A Few Reminders About Unemployment - Transcript

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Tom Mullooly: Welcome back to the podcast. This is episode number 315. I am Tom Mullooly, and with me today is Tim Mullooly and Brendan Mullooly.

Tim Mullooly: How's it going everybody? I think we have just a couple of things that we wanted to touch on in today's podcast. The first of which was an article that I saw in MarketWatch. It was for people receiving unemployment and it was just a reminder for them, or it said, "Read this before filing your taxes." I think the article was just reminding people that your unemployment benefits are in fact taxable income and a lot of people don't realize that that's the case.

Tom Mullooly: There's a lot of people out there who I think are going to be in for a nasty surprise next year when they go to get their taxes done.

Brendan M: They had some survey data in there, so take it with a grain of salt, but it seemed like most people didn't really know that this was taxable income. I think 37% said they didn't know that it was taxable income and then 51% said they didn't know that you needed to ask for tax to be withheld on it. You can withhold tax from unemployment, it's just a flat 10%, but better than not withholding anything. Ultimately people may choose not to withhold just because they need the maximum amount that they're getting from unemployment. It may or may not be helping them make ends meet based on what they were earning beforehand.

Tim Mullooly: I was going to say there's probably some people out there who do know that it's taxable but-

Brendan M: It doesn't matter.

Tim Mullooly: ... choose not to withhold anyway because they need every penny that was coming in from that check anyway. They can't afford to have anything less than that.

Brendan M: A good recommendation in there, regardless of whether you're receiving unemployment benefits or not, is just the idea of a mid year tax check-in, meaning June, July of each year, whatever you're getting your income from, you should take a look. I mean, you can just take a pay stub from that period of time, or if you have to dig into your QuickBooks, if you're a small business or whatever you're doing, and just take a look at what you've withheld so far and what you're on track to earn over the course of the year and make sure that it's at least in the ballpark so that there aren't any huge surprises. We can't predict the future, but you can make some small adjustments over the course of the year and not be blindsided come tax time.

Tom Mullooly: And the IRS actually has a free estimator that you can use. Just go to irs.gov and look for the tax withholding estimator. It's a free tool. It'll just give you a ballpark idea of where you're at, as you just said.

Brendan M: It's not that complex anymore either. I mean, 90 plus percent of people are taking the standard deduction. So the only math involved, even if you're not using the calculator, is just what you've earned or what you're on track to earn over the course of a year, minus your $12,200 standard deduction for an individual, two time that if you're married, and that should give you a pretty good idea of where you're going to lie at the end of the year. I mean, barring other front end deductions for AGI from an income tax return, it's pretty straightforward.

Tom Mullooly: So they did say that you can fill out a form to start having money withheld. If you haven't, you can't do it retroactively.

Tim Mullooly: Yeah. It doesn't go back in time, and with withhold from what you've already received, but you can fill out the form, I think is form W-4V. And like Brendan said, you can withhold up to 10% federally. Again, like you said, that's better than nothing. It might not be exact for people, but it's close.

Brendan M: If you end up going back to work, then you figure it out. I mean, you just factor that into, okay, I'm starting this job. Hopefully I'm going to make X over the remainder of the year here. I already know that I have Y in unemployment benefits that I withheld at 10%. Where is that going to put me in? And if this is too much to do, then ask a financial advisor or your tax preparer, just for some general guidance.

Tom Mullooly: There is a little bit of jujitsu that you need to land in the zone so that you don't wind up with a big tax bill next year. One of the things that always comes up when we're talking about this is what about taxability on the state level?

Tim Mullooly: What we've been talking about has been for federal taxes. Every state has their own different rules on how they tax income and different types of that, of income. So I know New Jersey, you don't need to worry about that, because it's not a thing here in New Jersey, but for people who might be listening to this outside of New Jersey, I think it'd be worth looking up how your state handles unemployment benefits and just state taxes in general.

Brendan M: Yeah, New York specifically. I saw that New Jersey and Pennsylvania were named in this article as ones where you're not going to have to worry about the unemployment benefit, and obviously any income tax free states, you don't have to worry about it, but just thinking of the tri-state area here, I think New York, and specifically, if you live in New York City too, I'm not sure about the city tax-ability of that. I know if you live in the city, you end up paying pretty high taxes for doing so.

