IFB203: Old 401k, Potential Fraud, and DRIP

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Dave: [00:00:00] All right, folks. Welcome to Investing for Beginners podcast. Tonight, we have episode 203 tonight. We are going to answer some listener questions, and I'm going to go ahead and start with the first question.

So I have; Hi Andrew. I'm a newbie in the investing world and also trying to gain control of my finances. I stumbled across an old 401k from a job years ago. And I'm wondering if it's a good idea to withdraw that money, to pay off some debt. It's not a substantial amount of money in a 401k, only $8,000 after taxes.

I'll be getting around 6,000 to help pay off my debt. Would you advise this, or should I leave it alone? Everywhere I read, it says to never dip into. But since it's an old 401k and I now have a pension along with a growing 401k that my company matches. I'm feeling eager to take this money out. I appreciate any advice you can give me.

Thank you, Darlene. Andrew, what are your thoughts on Darlene's really good question.

Andrew: [00:00:55] Yeah, Darlene, I totally get the desire to want to pay off some debt and get out of that hole and. It does make sense when you have a pile of cash somewhere or money that you can access and then account to be able to throw that to debt.

I know what the 401k is. So there are a couple of things to keep in mind. If you are withdrawing from a 401k before you're 59 and a half, you're going to get an early withdrawal fee. So that's something like 10%. No, as of we are recording this right now, 2021, it's a 10% fee. You also will have to pay taxes.

And you're going to want to make sure, based on where your tax bracket is. And then weigh all of that together, right? What's the interest rate on the debt you're paying off. And after you take off the early

withdrawal fee and the taxes are, does it make sense? I know that's very emotional, and I've been there, so I know, but.

If the numbers don't work out, sometimes you just kinda gotta, just do what's right. With the numbers rather than doing what might feel better.

Dave: [00:02:01] Yeah. And then there's also the impact of the potential loss of down the road of that $8,000 being added to your current 401k or your current retirement plan because that's a good chunk of money.

And. Put in the right place, whether it's an index fund or whether it's individual companies could bear a lot of fruit for you 10, 15, 20 years down the road. And. If the debt is less than that, there may be an opportunity for you to set up some sort of payment plan to help pay that down quicker as well.

And maybe you could; this is just an idea; instead of using the money to pay down your debt, you maybe reduce some of yours. Income going into your 401k for a short time and use that to pay down the debt quicker. So there are other options available to you, and I guess doing the math, reducing your $8,000 balance twos, 6,000.

That is what helped me out here. What is the math on that? So that's what. 2000 out of it's about a 25% hit to your total. Correct.

Three to five before. Yeah, that's exactly 25% because, okay,

well, thanks. I did it all in my head, all without a calculator. My math teachers in the high school would be proud oh,

Andrew: [00:03:29] everybody in the 21st century, he's proud of you.

Yeah.

Dave: [00:03:33] But I could do it on my head without my phone. Yeah. Yeah. On the spot. So anyway, getting back to the. The question at hand, a 25% drawdown on balance. That's extreme. So I guess my suggestion would be to consider other options, whether it's maybe reducing some of the money that you contribute to your 401k, and I'm not talking about for years, I'm talking about maybe figuring out a way that you could, depending on what your financial situation is, of course, is figuring out a way to.

Throw some money from it, from your paycheck, and then maybe reducing the amount that you put in your 401k. Let's say, just, for example, let's say that you contribute $300 a paycheck to your 401k, and you change that to $200 a paycheck. So now you have an extra $200 a month that you could throw towards paying off that debt.

And maybe with a combination of the two, maybe you could pay down that debt in a year. And then, after the year, you could turn around and go back to resume what you're doing with your 401k contribution. Plus, you also have the fact that you have another $8,000 that is now being used towards your retirement.

So you're not really reducing the amount of money that you're paying out. To pay down the debt, but you're actually adding to your retirement. You're still adding to your retirement, but you're using the other funds to pay down the debt quicker. It's an idea. It would be worth investigating because if you take a thousand dollars and you put it in an S and P five Index fund, for example, you're going to earn, depending on the, where the market goes from now until maybe a year from now, you're looking at realistically another 16 to

18%, probably if historical trends stay true to form over the last few years, and that by no means is nothing to sneeze at, and it certainly would offset any sort of potential loss you might get from reducing your 401k contributions.

That's something I guess to consider; what are your thoughts on that, Andrew?

Andrew: [00:05:37] Yeah, I like that idea of pretty creative. But there doesn't always have to be all or nothing. What I like about old 401ks is how you can roll them over into IRAs. And so you've got a lot more flexibility with that.

