IFB287: Listener Q&A – Employer Stock Plans

[This transcript was generated by artificial intelligence. Timestamps are not 100% accurate depending on the platform used for listening].

Dave

0:00

Alright folks, welcome to Investing for Beginners podcast today we have episode 287. Today we're going to spend some time talking about a great question we got from Mr. Chu. And if I butchered that I am so sorry. So we have Hi, Dave and Andrew. I really like your podcasts. Thanks for guiding newbies like me. I have a question about ETP. My company, Google is giving me options to opt into the ETP program. Under this program, I will not be able to sell or buy company stock, any account, things will automatically get sold quarterly. Regarding this, he has a few questions.

Number one, is it a good strategy to give away flexibility? And number two, what if I'm buying ETF that has this stock part of it? And number three, is this a good way to diversify my dependency on Google salaries slash stock. But like Munger said, unnecessary diversification can hurt as Google is a company with a good runway, even though the stock has been flat for quite some time. Really appreciate your feedback and input to rationalize this. Thanks, Mr. Chu. So again, if I butchered it, I'm sorry. So Andrew, I guess start to unpack this question a little bit, maybe we can start talking about give people an overview of maybe what an ET plan ETP plan is, or an espp plan, which is what we think he's referring to,

Andrew

1:16

I'd never heard of ATP. I don't know if that's what it's called Google. But yeah, a lot of public corporations give you the option to buy company stock at the place you work at. And oftentimes, they offer it to you at a discount, which can be a really great benefit for you. And, you know, it kind of helps you align with the company incentives, and it can be a great benefit that the employer offers to you. What are your, what's your kind of perspective on that kind of a program like a espp?

Dave

1:51

Well, they had one, when I worked at Wells Fargo, they had one for us, as well. And so part of our part of our bonus was paid in company stock. But we also after I worked there for a year, I was eligible to enroll in the employee stock purchase plan. And it it gave me the ability to buy shares for I think it was a 10% discount for what they're trading at in the market. And so I took advantage of it, I talked to the financial advisor in my branch, and he said, Hey, that's a 10% gain, you know, you're getting take advantage of it. So I did, and I still own the shares.

And a company has been all over the map as far as the price since I left the company, but I still think it's a great return on the investment. At some point, I will liquidate them. And you know, I'll get a nice return for that, because I got a good deal. And I was basically buying with a margin of safety from the get go. And I was a big fan of it. And I think anytime that the company can give you a benefit like that, depending on the company, you should, and what the incentive, I mean, what they're offering, I think you should consider taking part of it as part of your investment strategy.

Andrew

2:56

For sure. I mean, you know, I'm not going to speak on the specifics of Google or any other companies plan him on shoes, talking about how they get automatically sold quarterly, I'd never heard of that. But if that's the way it goes, and you're getting a discount on it, I think it's a great way to go. When I took advantage of my employers espp went back when I worked for them, that was something that a lot of my colleagues would do is we would buy it, get the discount, hold it for the minimum amount that they lock you up, and then sell it as soon as possible.

Because if you hang on to it, now you have to deal with how it performs in the market, which, you know, could be good, but also could be bad. So by selling out immediately, you can lock in that benefit part that your employer is giving you without taking on the risk of owning the stock, just because you simply work there.

Dave

3:55

Right? Yeah. And I think kind of maybe we can talk a little bit about kind of how this can fit into, like the overall benefits that the company can pay. You know, if you look at this in conjunction with a 401k, and just kind of your whole retirement. So like, what are your thoughts on? Like, if you have the espp, and you're already investing in a 401k? Maybe we could talk about 401k for a minute. Like if you're investing in the 401k? You know, how can this benefit you? And maybe how would you think about that,

Andrew

4:23

the most common recommendation I've heard is you kind of prioritize the different benefits. So usually, if an employer offers you a 401 K match, you want to take advantage of that as much as you can. Let's say they match you on 5%. So 5% of your income that you put towards the 401k they're going to match you $1 for dollar, they're going to give you $1 up to 5% of your income. You want to take that 100% of the time, all day every day, because you're getting a 100% return on your money, which is There's no way to do that every year, like, even Buffett doesn't, right.

So I would definitely try to utilize that if I was in those shoes, the other benefits of the 401k is it gives you a tax shield because you're saving for retirement. So you can reduce your taxes this year by contributing to your 401 K. And that can be really helpful for your overall financial picture. And then it feels me I'd also I really liked the Roth IRA, and the traditional IRA, those are other retirement accounts that give you tax shields. So I would take advantage of those.

And then the espp kind of falls after that in my book are the SPP is a great benefit, you can get 10% 15% Whatever the discount is, but you don't get any sort of the tax shield. So you will have to pay taxes on any gains you make from it. And so when you think of the priorities, it goes lower, when it comes to your disposable income that you're investing, it comes lower because doesn't get the same tax benefits. That's the kind of the way I look at it, do you look at it in a slightly different way?

