IFB245: Should You Max Out Your 401k + Resources to Learn More About Dividends

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Dave

0:00

All right, folks, welcome to investing for beginners Podcast. Today we have episode 245. Andrew and I have four great listener questions that we're going to answer. So I will go ahead and get us rollin with the first one. So here we go. Hi, Dave and Andrew. I'm new to investing like many of your listeners and have almost fully caught up on the episodes for the past six months. I first wanted to say thank you for all the helpful information you've helped to take investing seriously. First, a short background of me for context. I'm 29 and started my Roth IRA within the last two years, contributing the max 10% 401k contribution and have some money in an HSA no longer contributing all of these I'm currently investing in index funds.

But if you had to buy individual stocks, I have a fair amount in saving questions. Would it be smarter increasing slash maxing out my 401 K contribution? If I'm able, before picking individual stocks due to the tax advantage? This leaves the current savings I have? Can you still make good returns with an index fund in a brokerage account, even though you don't have the tax advantages? Like a 401k? Thanks, Clay. So Andrew, what are your thoughts on clays? Really? Good question.

Andrew

1:07

So would it be smarter to increase their max 401k contribution before picking individual stocks? First off clay, I think it's awesome to hear your background and I kind of see as you're killing it, you're maxing out different contributions, taking advantage of tax advantaged accounts. And you should be proud of that. And welcome to the journey for somebody who maybe is not all that familiar with 401k is versus some of the other accounts.

One of the drawbacks to 401k if you consider the drawback is a lot of them don't allow you to pick individual stocks. And so the obvious benefit to a 401k is that it lets you grow your money tax deferred and reduces your taxes today. So you kind of have to outweigh you know, if you're somebody who wants to pick stocks, do you take the tax advantage? Or do you take the potential benefit of if you can beat the market and get higher returns that way, and the way I look at it purely from a net worth perspective how to maximize your net worth, the taxes will probably outweigh the gains that you can get from the market. If you can beat the market by 1% a year over the long term, let's say you earn 11% instead of 10%.

Every year for the long term, that's really, really good. When you talk about paying taxes of 2025 30%. It's gonna take more than just an extra percent a year to overcome that. And so in my mind, if you're trying to maximize your net worth, you would want to maximize your tax savings before trying to do anything fancy or like making your own socks.

Dave

2:44

I would agree with that assessment, I think again, to to echo what Andrew was saying, you know, congratulations, Clay, welcome to the dance. Glad you decided to come in because the waters warm. I think one of the things that I guess I would consider is how much is your 401 K match? Go up to? So in other words, how much can you contribute to max out your 401 K and still get a match because that would have a bearing on that decision as well. Because as we've talked about before, that's free money.

And it's 100% return that you can get on your money if you can get all of that match. So that would be something that would definitely be something to consider. Along with this. I guess the other part of it too, really comes down to I guess what your preferences are in your personal finances personal. And I think the points that Andrew make are all great points in picking individual stocks can be a challenge, and outperforming the market over a long period of time can be a challenge. And the other part of it is it takes time. There's time involved in doing research on companies and trying to figure out what it is it's going to work best for you. And what kind of investments do you have? And there's a litany of different things you can go through. But I think the thing you have to consider is, how much of that is worth it to me.

For my lifestyle? Do you have a family? Do you not have a family? Do you want to spend more time with your friends and family. And if you do, then some of that will be not by investigating Berkshire Hathaway, to see if that's worth an investment or not. And so I think those are all things that you probably want to consider. Because the one thing would none of us can get more of his time. And you have to decide what your time is worth. And if you can beat the market over a long period of time and you want to spend the time to do it, then I'm not going to stand in your way and tell you not to do it. But I think a great way to look at it would be what is your time worth and if the 401k is going to get you where you want to go.

And you can do some stock picking on the side but maybe that's not your necessary, like main investment portion of it. Let's say you take I don't know just pick a number 4% of your portfolio and you want to play with some individual companies and stuff like that. By all means knock yourself out. But if you don't want to spend the time to do 100% of that, then I would definitely consider using the 401k to its full advantage. And if you're in a position where you can max that out every year, that's a very, very, very good place to be. And you're going to get, you're going to grow your wealth very quickly, you're going to be shocked at how quickly that's going to compound. You know, not to mention, you have other smart people that are managing that money for the 401k as well. So they're in it to win it too.

