Retirement Age, Paying Tuition, Savings Accounts, & More! - Transcript

Tom Mullooly: Welcome to the Mullooly Asset Management podcast. This is episode number 201. Let's do this.

Tim Mullooly: Yeah. Here we go. This is Tim Mullooly.

Tom Mullooly: I'm Tom Mullooly.

Tim Mullooly: We hope you guys liked episode 200. I know I enjoyed having that conversation with Tom about the Black Monday 1987 crash of the stock market. Lot of interesting stuff in that episode. If you missed it for some reason, you can go back and listen to that one as well. Today we're going to get back to our mailbag. These questions get sent into the website and we answer them as best we can.

Tom Mullooly: Understand that when we do pick up these questions out of the mailbag, we're trying to help people as much as we can. We get limited amount of information. We're not able to do a full profile on these folks that are asking investment or financial planning questions, so obviously, well obviously to us, this should not be considered investment advice or even financial planning guidance, but it is two investment advisors/financial planners who are trying to help people who are coming up with these questions out of the blue.

Tim Mullooly: Right. With that, let's dive right into the first question.

Tom Mullooly: Sounds good.

Tim Mullooly: The first question asks:

"Can you receive a tax benefit for contributing towards your child's school tuition?"

Tom Mullooly: Okay.

Tim Mullooly: There's a little sentence or two summary here. It says, "My wife and I are currently retired. We wish to invest $75,000 in our son's pursuit of a graduate degree. Can we receive any tax benefits for doing this?"

Tom Mullooly: Alright. Let's start to unpack this a little bit. If this son is going to pursue a law degree or go to med school, it's very possible that the cost could run up to $200,000.

Tim Mullooly: Yeah. It's definitely not a cheap thing.

Tom Mullooly: $75,000 is a gift. It's fantastic that the parents want to help their son as much as they can. There's a couple of things that they can do. I don't know if this is going to help answer their question, but both parents can give a gift of up to $14,000 per year. That means that mom can gift $14,000 and dad can gift $14,000, a total of $28,000, this year.

If you look at the calendar, we're recording this in November, but suppose you make a gift the last calendar week of the year, $28,000, a gift from mom and dad, and then on January 1, the next year a week later, you give another gift, $14,000 each, $28,000.

That's now $56,000 that you've gifted tax free to your son's further education, which is fantastic.

You would not get any kind of tax deduction for making a gift. It does remove the assets from your name because you're making a gift.

There's no tax implication on the son for receiving a gift up to $14,000. I suppose the other thing that they could do, Tim, and I think you're kind of thinking along these lines.

Tim Mullooly: Yeah. They could still use a 529 plan if they wanted to.

Tom Mullooly: You're absolutely right on that.

Tim Mullooly: A lot of people think of a 529 plan for little kids, start it when they're babies and it'll grow until they're 18 and they can use it for college, but it also applies to graduate school as well. It's not just made for little kids.

These people can definitely utilize that as well.

Tom Mullooly: Also understand that we don't know if this son of theirs has begun their graduate education or they're planning to in a year or two or three. Med school, you're in there for a while. Law school, you're going to be in there for three years.

There are some programs that go on and on and on. You don't get a tax break when you put money into a 529 plan, but you do benefit from tax deferred compounding. The

money can compound without any kind of tax, and it can be taken out if the expenses are tied to higher education.

That may be something that they'd want to talk about with their financial planner.

Tim Mullooly: Right. A couple different options for these people for that first question. Hopefully that helps them out. We're going to move on to the second question here. It asks:

"Should I wait until I am 70 years old to retire?"

We need a little background here on this person. They say, "I've just heard that people should forget about retiring until they are 70 years old.

Does this only apply to a certain target audience? I'm thinking about retiring when I am 60 years old, which is nine years from now."

Tom Mullooly: The person writing this is 51.

Tim Mullooly: Right.

Tom Mullooly: Okay.

Tim Mullooly: "I have about $2.3 million in investments split equally between a 401K and other investments. My wife and I have always lived well under our means."

Tom Mullooly: The most important takeaway was the very last line that Tim said. Can you say that again?

Tim Mullooly: Sure. "My wife and I have always lived well under our means."

Tom Mullooly: That my friends is the secret to saving money.

Tim Mullooly: Right.

Tom Mullooly: Live below your means. You may have an income of $150,000. It doesn't mean you have to spend it.

