IFB284: When Can You Open a Brokerage/How Should I Invest a Lump Sum?

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Dave

0:00

All right, folks, welcome to Investing for Beginners Podcast. Today we have episode 284. Today we're going to answer three great listener questions we got recently. And the first one we're gonna have a little fun with. So the first one is actually in Portuguese. And for those of you who are unaware, my fiance is Portuguese, she's Brazilian, and I've been attempting air quotes attempting to learn Portuguese for the last three years now. So unfortunately, I'm going to practice a little bit more with you guys here on the air. So bear with me, hold your ears, and maybe hold your nose. And for those of you who are fluent in Portuguese, I apologize in advance.

So here we go. So let's call Manos G, desert de anos. Poem invest there at theme como que en je, and this is from Nadia. So what that means for those of you not speak Portuguese, it means it's asking if people under 18 can invest? And if yes, how and where? So Andrew, would you like to go ahead and take the first stab at answering Nadia has great question. And thank you for sending it in. And let me practice on you guys for a moment or two.

Andrew

1:06

Although, I mean, as somebody who speaks zero Portuguese, that sounded perfectly flew into me. To answer the question, if you're in the United States, you do have to get a specific brokerage account that you can have your parent or guardian open for you. So I actually going to leave the specifics of that to Dave, because he knows the acronym and I don't, but that's kind of the gist of it, you can get it open as long as you have a parent or guardian do it for you. And then when you turn 18, they can transfer that account to you. And then it's yours.

Dave

1:42

Yep, exactly. So in the in the banking world is called an upon, which means uniform transfer. For a minor, I don't remember the exact acronyms, so don't hold me to that. But basically, what it means is, it's an account of that a minor can hold with a parent, or somebody of legal guardianship, that's above the age of 18. And when that child turns 18, they have a choice, they can either have it transferred to them solely, or they can close the account, cash out the account and be on their way.

So it really kind of depends on what it is and how they want to do things. But it's a fantastic way for children or anybody under 18 to start learning, investing, and they can do it with their parents, helping them guide them, especially if it's somebody that knows something about investing and whatnot. So it's a great vehicle, you can do it through your bank. So you can do Atmos. With savings accounts, you can do them with CDs, but you can also do them with brokerage accounts.

So you can do it either through your bank, or you can do it through a brokerage firm like Fidelity or Schwab. So either one of them can help you with that as well. And it's super easy to do. And it's really no different than opening any other account. And we actually had we had Seamus Medan join us a while back, I think it was a couple years ago, and he actually at the time was under 18. And that's what he his dad had done for him. And that's how we learned investing. And he really took a passion to it and, and has really gone on is going on to do a lot of great things in the investing space as well as BC and all that kind of stuff. So really great guy. So it's a fantastic vehicle to help get your kids started. If that's something you want to do if you're under 18. Unfortunately, you're gonna have to wait till you're 18 or find somebody to help you with it.

Andrew

3:23

Imagine that compounding you could get started at 16 or 14. That's, you know, not to mention when you're 18. And you've had for years picking stocks, I think it'd be pretty good at that point. It's like ridiculous if you run the numbers.

Dave

3:37

Oh, yeah, exactly. It's, it's, it's amazing. My, one of my good friends, her daughter is a freshman in college. And they did this for her when she was 14. And she was able to with the money that she saved working in summer during the summers as a lifeguard. And then during school, she was able to save up enough money to help pay for her tuition for her first year of college. So it was awesome. And she learned a lot to me. All right, so let's, let's move on to the next question.

Don't worry, this one will be in English. So here we go. I guys love the podcast and help you guys provide. I've got a question on compounding. Does compounding only happen when investing consistently in the same stock slash ETFs. For instance, if I'm investing in a new stock each month, am I really going to experience the benefits of compounding interest? As overtime, I'm not really increasing the amount of shares I have in that stock. Rather, I'm choosing to invest in a new stock each month instead. I hope that makes sense. I'm a listener from the UK and we'll have the show. Thanks, guys. So Andrew, I'm gonna let you take the first stab at this great question.

Andrew

4:38

Sure. So the way I understand the questions, basically, you know, do I get more compounding more compound interest from a big pile of money or little piles of money? Because it does make sense with compound interest. The more money you have, the more money it earns. So it would sound like the bigger pile of money would compound more than the smaller piles of money. But it really doesn't matter how you break it up, you will still get the same force of compounding. Because all that compounding really is is your money making more money. And the more of that money that you have, the more you will make, and the more that will accelerate.