Tom Mullooly: Whether you're collecting unemployment or not, it's the middle of the year. It's probably a good idea. I know we just did that this week here at Mullooly Asset, just going through our June 30th numbers and looking at where we stand in terms of profitability, what our revenue looks like, what's the situation for taxes. So it's a good thing to make a mental note or to jot it down in your calendar to do a mid-year review anyway and just see if you're on track.

Brendan M: I can appreciate that people who are collecting unemployment may, I mean, it's tough to project what the rest of the year is going to look like if you've had your life disrupted greatly in the first half year, but you can at least make some educated guesses. And if you have to err on one side or the other, I would recommend a shooting for a situation that might end up with you over withheld, as opposed to under withheld. Obviously best case in the world is just zero when you go to calculate your tax liability at the end of the year come tax time when you're doing your returns. But I mean, especially considering all the uncertainty right now, if you have to make a guess, then be overly cautious and then get some money back, not the end of the world.

Tim Mullooly: So they did offer some ways to quote unquote, fix the, if you haven't been withholding money from your unemployment benefits. The first one was for those people who would just start getting unemployment, the form W-4V. The second one was to make estimated quarterly payments throughout the year. They said the first and second quarter, those payments will be due by July 15th. And there was a form, or you can use a 1040-ES to calculate what your estimated payments might be. And then the third one was just to mentally account or physically put money away or aside for taxes for next year. I feel like that one would be a little difficult for people to do potentially, especially if they go through the rest of the year and end up needing money along the way.

Brendan M: Yeah, kind of the same situation why somebody might choose not to withhold, even though they know it's an option. It's like, "Okay, well, I'm only going to get X from my unemployment benefit and I need all of that right now. So I'm just going to have to figure this out at a later date," understanding that that could be a time bomb depending on how the rest of the year goes. I mean, if you don't have options, I'm not going to sit here and tell you to withhold and just make it work. I mean, that's tone deaf.

Tom Mullooly: It is, it is.

Tim Mullooly: Definitely.

Tom Mullooly: We're recording this on July 10th, and this morning we had new lows on Treasury yields. 30 year treasury this morning yield is 1.284. That's the lowest number I think I've ever seen. The 10 year yield is now 0.60, 60 basis points. And the five year yield hit just about a quarter of a point, 0.258. That ties in with another article we were talking about here in the office that was on Morningstar, written by Christine Benz.

Tim Mullooly: Yeah. She asked the question and wrote about what the best diversifier for stocks is. She looked at a couple of different asset classes, bonds, different types of bonds, cash, and different alternative investments. And she pretty much analyzed from the last time that she had checked in, which was in 2019, and looked at what held up or what was the lowest correlation to stocks during what has happened since the last time she checked in. And she pointed out how treasury bonds, like you just said, the yields are really low and they might not keep up with inflation moving forward, but the long-term treasuries and treasuries in general have really held their ground and pushed back against the low returns from stocks. You know, they zigged when stocks zagged, so to speak, earlier this year.

Brendan M: Yeah. I mean a lot of discussion lately about how to diversify portfolio. I understand people's points about bond yields being low and how that's not going to keep up with inflation. First off, that's not why you're putting money in bonds to begin with. But second off, I don't know what the alternative here is because in the past, people have, and obviously as Tom alluded to, the yields are even lower now than what I'm referencing in this point. But in the past, people have said the same exact thing for the last several years, in fact, that bond yields are low, so you might actually just want to hold stocks and cash, for instance. Maybe cash will be a better diversifier. I think, as we've discussed here on the podcast before, that is claiming the ability to be able to time the bond market, which I think is total nonsense.

I think you're going to cost yourself money because you still are collecting something by having your money in bonds. So, that incremental return is going to put ... If you're worried about inflation, you're going to put your money in cash? At least you're getting something from bonds. You're getting absolutely nothing from cash. I don't think people's ability to time the bond market is any better than their ability to time the stock market. And so I think you're implicitly stating that you know better and that you're going to somehow be opportunistic about this, and you'll know when to move from cash back into bonds as the diversifier in your portfolio. And I don't buy that for a second.

