1 in 4 People Are Making This Retirement Saving Mistake

Scott A. T.: Yeah, broadcasting from One Dallas Tower, it's the Financial Rock Star Show. I'm your host Scott Alan Turner ready to have you get out of debt, save more money and retire early. In studio with me is producer Katie who is spotting a new haircut. On the show today, talking retirement mistakes that one in four people are making and I'll be answering your questions about money, business and life. If you have a question you'll like answered on the show please visit goaskscott.com, shoot me an email leave me a voice mail

According to Fidelity one of the big broker, nearly one in four people have a 401k loan. The average loan amount is 9,500 dollars. Millennials are doing much worse with even higher borrowing rates. You might think "I've got a good reason to borrow for my 401k, I'll pay up my car, we need a down payment on the house, maybe I'll wipe out all my debts, maybe I'll pay for our wedding." I'm going to give you the reasons why you may want to think twice about borrowing from your retirement accounts.

First is you stop contributing. Many plans won't allow you to contribute to your retirement plan while the loan is being paid back. That could be years that you're not saving and trying to pay off debt. According to Fidelity 24% of borrowers decreased their savings rate after the first year of their loan. 9% stopped contributing altogether. Within five years 40% of borrowers reduced their savings from what they had initially started at 15% "I'm not going to save a dime." They stopped contributing completely.

Next is you lose your tax savings. This is the triple whammy of losing tax savings. You lose the tax savings now from not reducing your income, you pay back the loan with after tax dollars because you got to pay back the loan and then on top of that you lose the tax deferred growth for retirement. It's triple tax whammy. It's not good. What happens if your job situation changes? According a University of Pennsylvania pension research council study, about 10% of borrowers default on their 401k loan typically due to unanticipated job change.

If you get let go or some reason by your employer or an opportunity comes up for a better job, that 401k loan is due in 60 day. You have 60 days to come up with the balance and you don't have freedom to take that other job because you're locked in. You got to pay off that loan. That job could be offering 10,000 dollars more in salary per year but you have ... You take it because you don't have the money to pay off the loan. If you have the money to pay off the loan you won't need to borrow to begin with, so you wouldn't even have the loan.

Next it leads to serial borrowing. Fidelity, they found one out of two people that borrowed from their 401k later went back to borrow from it again. You think "Oh, this loan has helped me out in so many ways. I've got the money in there, it's my money." You borrow it again because I need some more money. The 401k starts to look like a piggy bank that you can crack open anytime something comes up and there're long term effects of doing that. People think "Oh. I'm borrowing for myself." It's your own money, you're just being your own bank. While that's true your retirement savings still end up being a lot less. What does this end up looking like? Well, we have a new calculator upon on the website say 401k loan calculator which allows you to plug in some numbers and see what the real math is behind the question.

Here's an example, the average savings rate which includes employee and employer contributions, that's around 12.5%. Average household income 53,000 dollars. Some of us 12% as our monthly savings rate. Average 401k balance ... This is the average person. Average 401k balance is 91,000 dollars, the average 401k loan is 9,000 dollars that's 10%, it's a nice round number, we'll use that. The average employee contribution is 350 dollars a month and the average employer contribution is 176 dollars a month say "Yeah, we got a plan on paying back the loan in 24 months." That's quick, out of our own money. It just two years to pay back, only two years to pay back 9,000 dollars." How much is that going to cost you over a 20 year period? We're not going to play the whole Jeopardy song.

That loan will cost you 8,291 dollars in lost money over a 20 year period. You borrowed 9,000 dollars, it cost 8,291. If that isn't a to the face, I do not know what is. Overall there's more bad than good from a 401k loan. You reduce your contributions, you pay more in taxes now. You have pack the loan with pretax money that will be taxed again in retirement, you're on the risk of having to pay quickly and it's going to cost you dearly to borrow that money.