But it doesn't matter if that piles all in one pile, or if you have 10 piles, if you were to combine into one pile, it's the same, but because you split it into 10 piles, that doesn't slow it down in any way. So you know, if we had $100, and each pile, say 20, piles of $100, and each pile made $10, that's the same as having all of those in the single pile and it making, let's say 10% or 20% on there.

So I know that's something that's maybe something that could trip you up as a beginner, but just keep in mind that because it all adds up to your own personal wealth, you're gonna get that compounding and it's those little returns that you get add up over time, regardless of whether you start small or you start big. And maybe that's the biggest takeaway, because the multiplications there.

Yeah, it's just I think times that the biggest factor there the biggest impact or so basically, when you look at a portfolio, let's say, Take Warren Buffett's if you look at his portfolio, just because Apple is the biggest portion of his portfolio doesn't mean that the portfolio is going to grow faster, because that's a bigger portion. Know what they mean? I guess I'm not making it clear, he has 150 million or 150 billion in assets that he's investing. It doesn't matter what the concentration of the individual companies, it's a matter of what the 150 is going to compound on 150. Irregardless of how it's broken up, correct? Yeah, if we assume everything returns the same, right, which, yeah, that's a good thing to bring up is like, obviously, the different piles might grow at different rates. And that's why we recommend diversifying and splitting it up into different piles, because you don't know which one's going to grow faster than the other. Right. But if you did have two piles versus four piles, the bigger piles, if they all grow at the same rate, the bigger ones not going to necessarily grow any faster. Because when you add up all your growth from the little piles, it adds up to what it would have been in a big pile. But yeah, that's a good clarification. Yeah.

Dave

7:28

So I guess the biggest takeaway is continue to invest. It's more about timing the market than timing the market and being consistent and putting money, you don't have to, you don't have to concentrate into just two stocks to get the benefits of different you know, of compounding, it's going to compound irregardless,

Andrew

7:47

it's gonna compound irregardless, and you're not handicapping yourself by picking the new stock each month. It's not like you're slowing down that process. If anything, I think that's great diversification to have a new stock every month. Yeah,

Dave

8:02

okay. Perfect. Okay. All right. Let's move on to the last question. So we have Hello, Andrew. Sadly, my father is going to be departing from us soon, and will be leaving a substantial amount of invested cash to his children slash stocks. I've been a longtime listener for your podcast. So I have heard so much about the end goal of being financially free. My question for both of you is, if you had the opportunity to be debt free, would you invest that cash to settle the debt, or continue to invest long term to maximize the long term benefits of compounding interest of the market?

Thank you so much for the work that you do, James. So obviously, James, we're very sorry to hear about your father. And we don't wish that on anybody. And that must be a very, very difficult time to be going through. And we appreciate you we reaching out to us to ask us this sensitive question. So, Andrew, I'm gonna let you take the first stab at answering James question.

Andrew

8:55

Again, my condolences James, that's really tough when it comes to you having a big pile of money. And what do you do with it? from an investment standpoint, I think there's, there's like strong, there's strong opinions on either side of the aisle, if you will, about what you should do with it. So there are some people who are very anti debt and they think you should pay off debt and become debt free as soon as you can. I'm not necessarily opposed to that. I think there's a lot of there's a lot of emotional benefit to being debt free.

And even if it's not optimal, there's a lot of emotional benefit to being debt free. There is also the other camp that says, well look at your interest rate. So if you have credit card debt, that's 20% interest rate, pay all of that off, but then if you have like, let's say student loan debt, that's 4% interest rate, but you could probably make 10% By putting it in the market. So don't pay off the 4% rate, pay off the credit card rate and then invest the rest of the market. And then you have guys like like me, sometimes you think, you know, I could do anything in the market and might as well put all of it in there. So it's hard because we don't know like what kind of debt James has, we don't know what his personal situation is.

And you know, I don't know at what stage of beginner you are. And I think that plays a big role too. Because if you've been in the market for like two months, and all of a sudden you have more money than you've ever had, and you put that into the market, be prepared to be on the biggest, most scary roller coaster of your life have you ever been on? I'm a huge proponent of when you get a big pile of money. And you know, whether we're talking about like a 401 K, rollover, or could be an inheritance. I'm a big fan of splitting that up over let's say 10 months or 20 months.

