What is Your Money REALLY For? - Transcript

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Tom Mullooly: Welcome back to the podcast, this is episode number 309. This is the Peoria, Illinois episode. I am Tom Mullooly and joining me today is Tim Mullooly and Brendan Mullooly.

Brendan: Good morning.

Tim: Good morning.

Brendan: Ready to rock.

Tom Mullooly: We're ready to rock on college savings day. Today is ... We're recording this on 5/29. May 29th.

Tim: Oh, wow. Nice.

Tom Mullooly: And I think a good way to kick this off would be a post that we read from Morningstar from Madeline Hume that talked about why college savers should stay the course through the coronavirus.

Tim: Yeah, it shared some numbers in terms of how certain allocations in 529 savings plans for college held up during the market decline. But I think ultimately there was a bigger point with the numbers that they shared, wherein they were talking about which portfolios held up the best and which ones held up the worst. And I think it doesn't just apply to people saving for college in 529 plans.

Brendan: Yeah, so a unique feature of 529 plans is that they have these age based options and they're similar to target date funds that you might find in a 401k menu. But the premise really is in these funds that they're lining you up with a time horizon and a portfolio that it makes sense based on your time horizon, in terms of when are you going to need this money?

And then they adjust the portfolio accordingly over time to make sense of that.

Tom Mullooly: And so what that means is as your student gets closer to college age, they shift from more growth oriented stuff into safer stuff, and start to really slow down the volatility.

Brendan: Right. Yeah. And I think it's easier to do this in 529s and savings accounts for college because that's more of a clear cut time. Usually ...

Tom Mullooly: We're going to this money.

Brendan: Majority. Exactly. Majority of people go to school and use this money when they're 18, 17, 18, 19 years old. So it's easier to target those dates out.

Tim: Yeah. I think sometimes the ones in retirement plans are misused, but I mean, if you're lining it up with generally when you're going to need the money, and for some people that doesn't coincide with their retirement date specifically, but if you treat it more "Hey, I'm going to need this money 2055, then you should use the 2055 fund."

Brendan: Right.

Tim: And just understand that it's going to be making these shifts for you and it's not custom. So if your situation is not the typical person, who's going to need money at that point, then it may not fit for you, but it's a heck of a lot better in most cases than just winging it.

Brendan: The point in the article was just, if you're using one of these funds based on when you're going to need the money, they kind of just hash out the performance from the first quarter. And people worry a lot when money is going to be needed sooner rather than later. And they can't afford stuff like what just happened in the first quarter of this year with the market. But for somebody who was in one of these portfolios who was going to need the money in zero to one year, the performance for the first quarter was minus 3%.

Tim: When the overall market took a hit of 30%.

Brendan: 20%, 30% dependent on where we drew the line.

Tim: On top of that, the youngest, or like the furthest away, the average draw down was 19%. If your kid was zero to I think, three years old or something like that, the average draw down for that kind of portfolio was 19%.

Brendan: Right. I think the overall point that I took away was if you're aligning your money appropriately with when you're going to need it, if you've got this purpose behind it and you know what you need from your money and when you're going to need it, it's a lot easier to align it so you're not taking a hits in the account that you can't recover from, or that you don't have time to make back. It's far from catastrophic for somebody with a two or three year old to be down 19% in a quarter, not great, but certainly not the end of the world and ...

Tom Mullooly: You got plenty of runway, plenty of time to make that money back.

Brendan: So they also showed that that portfolio for the same person that was down 19% in the first quarter, over the decade of 2010 to 2020 had averaged about 8% a year growth. So you're going to be just fine when you have another 10, 15 years to make and hopefully compound that, something like that 8%. You're going to be fine, especially if you're sending money in to, which is beside the point of what we're discussing here. But for that person, who's going to need the money, next year, being down 3% is far from a catastrophe. And that conservative portfolio has

returned about 3%, 4% on an annualized basis. So over the next year, before you actually start spending the dollars, you may recoup that just from the portfolio rebounding.

Tom Mullooly: Just from sitting still.

Brendan: Right.

Tim: Yeah.

Brendan: So I mean, and these are different too, because they're gliding you into, with a portfolio that's intended to then pay out its entire balance over the course of a few years while the child's in college.

When they're close to their target date, so to speak, they're very conservative. Whereas a retirement target date fund may not be this conservative at retirement because it's not ... I think people tend to mistakenly think in those binary terms where it's like, "I'm at retirement."