There is a lot of times you can only do mutual funds or maybe. An ETF, sometimes ETS, a lot of times as mutual funds. And you might not like the selections, but with an IRA, the world's your oyster, and you got all these choices. And you get that pile of cash that in other times you'd have to save a bunch of money for it.

And here it is on your lap. So I prefer flexibility, but at the same time, I sympathize with it. I wanted to pay down the debt. So if the numbers work, but if they don't, maybe try to think otherwise.

Dave: [00:06:22] Yeah. That's a very good point. So for those of you out there that are not familiar with a rollover, could you explain that in simple terms?

Andrew: [00:06:31] Sure. 401k rollover, IRA. Yeah. All foreign, basically. Like this question from Darlene, she has an old 401k. So basically what you can do, if you move jobs is you can move that over. And, in the past, when it's with your old employer, it's under their umbrella. Once you change jobs, you can move it and put it under your own umbrella, if that makes sense.

And so that's why it moves from. A 401k, which is usually tied with an employer to an IRA, which stands for an individual retirement account. And that one will go with you, regardless of whether you got now, it's not if you have a 401k somewhere with your employers, not like it's not yours forever. I'm just saying that's the way the management of the accounts work, and You can't always like rollover.

You have to wait for specific times. If you have a new job, something like that. And so what the rollover is just taking that account, turning it into another account, but it's still the, your same money. It's just changing forms,

Dave: [00:07:35] is there a, are there fees involved in doing rollovers?

Andrew: [00:07:39] I don't remember having to pay a fee. I did a rollover. It was four or five years ago. It was a while, but are any brokers happy to take your business. So they shouldn't charge you a fee, the rollover from another 401k. It's pretty simple. You just get on the phone with them, and they help you through the process.

You might have to fill out some paperwork, but it's reasonable, it's not as, it's not as bad as going to the dentist. Let's say

Dave: [00:08:02] thank God. I guess a couple of other quick questions with that. Do you have a choice of rolling it into a traditional or Roth, or is it only a traditional?

Andrew: [00:08:12] From my understanding, you can do both, but if you roll over to the Roth, you have to have a.

Your 401k has to be a Roth 401k, which is an option in a lot of places. If you could do from traditional to Roth, you'd have to pay the taxes on it. So that makes it interesting because it's like do I take the taxes out of this retirement account? Or do I pay the cash to the IRS separately?

Dave: [00:08:36] So yeah, it's probably easier to go from, to like, so go from a traditional IRA to a traditional IRA and likewise with a Roth.

Andrew: [00:08:45] Yeah. And depending on your broker, they might not even offer it unless you do like for exactly.

Dave: [00:08:50] That's a great question. Yeah. One thing that I did learn when I worked at Wells Fargo was that not?

So when I worked at Wells, they did not charge a fee to maintain your 401k after you left the company. But that's not always the case, so that I know that there are companies out there that will charge you fees too. Maintain your 401k after you've left the company. So if you are planning on leaving a company and you're not going to immediately take the money with you, that is something that is a question I would recommend you ask, or you can call your investor relations for the company that you work for, and they will tell you whether they charge you anything to make maintenance, the 401k for you after you leave the company.

So that's something to consider.

Andrew: [00:09:36] Wow. So I wonder if they just like slowly sell. Really. Wow.

Dave: [00:09:41] Yeah, they'll just bleed it. Those bleed it dry. If it's a big, if it's a big chunk of money, it's going to take a while, let's say it's a thousand dollars, it's not huge money, but it's still it's your money.

And if you forget about it over the course of five years, they could bleed it down to maybe 800 or $700. And that's kinda criminal. That's why it's always recommended to try to take the 401k with you as soon as it's possible for you to do so that you don't lose track of the money too, because that can happen as well.

I've seen that, I saw that happen at the bank where you know, one of the family members pass away and there, the other, the spouse that's left behind was trying to go through all their finances, and they discovered, several. 401ks at other companies that were never rolled into where the person was now.

And they were having a lot of difficulties trying to get access to that money because it was a lot of paperwork to do that,

Andrew: [00:10:35] I think. Yeah. And it's, it sounds like a minor inconvenience, but it could be something that accumulates over time. When I first started investing, I remember not realizing that you could have.

You could end up just collecting accounts like you collect baseball cards or something like that. If you're changing jobs a lot, sometimes that's the reality. So another benefit of rolling over is you can, if you already have an IRA with fidelity and you roll over to fidelity, you can. Two accounts and you log in online, and you just see the two accounts rather than having to juggle five different brokers.

