living out of giving a chicken dinner seminars on Social Security planning.

Brendan M.: I don't know about the seminars and how I feel about that, but people do need help with this. And it's something that most people are interested in because they have paid into the system, and unless they die prematurely, they stand to collect far more than they paid in. So it's an important decision for a lot of people to make.

Tom Mullooly: Yeah.

Brendan M.: I think that gets glossed over a lot, too; that if you calculate over your lifetime what you pay in Social Security tax, the 6.2 percent that comes out of your income; if you even live until your early 70s and you began collecting at some point during your 60s, you've already received back way more-

Tom Mullooly: You put in.

Brendan M.: -than you've paid in. That's not to get into maximization strategies, but yeah, you know what? It stinks that money comes out of our paychecks, but ...

Tom Mullooly: It's just as you say, just cash in, cash out.

Brendan M.: Right.

Tom Mullooly: Hey, I've paid $30,000 into this thing. After two years, I'm way ahead.

Brendan M.: But give me a break. Come on.

Tom Mullooly: Yeah.

Brendan M.: That's a great deal.

Tom Mullooly: Yeah, it really is.

Brendan M.: But you've got to give up the current consumption to get that deal in the future. And obviously none of us are promised tomorrow, so we don't know that we'll necessarly be there. But you know, you've got to put things in perspective sometimes because I know there's a lot of hand wringing out there about Social Security, and how it's a Ponzi scheme, or it's theft or something. And I just think that's a bunch of baloney.

Tom Mullooly: I went car shopping recently with a family member not on this podcast and I overheard a salesman at the next desk at the dealership asking the person sitting there, how much can you afford in a monthly payment? And I just cringed.

Brendan M.: Yikes.

Tom Mullooly: Yeah.

Brendan M.: That's the new thing though, right? And I would guess that pretty much anything you finance, the sales tactic that has been taught is to ask that question rather than what your overall budget for the car is. Don't ask them can you spend $20,000 on a car. It's what's the monthly payment?

Tom Mullooly: Right.

Brendan M.: And an article from the Journal backs this up; just talking about the now very common seven year auto loan.

Tom Mullooly: It is just crushing to think about this, because the very first time that I even read that a seven year loan was available was about 10 years ago, and Mercedes-Benz was the first one to offer it. Now if you're going to buy a Mercedes, you know what? If you're buying a Mercedes, not leasing; but if you're buying one, you buy it with the intention that this is going to be like a Rolex watch; like, you're going to drive this car forever. So a seven year loan, no big deal, no big deal. It's 84 months. If you're going to own it for 15 years, okay, it's a great investment. But now ...

Brendan M.: Great investment? I don't know.

Tom Mullooly: Well, okay, that's ...

Brendan M.: I think there is something to be considered for the idea that even if you're taking a seven year loan and your idea is I'm going to drive this forever, I think you still need to be realistic about the average duration most people in this country drive a car for, which is like five to seven years.

Tom Mullooly: We'll have to look this up, but I thought it was actually under five now. It's like four and a half years.

Brendan M.: You're only making my point better.

Tom Mullooly: Right.

Brendan M.: Okay. So my point is that this reminds me of people who are approaching retirement and are not fully prepared for it in terms of what they've been able to save, saying that, well, I'll just work longer. Yeah, that's great. If you want to work longer and you're capable of doing it, terrific. First thing is what I just mentioned, you need to be capable of doing it, which we don't have a ton of control over. Second off, there has to be a job for you and sometimes they're ...

Tom Mullooly: There isn't.

Brendan M.: There isn't as you get older in the workforce. We come across it a lot; it's a shame, but companies cut costs and they do it a lot of times by letting go of older employees, giving them a retirement package and hiring somebody younger who they can pay half the price. So just the idea that, well, I could take a seven year loan, but I plan to drive the car for 15. How the heck do you know if you're going to drive it for 15?

Tom Mullooly: You don't.

Brendan M.: I couldn't .. Do you remember where you were 15 years ago?

Tom Mullooly: Not making much money and trying to scratch out a business, so ...

Brendan M.: Yeah, a long time ago.

Tom Mullooly: It's really tough to say ...

Brendan M.: That's 2004.

Tom Mullooly: Right.

Brendan M.: So you don't know what you're going to be doing. You have no idea of what cars are going to look like. So to predict that you'll continue driving this well past the duration of a loan that stretches out to seven years? Ah, man. I don't know about that.

Tom Mullooly: Well, the problem is I think that people go into the dealership and they get hung up on stupid stuff like am I going to get car mats? I think this is also a stupid thing to get hung up on; a deal breaker for some. It shouldn't be. What's the interest rate that I'm going to pay? We've had discussions on this podcast and other videos before. As long as you're current on your payment, it doesn't matter what your rate is. It's when you stop paying a loan that the interest rate really matters because that debt continues to compound at that number, and it could be huge. But-

Brendan M.: And largely, that's going to be based on your credit score, right?

Tom Mullooly: Yes.

Brendan M.: And so it's not necessarily like, sure you might be able to go to your local dealership and deal through their financing division, and then take it back and shop it to your bank or a credit union who you use, and maybe you get a marginally better interest rate by doing it that way. But it's not as if you're going to get seven percent from the dealer, and two and a half percent from your credit union, or something. It's going to be similar and it's going to be based on your credit score. And so haggling over half a percent or something on the interest rate of a car? Sure, you can do the math and see the difference of what you'll pay over the lifetime of the loan, and half a percent does add up. But I agree with you, that there I think are more important aspects of the car decision to focus on than the interest rate or floor mats, for sure.