What can you do instead? That's right, never come to me with a problem without a solution. What can you do instead? We've all heard the doom and gloom about why you shouldn't touch your own money but what options do you have. It's going to be different depending on each of our situations. If you're looking for a house down payment, you just keep saving to get your 20% down. Make that house an affordable situation for you, not a burden. Paying off debt? Studies show this isn't your best solution fix the problems first, that being spending habits no amount of money, no matter where it comes from is going to help. You could inherit the exact penny to pay off your debts, six months you'd be back in debt. You have to manage what you've got first and get that in order.

Car down payment with 401k loan? Nope, I would never do that, never suggest that you do that. Medical emergency? No. The hospitals will work with you on a payment plan, if you're broke they will take a reduced payment if that all you can affordable. There are options there. What else do we want to borrow that money for? An awesome Christmas present to your significant other to send them to Cooper? Maybe that could be a good idea, no it's not a good idea, you can save up for that one too.

Work more decrease your expenses. Just take a step back before you start tapping 401k for money. If you really need the money look at it as if it was someone else's situation, what advice would you give them if you looked at it? Take a different viewpoint, ask for some help, if it's a debt issue get some credit counselling or some debt counselling. Get an outsider's view of your opinion to get the best possible advice before you make that long term decision that is going to impact for years and years and years of hitting that 401k for some cash. There are many many better options for you, you just need to think about it objectively. Now, onto your questions.

Kevin wonders if he should sell, sell , sell. He say,

Kevin: "I'm not a financial guy but I have brokerage account and the marketplace is tanking right now and I'm losing lots of money. Should I be worried about this or do you think that the market will turn around and I can see my stocks going up again?" One of my ... Actually, it's my favorite comedy movie is called Trading Places. It's got Eddie Murphy and Dan Aykroyd in it.

Scott A. T.: Warning, there's nudity and swearing in it but the premise of the movie is Eddie Murphy is a homeless guy, Dan Aykroyd is this really wealthy guy and there's these two old dudes who have massive amounts of money, they destroy the life of Dan Aykroyd putting him in the poor house and then they raise up Eddie Murphy to be this awesome stockbroker and basically replace Dan Aykroyd in his life and all his lifestyle. That's a great movie to learn about a little bit about the stock market works but at the very end the old guys they get ... Eddie Murphy and Dan Aykroyd get revenge on them and the old dudes are on the floor of the stock exchange about to lose all their money and they're yelling "Sell! Sell! Sell!" They get wiped out, they lose it all. Eddie Murphy and Dan

Aykroyd get the last laugh. Funny comedy but that what I think about when I see all the people now on TV talking about the stock market crash.

Let's look at stock market history, we're using the benchmark SMP500, that what we use to measure whether other mutual funds investments are performing how they perform compared to the benchmark. In 2008, the stock market returned 37% ... I'm sorry -37% in the 2008 crash, -37%. In 2009, it went up 26%, 2010 it went up 15%, can get there. In 2011 it up 2%. I can't it higher that that. 2012 ... The stock market is going to get higher. 2012, it went up 16%, 2013 it went up 32%, I don't have 2014 data. Last year, nothing happened. If you got out in 2008 when it dropped 37%, what did you do? You missed all those up years. You missed the recovery.

Now, what's going to happen in 2016? Who can say? Maybe we'll lose 37% again. Here's what I do know, over a period of a decade average is about 10%. I have a spreadsheet, I will give you the link on the website. It shows year by year in 1928 through 2014, this stock market, average is of SMP500 ... When you average it all out it becomes just shy of 10%. That where the 10% comes from. If you get out know, how are you going to decide when you get back in? Well, many people don't know or they get back in when the market is already on the rise so they missed the gains.

If you got out at bottom in 2008 and you didn't get back until 2015, you missed all the gains. You missed all the gains. Study shows, riding it out, keeping investing, that's the way to build long term wealth. If you're nearing retirement you shouldn't be heading stocks anyways so it should be aimed on issue. Investing, it's an emotional roller-coaster. If I were a financial planner, giving my clients advice, I'd get them on the phone, try to calm them down and say "Hey, let's ride this out." You know why? Because I will have you in well diversified portfolio with appropriate risk for your age and your goals and I don't react to the mad market that the sky's a falling mentality.