So I think all those things can help you in the long run. But I guess if I was doing it, that's kind of how I would look at it.

Andrew

5:31

And you can pick stocks in the Roth IRA. And you can pick stocks and an HSA, well, depending on your HSA, but if you have an HSA with fidelity, you can pick stocks inside there. So it doesn't have to be either or you could pick stocks in those tax advantaged accounts, and then max out your 401k for additional tax benefits. Rather than thinking I got to put this in a individual brokerage account pay taxes on it.

Dave

5:56

Yeah, exactly. I think the last thing that I would probably suggest to clay, if you're really going down this path, and you're concerned about taxes and benefits, I would reach out to your tax professional and sit down and have a conversation with them. And explain to them what you're trying to do. They will have ways

to help you take advantage of whatever tax advantages you could do and give you suggestions in that regard. All right. So let's move on to the next question.

So hey, guys love your podcast. I was hoping you could address a question for me about 529 on an upcoming episode. I've already maxed out 401 K contributions and my HSA to get tax benefits in those areas. And I see 520 nines is another important place to be investing for my three kids ages seven, four and one, in your opinion, should I fully build up the 529 accounts for my kids, before I contribute more to my brokerage account so I can get the tax free growth benefit associated with a 529? Thanks, Brian. So Andrew, I know you've done a little research on 529. And I believe you have one as well. So maybe you could be the perfect person to answer this.

Andrew

6:58

Okay, sounds good. I'll step up to the plate, then a 529. If you've never come across it, it's basically how Brian explained in the question. You can set money aside and invest it for your child. And when they go to college, they can access that. And while it's taxed, when you put the money in, it's, you don't get a tax deduction for putting money in. But when you sell the investments or take the money out to pay for college, that money does not get taxed for making gains. So it does have that tax benefit, and it can be beneficial.

And like you said, I have one for my daughter, I'm referencing an article from Merrill, which is owned by Bank of America they're talking about. So this is one of the downsides to a 529 account. And so you might be surprised by my answer, Brian. But you kind of have to think about what happens if the 529 never gets used. So you mentioned having three kids. So maybe some of that gets mitigated. Because, let's say kid, number one who's seven years old, for whatever reason, decides, you know, they don't want to do the college thing, maybe they want to become an entrepreneur, maybe they want to do a trade school, whatever it is, there are penalties for trying to access that money in a different way.

So you know, you originally planned to pay for H sevens college, you can't do that anymore, one of the options you can do is you can roll it over to another kid. So maybe if the first kid doesn't go to college, maybe this chances are the second or the third well, so you can roll over to them without penalty. But if you go through all three kids, and none of them go to college, or for whatever reason, all of the money that you saved in there doesn't get used, you get penalized in a couple of different ways. So you would pay taxes on all of the earnings that you earned from those investments. Plus, they give you a 10% additional federal tax plus state and local taxes. So you basically lose all the benefit of the tax savings from the earnings.

Plus you're getting this additional 10% tax plus state taxes. So it's almost kind of risky to put too much money in a 529. And I think that maybe is a little controversial, because the default idea is to always just max out max out tax advantaged accounts. But in this particular case, with a 529, there does seem to be some risk there. They do have a couple exclusions. So for as an example, if your kid gets a scholarship, and so that's the reason why the money wasn't used for their college expenses. You can get some of that back without the 10% penalty, but you still pay taxes on the earnings. So it was almost as if it should have been in your brokerage account anyways, and you have a lot more flexibility with it.

So I would kind of think of it a little more cautiously maybe than people might normally do. And just think you know, I don't know if this is just my experience, but it seems to me that because college has gotten so expensive, people are thinking about alternatives to college and talking about it maybe a little bit more than they did when I went to school, for example. So there could be other reasons that are not necessarily in your windshield today that you're aware of that contributed to that money being not used for college and you having to pay all these taxes and fees on it eventually. So I would probably use it. I'm using it, obviously, but with caution that I don't want to put too much money into this, because I would rather have the flexibility of just having that money myself, and not having to use it for college expenses. So I would kind of think of it as a balancing act. But that's great advice.