Tim Mullooly: Right.

Tom Mullooly: Unfortunately, a lot of people make $150,000 and they spend $155,000, and they never seem to get ahead.

Tim Mullooly: Just constantly digging themselves deeper and deeper into a hole.

Tom Mullooly: This person's question, should this person wait until they're 70 years old to retire, they can if they enjoy doing what they're doing.

Tim Mullooly: Right. I think when it comes to retirement, there's no real blanket age that you need to retire or you need to wait until to retire. This person, they said that they have $2.3 million already at age 51. If they wait until they're 70, that's

Tom Mullooly: 19 years.

Tim Mullooly: That's 19 more years, but like you said Tom, if they love what they do, then sure, you could wait until you're 70, if they want to. It's different for every individual.

Tom Mullooly: Yeah. We have no idea what things are going to cost in nine years, so it's impossible to tell. The Sunday newspaper that you buy today for $2 that could be $6.

It's just hard extrapolating how much your other weekly expenses are going to run. $2.3 million may not be enough in nine years, but you have $2.3 million now, so I will tell you, the person that wrote this question in, that you are well on your way to a comfortable retirement.

You don't get $2.3 million by accident. You started saving early and you lived well beneath your means. Very good.

Tim Mullooly: Sounds like they have a plan in place as well. They know when they're planning on retiring. They've just heard people on the streets saying 70 is the year to retire.

Tom Mullooly: There is the fact that if you can defer social security until age 70, the money that's coming to you does compound at a pretty good rate. That's something to consider, but that's a whole other ... We could do four podcasts on that alone, talking about social

security options. I think this person's in pretty good shape in terms of being well on their way for retirement.

Tim Mullooly: Yeah.

Tom Mullooly: Good question.

Tim Mullooly: I definitely agree. The next question asks:

"Should I sell my stock to pay off my mortgage?"

Summary goes on to say, "I am less than three years away from retirement and have 80% of my stock portfolio in a particular stock which has grown about 30% in the last two years."

Tom Mullooly: Hold it. They have 80% of their investment portfolio in one stock? That's a problem.

Tim Mullooly: That's a red flag.

Tom Mullooly: Right. It's grown 30% in the last two years. Good for you.

Tim Mullooly: Right. I was going to say that's good for them.

Tom Mullooly: We've seen the opposite.

Tim Mullooly: Right. When you have 80% in just one stock, it's kind of scary, at least for us, to sit there and look because it's kind of a roll of the dice at some point.

It went up 30% in the last two years, but it could have very easily just gone down 30% in the last two years.

Tom Mullooly: I don't want to get too far away from the story, but if they've clocked in with a 30% gain over the last two years, the average return has been 15%.

If this stock does nothing for the next two years, it just lays an egg, stays flat, they're going to have a 30% gain after four years. They're still averaging 7.5%.

Tim Mullooly: That's still very good.

Tom Mullooly: That's still solid.

Tim Mullooly: Yes.

Tom Mullooly: I don't know. Alright. Let's get back to the summary.

Tim Mullooly: Anyway. They're asking should they sell stock to pay off their mortgage. It goes on to say, "My mortgage is at 4.4% and my 401K is about 1/3 of my total assets. The other 2/3 being stock.

I am single with a salary between $100,000 and $150,000. I was thinking of paying off my mortgage by selling about 1/4 of that particular stock, which would include the capital gains and fees. Is it wise to sell stock at this time to pay off the mortgage?

I also thought that selling the stock and putting it into the apartment where I live would help diversify my portfolio."

Tom Mullooly: Okay.

Tim Mullooly: There's a lot going on here.

Tom Mullooly: There's a lot happening here. I am unfortunately going to go out of order with this. The last thing that this person wrote in with was, "I also thought selling the stock and putting it into the apartment where I live would help diversify my portfolio."

Tim Mullooly: Hate to break it to this person, but your apartment is not part of your portfolio.

Tom Mullooly: It's just not. It's not. Tim, do you remember when we used to do the newsletters?

Tim Mullooly: Yes.

Tom Mullooly: You guys were younger and I would help you write these different articles. I specifically remember in 2004 and 2005 writing to subscribers about your home is not your retirement plan. People were seeing the value of their home go up 10%, 20%, 25% in a year, and then it would go up again the following year.