I'm a math guy, I'm a logic guy when it comes to this. I look at the studies. Now I was not always this way, did the same thing everyone else does, sell at the bottom, buy at the top. It's the worst thing you can do. That's how I lost 40,000 dollars. I've done my own research, I've been with a certified financial planner for almost 11 years. They manage over 100 million dollars in other people's money. Their advice, because I just sent a newsletter about it "Stay invested and keep investing."

Then, they gave me a bunch of studies to go and look at and charts as to why this stuff works. That's my advice, same thing, stay invested and keep investing and of you want to go look at the studies and charts you'll find the exact same thing. People who stay in the market during the ups and downs, they are well diversified in good smart investments, low cost index funds, you're going to be just fine. Investing is for the long term. Trying to time the market does not work. Thanks Kevin for the question. Again that movie is Trading Places with Eddie Murphy and Dan Aykroyd, nudity and swearing if that offends you this is not the movie for you.

It's the Webster's Dictionary word of the day ... Oh, I'm sorry, it's the dictionary.com word of the day. I look online for my dictionary answers. Vesting is the granting to an eligible employee of the right to specified pension benefits regardless of discontinued employment status, usually after a fixed period of employment and the Scott Alan Turner version, when is my company going to give my company match? Say you put 500 dollars in an employee sponsored retirement account, 401k,403b, 457 and the company matches it 500 dollars. Let's just forget the percentages for a moment, keep it simple.

The 500 dollars you put in that's yours. You leave the company at anytime it's yours. It comes with you. The 500 dollars the company puts in sometimes, it's not always yours yet the employer contribution may have to vest the, VEST. Vest for a while before you get to keep it. Typically you get to keep 25% of it after you've worked there for a year. Another 25% after two years, another 25% after 3 years and after you've been there four years you get 100% of it. It's called the vesting schedule.

In that case it's 25% a year for four years. If you left the company after one year in our example, remember they put in 500 bucks you'll get to keep 125 dollars of it. If you left after two years 250 total after three, 375 after all four, 500 bucks all of it there, your promised. There are companies that vest 100% on the day you start working there, some vest 33% a year over three years. It just varies from place to place. The money is always in your 401k plan and it's growing for you but if you bug out early before the investing period ends for any reason, that money is gone, that has been vested.

Why do employers do that? Well, they want you to keep working for them , they call it the golden handcuffs. Say you max out your 401k the first year, you've got 18 grand that you put away because you're big saver, that's the IRS limit. The employer kicks in 20 grand and the vesting is 25% a year for four years, that their vesting schedule. If you left after 18 grand you'll take you would take your 18 grand that you put in of your 401k and you take 25% or 5 grand that the employer put in. You gave up 15 grand in your 401k because you left 3 years early. You didn't stay there until the whole thing was vested. Should you have stayed there three years to collect?

Well that depends. If you got a big raise somewhere else, maybe not, if you hate the job, maybe not, if you want to offer yourself at your own hours, maybe not but here's what you want to pay attention to, if you get the bug to go looking for a new job somewhere else you want to check the vesting schedule of your 401k and what the date is. Usually it's the anniversary of your start date so let's pretend it's March 1st. It's January you decide, "New year, new me, new job. I'm going to quit tomorrow." Don't do it because if you're not 100% vested you want to see how much you will be leaving on the table by leaving that company before March 1st.

If it's a lot, thousands and thousands of dollars that you don't think you're going to make up in your new job wait until after March 1st to quit or start work at your new company. After your vesting date. Same thing if you get paid a big yearly bonus, get your bonus first on whatever day it is, then quit. Then hand in your resignation. If you've worked for the company three or four years and you're already 100% vested or you were 100% vested on day one, it does matter when you leave, once you're fully vested. You're fully vested. You can take the entire company match with you whenever you leave. It's not a rolling amount but if you're not fully vested you get to keep only a portion of that match and sometimes none of it. You want to check with your plan administrator, see what the vesting schedule is to avoid missing out on any employer contribution if and when you decide to move on from your current job. That's a mouthful, let's get back some questions.