Tom Mullooly: This is the finish line.

Brendan: It's all going to cash and I'm just going to draw it down because it's like, if you do it that way, then you better have ...

Tom Mullooly: A lot more.

Brendan: 50 times your annual expenses in the account, which not many people have managed to do, just saving at even a healthy clip. You're going to need some growth from the portfolio, even after the retirement, which is not addressed in a 529 plan. But just the idea of knowing when you're going to need your money and to what degree and letting it guide your portfolio appropriately, you're going to get the outcomes that you should get if you're aligning those things.

And I think that people who don't align them are the ones who are freaking out when the market goes down because they're a 100% in stocks and they're retiring next year. That's a mistake. Don't do that.

Tom Mullooly: That's such an important point that you raise in the sense that with these 529 accounts, the money is going to be needed. All of it in the next short period as your student is turning 17 or 18, or for the next couple of years. But with a retirement account, that money has to last, sure a portion of it is going to be used immediately for draw downs, but the bulk of it still has to be invested to last over a longer period of time. We have heard comments from people who are on both sides of the camp, they think, "All right. When I retire, we should just put it all into something stable with no more growth." Like the party's over, game's over, it just doesn't work that way.

That's not real life.

Tim: Also, obviously the 529 is a perfect example of knowing exactly what the money is going to be used for. And the retirement example is also easy to draw as well. But I think in terms of knowing what your money is for, it goes for everything too. You don't necessarily need to be putting the money away for retirement. If you're putting it away for something else, like a couple years down the road, it's the same principle. So you need to determine when you're going to need the money. If someone is planning on buying a house in three years, it's kind of the same thing. As when you know, you have money in a five 29 plan. If you're only three years away from needing that money for something as important as a house, the only allocation is that you should have is maybe something extremely conservative if it's in the market at all.

So I think it goes towards pretty much every decision when you're determining how much risk you need or want to take with that money. Well, what is it for? And how far away is it?

Tom Mullooly: Well, that leads us to another article that we all saw that was in Forbes, where it talked about after this whole virus shut down phase has passed, everyone's basically going be forced into equities because you're not going to be able to get any kind of yield on short term investment, interesting piece.

Brendan: If I had a dollar for every time I read somebody saying that you had to be in stocks because of the fed and them putting interest rates so low, I would be super rich.

Tim: You wouldn't have to put money in stocks.

Brendan: Yeah. Exactly. Like I wouldn't have to contribute to my retirement accounts because I'd be very wealthy. I've been hearing this since 2012, when I started here at the firm because interest rates have been low just in general. They've been up, down over that timeframe, but they've never gotten high in the sense that they've never gotten back to the levels now that people are reminiscing about from the 80's and the early to mid 90's, when you could get 5% on a safe investment, a treasury or something like that. I don't know if reminiscing and hoping, wishing for those days. They're not coming back. That was a really long time ago.

Tom Mullooly: It was a really long time ago. I was in the business. I've said this on other podcasts and other videos. The last time people in the United States were able to live off of the income from a CD at a bank. Let's just use the numbers 6%. You could actually take 6% and pay taxes and then use the proceeds. It was 1994, which was over 25 years ago.

Brendan: Also to be fair, correct me if I'm wrong, but when rates were like that in the nineties, and you could do that, nobody wanted to, because stocks were going off so much that everybody was being ingredient buying stocks anyway.

Tom Mullooly: Correct. And we also had between 3% and 4% inflation, which nobody ever counts.

Brendan: Right. We're reminiscing about the good old days when you could like collect CD interest and you didn't have to take risk to earn a return on your money. But I don't think it was

actually like that in the moment. And not many people were actually doing that. That was all they were doing with their money. Nobody was living off of just CDs in the mid 90's.

Tom Mullooly: I'm going to hijack this a little bit, but I vividly remember my dad coming home, this was 1981 with a CD he had just rolled over at Marine Midland Bank. He came home. He actually showed me the piece of paper because he was going to earn 20%. I was like, "Wow, that's fantastic. For how long?" "90 days." And I was like, "Boy, it's too bad you couldn't get that for longer." He's like, "No, no, no rates are continuing to go higher. So I don't want to tie this money up for a long." And that's what everybody was saying.

Brendan: And that was the top.

Tom Mullooly: That was the top.

Brendan: Right.

Tim: The generational top, like literally the top. And we're still on the way down.