That period of time, real estate did really great in almost all parts of the country. People were starting to talk about, "I should just take money out of the market or out of my retirement account at work and just buy houses."

You can't live in your retirement plan. You can't do that. Your home is not going to be your portfolio. Just strike that from your thinking.

If you want to buy the apartment next to you and collect rental income, now we're talking about a different story.

Tim Mullooly: Right, because then you have money coming in from your renters every month.

Tom Mullooly: Right.

Tim Mullooly: Totally different story.

Tom Mullooly: Right. A couple of warning flags that Tim and I both caught as we were looking at this. This person is three years away from retirement and 80% of their stock portfolio is in one stock. That's dangerous.

Tim Mullooly: Scary.

Tom Mullooly: Very dangerous. That's a problem that we would want to talk about with this person right away. It's grown 30% in the last two years, great. They have a mortgage at 4.4%. Good rate. Anything under 5% historically is a great rate.

"My 401K is about 1/3 of my total assets, the other 2/3 being stock. I'm single, good income. Thinking about paying off my mortgage by selling about 1/4 of the stock, which includes capital gains." Okay.

A few things come to mind. If you're not selling ... We don't have the details of how much they owe on the mortgage. It would be great if we had all the information, but this is all we've got.

I'm not opposed to this, especially since they've done the math and they figured out that they're going to be paying capital gains.

Sometimes when you sit down with people and they get these great ideas and they talk about, "Why don't I just do this, take this investment over here and get rid of this debt? Or do that? Or do this?", then I start to tell them, "Oh, you know you're going to owe like x amount of dollars in capital gains?" "What are you talking about?"

Tim Mullooly: It's not always as simple as people make it out to be.

Tom Mullooly: It's not. One of the things that will go away, Congress may take it away first, but you're going to lose that interest on your mortgage that you write off every year.

You're going to lose that. I don't want to make this a conversation about Congress, but one of the proposals in the new tax bill is to cap property tax write offs at $10,000. You could have property taxes of $18,000, you could only write off $10,000.

I think that may provide some challenges to investing in real estate. A lot of people like investing in real estate because they can see it every day. Honestly, other than a short while in 1990 and '91 and 2008/09, a lot of people haven't seen the value of real estate go down.

We need more information on a question like this. It's not totally outlandish, but we'd have to see the details.

Tim Mullooly: Right. We would need more of the numbers involved with how much they need to pay off for the mortgage and how much they would have in capital gains. Just need more information overall.

Tom Mullooly: One of the things that I will mention before we move on to the next question is that we actually have phone calls like this where they come into the office and people give us a very cursory amount of information.

It's like, "Make a decision that's going to impact the rest of my life please, in five seconds." We just need more information.

Your doctor wouldn't prescribe something for you unless he had all the facts before him. Same here.

Tim Mullooly: Great point.

Tom Mullooly: Yeah.

Tim Mullooly: Let's move on. The next question asks:

"Can I use my mutual funds as a savings account?"

The summary says, "I have around $75,000 sitting in a money market savings account. This is pure savings. I don't plan on needing any of it for at least two years.

Should I park it in a mutual fund (or a few) and pull out what I need when I need it, or continue to contribute as I save? The money market does not pay much interest."

Tom Mullooly: Can I do the big weekly sigh here?

Tim Mullooly: Go for it.

Tom Mullooly: I just don't understand. After all these years ... This is going to sound like it's coming out of left field, but Tim, I'm going to ask you a question. Alright? When was the last time we had a one year CD that paid more than 5%?

Tim Mullooly: 1994.

Tom Mullooly: You are right. It's been over 20 years since we've had a one year CD that pays a decent amount of interest. I think people should understand by now the money market is not supposed to pay you a lot of interest.

It's not going to. Because of the changes that the SEC made after 2008, they're probably never going to happen unless we see T-bills trading at much higher rates than they are now.

The money market is a parking place. It's a parking place where you should put your safety net.

Tim Mullooly: It sounds like this is where the money should be for this person, in my opinion. There's a sentence here, it just says, plain and simple, "This is pure savings." Then they say, "I don't plan on needing it, any of it, for at least two years."

That gave me the impression that this person, the writer, believes that two years in the market is a long time to let something ride out, but I think it's the opposite. I don't think two years ... If you're going to need the money in two years, I would leave it in savings.