Dave

10:45

I have nothing else to add. Okay.

Andrew

10:48

Sweet. Well, I will move on to the next question then. Okay, so this is a three parter. So this should be kind of fun. So hi. I'm definitely interested in dividend stocks investing, I'm approaching 50. I'm not completely new to investing but definitely haven't traded myself, so far have only been putting my maximum out each year in the 401k account through work. I have three main questions. Number one, I'd like to educate myself more on the dividend stocks investment. So are there any books that you might recommend to get started?

Dave

11:18

Oh, that's a great question. I guess when I think about dividend investing, I don't think about it as a separate kind of investing, I think of it as part of investing. And so I think any great book that can help you learn more

about the basics of investing, I think would be amazing. I guess the books that really that we've always recommended to help people learn about investing and give you the basics things like the great books from Peter Lynch, one up on Wall Street, fantastic books, super easy to read, very, very geared towards beginners.

Another great book is the book from money's per bribe the Dondo investor, very, very well written, super easy to read. He gives great examples. And they're easy to understand examples. Another great book is common stocks, common profits by Phil Fisher. That's a great book as well. And these are all very easy to read. They're not super technical, there's not lots of math, and there's not a lot. So it's more about theory, and ideas and strategies and approaches, as opposed to numbers. And I think those are great books to help kind of educate you to get started. Another great one is the Joel Greenblatt book.

So you can be a stock market genius too. That's a fantastic book as well. I love his writing, and love his YouTube videos are great. And if you're really interested in this stuff, you could also go to our website, shameless plug e investing for beginners.com. Andrew is the drug king for a reason. And there's lots of articles on our site about dividends as well. So if you want to learn more about kind of the ins and outs of dividends themselves, the terminology and things like that, there's lots of great articles to help you about that. So I guess that would be my first start.

Andrew

12:55

And I approach it the same way I can't think of a book on the top of my head that is focused specifically on dividends. Like they've said, its dividends are just one way of companies giving back some of their earnings, it's really investing is investing. And that's you have to learn about the principles of investing. And you have to learn about how the business world works a little bit. And a lot of those books do that very, very well, particularly even if you're a beginner. So double click on Peter Lynch's books, because we've been doing this for so long, that it's hard to sometimes place yourself in the mind of a beginner.

But I can tell you for a fact, as an absolute beginner, I read beating the street by Peter Lynch, knowing nothing about the stock market. And that gave me enough to move me on to the next book and be able to understand more and more and more. So that's why I highly recommend Peter Lynch's book, I think common stocks and uncommon profits with Phil Fisher is good for you to read, in particular if you're into dividends, because he talks a lot about the downside to dividends and why you should think about where companies can maybe pay too much in dividends. So you always want to kind of invert the idea, right? Give me the good give me the risk. And I think reading that book would help a lot and richer, wiser happier with green. Yeah. William Green. Yeah. I would love to actually to get feedback on people if they were like, really,

really beginner and found that book easy to read, because I found it super easy to read. But I've also been reading investing books for years, right, but I just got the sense that it was like an easy book to read.

So I would love to hear if you guys feel the same way. But I mean, starting with probably any of those, particularly the ones that we highlighted that are good for beginners, I think is a perfect place to get started.

Dave

14:39

Yeah, I'll click on the money supply. That was actually the first book I read. It was perfect. It was super easy to read. And I really understood it and then after that I read The Richest Man in Babylon. And then after that I did the intelligent investor. So I think all three of those books gave me a great foundation to really start understanding kind of how to save money, how stock market works, and the Investing in general. So I think any of those books you're not gonna go wrong.

Andrew

15:03

May I remember the first chapter of niches book? It's like it's a sexy right then and you're like, oh, wow, how come? I never thought of it this way? Right, exactly. It's entertaining, too.