Dave: [00:11:08] Yeah, exactly. Exactly. All right, so let's move on to the next question. So I have, hello, been listening to the podcast for a bit now. Really appreciate all your guys' insight. I had a question about

Oatly and their current situation with investor fraud claims against them. Their stock has taken a hit. And if claims are true, I would imagine it would continue to drop further.

And your podcasts, you've mentioned not to be emotional with investments. Is this one of those cases or different as the price is dropping due to potential fraud? I did buy a few stocks at the beginning of the month before all of this. My question is. Is it better to hold, not take the loss and wait for things to settle and a price potential to go back up or get out now before it tanks further, any insight would be greatly appreciated.

Thank you, Matthew. Andrew, what are your thoughts on the situation with Oatly?

Andrew: [00:11:58] I'm curious to hear your first take first.

Dave: [00:12:02] My first take first. Okay. I, so here's what little, I do know. So I read a brief description of what is actually going on with Oatly. So there is an investment firm that I believe is a company that shorts companies.

So, in other words, they bet against the company going down. They recently reported that Oatly had some accounting discrepancies, including revenue and accounts receivable. And really, what they were getting at was that Oatly was fraudulently claiming revenue that they had not actually collected yet. In other words, they were saying that Oatly recognized revenue on their accounting statements that they haven't actually sold the products and collected money for yet. And that is a big no-no. And so some of the things that they were referencing were. I guess the classic red flags that you would see in any sort of accounting shenanigans.

So for those of you not familiar with Oatly, Oatly is one of the companies out there that produces milk from vegan sources. So in other words, there, this particular company I believe produces milk from oats, so therefore the name Oatly and they have other products as well. I'll be honest. I'm not super familiar with them.

But I do know that they're from England, and they've been around for a little while, and I think this was part of the huge. I guess they turn away from using cows for milk. And we had Jim Melon awhile back, and he was talking about the dairy industry and some of the changes that were going on with that.

And he was approaching it more from a production side and using the DNA from the cows and manufacturing the product, as opposed to using alternative sources for creating the milk like Oatly does with oats and almond milk and other things. Anyway, all that to say, what would I do if I saw that a company was doing that stuff, I guess the first thing I would do would be to read through the financials and see if I see anything that is a red flag. Because sometimes, these companies may report this as a way of manipulating the stock. Highly unethical, but it doesn't mean it doesn't happen. So I guess I would do a little bit of due diligence before I actually made a decision. After I did the due diligence, then I would probably make the decision from there if it was only if it, if it was only a few stocks, if this is a 1% position for me in my portfolio, for example, I would probably just ride it out and wait and see what's actually come up this.

Because it's not a big portion of my portfolio and it's, I don't have a lot of resources and money tied up in this. However, if the flip side of that is, let's say I got 25% of my portfolio in this, and let's say, it's, I don't know. I'll just throw something out on Facebook. And all of a sudden, something comes out like this, and it's Facebook.

And I have 25% of my portfolio. You bet your butt. I'm doing my diligence. I'm reading everything I could possibly read about this. And I'm seriously considering cutting back my position until I have a better idea of what's going on. The other flip side of that is, let's say that there is nothing going.

Wrong with Oatly or my example, and the stock does drop. Then it also gives you an opportunity to buy into the company at a lower price. So there, there could be a silver lining in this as well. So it's something to consider and think about. But I guess that's my; those are my initial thoughts. I'm curious to hear what Andrew has to say after I've blathered about that.

That's some good blather there. Good job. Thanks. I am okay. So I struggled to find their annual report. If they're not a US-based company, then they're not going to do a 10 K, but they should have an annual report. I went on their website, and it just said they have a tab for annual reports, and I clicked on it, and it just said more annual reports are coming soon.

So I don't know if that means they used to have it filled, and they took it down. They have other filings on there and not doing a super-deep dive on this company. You can't do that for every company. But I would echo what Dave said. And I would say if you're looking through the annual report, a really key section would be to look at what do the auditors themselves say?

So if you've never read an annual report, now I'm about to go super deep into the weeds. So you can just completely tune me out. But there's a section in every annual report where you'll get; you will get insight from the accounting firm that's doing the audit. So you think of some of the big accounting firms, like.

KPMG Deloitte and Price Waterhouse while that was yeah, those guys. You would hope to see one of them cause they're more of the more credible, sometimes a smaller account that could be in there too. And they can do just as find them a job. But what you'll see with the credible accounting firms is they will put in the paragraph, and they will say something like you have to read between the lines, but they'll generally say something like this ish, this part of the annual report was different or, I guess I'm not.