Tom Mullooly: I agree. If you need it in two years, you should leave it where it is. I was just thinking, Tim, when you were talking about two years in the market is really nothing.

We met with a client this morning, and we showed him how from the middle of August of the middle of 2015, August of 2015, until about a year later, August of 2016, small caps dropped 25%.

If you only had a year, or even two years, to invest and the first thing that happened was you lost 25%, you'd need a heck of a second year to get back to where you started. Two years in stocks, Tim's right, it's just not a long enough timeframe.

I want to go back, though, to what we've talked about on several other podcasts, is that we typically recommend figuring out what your fixed and variable costs are each month.

Then once you identify your fixed costs, they are regular, reoccurring expenses that happen every month, you really should aim to have six months of your fixed expenses in some type of savings account, not in a mutual fund, not in the stock market, not in some crazy bitcoin type of

Tim Mullooly: Definitely not in that, in bitcoin.

Tom Mullooly: You need to have that safety net. It will earn you close to nothing.

Tim Mullooly: That's okay.

Tom Mullooly: It is completely okay. That's the base of your investment pyramid.

Tim Mullooly: When I read the question initially, they asked, "Should I park it in a mutual fund?", and they said, "I have around $75,000 sitting in a money market savings account." If it's in money market, those are actually money market mutual funds, so technically, it is in a mutual fund.

Tom Mullooly: Right. Yeah. Okay. I think we got time for one more.

Tim Mullooly: Yep. The last question for today's episode is going to be:

"Should I contribute to a Roth IRA and a 401k simultaneously?"

Tom Mullooly: Before we even get into the details, what would your answer be?

Tim Mullooly: If you can afford it, go for it.

Tom Mullooly: Right. Also, if you're under the threshold and you can contribute to a Roth IRA, you should certainly consider it.

Tim Mullooly: Yeah. Saving more money is never a bad thing.

Tom Mullooly: The only issue ... Let's read the question.

Tim Mullooly: Sure. The summary says, "Are there any advantages to having both a 401K and a Roth IRA plan at the same time? Both plans would be equal in savings. Are there any potential penalties in regards to yearly contributions if this were to occur?

Would it be better to have only one long term savings plan and then invest in bonds/stocks that are more liquid? I am looking to maximize my portfolio and I'm just getting started."

Tom Mullooly: Okay. This question also qualifies for the big sigh of the week because it just makes me cringe when I hear or when people write in saying, "I want to maximize my savings. I feel stupid doing what I'm supposed to do.

I should be getting more for my money." No. You're doing well. You're asking all the right questions, so don't feel shy about asking questions, but saying that you want to maximize your portfolio is ridiculous.

Everybody wants to do that, but you have to make sure that you're maximizing with the part that can be maximized, not everything.

Tim Mullooly: Right.

Tom Mullooly: One of the things that I'll alert the writer to is that many companies are now offering a 401K and a Roth retirement account as well. If you're doing this through work, understand that you have an $18,000 maximum contribution for both plans combined.

If you want to do this equally, then at the end of a year, you're going to have $9,000 in your 401K pre-tax dollars and you're going to have $9,000 in a Roth account post-tax dollars.

If you are under the income threshold, if you're a single filer, I believe it's around $110,000, if you're a joint filer, it's like $186,000 for modified adjusted gross income, if

you fall under those thresholds, who's to stop you from fully funding your 401K at work $18,000 and then putting an additional $5,500 into a Roth IRA?

Tim Mullooly: If you can swing that on a cash flow basis every month or per year.

Tom Mullooly: Do it.

Tim Mullooly: Yeah. Why not? Go for it.

Tom Mullooly: I think that's great. In terms of potential penalties to yearly contributions, you just need to know where the caps are.

Tim Mullooly: Right. You don't want to overfund the accounts.

Tom Mullooly: Right. If you're going to contribute through some kind of Roth set up at work, understand that they're going to count that $18,000 a year as your, or next year it'll be $18,500, as your cap for both plans.

If you do one outside of work, it might be in your best interest. Certainly something to look into.

Tim Mullooly: That's all we have for episode 201 of the Mullooly Asset Management podcast. We want to thank you guys for listening. We'll start the countdown now to episode 300.

Tom Mullooly: Sounds good.

Tim Mullooly: Just kidding. Thanks again for listening. We'll see you next week.