EPISODE 154

[ASK FARNOOSH]

FT: Welcome back to So Money. I'm your host Farnoosh Torabi. This is Sunday, June 14th, Ask Farnoosh time! Going through my mail and seeing what is on your money mind. Hope you're having a really great weekend. Let's get going. We've got, let's see, a question here from Jason. He says:

J: “Hey Farnoosh, my wife and I are 36, we've got 2 kids, ages 4 and 2. We just finished paying off our house."

FT: Seriously? That's awesome! Congrats!

[00:01:00]

J: "What should we do with all that extra money?”

[00:01:03]

FT: Wow! That's a good question. That's a nice question. It's a good place to be in Jason. High-five to you and your wife for paying off that mortgage. That's pretty remarkable. Man, I dunno? What should you do with all that extra money? I suppose, if I were you, I would project where you all wanna be in the next few years. Do you want to maybe buy a vacation home? Do you want to send your kids to private school? Do you want to - well, first I'd also ask, how are you rainy-day savings doing? How's your rainy-day savings account functioning? Do you have at least 6 to 9 months reserved? If you don't, maybe you wanna cushion that? How's retirement doing? Do you guys feel like you're doing okay as far as retirement planning and retirement investing? If not, maybe that's where you some of that extra money would go.

So it's really about making sure that your foundation is still strong. So paying off your home at age 36, that's awesome. And if this is a house that you plan to live in for, you know, this is your "forever house" then that's awesome. You don't have to worry about a mortgage for the rest of

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your life again, unless maybe you take on a second property. I would also consider, because you have 2 kids now, how are their college savings accounts doing? Do you even have them set up for them? So if you don't, that's something I think would need attention - should merit some attention. If you feel as though they're not really full or they don't have enough in there for where, they're only 4, but say in the next 14 years, the next 16 years they're gonna go off to school. Have you done those projections? What will school cost at that point, and how much do you wanna contribute? So I think you wanna look down the road.

Maybe it's that you also start working with a financial planner to help guide you through this maze a little bit and really distill what it is that you need to plan for, what your priorities should be given that you have kids. So that's the conversation that I would be having with your wife that I might wanna bring in a financial advisor to to get a second, third opinion. But the good news is, is that you have a lot of options and that is financial freedom in my book. Being able to say now, the fact that you're asking that question - what should be do with all that extra money? That's a good place to be in and you're gonna be okay. Just make sure that you really stick to what is important to you and your family and your goals. And dedicate the money to achieving those particular goals both in the long, long run - like college and beyond, retirement - and in the interim. So whether you maybe wanna invest in another property or send your kids to private school, plan a vacation. This is where life gets fun and congratulations for climbing that mountain.

[00:03:53]

Marianne asks:

M: “My daughter is going into her 3rd year of law school. We have been helping her by giving her $1,400 a month. She graduated from a top 20 university with no loans due to a generous financial package - we paid her room and board and spending, which was $25,000 a year. If we don't help her with her 3rd year of law school she will end up with $120,000 in law school loans."

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FT: Am I understanding this right? She got a great financial package, oh but it was a loan. It wasn't - I was thinking like scholarship.

[00:04:26]

M: "We are running out of money now after also paying for our 21 year old's bachelor's degree. Should we help our daughter with her 3rd year or should we catch up on our own growing bills? Help!"

[00:04:36]

FT: Marianne, it feels like a rock and hard place, but I will tell you that just based on my conversations with people that are in your similar situation and perhaps even older, the ones who are in retirement - I don't think you're gonna regret having taken the time now to really save for yourself for your future. If you're telling me that you don't have much of a retirement, that you're having a hard time just paying your own bills, forget retirement. Then I think you know what you have to do. Your daughter's a big girl, $120,000 is scary, but the good news is that hopefully she finds that really lucrative job. She's graduating from a top 20 law school, she'll hopefully be qualified for a good job that pays 6 figures as a lawyer. This is something she needs to inherit as her own financial responsibility at this point. You guys have been very generous helping her with her housing and her books and paying her a monthly stipend. It's gotta stop.

