How To Get $1M In Your 401(k)

Intro
Welcome Rockstar Nation to the Financial Rockstar show. I'm your host Scott Alan Turner ready to help you get out of debt, save more money, and retire early. In the studio with me is producer Katie, who owns a dog who hates me. On the show today we will be answering your questions about money, business, and life. If you have a question you would like answered on the show visit GoAskScott.com

Segment: How would you like to have $1M in your 401(k)?

Discussion of the article: http://scottalanturner.com/how-to-save-1-million-in-your-401k/

Now on to your questions.

QUESTION: Graham asks about the benefits of paing off a mortgage vs. investing in other assets.
ANSWER: For anyone who wants to retire either pretty soon or decades away, we kind of know having a paid-off house is important heading into retirement.

Pretend someone buys a house and they put every dollar into paying off the mortgage. They don't put away anything for retirement and throw money at their mortgage for fifteen years. Then they decide to start saving for retirement. What happens is they end up being house rich and cash poor. Time isn't on their side because they missed out on fifteen years of having their investments compound in the stock market.

Compare that to someone who has a thirty year mortgage but invests regularly over the entire thirty years. They will end up having to invest significantly less money to end up with the same amount of money in retirement as the person who didn't invest for the first fifteen years.

Let's look at an example. And you can use any investment calculator online to play with the numbers yourself and I encourage you to try it. If you invest $375 a month for 30 years you can have $1M by retirement. But if you wait to start investing and spend 10 years paying off your mortgage first, you have to invest $1,200 a month for 20 years to get the same $1M. It's a lot easier to put away $375 a month than $1,200 a month.

Additionally when you hit retirement you can't eat your house. A paid for house with no retirement money to feed yourself doesn't do you any good. You'll end up selling your house to eat.

If you want to retire early you're going to need a lot of investments and a paid off house. It used to be financial planners would tell you to invest 15% of your income to maintain your lifestyle in retirement. Now that we're living longer, 20% is the new amount we need to start saving to maintain our standard of living when we retire.

If you want to retire early, you need to put away even more. 30%, 40%, 50%. Some people choosing frugal and minimalist lifestyles are putting away 75% of their income so they can retire in their 30's and 40's. It's not out of reach.

Graham I would say as a starting point, invest 20% towards your retirement. Then come back and pay extra on the house.

The longer you invest the more time your money will grow. Compound interest is your best friend for a rockstar retirement.

Thanks for the question Graham.

QUESTION: Antonio writes in and asks - How do I get out from under a foreclosure, I went through a divorce and my EX wife would not sign the papers to sell the house or rent it out so it got taken back by the bank. I make very good money now, and would like to know if there is anything I can do to fix my credit report.

ANSWER: Antonio I'm sorry to hear about your situation. Unfortunately once a foreclosure is on your credit report it can't be removed other than by time.

A foreclosure remains on your credit report for seven years, but its impact to your FICO score will lessen over time. While a foreclosure is considered a very negative event by your FICO score, it's a common misconception that it will ruin your score for a very long time. In fact, if you keep all of your other credit obligations in good standing, your FICO score can begin to rebound in as little as 2 years.

The important thing to keep in mind is that a foreclosure is a single negative item, and if you keep this item isolated, it will be much less damaging to your FICO score than if you had a foreclosure in addition to defaulting on other credit obligations.

Some things that will help you if you're looking to get into a new home. And these things apply to anyone that has bad credit and wants to improve their credit score.

1. Pay all of your bills on time - never have a late payment. Paying your bills on time accounts for 35% of your credit score
2. Don't take out any more credit/loans
3. Save up more than a 20% down payment. You won't have to wait seven years to get a new home but you will end up paying a higher interest rate because you're considered a greater risk. The greater your down payment, the lower your interest rate.
4. Keep a low credit utilization rate. This counts for 30% of your credit score. Six months prior to applying for a mortgage keep your debt to credit ratio as low as possible (money you spend on a credit card each month vs. the available balance).

You may have to rent 2-3 years before lenders are willing to take the risk on you again. But if you follow those tips you certainly won't have to wait seven years.

Thank you Antonio for the question.

I want to hear from you
If you have a money-related question you would like answered, please visit XXX to get in touch with me. That website has my email address, twitter, and you can also leave me a voicemail. Please contact me, I'm here to help you.

And that brings us to today's money hack.

Segment: Money Hacks
This is our money hacks segment where I show you simple ways to save money in your life while maintaining a rockstar lifestyle.

A couple years ago I was out wakeboarding one afternoon and my board didn't feel quite right after I landed a jump. I hit another jump and again, something didn't feel up to snuff. I dropped the handle, got back on the boat, and I saw my board had cracked in half. So it was trashed. My friend Nick said 'hey, you should contact the manufacturer and see if they'll replace it for you.' I wouldn't have thought of that because the board was a couple years old. Long story short, I worked with the manufacturer and the place where I originally bought the board and got a brand new replacement for free.

