Simple IRA's, Retirement Allocations, & Tim's Cliché New Year's Joke

Tim Mullooly: Welcome back to the podcast. This is episode number 207 of the Mullooly Asset Management podcast. This is Tim Mullooly, and today I have with me...

Brendan M.: Brendan Mullooly back again, and here to wrap up 2017 for the podcast, which is kind of neat.

Tim Mullooly: Yeah. We are recording this a couple days before New Year's, so this will be the last episode of 2017.

Brendan M.: It's good to do the finance podcast at the end of the year here, so maybe we'll get some extra listeners who are making resolutions and trying to make changes with their finances going into 2018. It's as good a time as any to make a positive change in your life, I guess.

Tim Mullooly: Yeah, definitely. You know, it's always a good time to think about your finances and make sure you have a plan in place. And what better time than New Year's?

So you know, if you have a financial planner, maybe now is a good time to reach out and make sure you're still on track. And if you don't, we'd be happy to take your calls and help you get set up on the right track.

We're going to continue today with the mailbag questions that we get. Got a couple here today, going to make it not too long for you guys. So let's dive right in.

The first question asks:

"What allocation strategy do you recommend for those approaching retirement?"

The summary says, "Me and my spouse are approaching retirement. How should we allocate our investments so that we can protect some and grow some?"

Brendan M.: This question comes up a lot, and the general textbook answer is, okay, you're approaching retirement. We're going to tamp down the volatility in the account. We probably want to have some more stable stuff, like bonds or cash.

What people I think forget is that if this is somebody around the average retirement age in their 60s, there's a good chance a married couple, one of them is going to live into their 90s.

Tim Mullooly: Right. And this is something that we've been touching on a lot in the office recently. Like Brendan, said, if you're 60 and you retire now and you have to make that money last for 30 years, that's a long time.

So the textbook plain vanilla answer of shrink down your exposure to stocks, increase your bond allocation or cash allocation, might not be the case for some people nowadays.

Brendan M.: Makes sense on the surface level, but the way that we really dig into these kind of questions for clients is by doing a financial plan for them. Retirement is not so far away for these kinds of people, so we figure out what it is they're spending on a month to month, yearly basis.

And we factor in things that they're going to get, like social security, or if they have a pension through work if they're lucky. Factor in those.

But what we want to discover is what we're going to need from the portfolio for them to continue living their lifestyle exactly how it is now, minus the job, minus the paycheck.

Tim Mullooly: Right. Sometimes you see on TV big firms pumping up retirement for people on sailboats and out on the golf course and stuff, and for most people, that's not reality.

So we like to just find the expenses that the people have on a monthly basis now, and how are we going to be able to continue that, you know? Just for regular people.

They don't need anything special or crazy to travel all across the globe, stuff like that. Just what do you need on a month to month basis to just continue living your comfortable lifestyle that you have now?

Brendan M.: Right. And so we take those numbers and we apply it to their portfolio to see what kind of returns that portfolio would need to earn to ensure that that lifestyle continues into the future. And sometimes that means more exposure to stocks than would be intuitive on a surface level after we take an examination.

Sometimes it means that people can afford to tamp down the volatility in their accounts because they don't need big returns to not outlive their money. But it's going to mean different things for different people, and doing that financial plan is really what allows you to back into an allocation that makes sense for somebody who's approaching retirement.

Because you and your spouse who are 65 are going to have a different answer than that guy down the street and their spouse who's also 65 years old. Your situation could be totally different based on expenses and what it is you're planning to do in retirement.

So the financial plan is the driver of how we answer that question for people, and it is one that we get a lot.

Tim Mullooly: Right. And it's a good thing that these people, they're approaching retirement now and they're asking this question.

Brendan M.: It's the right question.

Tim Mullooly: Right.

Brendan M.: It's a good one.

Tim Mullooly: And it's a good time to be asking it, too. It's always a good time to be thinking about retirement, but you know, it would be harder for us to make a proper allocation for someone who comes in and says, "I'm already retired, drawing this amount of money, and I'm used to this in retirement." And they can kind of see the endgame and they're like, "I'm going to run out of money."

Brendan M.: It's tougher to make the adjustments at that point in the game because the variables that you play with in this retirement planning scenario are really ... you kind of are handcuffing yourself then.

It's like, okay well I'm going to run out and I don't want to plan on dying earlier. That's probably not a good one. I'm not making money anymore, so I can't increase my savings.

Tim Mullooly: So really, the only option left is the investments, and you don't want to...

Brendan M.: Yeah. You don't want to be swinging for the fences with your retirement money going all in and levering up or anything. You would like to be in a place where you can have a portfolio that you can handle.

But if you put yourself in that spot, you may need returns to bail you out of not saving enough money. And that's why we like to work with clients all along the spectrum of preparing for retirement.

