The Problem with Car Loans Today - Transcript

Tom: Okay. Welcome back to the podcast. This is episode number 283. Your host, Tom and Brendan Mullooly are here to discuss all these crazy financial topics.

Brendan: Yeah, I know we have what? Two or two or three different articles that we're kind of going to use as jumping off points for discussion today. Any one in particular that you're dying to talk about first?

Tom: How do you spend $45,000 buying a $27,000 car?

Brendan: Yeah, that's there's got to be some magic there.

Tom: Well this was in the Wall Street Journal, not all that long ago. And it was really after you read it, it's very interesting. But after you read it, it's kind of sad. But we see stories like this unfolding every day.

Brendan: Yeah, regularly. In particular, the way that this is happening with car loans is that people are coming in and they still owe money on the car that they own. And the dealerships are now allowing people to finance a new car and wrap in what they owed on the old one all together into one new one, one new payment, one new loan.

Tom: We will meet or beat the competition's prices. Still stuck in an old loan? Come on down, we can talk.

Brendan: I'm sure some people out there explain what's going on fully. But I think a lot of other people maybe gloss over the details of what this is actually doing. And we'll tell you, if you're paying $300 a month now, we can get you into a newer car for still $300 a month. But the point they'd probably neglect is that, you're going from a balance of $15,000 to a new balance on the loan of $45,000 and it's a 10 year car loan.

Tom: And the problem, it used to be not all that long ago, 20 years ago, you could get a new car loan and stretch your payments out over four or five years. Now it's pretty routine to see six, seven, eight year payment schedules and worse. Now they're doing it on used cars. And so used cars, the maximum period of time that you could carry a loan was three years. That was it. These cars just don't last very long. And so I believe the particular subject in the story that we both read was getting into a used car. He was coming out of a car that had a loan against it and was going into a new for him but used car and now had a much, much bigger loan. And so the story actually was, he was buying a $27,000 car, but his loan balance was $45,000.

Brendan: I think that big thing, if you're actually out there shopping for a new car to avoid as much as possible is allowing whoever is selling you the vehicle to discuss it in terms of the monthly payment. Do not do that. Do not do that.

Tom: How much do you think you can afford each month?

Brendan: Right. Because that's a way, because they can take that number and then back into how many years this loan has to be for and what you can afford that way. When in reality you should be going in with an idea of of what you can afford to spend overall. What are you going to put down? What are you willing to finance? You do it that way, but unfortunately you kind of have to take charge for it to be that way. Because I think the default now is talk to people in terms of the monthly payment, because it's just psychological. It's an easier number to wrap your mind around. It's like, oh, well I can afford $300 a month. But you're glossing over the point that this guy, you're now on the hook for $45,000. you're going to be paying $300 a month for eternity.

Tom: Ever. You may have had two years left on your $300 car loan. Now you have a new $300 car loan, but it's for eight years.

Brendan: Forever.

Tom: Right.

Brendan: Forever. Sorry had to.

Tom: I feel bad. I really do because there are some people out there who don't understand the math when it comes to these things and so the ads that you hear on the radio and on TV and also in the paper, if you still read a paper, they're a little, not a little, they're misleading in the sense that hey, if you still own a balance on your current car, we can take care of that.

Brendan: Doesn't matter.

Tom: Yeah, so I think.

Brendan: Doesn't matter to them.

Tom: It doesn't render to them. They're wrapping this all into a brand new loan. The underlying message here is the money that you sign to borrow, that never goes away until it is all paid off.

Brendan: Right. Whether it's to this company or the old company, it's going to be paid. I think too that in the article, so they talked about this overarching theme, but then the anecdotal stories that they dropped in to give it a little bit of color as you often get in these type of articles I thought skewed it away from what is more typically the situation of people rolling these car loans up together. Because they used two or three instances of people who, one woman had just been sold a total lemon and the car, the first one that she bought literally didn't work anymore and she needed to get to work and stuff.

And it was something similar with the guy with the headline numbers, the Jeep that you were talking about, that was $45,000 for a $27,000 car. Something had gone wrong with the car and these people needed a new car and this was the only way to do it because as you said, the loan is a loan. You have to pay it off whether the car continues to work or not. And in a lot of cases unless you had some kind of a warranty, but I'm not sure that that's, we don't have the stats, but I don't think that that's generally what the average car buyer going to roll up loans is they're not in that situation. not everybody's car is broken. Some people are just rolling the loan together because somebody made it sound affordable and they're like, wow, I deserve a new car. I'm just going to get it.

Tom: I just want to get into a new car, exactly.

Brendan: And it's the same monthly payment, so what the heck does it matter?

Tom: Yeah, I don't lose.

Brendan: It does matter.