Dave

15:13

We are very much so yeah, I love it. All right. So let's move on to the second part of this question. So we've got I really enjoyed the episode from Ferdie. From div grow, check out his website and portfolio, how can you tell how much dividend you're been getting so far, so that he can provide info on how much he's getting each month somehow thought the dividend is given out each quarter year? Is there an easy way to track? So what are your thoughts on part of the question? This is an interesting?

Andrew

15:37

Yeah, I mean, I'll just say the way I do it personally, because I'm updating my spreadsheet, as I release that to subscribers of the weather every month. So I just, I pull up the brokerage account, look at the activity, and I can see which dividends came in for the month. And then you can plug those into a spreadsheet. That's one way the track, I also use nasdaq.com. And so they have a dividend history thing. So I really just like if

I'm looking at Microsoft, I'll go Microsoft dividend history and Google and then look for the NASDAQ page. And they will show you every dividend that they've posted recently.

So if I do it both ways, you can see how much dividends I earn. And then how much dividends has these companies given on a per share basis. And so that NASDAQ one is really nice, because it tells you when What was the date for when they said they're gonna pay a dividend, the dividend announcement? What was the date, you had to have the stock owned by to get the dividend, ex dividend date? And then when are you getting the dividend dividend paid date? And it has it just all out in a nice table. That's what I do when I'm updating the spreadsheet every month, I use those resources. Yeah, that's awesome.

Dave

16:49

I think I remember looking at my brokerage report when I was filing taxes, and it showed at the end of the year, how many dividends I've received for each company. So again, on the page, they had a page where you could kind of see how much you invested in each particular investment. And then what kind of dividends we received for the year for that, because that's what they were going to tax you on or could tax you on. And so that's kind of the way that I look at it. I don't follow it as closely as Andrew does. But that was a way that I looked at

Andrew

17:19

it, I think we should recommend people check their dividends more, especially at a time when the markets down. Because you might feel like you're not making progress. But if you see how your dividends, I mean, they're gonna grow pretty much every year, the amount that you receive, especially if you keep putting more money into the market. It's super, super motivating to see how your income stream grows. I mean, that's the name of the game in my book.

Dave

17:43

Yeah, it is, I guess the other benefit or perk, if you will, is if the stock price is down, and it's reinvesting it's going to reinvest at a lower price point, if you will, which means that when the stock recovers, and it will, that you're going to get a bigger benefit from that farther down the road. So that another thing that I think you can kind of keep in mind, and you know, it is hard when you see everything is in red. And you know, you look at a company, it's 42% for the year, but then you see that, you know, hey, you know I'm getting a 2%

return on his dividends. So I am moving the ball in the right direction, just will take a little longer than you want.

Andrew

18:21

That's good way to put it.

Dave

18:23

All right. So let's look at the last part of this question. So we have relating to the prior question. When should I aim to start taking out the dividends instead of reinvesting My goal is to have dividend income that I can live off of maybe not 100% on it, but comfortably. So thanks. Alright, so that's a great ending question. So how do we want to tackle this one?

Andrew

18:41

I'd be curious to hear what you have to say, because I'm the older one in the room. And now, I'm curious. Okay, so this

Dave

18:49

is where personal finance becomes personal. So I don't know that there's any book correct, err, quote, right way to do it. The standard is, you know, use 4% of your portfolio. And that allows you to reinvest and continue to maintain a certain level. And depending on how you're taking out that 4%, whether it's dividends, or whether it's liquidating portions of your portfolio, that's how I guess the traditional way has been to do it. And I think that's probably not a bad way to go.

But again, it's going to be really hard to determine where that is for each individual person. Because what you are comfortable living off of may be different than Andrew and I. And it may be different than you know, for my fiance, and it may be different from my neighbor. So it's all going to be a little bit different. So it's hard to give a hard fast rule. So something that I guess I wanted to throw out there and this is maybe something we could get some feedback on too, is when I was working at Wells Fargo, we had a this was for employees as part of our 401k they had this wealth portfolio tracker, which is kind of comical, but that's a whole other discussion, but what they would do is they would be able to based on your 401k contributions,

any money that you had, and your potential social security benefits, they would kind of calculate how much you could have when you retired.