Tom Mullooly: Yeah. I think the whole idea of going to seven years, that's 84 payments, is eye-popping. Because just some quick math; if you're making 84 payments at $400 a month, that's $33,600.

Brendan M.: Without any interest.

Tom Mullooly: That's just $400.

Brendan M.: Yeah.

Tom Mullooly: So if your payment, your payment may include interest ...

Brendan M.: Right, okay.

Tom Mullooly: ... but even still, you look at the sticker price on some of these cars that are out there and they start at $33,000, and they go up pretty quickly.

Brendan M.: Yeah.

Tom Mullooly: Buying a new car is financially often not a good deal. Most people are getting priced out of the market for new cars.

Brendan M.: It's a shame because I think that, I would imagine that most people who have a family; let's say a husband, wife, a kid or two; they probably are in the market for an SUV. Because if you look out at the road today, most people are driving SUVs, and yeah, these things are fricking expensive.

Tom Mullooly: Yeah. They're large. And Ford just announced a couple of months ago that they're going to stop selling sedans next year. So Ford Taurus, you'll never see that again. Right now they know that their market is SUVs and trucks.

Brendan M.: Yeah.

Tom Mullooly: So yeah, it makes it more difficult to ...

Brendan M.: If you do have a budget, it's easier to get sucked into the monthly number thing, even though it means a seven year loan if you can get the car that you want; versus having to make that tough call of, we looked at a bunch SUVs from different car companies, and we just don't think that it's affordable at this point. We're going to get a sedan because it's two-thirds of the price and we actually afford it, and it's in our overall budget of what we wanted to spend on a car.

Tom Mullooly: I just want to backtrack to something you said a couple of moments ago, where we were talking about the average length of time that people drive their cars. Right now it is, I was saying under five years, you were saying five years, so let's just use five years. All right? If you have a seven year loan, you take out a car; now you get a car and you get a car loan in 2019, that loan is going to come due in 2026. In 2024, you're shopping for a new car. What happens for most people at the transaction? What a lot of people don't understand, and this is ... I'm not trying to throw dealerships under the bus, but you have to understand the mechanics of the business. They're going to make a deal with you to get you into a new car that counts as a transaction for them, and they're going to take what you have left on your loan and pack it into your new loan.

Brendan M.: Right.

Tom Mullooly: And so not that you're looking to build equity in cars, they're a depreciating asset; but it's you are continually making payments. You never get out of that cycle. It's really hard to escape it.

Brendan M.: Yeah.

Tom Mullooly: And leasing is not the escape because leasing's even worse. You give the car back at the end of the term. Used to be that car companies would waive those end of lease payments. Now they take it and now you have to do something else. All right, now we're going to get into another car. How much do you want to put down on your lease? A lot of people don't understand when you're putting down money on a lease, you just prepaying several months of your lease payments.

Brendan M.: Right. It's like points on a mortgage, right?

Tom Mullooly: Yeah, yeah. That's really it.

Brendan M.: It's tough because there are things, it's things that almost all of us need unless you live in a big city and you can use public transport. Everybody needs a car to get to their place of work, and so you need it to earn an income, which is, that is the essence of livelihood there. So we can't say like, hey, just don't have a car. Oh, perfect. Sounds great. I'll just walk to my job.

Tom Mullooly: The other thing that I'll add is-

Brendan M.: But we need these things, so it's tough to tell people what to do about it because part of it is a need. But it's tough to draw a line between what portion of it is transportation and is a need, and is just something extra that we want.

Tom Mullooly: I think a point that people should keep in mind is that when they go into a dealership, be prepared to put a lot of money down because you won't have to buy gap insurance. You'll get a better deal on your loan if you put more equity down, more money into the car loan itself, and you're not choking on a payment. The worst scenario you can have is you've got a smoking Pinto that you had to roll into the dealership lot and you have no money, and now you're kind of at their mercy that I'm putting no money down; I'm financing the entire transaction. That's really, really expensive and hard to escape from. So if you can put some money down when you're buying the car and finance a piece of it, you're going to be better off. Nobody likes making a car payment, but ...

Brendan M.: Perfect world. You drive a car as long as you can, and when you're out of the payment period and you're driving a rust bucket around, you use the money that was formerly going to pay for that car to sock it away so that you do have something to put down in addition to whatever you get for the rust bucket when you roll it in there.

Tom Mullooly: One of the best pieces of advice I got. I finished paying off a car, and this was maybe 25 years ago, and a buddy of mine said what are you going to do with the $300 a month that you're, that you're doing? I'm like, well, I don't have to spend that money. He's like, pay yourself that money, that $300, and in two or three years when you want a new car, you're going to have seven, eight, $9,000 that you can put down on your next car.

Brendan M.: Or you can literally buy a car with that.

Tom Mullooly: Correct. So yeah, that's the other thing, too, is that cars being made today are built to last on average well over 100,000 miles. Some of them will say, oh, this car should run 200,000. But you know, they should run a long time. And as long as you're not commuting 75 miles each way to work, your car should last for awhile.

Brendan M.: Yeah, I love that debt strategy when for when a payment ends; whether it's directly sending it to one other source, or dividing it up amongst things that you're already doing and just ramping your savings so you don't end up with that extra money in your account, because if it's there, you'll spend it.

Tom Mullooly: It vanishes.

Brendan M.: Yeah. If you're intentional about it, you can pretend it still exists and keep doing positive stuff with it.

Tom Mullooly: Yeah. If you've got questions about these and other topics, get in touch with us. That's going to wrap up episode number 277. Thanks for tuning in.