And just doing kind of like the last question, they new stock every month, or even just an index fund if you want to stay safe and diversified from the onset, because when it's such a big pile of money compared to what else you will be investing later on. The emotional drag of that can be really, really extreme. And so it's hard to tell somebody who just started investing two months ago, Oh, yeah. Put it all into the market, and you'll be fine. I know there are studies and the numbers dictate that that's actually the best move to put your money in as soon as possible.

But we're talking about the real world, not hypothetical numbers here. And so for me, I think an investor needs to do what they can to stand the game, while also pushing the ball down the field. And I think splitting up money, if it's assuming that's going to go into the market, splitting up that money and dollar cost averaging it so that you can ride through multiple short term cycles, I think is a really great way to go about it. That's what I would do if I got a big pile of cash tomorrow. Yeah, that's

Dave

11:42

exactly what I would do, too. And the book tells you to pay off the debt. That's what the book says, whose was that? What's that? Well, who's buck? If you go on the internet, and you look up, you know, what do I do? Do I pay off debt first? Or do I put money in the market, most people are going to tell you to pay off the debt first. And but Andrew pointed out a good a very good point. And this is actually something that I learned when I was in the bank, it look at what the interest rates are that you have, like, obviously, like he said, if you have credit card debt, that's 2025 30%. Because the rates have gone up so much, you know, if you can invest at better at higher rates than that, then you should be doing the investing for beginners podcast show, the likelihood of that is less likely, let's say so, you know, paying off, that kind of debt would make a lot of sense.

But the flip side of that, like Andrew said, if you have a mortgage, that's 4%, you could likely do better than that. And so you could consider putting some of that money in the market in that way. And depending on how you invest in like Andrew said, whether you're new to this, whether you're experienced, whether you're a stock picker, or whether you're an index fund investor, there's lots of different options that you can choose all this but one of the mortgage bankers that I work with at Wells Fargo said to me one time that he said that he recommends to people and this was a gentleman who had been in the banking industry for 30 years. And his advice to clients was if you have a lump sum of money, put it in the market, because paying off your mortgage is only a three or 4% reduction in your rates.

And that money is not going to change, you're going to keep paying that for a very long period of time. And the the 10 years that you could maybe take off your mortgage not paying the whole thing off, for example, that 10 years, you could be compounding at 10%. Buying the s&p 500, for example. And that would be a better return for you than paying off a portion of your mortgage, for example, he said that, you know, the, the the calculus, the numbers change, let's say that you can pay off the mortgage, then the you know, there's you might want to consider that.

But his advice was if you cannot pay off the mortgage and you have a lump sum of money, is to look at what rate you're paying and calculate is, will I get a better return? If I put it in the market for 10 years and paying off 10 years of my mortgage? And I can see the logic with it. And I remember talking to the financial advisor at the branch about that very question. And he agreed he said that that was probably a really smart way to go about doing it. So again, it depends on what your debt situation is James and who you know what, when you're talking about being debt free.

We don't really know what that is. So it hamstrings us a bit. Answering the question as well. And I guess the other part of it too, is what's going to help you sleep better at night? is investing all the money going to help you sleep best at night is paying off your debt gonna help you or is it following in what your father's wishes were, you know, that's something to consider as well. And it depending on your relationship with your father and what he wanted to do.

And maybe that's something that if you have children, you can roll that into something for them. And so those are they mean that you have a lot of options to think about what it is you want to do. And the other thing you probably have to think about Who is the tax situation, we don't know what the tax situation is. And so before you pull the trigger on anything, please consult an accountant to see what kind of ramifications or what the situation is with that, because there probably is some sort of tax implication if if all that money is in the stock, and you have to liquidate it, to take possession of it, or even to take possession of the stock itself, I'm not entirely sure how that transfer would happen. There might be some tax implications either now or down the future that you need to plan for and think about.

And then I guess the last part of it that I think about, and this is something Andrew has talked about many times in the show, and I agree with him wholeheartedly. If you're going to take a lump sum of money, and put it into the market, I know that the math and some of the studies say that that's a good way to go. I will push back and say, find me 20 great investments to put it in

Andrew

15:53

today. I mean,

Dave

15:55

it's hard, it's really hard. And I'm not talking about like, once, I'm not talking about, you know, hey, I want to buy this, this and this, I'm talking about great investments from now until the next day with going from standing zero to picking these 20 companies overnight. That's a really, really tough policy challenge to do. And Warren Buffett could probably do it. But he has enough money to do that. And he doesn't. So I think that should tell you something that he denied out buying 20 things every month, there aren't always a lot of great opportunities.