And then they would also determine if you could use sliding scales. And so if you had 4%, you wanted to, you know, live off of, or 5% or 2%, or however you wanted to do it, they had sliding scales, and would tell you how much money that would be. And that was a cool thing. But frankly, I haven't seen anything out like that out there in the wild. And I'm curious if Andrew or anybody else, you know, any of our listeners have some suggestions about this, and we will be more than happy to follow up with everybody, if we learn some information about this.

So it mean, it's kind of interesting to think about, I don't have a hard and fast rule, my plan right now is my head is down trying to get to the finish line. So I really honestly haven't thought a whole lot about after that. And my goal is to try to maximize everything I can to that point. And as I get closer, then I will probably start looking at that. But 4% is probably a good place to start. And then you can kind of adjust from there. But I think each person is going to be individual and Ferdie actually would be a great person to reach out to he's a little farther on the towards the retirement curve. And so he would be a great resource to reach out to could find his email on his website, and you could send him an email and ask him this very question as well.

Andrew

21:24

I would be curious to hear if somebody's familiar with a tool like that, because I haven't been exposed to one. But I can't imagine it'd be that hard to come up with something, some sort of the calculator, the show, hey, I got this much I got this. This is how much I want to save for retirement, blah, blah, blah, and come out with a number for that, I'll give just like two ideas. And if you find one of these ideas useful and cool, the average stock market return over the very long term.

So I'm talking about going back over 100 years, is around 10% a year, and somewhere between six to 7% of that is from the stock price around three to 4% of that is from dividends that are reinvested. So when you reinvest the dividend, you are exposed to more of the stock price game, because you've compounded how much you own. So if you're happy, let's say maybe you're at a point in your savings, where you're like, hey, I'll be happy to just earn 567 percent on this amount from here on. And I don't need 10% anymore. Well, maybe that's one way to look at it. Another way is maybe other than like, I'm about to say I almost like want to stop myself because this could be a terrible idea. But like maybe if you feel like the market is more expensive, maybe you're more willing to take the dividends out.

Versus if the markets obviously really cheap, maybe you're just like, I'm gonna hang on a little longer and really reinvest those because this is a great time to reinvest your dividends and pick up more shares of stocks. That could be a couple other ways to look at it too. And I think everything they've said was on the ball right there like really is gonna depend on your own personal financial situation and what you're comfortable with. And it's good to think about and as long as you kind of have your expectations in place, then you probably can't go wrong.

Dave

23:10

That's all good advice. All of these questions are excellent questions. And you really stretched us and made us think so thank you for sending those in. Again, we'll put it back to our listeners. If anybody out there knows of any sort of website or calculator that we're not aware of that can help answer this question, please, by all means, pass it on to us, and then we'll share it with our listenership so that we can all benefit from that. Alright, so let's move on to the last question.

I listened to your podcast and visit your online archives now and then frequent return to Warren Buffett, but seem to refrain from offering us your assessment of Berkshire Hathaway, A and B. Class. Why is this? So Andrew, this is a fun one. So what are your thoughts on this question about Berkshire?

Andrew

23:50

Yeah, well, thanks for listening to our podcast now. And then I would direct your first episode two to four. If b two to four, we talked briefly about Berkshire Hathaway and how Dave and I personally invest in them. I selected this question, I thought it was kind of a good opportunity to talk about sort of like the I don't know if you'd call like a sliding scale or like investable risk return reward curve. But I think as a beginner, it's important to understand that risk and reward are kind of tied. And so I guess to summarize, I have to be two to four.

Dave has a significant ownership in Berkshire, I have just only one share. And so it speaks to like a difference in our investing philosophy. In a way. I think it's important if you're just starting to invest to understand how risk and reward can work in investing. So on one end of the spectrum, you have a bank account, right where the risk of you losing that money is zero because it's insured. But the return you get is basically limited to whatever short term interest rates are. So that's been going higher because of the Fed blah, blah, blah, blah, blah, but your return is limited to that. And then on the other side in Shark Tank, where you're like Shark Tank, Angel Investor investing in startups, where the risk is super high. And we all know

how many startups fail. And the risk is super high, but you could invest in Facebook and have one investment make you into a billionaire or something like that. So those are like the two extremes of investing risk and return.

