Tax-Loss Harvesting – Podcast #153

Podcast #153 Show Notes: Tax-Loss Harvesting

Tax-loss harvesting is an important topic, especially right now. If you have been hemorrhaging money in the markets, as most of us have, you may want to do some tax-loss harvesting. This a great way in which you can get Uncle Sam to share the pain of your losses in a taxable, non-qualified, brokerage account.

Why is tax-loss harvesting useful? You can take up to $3,000 per year in capital losses and offset your ordinary income with that loss so it lowers your tax bill. Any other losses are placed against your capital gains so you can use them in any limit, not just $3,000 a year, but hundreds of thousands of dollars a year if you want, toward any capital gains taxes you owe. If you don't use all of the losses in one year, you get to carry them forward and you can carry them forward for years and years. Thanks to the recent bear market I now have hundreds of thousands of dollars in tax losses.

In this episode, I talk about what I can do with those losses. In a lot of ways, you are just deferring taxes when you do tax-loss harvesting. But there are times when that is really helpful and we get into that in this episode. I also answer a listener question about tax-loss harvesting ETFs vs. mutual funds. If you have a taxable account, this will be a useful episode for you to listen to. Even if you don't I answer other listener questions about growth stock mutual funds, Roth conversions, PSLF, backdoor Roth IRAs, investing in bonds vs stocks, charitable contributions, your asset allocation in a bear market, glide paths, and bond tents.

Sponsor

This episode is sponsored by Bob Bhayani at drdisabilityquotes.com. Bob is a truly independent provider of disability insurance planning solutions to the medical community nationwide and a longtime WCI sponsor. He specializes in working with residents and fellows early in their careers to set up sound financial and insurance strategies. He has been extraordinarily responsive to me anytime any reader has any sort of an issue, so it was no surprise to get this feedback about him recently from a reader.

> *"Bob was generous enough to come speak to us in our residency last week. Bob was knowledgeable, straightforward, and answered all of our questions. I wouldn't hesitate to recommend him to anyone and his place on your recommended page is well deserved."*

If you need to review your disability insurance coverage to make sure it meets your needs or if you just haven't gotten around to getting this critical insurance in place, contact Bob Bhayani at drdisabilityquotes.com today by email, at info@drdisabilityquotes.com, or by calling (973) 771-9100.

Quote of the Day

Our quote of the day comes from one of my favorite doctors, William Bernstein.

> *"You are engaged in a life and death struggle with the financial services industry. If you act on the assumption that every broker, insurance salesman and financial advisor you encounter is a hardened criminal, you will do just fine."*

Tax Loss Harvesting

A listener asked,

> *"My question is regarding the consequences of tax loss harvesting. I understand the immediate benefits for the tax year of taking a capital loss. However, by taking a capital loss now aren't we as a result in a way lowering our cost basis for the future and thereby setting ourselves up for more capital gains down the road? So, I guess this is the rationale that long-term capital gains might be realized perhaps at a lower percentage with lower income in retirement or is it that a capital gains might be wiped out when inherited by my eventual beneficiaries upon my death? I just want to understand if tax loss harvesting is really all that*

is cracked up to be or am I thinking about this in a wrong way?”

This is a really important subject. If you’ve been hemorrhaging money in the markets, like most of us, you may want to do some tax-loss harvesting. This is a great way in which you can get Uncle Sam to share the pain of your losses. Now remember, it does not work in retirement accounts. You can’t do this in your 401(k) or your 403(b) or your cash balance plan or your Roth IRA. This is only in a taxable or a nonqualified or brokerage account. So, make sure if you’re going to do it, that you’re only doing it in that account. And what you most need to be careful of when tax loss harvesting is avoiding a wash sale. That is when you sell something and then you buy it within 30 days, either before or after the date you sell it. If you do that, it’s a wash sale and you cannot use that tax loss.

So why is a tax loss useful? Well, you can take up to $3,000 per year in capital losses and offset your ordinary income with that loss. So, it actually lowers your tax bill. Any other losses are placed against your capital gains. So you can use them in any limit, not just $3,000 a year, but hundreds of thousands of dollars a year if you want, toward any capital gains taxes you owe, whether those are capital gains on a property that you sell or a small business you sell or mutual fund that you sell for gains now or later in life. So, there’s a lot of benefit there in that you can use this to lower your taxes. If you don’t use all of the losses in one year, you get to carry them forward and you can carry them forward for years and years and years and years.

Now, thanks to this recent bear market, I now have hundreds of thousands of dollars in tax losses. So obviously if I was only able to use $3,000 a year, I’ve got more than enough to last the rest of my life, but I fully expect to be able to use it to offset other things including being able to spend from that taxable account, totally tax-free in retirement for instance, or just simply being able to reposition a portfolio without having to worry about the capital gains taxes that are due.