Tom Mullooly: For many, many years, the better of the best, if you could say that, was using longer term treasuries as your diversifier, but it actually turns out that in her research, that the shorter term, the shorter end of the curve has actually been better this year, this time around.

Tim Mullooly: Yeah. Yeah. I think what that said to me, it was the question she asked at the end was, is it repeatable? And I think that that's a really important question to ask when you're thinking about diversifying and picking which ones, because if you wanted to have the maximum diversification, you could just put all of your money into long-term treasuries and ignore the short term side of it. But this time around the short term actually worked better than the long-term. So you have to diversify your diversifiers. That's why she pointed out how an aggregate bond index, it worked well this time. And it obviously didn't work as if you were to just put it all into the long-term treasuries.

Brendan M: The amount you were punished for was the exposure to corporate bonds, which didn't hold up as well as ... and I don't think you should expect them to because these are bonds of publicly traded companies, not the US Government. And so when their stocks are going down, the bonds are put on pressure too, because-

Tom Mullooly: There's credit issues that come with them.

Brendan M: But the aggregate bond index, your core bond fund is 50% to 60% Treasury and agencies, maybe even more than that, but you're getting benefits. It's just a matter of how into this you want to go because long-term bonds are pretty volatile, when you look at how they move on a yearly basis. They're not as volatile as stocks, but they move around more than you'd probably want the bond component of your portfolio to do. Then there's the whole other category of alternatives here, which I just, I don't think-

Tom Mullooly: You see me smiling because you know that I'm going to tip over into that.

Brendan M: I just think these things are areas that people only buy after the fact. Managed futures were huge after '08, '09, and they've been terrible since. And it's not because the category itself is flawed. It's because people were greedily piling into something that worked in the past without understanding what it was going to do into the future. These things are going to cost you money. It is an insurance premium that you pay to own this, or a bear market type fund, which is just going to use options, basically, buy puts. So it's going to lose money most of the time, spending money on the puts. And then once in a while, it's going to pay off. And you're going to have this one thing in your portfolio, which some of these bear market funds earlier this year, when the market was down 35%, were just up insane amounts. But how much of your portfolio can you reasonably put into there when you know that 95% of the time it's going to be a money loser?

I'm not saying don't, it's just, you need to right size it, and you need to understand why you're hanging onto this thing when you could go years of it just losing you money. And if you're going to rebalance back into it, then that's an implicit cost that you have to be willing to bear. And if you're not, and you don't understand it, then stay away from the category.

Tom Mullooly: I think in the same bucket of alternatives, we can also throw gold and Bitcoin and some of these other things in there as well. Not really ... It's interesting to see that Christine, we have a lot of respect for her. She writes great, great topics. The headline was what's the best diversifier for stocks. It's really going to come down to simple stuff.

Tim Mullooly: Yeah. I think best is going to be best for your situation.

Tom Mullooly: Yeah, it's relative.

Brendan M: What you can hang onto. I mean, if you can own a managed futures fund and hang with it as a part of your diversification in your portfolio, then go right ahead. I just don't think the average person out there-

Tim Mullooly: Same thing, I think, with the long-term bonds. They're going to work better than an aggregate bond in terms of performance, but they're going to be more volatile, but if you can hang onto that, then great. If that works for you, great. That's relative, I think.

Brendan M: I've read too, one other thing that I'd want to add in, is the idea of holding cash as part of your diversifier. And it's tough because ideally if you're going to hold cash, you would want to put it into something like an online bank that yields something like 1% instead of zero, like a cash sweep account at some of the brokerage firms or most of them, or a regular brick and mortar bank account. But I think there's a big problem with decoupling. I think there's a benefit of holding the cash or your diversifier in the same place as your stocks, because then you could see the benefit of, "Hey, I had X. The market went down 10% and now I'm I'm here."

Whereas I just don't think you're going to mentally be like, "Hey, here's my stocks in this brokerage account. And oh yeah, I have this other portion of cash. This is my bond basically," and I'm using air quotes on bond there, "but it's over at the bank and I have to mentally calculate the benefit of having those two things and putting them together." I don't think you're going to do that and you're going to have more volatility than you can deal with in your portfolio as a result.

Tom Mullooly: That's a really good point. I think we'll end there for episode 315. Thanks again for tuning in and we will catch up with you on the next episode.