And so when we talk about Dave always calls me the drip keen, why I sit on that spectrum, is because to me, I'm comfortable with where that risk return balance is. So I almost look at it like you have the bank account. And then you have there's other things along the way, you have bonds, you have dividend stocks, and then you have non dividend paying stocks, and then grow stocks. And so it kind of goes along that spectrum.

So I almost see it as I love Berkshire, I love Buffett, obviously, I follow everything he teaches, I have not invested significantly in Berkshire because my philosophy is to only invest in dividend paying stocks, which puts me at a lower potential return, but also a lower potential risk. And that's where I have found that that's kind of my circle of competence.

Dave

26:16

Yeah, that's perfect. I think that's a great illustration of it, and the risk return ideas, not something that we've explored a lot. In the past, in probably something we should discuss more going forward. But I think that's a perfect illustration of, you have to think about what kind of investor you are, and what you're comfortable with. And just because everybody in your brother is out buying peloton doesn't mean you needed to go out and buy a peloton.

And I think it really comes down to what you're comfortable investing in. And for me, Andrew and I were talking before the show a little bit about this. And, you know, I think I fit more into the, you know, a little higher risk, but also a little higher reward spectrum than he does. And that doesn't mean that I'm better than him or that he's better than me, it just means that that's what we're comfortable with. And I guess, you know, to loosely, loosely aligned ourselves with this idea is, you know, Andrew probably fits more with really what Warren tries to do, where I probably look them a little bit more Charlie tries to do.

But it really comes down to, you know, shades of what you're comfortable with doing. And for me owning Berkshire is I'm giving Warren Buffett my money to manage for me, that's the way I look at it. And I'd be hard pressed to think of somebody else that could manage my money better than he can. And so by giving him my hard earned money to grow, the value of Berkshire Hathaway is a great trade off, if they paid a dividend, I

think Andrew probably would be more on board with investing in Berkshire, just because of the nature of the business and everything. I think that really is a good illustration of the idea of the risk of return.

And I think when you're thinking about these kinds of companies, you have to look at what you're comfortable investing in, and I'm comfortable investing in Berkshire, and I'm comfortable investing in some of the payments companies that I've invested in, like Gajan, and PayPal, and Fiserv. And will they all be winners? Maybe not? You know, I don't know. I certainly hope so. And I believe so. But they may not be and that's okay, that's part of the game. And I think you just have to learn what you're comfortable with.

And if you're not comfortable investing in, you know, these really exciting tech growth companies, then don't, you know, it's perfectly okay to invest in Berkshire Hathaway, there's nothing wrong with that there's nothing wrong with investing in Johnson and Johnson or AV V, or Bristol Myers, or any of these companies, you know, there's a million different ways to make money in the stock market, you just have to figure out what you're comfortable with. And try to stick to that. And if you start playing the game of bouncing back and forth between different styles and different strategies, and all that kind of stuff, you're going to lose your way. And I think it's better to kind of figure out what's important to you, and then stick with it.

And over the long term, you're going to do great. And it's just a matter of being disciplined, being consistent, and sticking to your plan. So I think those are kind of the ways now, we don't refrain from talking about Berkshire Hathaway, as a matter of fact, it probably will be a bird's eye view, and probably the near term, if you will, so we can give you kind of our assessment of the company from the master himself. But it really comes down to our risk reward profiles, and why we choose to invest the way we do. And I think that's really what you got to think about.

All right, so with that, then we will go ahead and wrap up our conversation for this evening. I want to thank everybody for sending us the fantastic questions, please keep them coming. I can't stress enough how great these questions are, and how advanced everything is that you got. These are not beginner questions. These are very high level advanced questions, so please keep them coming.

And we appreciate you guys taking the time to send us these. So without any further You I will go ahead and sign us off you guys go out there and invest in a margin of safety emphasis on the safety Have a great week we'll talk to you all next week

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