There may be periods where there are, but there isn't. And so I guess I lean way more towards what Andrew was suggesting of using it and putting chunks in at a time. Because it gives you more time to think about what it is you want to invest in different kinds of allocations, you can find different companies you can find it also gives you more experience. And like Andrew said that, if you put that whole lump sum in and you are not an experienced invents investor, you're gonna have a lot of heartburn, you might want to buy a lot of times a lot a lot of times because every day you look at that balance. And it's a lot lower than it was the day before because of something that happened in the market.

That's not easy to deal with. And it's part of the game. And so I guess all those things to say, I would follow a lot of the advice that Andrew was talking about, you know, think about what your heart tells you what you sleep with? And what do you think your father would want you to do? And just kind of go from there. And you'll figure out the right decisions from there.

Andrew

17:22

Yeah, that was so good. I love all the nuanced behind that, because there is a lot of factors. And it's not as easy as just go out and buy Microsoft tomorrow,

Dave

17:32

you know, wish it was

Andrew

17:34

maybe can you describe, you know, obviously, inheritance. And you know, we're not trying to open up a tax law book or anything, but can you like, give some examples to somebody who's not aware even that investments are tax, like what kind of thing could come up? Because I, you know, I feel like we talk a lot to people building a portfolio. And you don't really need a financial advisor or somebody that look at your taxes when you're first building a portfolio. But when you come across, let's say $100,000 or $500,000 or million dollars, you might want to seriously consider talking to a professional about the tax implications to your point, because that could pay off 10s of 1000s of dollars.

And we're talking about something that's very specific, like an inheritance. But can you speak on like, some of the typical taxes that maybe a beginner won't even realize is involved with big lump sum of money?

Dave

18:30

Yeah, well, I guess a few things that kind of springs to mind. First one is what kind of inheritance tax would be assigned to this? And how would that be assigned to that depending on the the amount of money that you're receiving, you could have to pay something now, when you liquidate the stocks, when you sell stocks, depending on what kind of account they're in, you may be responsible for taxes, and you will and chances are you will be responsible for taxes, it just depends on how much you know, there's the difference between the short term and the long term gains that you could be taxed on and those rates are different.

And basically, in a very simplified way, you know, the short term are going to be taxed at a higher rate, which means that those are monies that you would gain on in less than a year. And then long term gains are anything that you hold tasks that you're holding period, and you'll pay some taxes. Now, if you're in if you're in a Roth IRA, then you've already paid your taxes and so that part of as easier, but if you're in a traditional you haven't, and so then you have to figure out what kind of taxes are owed. And when the money is being liquidated or transferred to you.

You may that may be assigned as income to you. And then all of a sudden that puts you in a way thank your tax bracket. Let's you know let's say that it is a million dollars just hypothetical. You know, that puts you in a way higher tax bracket then you know, I would be in right now. And so before I could do anything I'd have to talk about count and then find out what kind of taxes am I going to owe for this and when am I going to owe those, it may be on transfer of the funds, or it may be when I retire, it just depends on what kind of tax vehicle you put it in, and how you want to invest that. And so those are some just initial things that I can think of.

And then depending on if it's in a trust or not a trust, there will be taxes associated with that. Bottom line is, Uncle Sam's going to come for his cut, in one way, shape, or form. And it's just a good idea to try to be, I guess, prepared as much as you can, for stuff like that. And those are things that you may think, hey, great, I got all this money, it's all in the stock market, I can just sell all my Microsoft and just take all my money, it's not quite always that simple.

There's going to be Uncle Sam's going to be standing there for over a little bit of a handout. And he's just got to figure out what, what is what your responsibility is, and how you can try to lessen that legally, I would always always, you know, whether it's $10,000 or $10 million, I would talk to an accountant and figure out what it is you need to do in regards to all that. So is there anything I missed, or anything you'd like to add, that I didn't touch?

Andrew

21:08

I think they're all good points and good things for people to think about. I mean, to your point, like if you have a stock, and like let's say you did get left Microsoft, and you wanted to sell, which would be crazy, I'd have to come across the mic and like, slaps you, let's say you did, because you liked a different company, instead, to your point, do not just put all of the Microsoft money into the next stock, because that tax bill will still come due even if you then set that money aside.

