EPISODE 623

[ASK FARNOOSH]

[0:00:35.7]

FT: Welcome to So Money everyone, I'm your host Farnoosh Torabi. It is September 8th 2017, welcome to the show, hope you all had a wonderful, relaxing Labor Day break.

It is fall, for all intensive purposes, I'm no longer wearing my white pants and my white shoes. Although, it's fashion week too and I don't know, maybe that's okay. Our special guest cohost today is a real fan of the show. I know in the last few weeks I've had on friends and previous guests and so I'm really excited to bring on a true bonafide Fan, capital F, of the show.

David Fox has been listening, not only to the podcast, probably from its beginning but I understand also has been watching videos on Yahoo Finance when I was a host there of Financially Fit.

It's really an honor and a pleasure to meet someone who has been following my work for so long and I'm really interested to hear about you David, welcome to the show.

[0:01:31.2]

DF: Yeah, thank you. No, it's really awesome to be here, like you said, I kind of listen to Yahoo Finance, they were like my finance Bible going through college. I did see a few of your videos, read some of your articles and yeah, I started listening to So Mooney. I was kind of amazed because you took So Money the podcast from like zero to a hundred, real quick.

You know, you had these really cool guests on and stuff. Yeah, have been a listener pretty much since you started that and yeah, as for me, I kind of followed the personal finance realm through college. I'm an accountant, I'm working on my CPA right now. Personal finance is kind of a – it's like a – just a personal interest of mine, I intend to do more corporate audit type of work.

I just thought it would be awesome to kind of help people answer their questions. I've definitely been through my own personal finance journey. I moved to Japan after I graduated from college to teach English while I was paying down student debts and then came back, started with a big accounting firm, moved over to Paris for a while with work and then recently moved back.

Working in Silicon Valley now, doing some work out here with a client of mine and yeah, just kind of trying to balance you know, work life, travel. All the good stuff.

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FT: Are you the friend that everybody goes to for money advice?

[0:02:50.0]

DF: Definitely. I do get asked some interesting questions sometimes. What surprises me is how various people's situations are. You could have your financial situation figured out to a T and even with some of the questions that we have in on the podcast today, you could tell, people just have – on the podcast today, you can tell, people just have such different experiences and so it really is kind of a tailor made…

Personal finance is such a specific personal thing. It's kind of interesting for people and it's important for people to get to know how it affects their lives. I think what you're doing with the podcast is really intelligent. I encourage people to not just listen to the podcast and hear the answer to their question but to really dive deep into some of the thing. Like their taxes or their budgets, things that really can benefit them a lot.

[0:03:35.0]

FT: Well, I'm really happy to have you here with us. Our first question is from a 25 year old. So I love that she's young and interested and being proactive about her money. She's anonymous, I don't want to be mentioning her name on the air, that's cool.

She lives in Chicago, she makes about 60 grand a year, she's got no debt which is awesome. 22,000 in savings, can I ask you David how much you have in savings? Is it more than that?

[0:04:01.8]

DF: Well, savings, I mean, the important thing is to have enough on tap. I have enough on tap but it is well invested.

[0:04:10.1]

FT: Cool, alright, she is single and she wants to know how much of her savings should she invest in an index fund? You know, we're big fans of index funds on this show. Warren Buffett likes index funds, most people he says, should be just in index funds. I mean, I don't know if she has – I don't know anonymous, if you have a 401(k) at work, would start there and maybe do up to 10% of your income, if there's a match, even better.

Additionally if you wanted to start an index fund or alternatively an index fund and you don't have a 401(k) at work, then there I would say, you know, 10% could be a good place to start. Given that she's only 25 and hopefully this is something that we'll be consistently, automatically done every year, what's your approach?

[0:05:00.5]

DF: Honestly, I'm a big financial independence fan, so I think the more you have in investments is probably the better. At her age, she's single, it says she has no debt, $22,000 in savings is super high. The other interesting thing is your 401(k) benefits from compound interest, any index fund, that's really where you're going to get the most value is putting in an early and then having it in there for a long time.