Now it is true that in a lot of ways you are just deferring tax, not that there isn’t any value to that. There is value in paying tax in 20 years instead of paying it now. But if you tax loss harvest, you are lowering the basis on the investment and will owe more in taxes later when you sell it.

However, there are a couple of ways in which that’s helpful. First of all, you get a delay of the taxes, which is not as good as avoiding them completely, but it’s better than nothing. It is not the same thing to have to pay taxes now versus paying taxes later. Second, if you give anything to charity, instead of giving cash, you could give appreciated shares and then flush those gains right out of your portfolio. This is what I do every year. I tax loss harvest the losses and when I have shares that have appreciated, when I’ve held them for at least a year and I have a positive gain in them, I use those for my charitable contributions. You can do that either through a donor advised fund or you can give it directly to the charity so long as they have a brokerage account and they can handle that sort of a contribution. If you do that, you get the full deduction for the entire contribution off your taxes when you itemize. It’s a charitable contribution but you don’t pay the capital gains taxes and neither does the charity. It’s really a great deal. You get the tax loss and you don’t pay the gains. So, that’s one way in which you don’t pay it at all and tax loss harvesting can be really, really valuable.

The second way is if you die. When you die your heirs get a step up in basis at death. So, their basis is essentially whatever it was worth when you died. And so, if you have a really low basis because you did a bunch of tax loss harvesting, that’s okay because nobody ever pays those gains back. In those situations, it really can be super beneficial to tax loss harvest. But even if you end up selling those shares later and paying those capital gains, just deferring it is helpful. Of course, you can take $3,000 of it each year against your ordinary income and that's helpful as well.

Another listener asked about tax loss harvesting between ETFs and mutual funds.

> *"I was going from a mutual fund so I actually had to sell the mutual fund at 04:00 o'clock, that's when it goes through, but then for the ETF, I had to wait until the market opens at 9:00 AM. By the time I put it through, the work had actually gone up 2%. So, is this a problem in other brokerage firms? And also, did I do something wrong waiting for the market to open and now losing 2% of the market going up because I had to go from mutual funds to ETFs?"*

How do you tax loss harvest when you're using funds? How do you do it when you're using ETFs? If you are all in mutual funds in your taxable account, this is really easy. You make sure you look at the cost basis page and are actually in the red on what you're going to sell. You find something that is similar, i.e. highly correlated, but not substantially identical. For instance, you would put in an order into vanguard.com to exchange 100% of your total stock market index fund for a 500-index fund. That would take place at the price at 04:00 o'clock, the end of the trading day, 04:00 o'clock East Coast time, that's when the exchange takes place. Whatever your total stock market is worth at 04:00 o'clock is how much 500-index you exchange it for. That is my favorite way to do it. That is one reason I like mutual funds. There is no worry about a volatile market going up and down in between the time you buy and you sell. It all takes place at the exact same time so, with funds, I think it's very, very easy.

The downside is if it takes a big dip during the day and then recovers at the end, you might've put that order in and then actually harvested a gain even or not gotten as much of a loss as you wanted. So that can be problematic just because you can't do it as you go along.

With an exchange traded fund that is exchanged during the day, you can control for that. You know about where the market is when you put the order in, but in a really volatile market, that can be tricky. What if you sell at one price and then you end up buying at a higher price? You essentially just sold low and bought high when you thought you were just exchanging investments. You thought you were tax-loss harvesting, you ended up losing money. So, you have to be really careful when doing that. In fact, it's probably great to avoid doing it in a really volatile market like we've been having lately, but unfortunately, every time you start losing money, it tends to be really volatile, so it makes it difficult.

It becomes particularly tricky when you're going from funds to ETFs or ETFs to funds. For example, I had to do this yesterday. I had my taxable account primarily in mutual funds and I had already gone from the Vanguard total stock market index to the Vanguard large cap index to the Vanguard 500-index fund and now the market had dropped out underneath this again. I think it was down 10% or something yesterday. I really needed to go to an ETF because this is all happened in less than 30 days, so I can't go back to the first fund but I wanted to capture that loss. I decided I was going to go to the iShares total stock market ETF. What did I have to do in order to do that? I had to buy the ETF while the market was open and then put it in an order to sell the fund at market close.