That's a great example for a beginner to think about. Another one would be let's say you did keep the stock, but then you're paid dividends. And if you're just reinvesting those dividends, without holding some of that, back for taxes, you're gonna know that during tax time, too. So it does pay off. And I would say about the more money is involved, probably the more ROI you get from talking to a professional on the tax side

Dave

22:04

of it. Yeah, absolutely. And I guess the last thing I want to throw out there is the two main retirement vehicles, the and the Roth IRA and the traditional IRA, have different acts, not loopholes, but they have tax restrictions, they also have restrictions on when you can take the money out. And so the traditional, for example, you if you take that money out, let's say that you take, you take a lump sum, and you put it in a traditional IRA. And then something comes along and five years that you want to take some of the money out and go buy a car, for example, just as an example, you're gonna get taxed pretty heavily on taking that money out, I think it's around 25 27%.

But don't hold my feet to the fire on that. And that's a big chunk of change to get, because you're taking out before the required time. With a traditional IRA, that money is basically being held in that account, until you are till you retire, officially retire and start taking required minimum distributions. That's what they're called RMDs. And by the time you get to be, I think it's 72, you have to start taking those. But prior to that, you can take what you want, but there's a certain amount anyway, it's, it can be a little complicated, but there are tax implications for all that, because you haven't paid taxes on that money when you first put it in that account. Whereas the Roth IRA, you've already been taxed on that money.

And I believe it's after five years, you can withdraw the money without being taxed on the money because it's yours. Or if you're going to buy a home, the first time home, you can take it out at any time without any tax penalties, I believe.

Andrew

23:44

So we're talking about now the other side of Yes, putting the money somewhere. Yeah, exactly. So there's Yeah. To your point, there's tax implications on both. Yeah, there's

Dave

23:55

gonna be some things you're going to have to think about tax wise when you take the possession of the money. And then there's also going to be tax implications or things you got to think through, would you once you have possession and you start investing it in one way, shape, or form, you got to think about kind of both sides of the coin, I guess, is what I was trying to say. Yeah, maybe not as clearly as I want to do.

Andrew

24:16

I think we could all give you some leeway there. Oh, that's all really great stuff. I guess the last kind of question would be if somebody's in that kind of $10,000 range, or maybe it doesn't make much sense to talk to a professional where can they learn more about the basics of investing taxes and stuff like that, that kind of make it more simpler

Dave

24:35

our website? Yeah, investing for beginners.com is a great place to go. I would go to I would frankly go to someplace like h&r block, or I would also go to irs.gov. And work on those two places. Those are great websites as well. That will have lots of information that you can read for free. And you can learn more about the the opportunities for different IRAs. If that's the route you Want to go, and what kinds of things you may have to consider or think about in relation to any sort of taxes.

Again, if it starts getting into things like trusts, and anything of that nature, I would probably want to talk, at least talk to a professional. You don't have to pay somebody right away to do that, you can just go for a consultation. And most of them will do the that kind of stuff for free, because they want your business and they want to give you advice. And so you can just try to find somebody and see if that's something that that could help you.

Andrew

25:27

I feel like we did like a series on some of these accounts turned off, I'm trying to pull it up while we're recording, which always makes for great content. I think it was, I have B 60 through IV 64. Okay, we have, like a personal finance series we did back then. And we kind of talked about getting started with thinking about when you're building your investments, and how that, like the basics of tax and some of the IRA stuff that you were mentioning. So you can kind of go through that series and get a good I think brain dump kind of background knowledge that should help you go far when you're thinking about okay, these are how to set my expectations for taxes with investments, so I would recommend IFP 60 and then kind of move up from there. Yeah, that sounds

Dave

26:19

great. That's perfect. Yeah, those are, I think all those resources would be very helpful. And again, you know, I hate to keep beating the dead horse. But I will, again, if you have questions, you can reach out to us if there's something that we don't know, we're not tax professionals. So just keep that in mind. I would definitely strongly encourage you to just talk to the person that does your taxes for you. A lot of these questions are things that they could probably answer at a, at least an intermediate or beginner level. And if it's anything more complicated than that, though, either want to take you on retainer, or they will recommend you to somebody else that maybe specializes in these particular questions, because some of these things may be very specific.

And the you may have to work a professional that works with these situations on a regular basis. All right, well, with that, we will go ahead and wrap up the show for this week. Don't forget to subscribe to the show on your preferred podcast app if you enjoyed our little show. If you would kindly consider giving us a review.

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