Being 25, she's in a perfect spot to stock away a bunch of that savings into her 401(k) and like you said, I would recommend 60k annual salary, she's probably in the 25% tax bracket. I would have her look at what she could put into her 401(k) that it will at least get her to a lower tax bracket and live off some of that savings for a while to draw it down. And in the meantime, really try and hit that $18,000 limit on your 401(k).

Lower your taxable income and you'll save yourself some taxes, not only that you'll bring down that savings, you'll defer the tax on your 401(k). You can only do that once, once the year's over, you can't go back and put it in for that year. So she can check off 25 on the list as he or she maxed out her 401(k) and that's fantastic.

[0:06:10.1]

FT: That's a really good point you bring up which is that you contribute as much as to the 401(k) where your taxable income reduces enough and you're in a new income bracket, a new tax bracket rather. That's a good way to put it I think because after all, that's a huge benefit of the 401(k) is the tax deduction. You're So Money anonymous and I don't know why you wouldn't want to name drop your name on the show, I think that there's a lot to be proud of.

[0:06:39.6]

DF: Before we move on, what would you think of like how much of her savings should she invest in her index fund? 22k is an awful lot.

[0:06:45.2]

FT: Of her savings, you know, I would say, you know, yeah, I kind of didn't catch that. To specifically with the 22,000 in savings, I would keep enough liquid where if you lost your job, you could cover your expenses for three months. You know, normally we say six to nine months, for the average person a year, for entrepreneurs. But for someone who is in her 20's, who is gainfully employed, who could probably find another job in this market, relatively quickly. It's not necessary to have like you know, massive amount of cash on hand.

I think like, three months is good, you'll be – I trust that you'll be able to bring some income in within those three months so that – from there, I think you know, see where you land and then the rest goes into investing, right?

[0:07:36.3]

DF: Safety net of mom and dad too. I think like if you put the money away and you're saying hey, I contributed to my 401(k), it's going to be a lot better than "Hey, I spent the money on booze and friends", you know?

[0:07:47.4]

FT: Right, which is not so hard to do that when you're 25.

[0:07:51.5]

DF: Exactly.

[0:07:52.3]

FT: When you're 37 either. Okay, tell us what is on Jordan's mind, I'm going to have you do a little work for us here David, read us Jordan's question.

[0:08:04.5]

DF: Sure. Jordan has three student loans that are $5,000 each. He's contacted the lenders and says they won't accept principle only payments to help pay them down. He asks if we had any ideas to help him either get around that or kind of to effectively pay down the principle I suppose.

[0:08:21.2]

FT: That's unfortunate, isn't it? I wonder if he could at least with one or two of them or all of them, if they're private consolidate and then just maybe then get a new lender in the process, who would be a little bit more flexible and open to making principle payments. Another way to navigate this potentially, is look at some 0% APR credit cards that may start you off with like a six or $8,000 limit. Convert one of those loans to that card and effectively, you know, you're making 0% interest payments.

That again may require some strategy and some permission, so make sure that that's even possible but you know, I think in this case, it's really about finding a new lender who would be open to making principle only payments.

As we know, that's a great way to knock down the debt. Is you pay your minimums but if you have extra money, make that additional payment towards the loan and make it specifically for principle only.

Did you have student loans Jordan when you graduated from college?

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DF: I did, yeah.

[0:09:28.3]

FT: I'm sorry, I called you Jordan.

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DF: That's okay. That totally make sense.

[0:09:31.8]

FT: Jordan is asking a question, you're David.

[0:09:35.4]

DF: That's right. Yeah. I did, yeah and actually, this is probably for the listeners. I think they might benefit from knowing – like this is an important example of when it's really important to read your loan documentation. To know, okay, what are the terms of them entering into, what's the interest rate, are there going to be any penalties for early payoff, whether it's a car loan, a student loan, you know, mortgage, anything like that. That's really important to read that documentation and ask those questions before you accept them.