Because the earlier we can help people get on the correct course, hopefully we can prevent things like that where people are hoping for greater than average market returns to bail them out, so to speak.

Tim Mullooly: Yeah. The last minute scramble to try and make things work. So hats off to these people for planning ahead and at least thinking about it before they retire.

So moving onto the second question for today's episode. The question says:

"I inherited an IRA that was passed down two different times. Do I qualify for a five year disbursement?"

The summary says, "I inherited an IRA from my grandma, who died at the age of 95 last year. She inherited the IRA from her son just months prior to her death. Do I qualify for a five year disbursement? I think that I will get penalized if I don't withdraw by the end of the year, but I am confused. I want to take out the least amount possible when I withdraw from the account."

So Bren, what do you think the options are for this person?

Brendan M.: Right. So there are a couple, and I'll refer to this as a twice inherited IRA. It reminds me of twice baked potatoes. Anyway, moving on.

Tim Mullooly: You got me hungry.

Brendan M.: Yeah. So, twice inherited IRA. Usually when you're the first person to inherit an IRA, one of your options is to take the RMDs from the account based on your own life expectancy.

And this is a non-spousal inheritance, which is the case here. This person does not have that option since it's a twice inherited IRA, so one of his options is to continue taking the RMDs based on his grandmother's life expectancy, who was the first person to inherit this IRA.

Seeing that she was 95, those might be a little on the high side. It's not going to be the same as if somebody in their 20s or 30s inherited this. So the number may be larger than anticipated.

That's something you can figure out pretty easily. There's tables online that allow you to calculate that. And normally if this IRA is with a brokerage firm, you can probably get somebody on the phone who can tell you exactly what you'll have to take from the account.

Tim Mullooly: Right. And this person's saying, "I want to take out the least amount possible when I withdraw from the account." So that, based on the 95 year old, might not be the best option. But there are some other options.

Brendan M.: Yeah. So the five year disbursement, certainly an option too, as well as taking a lump sum, which is always on the table when you inherit something like this. There's going to be taxes, obviously.

The money coming out of an IRA has never been taxed. It was tax deductible when it went in, so it's going to be ordinary income when you take it out, which is just something to keep in your back pocket.

You certainly want to know that. So I think that the lump sum, the five year disbursement, or continuing the RMDs of the grandmother are the options here that I can think of.

And you know, one of those is going to yield the lowest number, so whichever one that is, is the one to roll with if the objective is to take out the least amount possible and continue letting the rest of it grow tax deferred. So that's what I would recommend.

Tim Mullooly: Yep. So good to know that this person has options and they'll just have to figure that number out on their own and take the lowest one.

Brendan M.: Yeah, based on the value of the account. So you take the value, apply it to the life expectancy tables to find out what the RMDs would be, and that should give this person a better idea of what they can take out of it.

Tim Mullooly: Right. All right, moving on. The next question asks:

"Where should I move my 401k account from my past employer?"

Summary says, "I set up a 401k account through Merrill Lynch with my past employer. Do you have any suggestions for places I can move it?"

There seems to be some sort of misconception among some people. They think that they need to move their 401k when they switch jobs. That's not always the case. A lot of 401ks allow you to leave the 401k where it is.

Depends on the employer or the plan. They might require you to move your 401k, but if they don't, just know that you don't have to. You can leave it through Merrill Lynch. You can leave it in the plan. So that's always an option.

Brendan M.: Yeah. In most cases, the only time they're going to force you to move the 401k is if you have a very low balance, something under $10,000. You might run the risk of them contacting you to alert you to the fact that you need to move it, in which case roll over to an IRA is definitely an option.

You always have the option of just taking the money from the account, but there is going to be a 10% penalty if you're not over 59 and a half. So that's an option. A lot of young people end up doing that because they have a couple thousand bucks in a 401k and they're changing jobs frequently.

So not that I would necessarily recommend that, but if that seems like a good option for you, maybe it's something you think about. Roll over to an IRA is an option. You can leave it, like Tim had alluded to.

You could also see if the place you're working now allows rollovers into their retirement plan if there's one offered through work. So those are probably the four options that you would want to consider.

None of them are bad. It's just an answer ... or it's a question, rather, of what is the best answer for your situation right now. What do you need to accomplish?

Tim Mullooly: Right. And in terms of what they were asking, where should they think about moving it to, any discount broker really. We like to use TD Ameritrade here. You could go to Vanguard or Fidelity.

Anywhere that you could open up an IRA to roll it over to. It's personal preference, so wherever you feel like moving it would be fine.

Brendan M.: Yeah. All the major brokerages would be happy to have your account. You want to look into cost of having account somewhere and if they have any limitations in terms of account size.

But most places these days will be happy to accept your rollover, so do your homework and find out which one is best fit for you.