I wrote a blog post on it. And so that probably explains a way better than I could on the podcast. Cause I'm like hesitating to use all the, all this kind of accounting jargon, but that would be a place to, to look, would be to look through the annual report and figure out what did the firm that did the audit?

What did they have to say? And then the second would be. What's the track record of this company? It, the track record of managing a company like this I look on their financials Quickfs.net, and they only have two years of financials posted. And so that's not much of a track record to go on.

And so that makes me nervous. So it's tough; if you really have faith in that company, I'm in the business; those are all great things. But if you're being misled as an investor, you only have to look as far as some of the other accounting frauds. I Enron was a perfect example of that, right?

And so you could be a big believer in everything Oatly does. Maybe you're a big believer in their brands and their products. I'm not familiar with the company myself. Those could all be things. And, for all we know. That could all live on and succeed very well, but that doesn't mean that the investors in the stock will not get hurt in the process.

So you have a lot of companies that will go through this, basically like a bankruptcy process where. The company continues. So Krispy Kreme could be an example of this where the company is still there. There are still restaurants out there. It's just the people who own the stock get wiped out.

And so that's something that's the risk in owning stocks is I even, if a business survives, it doesn't mean your investment will, and it's accounting frauds like this or times when. Companies have negative earnings. And then they run into a crunch where they can't make their bills. Those are the types of things that will wipe stock market investors out.

And those are the exact things that we preach about that you want to avoid at all costs. And what's the risk-reward, and the risk is I miss the rebound. The reward is I didn't get completely wiped out.

Pretty good risk-reward, huh?

Yeah. So I hope that answers help answer your question, Matthew, but I guess the bottom line is before you make a decision, try to do a little, extra, little, extra research, a little extra reading, and think about. Really what it is you want from this investment and what you think might be going on, and time is on your side.

None of this is going to get resolved immediately, and it could take a while for this to play out. And it could just be nothing. It could end up to be nothing, or it could be something serious, but if it's a smaller portion of your portfolio, I guess I wouldn't get too excited about it, but it could be a great learning experience to just experience some of that.

Some of the ups and downs of what's going on with this. And, it's exciting because it's a new company and it's new, it's a new brand, and it's, got a lot of hype for sure. So it'll be interesting to see how this all plays out. Okay,

Andrew: [00:20:34] I'm going to move on to this next question here.

So this one's from Professor Doctor Federico. He says, dear Andrew, I like your show. And I started investing this year in stocks. I'm a long-term investor. And as you advocate, I do like to prioritize dividends and reinvest them. However, the value paid by dividends is small and probably allows me to buy a fraction of it.

Whether you recommend one reinvest in the same company, buy more shares, no matter the share price, to pay out in cash, accumulate it, and try to find an opportunity to reinvest in the same or other.

Dave: [00:21:05] I think the Drip King should tackle this because I think I know the answer, but, and probably a lot of you do too, but I want to hear the words.

Andrew: [00:21:15] Yeah. Hopefully, the message gets across, and hopefully, I can inspire you too. You are doing what's best for the portfolio. In my mind, that's always reinvesting in the same company, and it's, for several reasons, but basically, when you buy a stock, okay, you're going to get a certain dividend yield on that stock.

So let's say I buy a pick a company. Don't say Facebook because they don't pay a dividend. So we can't. No. How about, I can't say Disney there. No, I can't. How about you buy Apple? What's that?

Dave: [00:21:52] No, let's say we do Bank of America. Okay.

Andrew: [00:21:55] Let's say you do bank of America. You get like a nice two and a half, 3% yield, something like that.

Let's say Bank of America doubles from here there; the way that dividend yields and price work is the higher, the price goes the lower the yield because they're paying basically the same dividend amount, but as the price moves up or down, it's going to determine how much income you get from the dividend investment.

If the bank of America doubles or triples from here, you're still getting that same two and a half to 3%. In income, even if the stock doubles, because when you bought it when it was two and a half, 3%. So that's going to be true for the life that you hold the investment. So if I put 200 bucks into this thing and I'm getting 3%, that's going to be $6 to my account every year; when we buy dividend growth stocks, we want to buy them that continue to grow the business, and they continue to grow the dividend payment every year. So that $6 might become $7, $8, $10. So that's continually growing while you're not moving it. You're not touching it at all.