Eric says,

Eric: "What's your thoughts on robo advisors? Schwab and they pitched the Schwab Intelligent Portfolios to me early last year and I declined. I just read an article that they gained 29% in quarter four, they did not disclose how much was new customer deposits versus investment growth so I'm now taking another look, I would be in the most aggressive category. I'm 42 years old and will be using my rollover IRA to fund this so it'll be 94% stock and only 6% cash. A lot of that growth from the Schwab Portfolio came from people moving from one area of Schwab to the other area, the new portfolio management."

Scott A. T.: Now what do we know about free launches? They don't exist, there's no such thing as a free launch the Schwab Intelligent Portfolio is sold as no advisor fees, no account services fees and no commissions charged, free. The only fee you pay on them are their operating expenses on the exchange traded funds, ETFs in that portfolio which are very low fees. According to the Schwab website, I'm just quoting here "Schwab affiliates and revenues from the underlying assets in Schwab Intelligent Portfolio ..." blah blah blah.

They earn revenue based on the interests they make on the cash that held in their, 6% minimum up to a 30% max if you're in a more conservative investment group. As you're approaching retirement then you'll pour more in cash up to a max of 30% and then they're going to go out and invest that themselves and that's how they're going to make their money. No pretty much any mutual fund or any fund. They keep a minimum of about 1% in cash. Anyways Schwab keeping 6% even their most aggressive funds. That's 5% and if you're comparing it with everybody else over your money that's not working for, it's just sitting there in cash. That's how they're making their money the ways.

It's not free, you're paying for it with that money that's sitting in the cash that is not working for you. Now in the show notes, I'll include a link to the FAQ on the website they go through all ... How are you guys going to do all this for free and how are you making money? Is this really free? It's not free, you're paying for it with that cash as I just mentioned. Is it a bad product? No, it's not a bad product. Would I personally use that product? No, I won't use it. Should you do what I tell you to do? No, you should do what you tell you to do after you've done all your research in anything money related. That goes down for investment advice down to buying milk at Costco versus Walmart. Price is the same by the way on milk at Costco versus Walmart.

Now, I like something like a Vanguard or a Betterment because they are very clear on what their fees are. Betterment if you're not up above 100,000 dollars it's 0.3 percent, that's the fee. It's not free and all these stuff that you can't really figure out like the Schwab, is one really better than the other? It was really difficult to find the math to figure that out, in fact it didn't exist out there. I was not able to say, "Well, over here we have Schwab, who is free they're charging their money this way and over here we got Betterment which is pretty clear." There's nothing out there that says one is better that the other when it comes down to just math forgetting about the underlying investment which is just a different thing. We're just talking about expenses here. That research didn't exist. They're probably comfortable, I would say. Probably comfortable, one is just clear on how they're charging you and Schwab is a little bit unclear in my opinion.

Also I want to throw something outside here, is Vanguard Robo Advisor, they have one which says "A human touch ..." If you want to actually talk to somebody, "You're going to charge them 0.3 % management fees, not counting the fees they are charging for your underlying investments but 0.3 % of the assets managed per year to speak with someone. Compare that to the industry average which is 1% typically, so it's another twist if you want to go to Vanguard and actually talk to a human being, if you don't want to talk to a human being you can go with Betterment or Schwab.

You want a human, Vanguard or you can hire a fee only certified financial planner for a couple hours of their time depending on how much assets you manage, have and they will manage or you can do that math and say "Alright, this is some many dollars for hour to speak with a human who lives near me or I'm communicating with online or I can go with Vanguard, they're going to charge me 0.3% on my assets managed, how much that's going to be each year and do your math and figure out what's better. The most important choice is to be in good low cost index funds which all those are whichever you chose and staying away from huge commission front loaded funds to huge actively managed funds. You really cannot go wrong with any of those as long as you're doing something. As long as you're doing something. Thanks Eric for the question.