Tom: Yeah, it really does. Everybody's got a phone and just about every single phone I've ever seen has a calculator on it while you're sitting at the car dealership and they tell you your payment is going to be 375 a month or $400 a month, just do the quick math. 400 times 84 months. That's seven years of payments. You're going to be paying $34,600 for a car. Now look at that car. Do you really want to pay almost 35 grand for that?

Brendan: I think you need to just be realistic when you're financing a car, most people have to finance to some degree, but when you're going to finance, do you think that the car is going to last, outlast the duration of the loan? Because it should because theoretically things happen to cars. I know that we don't live in a perfect world. Theoretically you make your car payments because you put something down, it's reasonable. You pay it off in three or four years, maybe five.

But then hopefully you have a car that you can drive for another three, four, five years after that. And while you're doing that, here's the trick, you continue to take what you were making in car payments and put it in your special car fund that helps to pay for some repairs over the time, but also gives you something to then put down into the next car so that when you're seven, eight years into this whole thing, you've been driving one car the whole time. You had a payment for maybe half of that time period, and then you're taking a bunch of money plus whatever you get for the trade in value at that point, rolling into a new one. And that's how we do this without paying too much interest on a depreciating asset like a car. Those are the worst things to finance.

Tom: They really are. And so I know some people call us and they get hung up on, I got a terrible rate from the dealership when I bought my car. You've heard so many, if you've listened to us, you've heard so many podcasts and videos, interest rate really doesn't move the needle when it comes to this. It's the money that you're laying out. And so if you do what Brendan just suggested, and we've been talking about this for years, if you're doing, if you're making the same car payment after the car is paid off, just pay yourself that $400 a month or $300 a month for three years. That's $10,000 that you'll have available to put down immediately on the next car. Plus you'll have your trade in.

Brendan: Pull that off with a couple thousand dollars or whatever's the value of what you have been driving. I don't know. Obviously it's not a perfect world and as this article shared, there are stories and instances where things happen to cars and people.

Tom: That's really bad.

Brendan: I really felt bad for some of the people in this article because it didn't really seem like they had better alternatives and they were just kind of in a spot where you need a car to get to your job nine times out of 10 so if you want to be a functioning member of society and earn an income and support your family and feed your kids and all that, you need to have a way to get there. But I don't know if a nine year car loan is the way to do it. I would rather drive a total clunker than do a nine year car loan to have a semi-new vehicle.

Tom: Sometimes even driving a clunker for a year is worth it if you can sock away the cash.

Brendan: You can pay for the clunker in cash and then use it for a year or two and then stop the cycle.

Tom: That's what Casey did with his Saturn.

Brendan: Yeah, I remember that.

Tom: Yeah. It's the same situation.

Brendan: The thing has to work enough for you to get from A to B. There's a minimum level here. You don't want to have a total jalopy.

Tom: You don't want to be putting money into it. But we'll also add that many cars today are being built to last.

Brendan: I forget the exact numbers, but I read something recently that the average age of the car on the roads today is I think the oldest that it's ever been.

Tom: Right. But the new cars today are being built to last a 100,000 miles plus.

Brendan: Right. And that's the same point, meaning that people are driving their cars for longer because the things are still completely fine.

Tom: They can.

Brendan: It doesn't, you hitting a number on the odometer doesn't necessarily mean you need something new.

Tom: Yeah, keep putting oil in it. That's it.

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Tom: Okay, so this was in the Wall Street Journal. The headline was $45,000 loan for a two for a $27,000 car, which still makes me shudder looking at that, but lo and behold, the very next day I saw the same, the exact same article word for word, and they even said from the Wall Street Journal with the day before's date.

Brendan: Syndicated content or whatever they're calling it.

Tom: Market Watch and Wall Street Journal owned by the same company. This was the headline for the very same story. Rising car prices force man to buy $27,000 Jeep with a $45,000 loan. What the hell is that? Nowhere in that story did it say that car prices have been rising and people are forced into paying up for cars. Why would they do that?

Brendan: I think it's important to remember that the clicks are paying the bills when it comes to the news these days. More and more where we're getting news and information online and the way that news companies are being compensated are by advertisers who want views on their ads and that means more clicks on these headlines and so that headline is a little more outrageous than the original one. And so I would imagine these companies they're doing AB testing, ABC testing and seeing which headline gets more clicks on the same story. Using that mold to then craft new headlines that are more like the ones that get more clicks.

Tom: More salacious, ones that want to attract the stories, headlines that are going to attract eyeballs.

Brendan: We see this all the time with with market headlines. Some of the headlines are just utterly outrageous. I know we've talked about, my favorite word that they drop in the headlines is jitters. Market up on trade jitters. Market up on, market down on trade jitters, market up on trade optimism two hours apart from one another. And meanwhile the market has taken an overall trip of half a percent. But they make it seem like...

Tom: Yeah, you missed the rollercoaster ride of the century if you missed what happened in the market this week.