Tim Mullooly: Yep. All right, so we're going to move onto the last question for this episode. The final question asks:

"I'm 24 and contributing to a simple IRA. What else should I be doing to prepare for retirement?"

Summary is a little longer. It says, "I am 24 years old and I'm trying to figure out what to do for retirement. I work as a structural engineer and I earn roughly $68,000 a year. I am currently putting away 11% of my salary into a simple IRA with a 3% company match. At the end of this year, I will have about $23,000 in the account. Is this sufficient, or is there something else I should be doing? I am enrolled in an online master's degree program right now. After I make my final payment in January, I will have a little bit more flexibility with my cash."

So Bren, what should this 24 year old be doing other than his simple IRA to prepare for retirement, if anything?

Brendan M.: Well first and foremost, I know that something you and Tom discuss very frequently on the podcast is the need to have an emergency fund, especially for a young person. This seems to be a step that gets bypassed pretty frequently.

People are focusing on saving for retirement, which is great. I love it when especially young people are focused in on something that's important like that. But you don't want to put the cart before the horse and send money to a retirement account that'll have penalties in terms of getting access to the money when you don't even have three to six months of money socked away in a savings account for emergencies.

So that's probably step one, to make sure that this person has that covered.

Tim Mullooly: Also another thing to keep in mind, I was once a 24 year old a long time ago, a year or so ago. But just being that young, there are probably a lot of bigger purchases in your life along the way.

We talk about this a lot too. I don't know this person's situation, so they might be fine renting an apartment for their entire life or renting a condo or a house or something like that. But if you're 24 years old and you have plans of someday buying a house, that is also something that you might want to put money ... not tie it up in a retirement account.

Brendan M.: That's a great point. You want to have access to that money. So even if it's something where you plan on buying a house and it's more than five years away, let's say, like maybe this person plans on buying a house in their 30s at some point.

You don't want to have a penalty for accessing that money, so maybe you save it somewhere else where you can invest it, since you have a long enough time horizon to do so.

But you wouldn't want it in a simple IRA. Maybe it just goes into a brokerage account.

Tim Mullooly: Right. Because at 24, buying a house might not be right around the corner for this person. But at the same time, they're going to be buying the house most likely before they're 59 and a half.

So maybe just a regular brokerage account so they could invest the money over the next five to ten years or whenever they want to use the money to buy a house.

Brendan M.: Right. Another option could be a Roth IRA, which they could contribute based on a $68,000 salary, if this person is single, not married, they could contribute to a Roth IRA up to $5,500 a year.

And you can always get your contributions to a Roth IRA back without penalty because the money goes in after tax. So you can always get your basis back from a Roth IRA if you want. So it's a more flexible way where you could put money in there that you hope is for retirement but also know in the back of your mind that you can get access to it in an emergency or if you do end up needing it for a home.

You can access some or most of the money that's in there, depending on how it's invested. The gains from the account, any money that you make via investments in a Roth IRA, there's going to be a penalty for taking that out prior to 59 and a half. But you can get some of the money back from a Roth IRA, which is a good option to have.

Additionally, one thing I wanted to add was that if this person wanted to contribute more to their simply IRA, sounds like they can since 11% of $68,000 a year is $7,000, something like that.

So simple IRAs, you can put in up to $12,500 for the year as long as he's making ... yeah, he is making more than that. So he should be fine to bump that percentage up in terms of if he has all these other things that we've talked about covered and they don't seem to make sense for his situation.

This could be a scenario where he just bumps that percentage up so that he's maxing out the simple IRA that he already has.

Tim Mullooly: Right. So to sum up, this person could max out the simple IRA that they already have. And then if they want to keep saving in a retirement account, a Roth IRA sounds like a really good option for them.

They could put $5,500 in and be able to take out those contributions if they want to buy a home. And then on top of that, if they still have extra money that they want to save, you can open up just a regular brokerage account and put as much money in there as you want and invest it, and take it out when you need it.

Brendan M.: All good options, and that was a perfect summary to clarify our meandering answer there a little bit. So it was a good summary, and they're all good options in terms of where to put money. It's just a matter of what's right for this person specifically.

Tim Mullooly: Right. And as we wrap up, that's one thing I want to touch on as well. We don't know too much about all these people's situations, just what they give us in the questions. So nothing that we said here was specific to you listening or to the people who asked the questions.

It's just general, generic advice. To give more specific actual investment advice or financial advice, planning advice, we would need to come in and sit down with you on a one to one basis and be able to give you more specific advice that way. So nothing we said on here was specific advice.

Just wanted to cover that. So that's going to do it for episode 207. I will make the cliché joke and say that we will “see you next year”. Oh. That's the big sigh for the episode.

Brendan M.: You did it.

Tim Mullooly: My terrible joke.

Brendan M.: We did it.

Tim Mullooly: All right. We'll see you next week, guys. Thanks for listening.