If you're a homeowner, if you own some electronics like a printer, if you own some mechanical equipment like a lawnmower, you might be spending money if something breaks when you don't have to. One more example because I want to get you thinking - double paned energey efficient windows. These suckers are expensive. Six of these windows have had the seal break in my house since I had the house built. The manufacturer has a lifetime warranty that is transferrable to whoever owns the home. All I have to do is pay for the labor to have them replaced. If you own a home with energy efficient windows and it looks like there is condensation between the double panes, chances are the seal is broke. Which means your window is broke. Which means it's not energy efficient anymore. Find out who the home builder was, find out who supplied the windows, and find out if there is a warranty. You'll save money on your energy bills if you get those windows replaced.

So before you run out to Home Depot and pay for a replacement part, do a little online research first and see if the item is still under warranty. And if it isn't contact the manufacturer anyway and see if they can help you out. You won't know if you can get a discount or a free replacement unless you ask.

Now back to your questions rockstar nation.

QUESTION: Jason has a question about emergency funds. Should money in an employee stock purchase program, in an annuity or in and 401(k) count as an emergency fund? I know what you will say about the 401(k) because you recently talked about not borrowing money against your 401(k) but if you have an emergency does that qualify?

ANSWER: An emergency fund should consist of cash or cash equivalents such as checking accounts, savings accounts, or money market funds that can be converted to cash quickly.

So let's talk about some sources you shouldn't be tapping for an emergency.

Life insurance cash values have delay clauses built into them of up to six months, so they don't meet the definition of being quickly available. A side note that six month clause is built in to keep a run on the issuers from happening in case of some type of economic meltdown. Typically you can get the money out quickly. But you should use these as a last resort.

Additionally in the case of if you lose your job or become disabled and unable to work, when you cash out a policy you've done two things - you're increasing your debt and reducing your the amount of life insurance you have. When you don't have an income, you need to maintain your life insurance, and you want to avoid more debt.

Lines of credit like a HELOC aren't appropriate because they can be pulled by the bank. That includes second mortgages. You add risk if you're relying on those.

Employee stock purchase programs, annuities, and 401(k)s are all geared towards investing and retirement. If you have an emergency and you rely on your 401(k), what happens if the market goes down 50% like it did in 2008-2009? Not only do you have less money for an emergency, if you withdraw your money at the market bottom, you completely miss out on the market upswing when it recovers. You're getting hit twice. You're retirement is getting a big ding in it.

What you need to do is build up a 3-6 month emergency fund in cash. Do that after all your debts are paid off, such as your credit cards. In your case Jason I would do a couple things.

1. I would reduce my 401(k) withholding to just the company match. Get that free money if your employer is giving you some. Then take any extra you were putting in your 401(k) and start building up an emergency fund.
2. I like ESOPs because it's more free money. But my preference is to get in and get out. Sell the stock as quickly as you are allowed to. Often that's every quarter depending on the plan. We want diversified investments to reduce our risk. Investing in company stock is much more risky. You will be taxed at the ordinary income rate instead of the long term capital gains rate, but for me I prefer the lower risk of not holding on to company stock and paying the higher tax rate. Employees who had company stock in Enron, Worldcom, Lehman Brothers - when those companies went bankrupt the company stock was worth zero. Even if you work for a stable company like WalMart - you would never expect WalMart to go bankrupt - the risk is higher because of the lack of diversification.

So while you could use your company stock, an annuity, or the 401(k) as an emergency fund. They should be last resorts. It's much better and less risky to have an emergency fund in cash earning a little interest in an online bank.

And that's not just my opinion by the way. Everything I've shared with you is taught to people who want to become Certified Financial Planners.

Thanks for the question Jason.

QUESTION: Leo asks How do you budget for unexpected expenses. Especially for me I whitewater kayak and we find out last minute about a good rain and higher river flows. If that isn't happening, a friend will find a rare opportunity to see a show in town. This problem isn't even limited to experiences, a friends birthday comes up or a collection is taken at work for something new. I feel like my budget could have a million line items that may or may not be used because of this nonstandard spending.

I have a good hold on putting money away for car repairs; it is probably pretty sad when that is more predictable than your social life! Usually, these expenses don't feel extravagant and saying no would a bit extreme.

ANSWER: So for all of us, Christmas is coming again this year. At least the last time I checked anyway. But we know this, right? We're going to have to buy presents. We expect December 25th to come around. Which makes it expected.

Kids always go back-to-school. Fido always needs shots once-a-year. Christmas is always in December. Property taxes are always due in January.

Leo, you have a lot of different things you spend money on that are different types of expenses. Travel, gifts, unplanned weekend activities. Those are all great, but we need an easy way to handle them. There not what we would call unexpected, but some of them are variable and infrequent throughout the year.

My two biggest variable expense categories are Groceries and Entertainment.