So I'm always in the camp of just dripping and keeping the dividends coming in the same investment that you always do. And so there are reasons behind it. What I really like is. When you find really good businesses, it's really hard to find them sometimes.

And it's hard to find them at a good price. And so if you are able to do that, then you've pretty much hit it out of the park. And then you can ask any investor. It's hard to replicate that over and over again. So if you were to buy like a Coca-Cola or an apple, or one of these like grand slam businesses, like Buffett has done.

If it's a good investment, it's going to continue to go up, and you're never going to be able to get in at that great deal that you used to be able to get in it. And so what those dividends that you've you're reinvesting in this company are doing is it's giving you that, that extra ownership of that business.

And, you're not going to be able to find that in other companies. And if you were to pick like ten stocks and you had two that were like super big winners, and the rest are just whatever, just average, it's those two big winners that are gonna drive a huge part of your portfolio.

And if you haven't been dripping in those stocks all along then, you're really just missing out on all of the compoundings that would have happened from those great businesses because you decided to just put a fraction a little bit more money in these tiny businesses. So drip works because you get small dividends that turn into small pieces of shares, which turn into huge amounts of money.

Why in the business doubles triples 10 X, that small amount of a dividend doubles triples, or goes 10 X or more. You don't get that, though. Suppose you're constantly taking small little dividends and moving them to different companies unless you are the most brilliant person we've ever seen and you're able to pick the best winning stock every single time you make an investment. Outside of that, though, if you just stick to dripping the same stocks that you always do, the ones who keep the longest are going to accumulate the biggest amount of shares, and they're going to continue the accumulate in the best businesses that you have, cause the best businesses you have. Are going to grow the most. They're going to become the most expensive guess why? Because they're the best businesses. So you just need a, even if it's a little bit, you are able to get in early, you're able to get in at a good price.

You're probably able to get another good yield. So you're getting good income from it. Don't move it around; just let it accumulate and grow within itself. And that's how you'll get in my mind—better compounding than trying to shuffle these little dividends around.

Dave: [00:25:42] Yeah, I would totally agree with that. And I think that's the easiest and the best way you've already done all the work, all the hard work to find that great company and. Why wouldn't you want to put

more money back into that company and continue to ride that horse to wherever it is you want to go. And that just makes the most sense, and Buffett often talks a lot about giving people a punch card with 20 holes.

That you can punch in the card, and that would be the total amount of investments you could get within your lifetime. And that's just picking the best of the best. And so imagine if you are like Andrew was talking about, you're picking other companies that maybe weren't doing so great. So you have this company that's doing awesome.

It's giving you this dividend, and then you turn around and use it, put it in another company that maybe doesn't do as well. Then that's now you've basically just shot yourself in the foot because you have that you've taken away that opportunity cost of adding more to the company that's doing well.

Imagine investing in a company like, I'll say, Costco and who's, ridiculous returns over the line. 30 40 years and part of huge success for of the wealth of somebody like Charlie Munger and Warren Buffett and getting the opportunity to keep reinvesting in that company. After the one initial investment would be monstrously huge and would continue to pay you.

Those dividends far into the future are far better than taking that extra cash that Costco gives you to go out and find maybe a company not as good as Costco. So you have to consider the opportunity costs of trying to find that other company, because I'll say it, sometimes we stumble in or get lucky and find a good company.

And sometimes, that's what it is. And. If you got that great horse that's running awesome, then you just, you just want to keep riding that. And so I think that's, I would encourage you to consider the drip because reinvesting in a company is the way to go. And another point that Andrew was making that I'll pound on the sand a little bit more is the impact of stopping compounding in its tracks and starting it over again also in a way can set you back as well because the power of compounding is the continual adding to the pile because as the pile gets bigger, it gets bigger by compounding. And if you stop that, then you have to start that sandpile over again. Interrupts that flow and something Charlie Munger always likes to say is the power of compounding; you'd never want to stop it.

You don't ever want to stop it unnecessarily because that's really what he's getting at with what Andrew was talking about earlier. So I would highly encourage you to reinvest in the same company and buy more shares. No matter if the share price.

All right, folks. Well, with that, we are going to wrap up our discussion for this evening. I wanted to take the time to thank everybody for taking the time to send us those great questions. Keep them coming. This is awesome.

You guys asked some really good questions. I appreciate you taking the time to send them to us. So we hope you guys get some value out of this. And if you do have any questions, please reach out to us to let us know we're here to help. So without any further ado, I'm going to go ahead and sign us off.

You guys. Go out there and invest with a margin of safety emphasis on the safety. Have a great week. We'll talk to you all next week.