But like you said, I'm a huge fan of the balance transfer offer method. I used it for my student loans. I graduated with probably $25,000 in student loans. I paid them off years ago and it took a lot of work and it took a lot of focus. It's done. I think the balance transfer offer is a great idea if you're going to have the savings on your interest rate, most balance transfer offers charge an upfront fee.

Actually, Farnoosh, I asked you this question on one of your other Ask Farnoosh. Just go back a little bit in the podcast list and listen to that one. But yeah, as long as you're able to pay off the credit card, not put too much on there. Let's say, you have three student loans, that's $15,000, let's say you're able to put $10,000 on a no interest balance transfer card.

Let's say you pay 3% on that. If you're interest rate on the $10,000 is 10% and you're able to pay 3% and extend that for two years, then that saves you that 7% net in interest. The important thing is that you pay it off before the due date comes because in that case, some cards and again, this is important. It's important to read the terms of the loan, right?

Even though it's 3% balance transfer, it's still a loan. You want to read the terms and make sure some of them charge interest retroactively. So, if you don't pay it off by the end of the date, they'll actually charge you from the beginning of the one or two-year period at 22% or whatever their interest rate is.

It's really important to read that and if you're not sure on your job, you're unsure, then honestly, if you're not sure in your job and you can't do a balance transfer offer, I would just take the money that you're going to throw towards the loan each month and put it into a high yield savings account. Something like with Allied Bank and just sock it away every month.

Once you have enough to pay off the loans, if you're allowed to do a payoff, then do a lumpsum payoff. If not, then just once you reach your limit in that account, just let it sit there, forget about it, setup an auto pay each month and you've effectively paid down the loan. You just have to check in on it every now and then.

[0:12:07.7]

FT: David, you should have your own podcast or at least a blog. You're a wealth of information.

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DF: Yeah, I try to blog a lot – I actually started my own website but it's like literally…

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FT: What is it? We'll stalk it, tell us.

[0:12:23.2]

DF: It's davidfox.info

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FT: Okay.

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DF: Yeah, it's more of like a personal project that I kind of started to setup because I feel like you know, I spend so much time on Facebook.

[0:12:35.0]

FT: I think you're on to something. I mean, I could just sit back and have you answer to all these questions. I'm just going to like sit here and doodle. No, that's great advice, that's really specific advice. I love having you on this show.

Alright, Erica says that the stocks in her 401(k) were preselected on risk assessment quiz. She wants to know, should she instead pick stocks based on expense ratio? I'm a little conflicted about this David. I mean, I think both are important factors in creating a portfolio, right? You want to make sure that it's risk adjusted to address your risk tolerance and that's very important that it's a diverse mix of investments that really kind of size up to how you are –

How comfortable an investor you are. Also, you want to be mindful of the expense ratios. I think that what I would do Erica, honestly if I were you, I would kind of go into the portfolio as it was created from this risk assessment quiz and go line by line, fund by fund, stock by stock whichever – you know, whatever the investments are. Talk to somebody at the 401(k) provider and just say you know, "Is there a way to maintain this portfolio mix, the sort of the spirit of this portfolio mix but reduce the expense ratios?"

Swapping one fund for another that is more or less the same kind of fund but maybe less expensive in terms of expense ratio. In terms of what is an expensive expense ratio? I think anything over 1%, you may want to look at that a little more critically and wonder if there's something more affordable to swap in.

What's your take?

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DF: Yeah, that's a great point. Yeah, I'm a big fan of peeling things down to the foundational a little bit and seeing what their risk assessment quiz really bases things on. Maybe get some feel for, okay, maybe take the risk assessment quiz again if you can. Answer it like you know, choose the opposite answers of what you would normally choose and see what mixed with assets that puts you in then.

Because you know, there's something going on in the black box that we don't know quite yet for the risk assessment part. But, if you're – I'm not sure how old you are Erica but I'm guessing, I don't know what your target demo is there Farnoosh? But I'm guessing you're probably –

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FT: You could probably guess safely between 20 and 40, that's a big range but yeah.