And she was very fortunate that she had you to do that for her, I think that at this point if you're recognizing that you are financially fragile as an individual, as someone who's got to worry about your own financial needs and retirement, I think it's time to have a conversation with your daughter and just be honest. And say, "Look, we wanna help you, we have been helping you, it is our honor to help you. We wanna see you achieve your goal to become a lawyer, but at the same time we have to also be conscious about our growing needs as a family. And retirement's not too far off and we wanna be able to retire comfortably and not have to be stressed at that point. We wanna be able to enjoy our retirement to be able to spend time with you wherever you end up moving, we wanna visit you and we don't wanna be strapped. We definitely don't wanna ever be in a situation where we're in our retirement and needing money from you, our rich lawyer daughter." [Laughs]

I jest, but it's something that a lot of parents are going through. We talk a lot about, we know a lot about the sort of sandwich generation of maybe 40-year-olds who are supporting their own kids and then also their parents because their parents didn't save quite as much or enough for retirement. So I think you need to just kind of apply a little bit of tough love to your daughter, but it's not even that tough. I mean, if she is gonna graduate and get that good great big job, hopefully she will, then theoretically she'll be able to pay off that 6-figure loan - assuming she doesn't have this extravagant lifestyle. That she's smart about how she's paying for things like housing and food and she budgets smart and she prioritizes those loans. So, and she sounds like a smart lady. So that would be my honest to goodness advice.

[00:07:32]

Chris asks:

C: “Farnoosh, I love listening to your podcast. Great advice from you and your guests. I have a 401(k) and I'm considering opening a traditional IRA as well. Is that a good idea to open one even though I currently have 401(k)? I would also love to know your thoughts on target date funds on 401(k) accounts? My 401(k) is currently invested in a target date fund and just read an article by Jeff Rose saying that we should not invest in one. Wanted to know your thoughts about these particular funds.”

[00:08:00]

FT: Sure. Well Chris, first to answer your first question, which is "I have a 401(k), you're considering a traditional IRA as well". I would say that if you feel as though you might be - so the way that a 401(k) works and the way that a traditional IRA works as far as taxes go is similar. So you're gonna be able to get the same kind of tax benefits. The money that you contribute to the fund will be - you'll be able to lower your taxable income with that contribution, which is great. And you save today, and then in the future you pay taxes on your withdrawals. If you feel as though your 401(k) at work is limiting in so far as the kinds of mutual fund options and

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investment options they have for you, then maybe a traditional IRA beyond that would be attractive. Because then you'll be able to get access to more funds, a diverse array of funds to help you stay better diversified and have better access to ways to grow your money.

If you also feel as though your 401(k), if you've maxed that out, you've put in the I think it's $18 thousand this year, you've done the most that you can and you wanna save more, well then that's when and IRA is handy. You can open one up and I believe it's $5,500 annually to contribute. If you're playing catchup then it's, in your older years, I believe it's $6,000. So those would be like the two scenarios, or all of the above, when it makes sense to open up a traditional IRA. You want access to more diversity of assets and funds that your 401(k) is not necessarily providing and/or you've maxed out your 401(k) and you want another way to save for retirement. Great vehicle: traditional IRA. So that's the answer to the first question.

Your second question is about target date funds. You know, target date funds are controversial. I've read Jeff's article. Jeff's a friend of mine. He's a fantastic guy and also personal finance expert. He's a CFP, he's a financial planner, his website - just to give him a shout out - check it out it's Jeffrosefinancial.com. And then he's also got a blog called Goodfinancialcents.com. He's on Twitter @jjeffrose. I should have him on the podcast actually. It's time. Jeff, if you're listening, get in touch or I'll get in touch with you. But so he doesn't like target date funds. HIs argument is that they've been - target date funds, just to educate everybody who may not know cause you can't assume that everyone knows what a target date fund is. It's essentially a type of mutual fund that is, usually you find these target date funds and they'll say, "Target date 2020. Target date 2030. Target date 2040." That year implies that that's the year that you're planning to retire. And so given that time length, that time frame between now and 2040, or now and 2050, that fund is designed in such a way to adjust for risk as you get closer, and closer, and closer to that target date of retirement.

So if you're 20 years old now and you're gonna retire in 40 years - so that would be in like 2055 - then right now the target date fund just generally speaking, it would be a little riskier, a lot riskier than it would be the closer and closer you get to retirement. So it's very convenient, and they're sold on their convenience that you don't have to worry about asset allocation, you don't have to worry about rebalancing, we do it for you automatically. It's target date will determine how the fund is designed as far as how risky it is, and then it'll adjust to be less risky as you approach retirement. So people love them because they are convenient. However, Jeff takes the position that they don't really return much. That they're - what did he call them? He said they're "crappy" or something. [Chuckles]

He's crystal clear about how he felt about them. Just because he believes in active management of your fund, and his pitch was, "Look, scrap the target date fund. The returns are no good, they're very small, and then on top of that there's fees probably attached to them. So they're actually not good for your portfolio. Instead you would benefit more from hand picking investments, creating your own DIY target date fund that a financial planner could help you with." And he's a financial planner, so you know, let's be honest here, it's to his advantage to say this, but I think he's being honest too. You would be far better off if you hired someone to help you pick and choose assets that met your retirement date, your risk tolerance, that were just a little more hand picked. Do like an a la carte approach. You have to pay for that, it doesn't come free. So you gotta work with a financial planner, so there's a caveat to that.