Tom Mullooly: We still are. Yeah. And that actually kind of ties in with what somebody said in the article.

I think it was someone from BlackRock who had said, "There's no value, no value in investment grade bonds, unless yields go negative." What?

Tim: I just think there's some, I think you used the word greedy before and it's spot on. There's just some obsession with like needing to maximize the return on every single dollar in your bank account or in your account. And in my opinion, it's the wrong way to think about your money.

Brendan: It's the phrase in there. Dead money.

Tim: There's a couple of quotes in here that just made me scratch my head and be like, "Oh my God, are you kidding?" The first quote is "Your savings account, in other words is becoming dead money." What? what if you're saving for what we were just talking about. You have something coming up in a year or in two years and that's dead money. It's like, well, what happens if you put it at risk and then you lose it and you don't have the money for what you need it for.

And the other quote that piggybacks on that is "Investors are going to have to learn to be comfortable putting $500 in Disney stock or some ETF, and use that as a form of savings." And he goes on to say, "The good news is that most online brokerage firms don't charge commissions anymore." Encouraging people to go in and put their savings account into individual stocks and trad it away because they don't have commissions anymore.

Tom Mullooly: Just shoot me now.

Tim: How did this get into Forbes? I feel bad bashing articles like this, but I looked it up, this guy has 22,000 followers on Twitter. You're speaking to the masses here.

It's no wonder so many people have poor finance habits because they read stuff like this in Forbes.

Tom Mullooly: And people are now being shamed for having money in reserve.

Tim: Yeah. What are you doing wrong? What are you stupid or something? You have money in the bank. That's dead money.

Brendan: Right. And so the other phrase in here that I'm very tired of, aside from just being forced into stocks or that whole idea is just bunk, but "Fixed income is broken." Can we stop calling things broken? Yeah. I've heard 60/40 is broken. That's one of the better performing portfolios this year is the 60/40.

Tom Mullooly: The shift is also broken.

Brendan: Baseball fans. Every time a hit goes opposite field. We hear from the broadcasters that the shift is broken because they're cranky, retired players. But I don't think that we've talked on the podcast before.

Obviously, there are a couple of things you think about from fixed income in your portfolio, you think about getting interest, getting some income. And obviously that has changed a lot from what it used to be in the 90's, but I don't think it used to be ...

Tom Mullooly: I'm going to push back because I think that the net real returns ...

Tim: Right, the real returns.

Tom Mullooly: Are about the same.

Brendan: Because there is no inflation right now. Right. And it was the same in the 80's when you got a 20% CD, inflation was through the roof. It's not like you were ...

But I understand that we look at the nominal returns or yields and it's enticing to reminisce about the days where you could get 5% "risk free" okay. But I don't think that's coming back.

And I think that there's a pretty good case to be made that that period of the late 70's and into the 80's, and then even into the mid 90's, if you look at the history of interest rates, that is the outlier, that's not the norm. So to say that that we need to go back to that I think is a little bit misguided. And we've talked about the same concept with GDP growth.

Tom Mullooly: That also means if we go to those kinds of rates ...

Brendan: It's not good for us.

Tom Mullooly: We're going to have an 1800 Dow Jones.

Brendan: Do you remember? I know this from reading history books, you can speak to it, but people, we were in like gas lines in the period of time where we're reminiscing.

Tom Mullooly: I got my driver's license, I was put on a gas line.

Brendan: Right. And that was a part of the reason why rates were where they were, was because what was going on with oil and things cost a lot more on a year to year basis then what we see now, and it's not necessarily something I think that we should be wishing for. Rates being high means that inflation is high, which means a lot of stuff is wacky in terms of the day to day life that we have.

Tom Mullooly: There will be a lot of other broken things.

Tim: You can't just cherry pick the good numbers and say, we got to get back to that. You have to remember all the other variables that come along with it too.

Tom Mullooly: If we have double digit interest rates, I wasn't kidding when I said this before, we're going to be back to a very low Dow Jones industrial average.

Brendan: That was a bad time for stocks in the late 70's, early 80's. Terrible.

Tom Mullooly: Don't wish too hard for that kind of stuff.

Brendan: Right. But, just back to the point of the article though, this doesn't mean that you have to put every dime of money you have into the stock market, because you can only earn 1% on a CD now or a savings account or that you need to not have bonds in your portfolio anymore because they don't offer interest rates. I think you just need to, again, consider what these different piles of money are for.