[0:15:09.3]

DF: Something like that. I mean, even 40, you have 20 years before you're probably going to retire if you retire early. You have some time to take a bit of additional risk and try to reap some of the rewards of that. I would say, definitely pay attention to the expense ratios. There are a few calculators out there that you can use to estimate the expense ratios and see.

If you have two funds and you have their expense ratios, you can plug in the same data for both and just change the expense ratio and see how it would affect your earnings over 10, 20, 30 years and see if it's worth it to you to make a switch. Yeah, I'm a big fan of picking based on expense ratio and kind of the set it and forget it index method. But most 401(k)'s have an SMP 500 index fund. Honestly if you don't have a risk assessment quiz like this 401(k) offers, I found it's easiest and the least stressful just to throw it into that SMP 500. Then only going to check it periodically until you retire really.

[0:16:08.8]

FT: Yeah, to your point, Erica could afford a good bit of risk assuming that she's in her 20's, 30's. Even if she's 40, she has a long time until she's going to be pulling this money out. So that's not – assuming they're not putting her all in stocks you know? All really aggressive stocks, I think…

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DF: Bonds and -

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FT: Yeah. I think you're probably going to be okay and it is very important to keep a close eye on that expense ratio because it does compound. And it could be tens of thousands if not hundreds of thousands of dollars over decades.

Heather has gotten a personal offer for a personal loan and she wants to use it to consolidate $13,000 worth of credit card debt. Is it worth it? I think this is a simple math question, right David? What's the interest rate Heather on your credit cards versus the one on this personal loan?

The other benefit of course to consolidating is that you get one bill every month, as supposed to multiple, and so it's easier to manage your payments. It's less likely that you will forget or have anything falling through the cracks. I'm okay with it. I mean, if it's really your question is more about is it cool to kind of relocate these loans, move them from one place to the other? Sure.

I mean, if it's going to be financially beneficial to you and it will mean that you'll be able to manage this better and pay this off, perhaps sooner or less expensively. Then I think I'm all for it. Any other things that you should look out for David?

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DF: Just in the way of, the benefit of like you said, having the kind of peace of mind of knowing you have a lower interest rate and that you're only making one payment to one service every month. That's kind of nice. But, if she really wants to do the money savings, then perhaps she's eligible for this balance transfer credit card method as well.

Again, just weighing the risk of that scenario. 13,000 is kind of a lot depending on her financial situation to kind of ride on the balance transfer offer. If you get laid off or whatever happens, It might not be too smart. But I think the savings is certainly, especially with credit card debt when you're talking, you know, anywhere from 15 to 25% interest. To slam it down on a balance transfer at 0% interest.

Actually, effectively 3% interest because you pay the balance transfer fee. Then you know, that's going to make a huge difference in her finances. As long as she knows like "Okay, I need to pay this off, I'm not just going to throw it on a balance transfer card and then leave it there and then have that become another credit card debt down the line." I think it really just depends if she wants money savings or the convenience. So depending what her values are, she pick – let her pick one and then go with it.

[0:19:01.7]

FT: Good advice. Alright, rounding us out is a question here from Mary Grace and it's a business question. You want to tell us what's on her money mind David?

[0:19:12.5]

DF: Yeah, it says: Thanks So Money, there you go Farnoosh. She says, she finally made the plunge this year and started her own business.

[0:19:19.4]

FT: Woohoo.

[0:19:19.6]

DF: She wants to know what you're –

[0:19:21.5]

FT: I wish I had some noise effects back here. I don't know, some kind of like, I don't know.

[0:19:29.9]

DF: Like fireworks or like something blowing up….

[0:19:32.3]

FT: Yeah, something like that.

[0:19:34.0]

DF: Yup. Well, I mean, this show is young, right? There's still time to get all that stuff put into place.

[0:19:38.5]

FT: Yeah, like a band or something. Yeah.