So what do I think? I think like any investment, you have to do your homework, do your research. Not all target date funds are lousy. Some are great. It depends on the performance. And you can track performance, you can see performance, you can go to sites like Yahoo Finance, Morningstar. A lot of times they have the historical price charts and return charts that you can see how funds have performed over a period of time and you can use that as context for you as you decide where to put your money. And if your 401(k) does in fact have lousy target date funds that have lousy returns, then maybe you wanna go and work with a financial planner or just call the 401(k) plan administrator and say, "I don't wanna do the target date fund. I wanna do something that's a little more specific to me. I don't like the returns that I'm seeing. Is there a way to maybe create something a little more unique for me that acknowledges that I'm not gonna retire for a while but I wanna be maybe moderate to very risky right now, and then change that as time goes on?"

Help is out there for you. And that's I think the real takeaway. Don't just assume, don't just be sold on a product because it's "convenient". Really do the research, ask the right questions. It sounds like you are reading up on this, that's great. And be your biggest financial advocate. If you find out that these funds are lousy because their track records are poor, then don't invest in them. Go find something that's better, that you feel more comfortable, that you feel your dollar is better spent doing. So that's my advice. And it's kind of across the board with any financial product. If you feel as though you're not getting your money's worth, that there are other better thing out there for you, explore them. Explore those better options and then come to making a better more educated choice at that point.

[00:15:10]

Sriti asks:

S: “Hey Farnoosh. What is a difference between ROTH 401(k) and a ROTH IRA. My current employer offers 401(k) and ROTH 401(k) and I am funding both and have been thinking to start ROTH IRA also. Should I? Love your podcasts! Thanks.”

[00:15:28]

FT: Well Sriti, I think that it's a good question. There are many differences between a ROTH 401(k) and a ROTH IRA. So some of the bigger differences: a ROTH 401(k), because it's a 401(k) essentially, allows you to contribute more annually than a ROTH IRA. The limit this year for a ROTH 401(k) is 17,500. It's 23,000 if you're age 50 or older. With a ROTH IRA you have a much smaller contribution limit. I believe it's $5,500 and then an extra $1,000 if you're 50 or older for catchup contributions. So if you feel as though you've maxed out your 401(k) at work, your ROTH 401(k), you wanna contribute more to retirement, a ROTH IRA could be a great vehicle for you.

Another difference between a ROTH 401(k) and a ROTH IRA: distributions. One of the benefits of a ROTH IRA is that the account can exist pretty much in perpetuity, forever, without any minimum required distributions. But a ROTH 401(k) you will have to start making distributions at 70 and a half years old. Something else to keep in mind about a ROTH 401(k) is that, well I think it's an advantage, potentially is if your employer offers a match then you get to take advantage of that match. With a ROTH IRA there is no match. And then to flip it, a ROTH IRA a lot of times people like to have some investment vehicle outside of their work plan because it exposes them to a lot more investment options. So the 401(k) plan at work or whatever you have, whether it's a 403(b) or a 401(k), a lot of times there is a limited basket of funds you can

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choose from. So if you like those funds, great. If you don't, maybe you wanna shop around for something supplementary like a ROTH IRA or a traditional IRA outside of your work's retirement plan. So that is great too I think because it has more options, more chances to be diversified, more chances to find low-fee funds, etc.

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And so those are the differences. Should you have both? I mean, after hearing this and you think that there are benefits to having another retirement account outside of work like you wanna contribute even more to retirement, you want to have access to more investment options, then a ROTH IRA could be another great way to diversify your approach. Alright Sriti, thanks so much for you question.

And that is a wrap for this Sunday. Thanks so much for tuning in. It's gonna be another great week of re-runs this week actually. We've got re-runs this week with Tony Robbins, Tim Ferriss, Seth Godin, Danielle LaPorte, Gretchen Rubin. So if you missed any of those top podcasts that I aired earlier in the year, don't fret. They will be back this week, front and centre. So thank you so much for tuning in. And thank you to Sriti, and Chris, and Marianne, and Jason for your fantastic questions. Love them guys, keep them coming. In the meantime, hope your day is So Money!

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