Brendan: Missed 75 points on the Dow today. Film at 11:00.

Tom: Stand by for news. But we're seeing this as you said, more and more in places.

Brendan: This is an important clarification I'd like to make is that I don't think this is, the company, the news companies are doing what they're supposed to be doing. These are publicly traded companies that have shareholders and they have a duty to their shareholders to be as profitable as possible. It says that's what they're trying to do. These aren't public, news companies aren't public utilities. They don't have to do everything like goody two shoes. Sure, it leaves a bad taste in your mouth that they're using headlines and twisting them around to get more clicks. But that's what they're supposed to be doing.

I don't really have a problem with it. It's just you read some of these headlines and then you click the article and you're like, that's not actually what this was about at all. And I guess it's important then to if you're going to be outraged by a headline to just clarify that that's actually what they're talking about at all.

Tom: Yeah. And so they're testing to see which headlines get the most clicks as Brendan was describing. But we're also, we want to write headlines that'll make people click as well. In all transparency, we want to write headlines for our blog posts and for our videos and podcasts.

Brendan: We put out our weekly email and I know for a fact that we're trying to come up with stuff that sounds cool so you guys will all click on it and listen or watch or read the content that we've put out because we know attention is a, it's scarce.

Tom: It's in short supply.

Brendan: We're asking people for, it's a transaction. We're asking for time, which is our most valuable resource. We're asking somebody to trade time to come listen to this podcast or read our blog. It's the same for everybody who's putting on a TV show or creating content out there. You're asking somebody for something that's really valuable. And so to get them there to consume the content, there's a little gamesmanship there and you have to figure out what gets people there.

Tom: Yeah. And it's not just Mullooly Asset Management and Dow Jones. Everybody's out there doing it.

Brendan: Yeah, of course.

Tom: That's the way it is in 2019. Some are better at it than others.

Brendan: It's been this way forever. We had AB tests going on, they just weren't as sophisticated, but you could run AB tests in a newspaper in the 1950s too.

Tom: Sure, sure. It happens.

Brendan: This is marketing. This has always been a thing.

Tom: Yeah, exactly. Speaking of marketing, I have one radio station plugged into my car, WCBS News Radio 88.

Brendan: Is this the one that the Mets are on now?

Tom: Yes.

Brendan: Because since ever since they left 660 the Fan the other year, I have hopped each season because this is their third home if you count The Fan, in four or five years.

Tom: Yeah. They went to WOR for awhile. It's a funny thing, is they were on WOR in when they started in the sixties and seventies and through the 80s.

Brendan: It was a traumatizing for me when they left The Fan because that's, I grew up with the little, the jingle. Let's go Mets. Anyway, so this is where the Mets are now. The point I was going to make is that this is the only radio station that's programmed into my car too. Because the only time I turn on the radio is if I want to catch the ballgame when I'm driving home or something.

Tom: Now I'm a little spoiled because now I have about a six minute commute to and from the office. And, but I used to have a much longer commute and I'd be on the Parkway listening in the morning. For 20 years I've been listening to CBS and they have the business report at 25 and 55 after the hour. That's exactly how they say it. At 25 and 55 after the hour. And most of these business reports are read by a guy named Joe Connelly and Joe Connelly used to work for the Wall Street Journal. He now works for Bloomberg and he's got a very, very distinctive voice. Once you hear him once or twice, you will never miss this. You'll never not recognize this voice.

Brendan: You've come to associate him with business news.

Tom: The business report.

Brendan: Legitimate stuff.

Tom: Yeah, you're going to tell me that the market's up, market's down.

Brendan: What's happening.

Tom: Yeah. What stocks are moving, what's the big story today? Things like that. Lo and behold, just in the last few weeks, he's now recorded a commercial for Online Trading Academy. And what makes it, I think worse, is that that commercial gets played right before or right after the business report.

Brendan: That is not a mistake. It's not a mistake at all.

Tom: You're listening and you think he's talking about the market and investments and what's going on. It's really a commercial for Online Trading Academy.

Brendan: It's a pitch for their services.

Tom: Oh yeah. It's a pitch to get two free tickets to their upcoming seminar. Which should be free anyway. They want you to come, get on their mailing list. It's a little, it would be for some of our older listeners.

Brendan: He's the original influencer.

Tom: He's right.

Brendan: Not on Instagram, but this is, they're using somebody's clout, business, to blend together seamlessly so you don't know that you're being advertised to.

Tom: I've listened to this guy, I've heard him do the business report for 20 years because I heard him on days when I was driving to the office at Dean Witter. That was 20 years ago, and so he's been on the radio doing the business report. I kind of feel he's a little bit of a sellout. It would be for our older listeners, it would be kind of like if Walter Cronkite started doing infomercials or Tom Brokaw, I don't know, maybe he has, but I can't find a modern day example, but you get the idea. You got used to hearing this guy and okay, now we're going to talk about the market and now it's get two free tickets to the Online Trading Academy seminar. Online Trading Academy.