[0:19:43.4]

DF: So her question is, what is your advice on entity formations? So LLC, S Corp, you have limited partnerships, corporations, all kinds of fun stuff. What do you think Farnoosh?

[0:19:53.7]

FT: Well I'm not a tax attorney and I will defer to all the great tax attorneys out there for the real answer to this Mary Grace. But I will offer some personal anecdote here which is I'm an S corp and at the time when I was forming my business, my accountant explained it to me as being something that compared to an LLC, may prove more tax advantageous. I know one of the differences with an S corp versus some other entity formations, is that you have to claim a salary every year.

That is kind of on par with you know, "market salary" for your job role, job description. Which you know, which is, my attorney explained it to me, my tax accountant explained it to me as something that could be beneficial tax wise.

You know, I think that if you're at the point where you're really considering this question, it's probably also a sign that you're ready to work with somebody more formally on your taxes and on your profit and loss statements.

In that case, do look to find someone. Maybe it's someone like a book keeper, a tax attorney, even if you just have one meeting with a tax attorney to help you setup the entity formation and then you can go and work with a simple book keeper for the kind of month to month book keeping. I think that's one way to save money, you don't' have to work with someone super sophisticated all year.

Until your business really starts to really grow and you feel like you need some tax advice throughout the year. Do you have any sort of side hustle or side business David? I know you got your website but any other like side income?

[0:21:37.9]

DF: Currently now, no. I did drive for Lift and Uber when I was paying off my student loans. So I definitely did that for a while. I do, do some rental activity, things like that. But I operate all that through kind of my personal – it's not big enough yet to where I would consider throwing it into an LLC or anything like that.

As a general rule of thumb, I think that LLC is probably best if you're just starting off. It kind of depends on what you're making net. Also, probably how many employees you have if you have employees. I think the limited partnership and your LLC are more flow through entities so those with flow through to your personal income. But if you start to see income retire and hire or you're starting to hire people, then you start looking at those S corp and corporation models.

I think that's probably the best way to do it. LLC also offered the limited liability protection which is really important for you. If somebody sues the business, they can't come after your personal assets necessarily unless you're personally negligent. You know, I don't know which – it depends what you're doing, what you're selling. But you know, if somebody tries to go after the business, it's not necessarily going to ruin –

[0:22:49.2]

FT: That's a good point. It does depend on like, if you have a real product, like a physical product, I think in that case maybe an LLC is better, you know. I'm on Inc's website. Inc.com. They actually have a really great article here on the pros and cons of LLC's versus S corp.

You know, the internet in this case can be a really great resource for you. I don't want to generalize too much because this is not my area of expertise. I can only speak personally but yeah, I think in general, an LLC can be easier in some cases to setup. Especially if you're new, I know it's sometimes less expensive to start.

Yeah, I think as more complex – potential your business and depending on where – what kind of business you have and how much money you're generating, that will steer you in one direction or another. Good luck and I'm so proud of you Mary Grace. I'm really happy to hear about this new venture of yours. Tell us more and as everyone knows, you know, you don't have to ask one question and go away on this show. You can continue to reach out to me and like you David.

I think we've answered your questions maybe one or two times and now you're a cohost. The point is, stay in touch. I want to build relationships with my listeners and this is a great way to start.

David, was this everything you dreamed of and more?

[0:24:07.3]

DF: No, it's fantastic. Dream come true. So I'm archived in the history at this point.

[0:24:12.8]

FT: Life complete, right, okay. Living the dream. Really appreciate you coming on the show, especially because you brought such great advice, specific and helpful guidance to our listeners and I'm just really appreciative. Thank you so much.

[0:24:28.2]

DF: Yeah, thanks for the opportunity. Look forward to listening to all your upcoming episodes and best of luck educating the masses, love it.

[0:24:36.0]

FT: Keep up that blog.

[0:24:37.7]

DF: I'm working on it, in my free time when I have it, definitely.

[END]