I waited until it was nearly market close. There were just a few minutes left, maybe 15 minutes left, which is not my favorite time to be buying and selling ETFs because the market can be particularly volatile at that time. So, I bought the new shares, no problem, it let me put in that order. Of course, it gives me the warning that I have t to have the money in the account by the settlement date, but that settlement date is still three days away. Then I put it in an order to sell a 500-index fund at the end of the day. I don't know where I came out either slightly ahead or slightly behind. I think I actually lost money. I think I came out slightly behind because I think the market dropped in those last 15 minutes, another 1% or so. Unfortunately, I ended up buying high and selling low to a certain extent in order to capture that loss.

Likewise, if you're going from an ETF to a fund, it's the same story. You have to sell the ETF and then wait until market close before the mutual fund is marked to market. You have to be a little bit careful doing that. It may not be worth it in a really volatile market because the loss of that 1% like I had on that particular exchange, may be more than you're actually getting from the tax losses that you are harvesting. You have to be careful.

Listener and Reader Q&As

Growth Stock Mutual Funds

> *"I've been listening to a popular financial guru and he constantly recommends growth stock mutual funds with a history of success. This doesn't make a ton of sense to me as Jack Bogle recommends index funds that are low cost as the best way based on his research to grow your portfolio. In addition, past success does not equate to future success and growth stocks have seemed to continually lag value stocks over their lifetime. So, is this growth stock mutual fund focused investing a strategy that we should maybe look more into or is this gentleman just likely not giving the best financial advice?"*

We all know who he is talking about, Dave Ramsey. He tells you to invest in good growth stock mutual funds for the long run. Well, why growth stocks? Why does he always say that? Well, I don't know if it's this idea that he thinks growth stocks grow more than anything else. While that actually has been true the last few years, growth has outperformed value and it probably was pretty true while Dave Ramsey was kind of coming of age in the financial services industry in the 90s when gross stocks also did very well. In the long run, the data is pretty clear that value stocks outperform growth stocks. No one really knows if that is a risk story because value stocks are riskier or if it's simply a behavioral story in that people ignore value stocks. You would just much rather invest in the leaders in the Apples and the Googles and the Walmarts instead of the Kmarts and the Sears.

But the fact is that you're able to buy dollar of earnings much cheaper using a value stock than you are a growth stock. So in general people are going to tilt their portfolio one way or another, toward growth stocks or toward value stocks. They typically do it toward value stocks, not growth stocks. So, I have to disagree with Dave Ramsey's advice. In fact, there's a lot of Dave Ramsey advice I disagree with (but he does get a lot of things right.) Particularly with investing there are some things he does that I think you should find concerning. Not the least of which is referring you to commission salesmen masquerading as advisors. I really don't like that method of paying for financial advice and I'm not a big fan of actively managed mutual funds and certainly not this idea that you should preferentially invest in growth stock mutual funds. For the Dave Ramsey portfolio he talks about growth and aggressive growth and he talks about international. So, it is basically an all equity portfolio, heavily tilted toward growth. I think you're far better off with a typical index fund-based portfolio, lower costs, less manager risk. You get a more balanced portfolio between value and growth. If you want to tilt your portfolio one way or another, realize that this is a decades-long decision. This is something you commit to for your whole life because it might take multiple decades for any sort of value stock premium to show up.

Roth Conversions

> *"We recently converted a pension for my wife's previous employer to a rollover IRA with Fidelity. I was hoping to be able to convert this to a Roth IRA within the 2019 tax year, but it has taken longer than expected. My question is whether or not I can still claim this on 2019 taxes. I am a new grad with only half a year of income in 2019 so the tax difference will be significant compared to 2020."*

Conversions are taxed in the year that you do them. So, if you do a conversion on January 2nd, 2020 you pay taxes on it for tax year 2020. They're due by April 15th, 2021. If you do a conversion, a Roth conversion, in December of 2019, you pay taxes on that in 2019. It's just the year of the conversion. You have to get that conversion done before the end of the year if you want to pay taxes on it and it sounds like he unfortunately, missed the date. Sometimes people get confused because you are allowed to contribute to an IRA until your tax due date of the following year, usually April 15th. That confuses a lot of people, especially when we start combining these two steps like you do in the backdoor Roth IRA process.

Remember the backdoor Roth IRA is a two-step process. Step one is the contribution and you can make that until April 15th of the next year and that is reported on the previous year’s taxes. If you make a 2019 contribution on April 1st of 2020 that’s reported on your 2019 taxes on form 8606, but if you converted it the next day to a Roth IRA on April 3rd of 2020 that conversion step is reported on your 2020 8606. So that can kind of make your tax forms a little bit more complicated. It’s definitely far easier to just do both steps in January of that calendar year, and that’s what I recommend people do. But you can do it up until April 15th of the next year. Just realize it makes your paperwork just a little bit more complicated. But when you understand that it’s not really one process, it’s two processes, then it’s a little bit easier to remember which tax forms you have to report those on. I hope that’s helpful.