People come to us all the time with whatever they have in their savings account, as we're putting together their financial plan, we're building a balance sheet and they have money in savings. And a lot of times they want our opinion on if it's too much too little, and we try to help them get it to just right. But that number is a little different for everybody. And the money that you're keeping in safety at the bank, you need to come up with what makes sense, given your situation and what kind of short term cash needs you're going to have. If it only earns 1% then so be it because it's purpose is not growth.

There's going to be a portion of your money, whose purpose is growth. And you're not going to have that in stuff that's earning 1%, but you need to fine tune it and have that be the correct amount because it's not all or nothing. It's not like either be all in on stocks, maximizing your returns for every penny that you have or all in on savings account, because you're scared or you need the money all in the next year. I don't know.

Tom Mullooly: One more thing. I'm just going to add. We're reading this article at the of May. Can you imagine if our clients that owned bonds didn't own bonds the last couple of months? Holy cow.

Brendan: We have people living on the portfolios that we've put together for them. And of course they have money in bonds and they are very happy that they did because their performance in the first quarter was a lot less volatile and negative, than clients who have many, many years to go and all in stocks or close to it.

Tim: Yeah. I think the last quote that just made me cringe in this article was when he said stocks are where it's at. I was like, what are you a college kid, college bro saying stocks are where it's at guys.

Brendan: Nobody was writing this article in March either.

Tom Mullooly: Yeah. In March, everybody was like, Oh my God, get out.

Tim: It's easy to write an article like this now after the markets rallied 30% in a month.

Brendan: Did I tell you? You should have backed up the truck in March and put all of your savings account into stocks. Yeah, it sounds good. Nobody wanted to do that in March.

Tom Mullooly: So Tim, leading on to the next piece from this, we talk about what you should have in emergency savings. And the wall street journal actually came up with a list of 35 different ways that you could bulk up your emergency savings. And they actually got ideas from different advisors and bankers. It was pretty interesting list some ... Yeah, I don't know. What do you think?

Tim: No. I think I liked about half of them and I didn't really care for about half of them. I guess all of them could work, but there were just some that I thought were better than others. I picked out my two favorites and my two least favorites.

My first favorite was actually the first one that they said, it was from Peter Lazaroff, who I interviewed on Living with Money, really good guy. He titled his Rank Your Expenses. And he pretty much said you print out your last handful of bank statements and you actually look at where you spent your money and you rank those expenses, high importance, medium importance, and then low importance. And then the ones that are ranked low importance, you have to decide if you actually need to continue spending money on that. And if you decide that you don't, you can cross that off the list and that money that went to the low important expenses can go into your emergency savings.

I liked this one because it actually forces you to print out bank statements and look at what you're doing. It's not necessarily a trick. It's literally just doing the work and sitting down and looking at it. And I think that that's really the best way for people to get a handle on their spending and in turn their savings.

Brendan: Yeah. No shortcuts. And I jotted that down as one of my favorites too, and not surprised it came from Peter. Good dude. Very smart guy.

Tim: I think my least favorite one was, it was titled Pay It With Points, and it said build up a stash of credit card rewards points as part of an emergency fund. If that's going to be part of your emergency fund, I think it, at most, should be a very, very small part of your emergency fund.

We've talked, it was either on a podcast or a video about how credit card rewards are great until the credit card company decides to change what you can and can't use their rewards for.
Brendan: They're Schrute Bucks.

Tim: Yeah, exactly. Yeah. Yeah. From The Office. They're imaginary in a sense until you can use them or they have the ability to take them away.

Brendan: They change the terminology. We've talked too about your emergency fund, not being at somebody else's discretion. So some people will tell us that their home equity line of credit is part of their emergency fund, but we just talked about this.

Tom Mullooly: I was just going to go there.

Brendan: We've talked about this on podcasts and videos too, about how those are like the first things to get cut when the economy gets bad and banks can reduce these lines at any time and you often have nothing to say about it. And so, same thing can happen with these rewards points. I mean, this maybe is different, you wouldn't count travel points as your emergency. This is probably like cash points that you can actually use. But all these people who have racked up airline miles now, what's going to happen to those. I have a feeling that airlines are going to be changing the rules on that. Or some of them are going to have to be merged together in the future. And then how do ...