Brendan: It's lending credibility to something that I personally don't believe should have any credibility went to it. Bunch of nonsense.

Tom: Let's talk about that. Their commercials basically talk about how hey, if you're getting to retire and the market goes down, telling people to wait, it'll come back is not really the answer you want to hear when you're retired or getting ready to retire.

Brendan: They're going to teach you how to sidestep all the damage in the market and only make money and never lose.

Tom: And never lose.

Brendan: That's what it's supposed to be inferred from this advertisement.

Tom: I think as a firm we kind of have a real problem with that because it's a very hard thing to do and they're taking folks that have little to no experience doing these kind of things and trying to teach them how to buy and sell options and how to, I'm using air quotes, protect their account. When they may actually be putting themselves in a more dangerous situation.

Brendan: Yeah, and so I'm not sure, again what the actual cost is since you go to a free seminar, but the service that they actually pitch you on or the host of services that they have, would imagine it's not super expensive because they want to sell it to regular people, so maybe it costs like a couple of hundred dollars a month or you go to some program for 1,200 bucks or something. All I'm saying is if they have the magic potion to only make money and never lose it, and they're offering to sell it to you for $1,200 a year. I'm sorry.

Tom: Why are they even they hosting a commercial? They could just trade on their own.

Brendan: Yeah. Why don't they have a hedge fund? Why aren't they with Jim Simons at Renaissance Technologies earning a 100% returns a year. This, it's nonsense. But the way that they advertise it and then the stuff that they're saying, it connects with people.

Tom: They use all the right buzz words and it does get people's attention. And like you said earlier, they're using, they're getting credibility from a familiar voice that people who listen to this radio station have heard for a very long time.

Hey, there's something else I wanted to just touch on briefly that we found in Mises Institute.

Brendan: Yeah. Everything we hear, not everything, but a lot of things we hear are about how people don't have enough saved. And there's plenty of surveys that I think we've even discussed here that talk about how most people can't cover a few hundred dollars of emergency expense, $400 or people don't even have a $1,000 in the bank, that sort of thing.

Tom: Right. Which is actually true.

Brendan: Right. However, some some information from the Bureau of Economic Analysis shows that the savings rate in the US as of September of this year is at 8.3%. This is the personal saving rate. I'm not exactly sure what feeds into that, because if that includes, if that's just extra savings on top of what people do for retirement, then that sounds pretty good. But if that includes retirement savings, that it's dismal.

Tom: Pretty bad. My understanding is that is after retirement savings.

Brendan: Okay. Not bad. That was the point was that this number a is at 8.3% which is a new six year high. And it's comparable to numbers that we were seeing in the 90s. But I guess the most surprising aspect of it was that this is usually the savings rate spikes, counter cyclically. Meaning that when we're in a recession, you see people saving more money. Economy bad, savings rate goes up because people are nervous or worried about their jobs. Stock market, overall economy so savings rate spikes and they have a chart here and there's one spike in the last two decades and it was during 2008, 2009. Spiked up to almost 12%. that's not the case now. Economy's doing pretty well. Stock market's doing well and we see the savings rate creeping back up to levels that we haven't seen outside of the financial crisis since the nineties essentially.

Tom: And actually it equals a level that we saw in the seventies when we had pretty high inflation and it was really hard to save money, but some people figured a way out to do it.

Brendan: I guess we mostly just thought it was interesting because it is a little counter to some of the other narratives we're seeing out there. Again, whenever we're talking about this, whether it's survey information, I'm not sure how they actually get this information, whether it's based on survey results or they have a way of actually measuring this. We're talking about averages. And so the average savings rate may be 8.3% but that means obviously there's people out there saving half of their income and there's people who are running a monthly deficit. There's a lot more than meets the eye when you look at a number like this. But it has to be encouraging.

Tom: I think when I read a story like that, and I also read all these other stories that we've talked about where there's plenty of Americans out there, the number I think is something like 40%, don't have $400 or $500 or something like that to their name. That tells me that the gulf between the haves and have nots is just getting wider and wider and wider. That there is a very large part of the population that is truly struggling and they need help. And yet there's also a large gulf in between, and then there's a group at the other end that's doing okay and they're saving money.

Brendan: They're saving more than ever because they're offsetting the monthly deficits that are at the other end of that spectrum maybe. Don't know the ramifications or what kind of solution there is, but I think that that's definitely plausible. That could explain how we're seeing a number like this rise where we're still hearing stories that conflict it directly where people can't cover expenses.

Tom: That's going to wrap up episode 283. We appreciate you tuning in and we will catch up with you on the next episode.