But here is what Entertainment includes for me:
- Eating out
- Babysitters
- Wine and beer if we throw a party
- Concert tickets
- Parking fees
- Any type of show or sporting event
- Netflix, movies, magazines, books for the family

I also have a big Vacation budget. It includes big trips overseas and little weekend getaways.

And a third thing that we have budgeted for is Gifts. Not Christmas gifts but everything else you might get hit with in a year - birthdays, weddings, funerals, someone needs cheering up. That category was a lot harder and it wasn't accurate until we had about a year of tracking to make a good estimate as to what we were spending each month, and what we wanted to spend each month.

Our budgets don't need to have a million line items like you mentioned. What I would suggest is you collect for a month or two all of receipts on everything you spend money on over the weekends. Then divide them up into a few categories that make sense to you. You could have a weekend blow money category if that makes sense for you. Once you have everything named and organized, add up how much your spending in each category. This becomes your starting point for either increasing or cutting back in each of those categories.

But here is where the change has to occur - once you decide how much money you want to spend each month on your weekend activities, you need to stick to it. For me, I know if I eat at Ruth's Chris Steakhouse the first weekend of the month, my eating out budget is shot for the rest of the month. I may have to go out with friends at the end of the month and get a diet coke for dinner.

And there is one way that will make your life easier when it comes to sticking to your plan and make it more likely you will stick to the plan - take out in cash at the beginning of each month how much you plan on spending, and spend no more than that amount. It's called the envelope system. You can search for the term envelope on my website and you'll see an article as to how it works. The basics are you have an envelope for every budget category - entertainment for example - and you put cash in it on the first of the month. When you go out you grab cash from the envelope. When you run out of cash in the month, that's it. You won't be entertained again until the first of the next month.

This isn't a restrictive system. Quite the opposite - it's a system that will free you to make wiser choices. You'll have more fun, not less, because you'll be learn to manage your money better and stretch a dollar farther. And you're spending limits can be whatever you're comfortable with as long as you're meeting your long term saving goals. If you want a $1,000 a month outdoor activity spending category and that makes you happy - I'm happy for you as long as your saving for your future and aren't going into debt to spend more time on the water.

I guarantee if you try this for 90 days, you'll still be doing what you want, having fun, but you'll end up saving more money and have a better handle on your finances.

Thanks for the question Leo.

Commercial break

Welcome back, everyone.

QUESTION: Richard writes in I have been a contract construction foreman in the oil and gas industry for about 10 years and have recently been laid off. I'm 54 years old and this industry has hit quite a downturn. I have a mortgage on my house and a loan on a large RV that I lived in while traveling for my job and of course living expenses. I owe about $55,000 on the RV. I bought it new 2-1/2 years ago it's now only worth about $40,000 to $45,000. Should I keep the RV in case I need to live in it?

ANSWER: I live in Texas and I've heard plenty about the oil and gas industry. It was like the gold rush in the 1800's where towns sprang up overnight. Land was being bought and flipped multiple times a month prices were so crazy. Hotel rooms that were once $50 a night were suddenly $150, $200 a night because of the demand. I can understand why you bought an RV. You can move to where the work is and you never had to worry about finding a hotel room - it makes sense to me.

You can pick up a temporary job - doing anything you can - to keep paying on the RV loan, and hope you find some work soon. If you find yourself not being able to get a job in oil and gas where you would need the RV, then you have to consider selling. Since you're upside down on the loan if you don't have the cash sitting around to pay the difference you have on the balance, you may need to borrow the difference. Call whoever has the loan now and see what they can do for you. Say - 'hey, I'm out of work. The RV is worth $45k, I owe $55k. I'd rather be on the hook for $10k instead of $55k, can I sign a loan for the difference between what the RV will sell for and what I owe.' If it's a national company they might not be willing to work with you. Call your local credit union or a local bank and explain the situation to them and see what they can do too. If you decide to sell I wouldn't raid your retirement accounts to pay the difference. You can pick up an extra job to pay off the difference in twelve months. It won't be easy, but you can do it.

There's not an easy solution and because we don't' have a crystal ball to tell if you're going to be out in the shale fields three months from now, you have to make a decision on where you are today. And if you sell the RV and find a job in five months - that's ok. I wouldn't look back and say 'man, I wish I would have kept that RV.' You might need to unload it now to keep your head above water until the industry starts hiring again.

Thanks Richard and good luck.

Daily inspiration
Choose to be more today, nation. More than just average. You may not be there yet, but you can be closer than you were yesterday.

Those are the words.

Outro
I know you have a choice in who you listen to for financial advice and I truly appreciate you letting me borrow your ears today. I'm here to help you. Thank you, thank you, thank you.

That's it for this episode. I'm your host Scott Alan Turner. Rockstar Katie is my producer. Today's episode was powered by Ben & Jerry's ice cream.

Thanks for listening!