Tom Mullooly: Well, first of all I mean, a lot of people just aren't flying and then a lot of these airlines have built in programs where they say, you know, if you don't use your miles, they'll expire. So they have to address that too. And it's a real problem.

Brendan: So your emergency money should be accessible, always at your full discretion with nobody else who can pull the rug out from underneath you. And I don't think you're fully getting that if you're banking on a credit card, credit card points or something like a home equity line of credit where the bank can change the rules on you.

Tim: You can use those things. They're fine. It's just, don't ...

Brendan: If that's your first line of defense, you should be a little worried and you need to work on getting something else in place before, before that.

Tom Mullooly: Yeah. A couple of things that I pulled out. The first one stop outsourcing. I think that's kind of a no brainer in the sense that, "Hey, I don't have to pay that guy to detail my car

every two weeks." Bank the refund always, I mean that really it's a windfall. It comes in all at once.

We could do an entire podcast on what they called the extra paycheck. There are still plenty of people who get 26 paychecks a year. They get paid every two weeks. The stuff that you could do with that is fantastic. But the problem is that most people try to squeeze a monthly budget into paychecks that are coming in every 14 days. It's very hard to do, but we could do a whole other chapter on that.

Tim: I actually picked out the one Funding With a Refund as one of my least favorites.

Tom Mullooly: Tell me why.

Tim: It's more of a personal preference for me. I don't necessarily have that big of an issue with it. I think it could definitely work, but I'm more of a proponent of getting more money in your weekly paychecks. Then having a huge refund once a year. If you can learn to have more money in your weekly paychecks and spend that wisely, it promotes better behavior than just doing it once a year.

Also, I know whenever I get my tax refund, it's not big, but I do get one every year. And when I get that check, I don't want to just put it in savings. You get it and it feels like a bonus. It's like, Oh, I want to go spend it on something. So if that's the only measure that you have of funding your emergency fund, I think it puts the odds of it not getting deposited into your savings account a little higher when it only happens one time a year. I think you'll learn better habits if you can periodically put more money into the account on a weekly basis.

Tom Mullooly: I want to go back and amend my answer because everything you've said is right. And we sit down with folks and say, if you're perpetually getting a refund every year, you're not withholding the right amount, but it is a much better answer ...

Tim: But it's personal preference though and it definitely could work. I'm not saying it wouldn't work, but you just have to be disciplined enough to take that one lump sum once a year and put it into your emergency funds.

Brendan: It's tough to do that. But if the person knows all that stuff, and then they say like, "Yeah, I'm the worst. And I'm saving myself from myself here. And I'm just going to over withhold because I know that it's like a forced savings kind of thing." Then fine. Because I also know what you said about, if you get a refund, it's hard to actually do the part where you shifted over to savings. That's rung true with what we've seen in terms of people getting these stimulus checks. We've seen data that shows people spikes in activity on things like Wayfair or like people dumping this into like Robinhood accounts and like entertaining themselves, trading with their $1,200 or whatever.

Tom Mullooly: They can't bet on sports.

Brendan: It's easier said than done to take the lump sum and then actually do something like shift it to savings or do something wise with it. Like you said, you got it and it feels like a bonus and you want to do something fun or entertaining with it. So ...

Tom Mullooly: The real issue now in May of 2020, is that there are some folks who have depleted their emergency savings in the last couple of months. And so this is now become really important. You've got to find a method or a way to boost up that emergency savings again, because you don't know when the next shoe is going to drop. It may not be a virus next time, you could be out of work. Something could happen. You could have a true emergency where you're going to need the money.

Brendan: Yeah. The lesson here, isn't that we're going to have pandemics all the time. The lesson here, don't learn too specifically, the lesson here is, that just stuff happens and we can't plan for it. So we have this money set aside for that reason. But to your point, building an emergency fund or rebuilding an emergency fund can feel really feudal. You can feel like Sisyphus, pushing the boulder up the hill only to have to redo it day after day. When you're trying to refill these things and you're saving $1000 a month or a few hundred dollars a paycheck, it takes a while for it to add back up, to get to that level of comfort. That's maybe 3, 6, 12 months expenses, whatever your situation dictates. And it's tough when you have to serve multiple masters. But if any of these things from the article can help people to rebuild that after they've used it, then you're going to have to do it at some point and it's not easy.

Tom Mullooly: Okay. That's going to wrap up episodes number 309. We've enjoyed our visit to Peoria, and we'll catch you on the next podcast.