You're listening to the Scott Alan Turner show, I don't feel like playing a commercial. Let's listen to some Star trek music. Who would you rather serve, under Captain Kirk or Captain Picard. Send me an email, let me know your opinion. You're never going to know what shenanigans are going to happen on this show.

Mariah writes,

Mariah: "I'm just starting this journey and my biggest struggle right now is saving. I'm living at home so I don't pay rent but I help with other bills as well as pay for my own phone, insurance, student loans et cetera. I try to put money aside as soon as I get paid but I end up having to transfer it back because things come up." What's happening here is present Mariah is robbing future Mariah. Welcome to the club, your paycheck or bonus before it's in your hand. I'm sure no one else has ever done this, just you and me Mariah.

Scott A. T.: You need to pay yourself first. Pay yourself first. Set aside that money before you do anything else how we do that. You got limited bills so you figure out what those are each month. That's super simple for you because you're single, just starting out. You'll probably get by with writing down on a sticky note or an index card, then you just add them all up. Your insurance, your phone, your student loans, average what you spend on groceries, you have to track that for a few months to figure out what that is, then the left over is what you have to put it away automatically each month. But you need to add up everything else first to figure out how much extra that you can actually set aside.

From my experience the somethings that usually come into our live, they're usually a want not a need. The birthday party or the concert, the night out with the friends all good stuff but if you don't want to rob yourself, rob your future self you need to impose a limit on what you spend each month on your wants. It is very very easy to spend it all, very easy but if you set a dollar limit upfront, pull it out in cash at the first of the month and stick to it you learn to make it work and still have fun even though I'm saying the word limit, it is not limiting.

Take myself for example, I really like Subway sandwiches, they just taste good to me. I don't usually get sick of them but eating at Subway every week is not really that important to me, now I got to eat by myself lunch that comes out of my personal spending account, it's not the family. I can go without eating at subway. I still have it sometimes just like I Starbucks sometimes but I don't have them everyday, I buy other things instead. It's because my wife and I we have agreed on limits for each of us throughout the month and that's what works for us. I don't feel like I'm living a deprived life because I can't eat Subway seven days a week.

I'm just aware that two months from now I'm not going to be looking back and thinking "Man, I so regret not eating that Subway sandwich on Tuesday, 63 days ago. I missed out. My life sucks." It doesn't happen you get rid of the unimportant stuff then you can both save and spend on the weekend get away, whatever your extra-curricular activities are. The things you want to have memories from. Not the random insignificant stuff. It's going to take you about 90 days to get things running smoothly, not perfect, just smoothly. Perfect won't happen, we will take smoothly though. Smoothly will take us to where we want to go and it minimizes the bumps in the road.

Write down your expenditures, figure out how much you want to save each month and automate that savings and just stick with it. After a period of time, it's going to become part of your life, you're becoming more conscientious spender and you won't like buying Subway sandwiches, seven days a week if that's what you're doing. Thanks Mariah for the question.

If you have a car payment and haven't run the numbers already, use the investment calculator on the website and see what you could have over a period of decades. 99% of new cars are financed and the average price of a new car today is 33 grand. Nearly every car that you see on the road have the potential to worth a million dollars in investments over the owner's lifetime including your car if you own one right now. City dwellers not so much but you get a big discount because you don't have to pay for public transportation, when you're pulling up at the stoplight today, if you're driving more often than if you're on the bus you see cars on the road. Take a peek at your neighbor, in the lane next to you, across the intersection at the stop light, passing you by the highway, that is someone with millionaire potential. Everyone has millionaire potential. A million dollar just being a number we have to keep in perspective but it's a fun number. Take those car payments, invest it over a period of 20, 30 years. That is where you have your millionaire potential.

Those are the words, that's it for this episode. I'm your host Scott Alan Turner on all the links mentioned in the show are available on the show notes on Scottalanturner.com. Any question you would like answered by me, visit goaskscott.com leave an email, send me a voice mail, just say hello. Thanks for listening.

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