Dave

6:09

No, I mean, I think I look at all of those, I would agree with you on like the order of how I would order off the menu, like I'll take the form, I'll take the match first, then I'll look at the you know, any sort of tax benefits I can get, I guess the thing with the espp, for me, would be you know, if you work for a company, and let's say they have a 401 K, but let's say they only have a 1% match, or something, and maybe you work for a really strong company that the stock is, you know, the stock has done really well for a really long period of time.

And the company is a really strong company that has a lot of great potential going forward, the SPP might be a way to maybe offset the fact that you don't have a big match with your company.

And you could use that to, you know, take advantage of a discount of, you know, buying Google, for example. And if you had that opportunity, that would be something I guess I would consider taking maybe a bigger bite of kind of depending on what my match was just because, you know, you don't want to get over allocated to one company. And that's, you know, something that can happen when you get a lot of stock in one particular company as far as the order of operations in the menu. Yeah, I would definitely agree with what you were saying.

But I think I would look at the espp in conjunction with my 401k and maybe how that would work. And I guess also where I fall on the tax bracket. Because you know, the point you made about that there's not a tax benefit for the espp. That's something you have to take into consideration. Because, you know, especially if a company like Google, if they're buying and selling within a year, then you could be at risk for some sort of capital gains taxes for that.

And then Google doesn't pay a dividend. So you don't have any shelter for that, either. So that's something to consider is like, what kind of tax benefit would this impact somebody if they're doing it that way? Or even if they're just doing the SPP, you know, I would want to make sure that if I am doing that I'm trying to hold the stock longer than a year so that I don't get hit with as high of a tax rate. So I guess that's something I would consider.

Andrew

8:14

Yeah, those are good things to think about. How would you answer this question? Is it a good strategy to give away flexibility?

Dave

8:19

Yeah, that's that's the harder part. I think it depends, you know, like everything else in finance? It depends. I would, I would say, I

Andrew

8:29

think he's more referring to. He's saying that he's not able to buy or sell company stock than that things are bought, and then sold quarterly automatically. So I think that's what he's referring to about this flexibility.

Dave

8:43

Yeah, I guess that part of it. I wouldn't like I don't necessarily like somebody dictating to me when an investment choice has to be made. I don't particularly care for that, I guess, what are your thoughts,

Andrew

8:56

I would disagree, because in my mind, the benefits getting the discount. So if it's something I was going to do anyway, then it wouldn't negatively affect me. But I can see where that can be unattractive. Depending on the purchase plans, you can go on there while they're on those. So that is something to think about. But then I guess the other way to think about it is if you're worried about it going about the stock going down, then is something you shouldn't have bought in the first place. Right? Because then you're not really having a long term mindset.

Dave

9:26

Right? Yeah, for sure. That's a very good point. I would concede that.

Andrew

9:29

He asked, What about if I'm buying ETF that has the stock part of it? So Himanshi I guess I would just recommend reading the fine print on your particular plan because we don't have that information. And like we said, everything can be structured a little bit differently. So if you're saying they're not letting you buy or sell company stock that may or may not include ETFs. I wouldn't be shocked if it said okay, you can't have any ETF that has Google stock in it because right That would disqualify every index fund pretty much, pretty much.

So yeah, I would just double check the fine print. And I think that's maybe a good, good advice for any sort of employee stock plan. Because, yeah, Andrew said that he likes using it in a certain way. But that's what worked for him and at his company that he was at, your company might do it a slightly different way. And so kind of to Dave's point, maybe the discount your company offers you isn't even worth the taxes that you might face, or even the downside you might be exposed to, and for how long your money is locked up. So those are all things to think about. Yeah, they are. And

Dave

10:39

guess, kind of thinking through that whole ETF question. If he has a 401k with a company, depending on what they offer, does that mean that you wouldn't be able to invest in certain index funds in your 401 K? Because chances are excellent, that that's going to contain, you know, a Google in it. And, you know, if it's s&p, NASDAQ, any of those kinds of things, any sort of tech related thing, it's going to have Google in it.

And so does that mean, so I guess I would, before I would decide on what you're going to do with that, I would read the fine print to see what the restrictions are, before you pull the trigger on something like that, just because you want to try to avoid any messiness. You don't want to go down the path of buying company stock, and then you find out down the road that you're getting penalized. And so any benefits that you may have received for buying that may be negated because you unknowingly bought an ETF that had Google in it, and you weren't allowed to do that.

That would be a shame. So I guess the last part of the question, maybe we could talk a little bit about diversification, he kind of mentioned the whole Charlie Munger idea and diversification, and I kind of mentioned, when you buy stock with a company, especially if you're getting a 401 K match, at least when I was at Wells Fargo, it was all the match was all in company stock. And so rather quickly, I grew to a large portion of my wealth tied up into one company based on that benefit. And if you peg on the employee stock purchase plan or his plan, you could kind of run into the same problem. So I guess, what are your thoughts on that?

Andrew

12:21

Yeah, I like the way you kind of framed the idea of looking at your entire picture. I know, when we're looking at individual accounts, it's easy to see, okay, I have 5% here, 5% there. But really, how does that look in the span of all of the accounts that you own. So maybe for somebody who has 200,000 in the 401k, from a previous job, maybe having all of their money in, in Google stock as it builds. And it's like $5,000, that's not bad diversification, because you have holistically you have a lot of diversification. So to me, it all comes down to the context. But I would certainly agree with the idea that you want to reduce the dependency you have on the company that you work at.

Because as we've said, over and over again, even the greatest companies stumble, and even the greatest ones fall flat on their face. And we've seen it over and over again over the years. I've been picking on GE lately, but it's for good reason. 20 years ago, they were probably how we consider Google and Apple and Microsoft today, if you were to combine all of them. That's like what GE was 20 years ago, everybody loved the company, they thought it was the greatest company on earth. You fast forward a few years. And that was a really bad place to be at for many years. So you don't want to be in a situation where you can lose your job and your retirement savings all all because of one company that used to be great. That's not anymore. So any prudent financial decision would include diversifying, and if that percentage of your wealth income kind of mix is tied up too much at one company, then please diversify it. That's what I would do.

Dave

14:10

Yeah, I would I 100% agree with that I that's what I ran into a problem with when I was at Wells Fargo was that eventually, the stock that I owned for the company became larger. I think it when I left the company, I want to say it was around 35% of my 401k was in just Wells Fargo stock. The other 65 was tied up in other ETFs. So when the company stumbled, and when I left they were trading around 45 $50 A share and during the pandemic, and a little bit after that it dropped to around 20 to $25 a share. So my 401k dropped quite a bit in that time period. And so if I had had, let's say Fast Forward 30 years and I had been working for them all that time and I had never really adjusted that.

As a percentage of company stock would have grown to probably 70, or 80% of my overall wealth in the 401k, maybe not that much, but it would have been quite a bit. And if I'm set to retire, and then the stock price drops to 25 bucks a share, that can put a real crimp on your retirement and kind of to Andrew's point, you know, GE was number one or number two in a world and market cap at one point. It's one of the largest companies in the world. And it's almost not, it's collapsed. And there's no nice way to say it. And there was probably a lot of people that had that situation where they had the majority of their wealth tied up in the company. And that can be a tough, tough place to be, especially as you're getting closer to retirement.

So if there's any way that you can, like Andrew was saying, kind of look at your whole, picture holistically and try to manage that as best you can be. And it's okay to have a lot in company stock, but then you have to offset it by diversifying into other things to mitigate any sort of downsizing or downturn that that Google for example, could happen, could have. And that's the way that you can kind of hedge your bets and protect yourself in the future. I think it's great to be enthusiastic about where you work and want to partake in the the

the the gains and the splendor of a company doing great. But you also have to balance that out with reality of nothing lasts forever.

And you have to try to, I guess, sometimes in investing, you have to kind of plan for the worst, and adjust for it because you can't, a lot of times you can't adjust on the dime. And so you have to kind of plan for those things. And that's what diversification can help you do is avoid some of those downturns by planning ahead. So instead of having all your stock in Google can have it in other companies that are maybe not tech related, or away from that kind of concentration of what it is they do. And that can be helpful, too

Andrew

16:59

What about this idea from Charlie Munger that too much diversification is a bad thing? Well,

Dave

17:05

I guess there's a couple of ways you could probably look at that. Number one, he's one of the smartest guys that ever walked the earth. And he's also a fantastic investor. And he's also built his life around investing. And he has been able to pick some great companies and be really concentrated for a really, really long time. And he's 99 years old, and he I guess, he doesn't care. It's just a different mindset. I am not, I'm not as comfortable owning four companies.

And I don't feel like I am the master of those companies. And I know that I mean, he sits on the board for Costco, for example, which is one of his biggest holdings. If there's not a company, he doesn't know better than Costco. I don't know what there is. And so that makes sense to me. But for me to do that, and maybe to rec

ommend other people to do that, I guess I'm not as comfortable with that, that decision. And I think, can you have, can you diversify away everything course. I mean, you have to do everything, I think in moderation. But I think having four stocks, you know, all you know, two of them in banks, for example, like he does Wells Fargo and Bank of America, and then Costco and then the fund in China. That's to me is, obviously it works great for him. And for other people, they may be able to have that level of of knowledge and concentration and conviction about those kinds of companies. I just I don't have that. So because I don't have that I choose to diversify. And that's just what works for me. And that's what I think would work best for most people. What are your thoughts?

Andrew

18:42

Yeah, I agree. And I liked that you included the thought what works for most people? Because I think too often what's said by really successful investors is not thought through necessarily and everybody's situation and context is different. I think there's a fine line between conviction and blissful ignorance. And, you know, always get to see who's on the right side of that side of that line. So I agree that for myself, and for most people, what looks like unnecessary diversification to Charlie Munger probably is good at diversification for me. Yeah, I would agree with that.

Dave

19:29

All right. Well, everyone that is going to wrap up our 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. It greatly helps the show. And don't forget to browse the incredible materials we've created for you at E investing for beginners.com. Last week, consider growing your knowledge as an investing for beginners insider with insights and educational tips delivered right to your inbox for free sign up today. And with that, we will go ahead and wrap up our show for today. I want everyone to go out there to invest with a margin of safety emphasis on the safety Have a great week and we'll talk to you all next week