PSLF Qualifying Jobs

> *“Is there any data on percentage of PSLF qualifying jobs after residency or fellowship? I’ve heard of several 501(c) three hospitals paying the physicians in a way where it would not qualify for PSLF. How common is this?*

This is a great question and I didn’t really have the answer. My sense is that it’s less than a lot of medical students think. If you ask medical students in their post-graduation survey of whether they’re going for public service loan forgiveness, something like 45% to 50% of medical students will tell you they are going for public service loan forgiveness. Now in some specialties and some states, far less than 45% of the jobs are at a 501 (c) three or a government employer, a job that would actually qualify for public service loan forgiveness. For example, in emergency medicine in the Wasatch Front area here around Salt Lake City, the only job that qualifies is being employed at the University. Those guys are employees of the University and their job would qualify.

But if you work at the VA, you don’t qualify because that job, they contract with the VA to provide services.

Same thing with the big Inner Mountain health system here in the Valley. The emergency docs that work there are a separate private for-profit group that contracts with the hospital. So that job doesn’t qualify for public service loan forgiveness. Remember, you must be directly employed by the hospital for the job to qualify and the hospital has to be a nonprofit. It has to be a 501(c)(3). In between the time I got this question and the time that I answered it on the podcast, I actually put a Twitter survey out.

I gave them four options. If you’re a doc, are you directly employed full time by a 501(c)(3) i.e. would your job if held by a new indebted grad qualify for public service loan forgiveness? I received 250 votes. 45% of them said yes, 22% said no. The rest said they just pretty much wanted to see the answers. So according to that Twitter survey it looks like almost 2/3 of the jobs qualify for public service loan forgiveness. That seems a little high to me, but certainly, it’s a significant percentage. If you really want a job in most specialties, you can find a job. It might be working for the VA or even the military, but more likely it’s going to be being directly employed by a nonprofit hospital. There are so many jobs that are employee jobs in every specialty these days. If you really need a job that’s public service loan forgiveness, it probably shouldn’t be that hard for you to find it.

Backdoor Roth IRAs

> *“I had a question about backdoor Roth IRAs and the pro rata rule. I know we want to avoid the pro rata rule and everything needs to be zeroed out, but I’m wondering if that’s possible or what would happen if you were to contribute to an IRA, an existing IRA that had say $50,000 and you put your $6,000 in, but you didn’t take your tax*

> *deduction and then only converted over $6,000 from that into a Roth. I mean, is that even allowed or do you get taxed on everything as if you transferred everything over? Just wondering what happens if you break the pro rata rule."*

How does the pro rata rule really work? If you have this $50,000 IRA and you put $6,000 into it and you convert $6,000 of that IRA to a Roth, it's going to be prorated. That's what the pro rata rule means. So, you'd divide the $56,000 total. You divide $6,000 by $56,000 and that gives you the percentage of your conversion that is going to be tax free. That is going to be a very small percentage, like 10%. So, in reality, only like $600 is going to be a tax-free conversion. The other $5,400 is going to be taxable income to you in that year. That is why you do not, when you were trying to do a backdoor Roth IRA, you do not put your $6,000 contribution into some existing IRA. It's like putting cream in your coffee. Once you put it in there, you can't get it back out. So, take care of that IRA first, roll it into a 401(k) or just plan on converting the whole thing to a Roth IRA and then put another $6,000 into that or another traditional IRA and then move that to a Roth IRA so you can get the tax free Roth conversion that is part of the backdoor Roth IRA process.

Investing in Bonds vs Stocks

> *"This isn't really much of a question, just a general comment and observation and hopefully a helpful reminder for other people as well. Just how in these uncertain times there are different risks with various asset classes. I know people often say that bonds are for stability, but just notice that VTEB, Vanguards municipal bond ETF is down over 6% just in one day alone. So hopefully a helpful reminder for other investors as well to just stay the course rather than trying to time the market. If you need funds to stick it into a high yield savings account or money market."*

Yes, the Vanguard tax exempt bond fund recently dropped 6% in a day. It turns out that bonds have risks and that day that bond dropped dramatically. To be fair that was a day the stock market went up 10%. We've had some very volatile days in this bear market lately and you now what? Stocks and bonds both go up and down and they don't always go in opposite directions. They are uncorrelated assets, not negatively correlated assets. If you look at their correlation, it's about zero. So yes, bonds often do well when stocks do poorly, but there is no guarantee. It is entirely possible for bonds and stocks and gold and real estate to all fall in the same day or the same month or the same year. So, keep that in mind. There are no guarantees and bonds have risks. If you want the very, very safest bonds that don't have much volatility, stick with very short-term bonds and very safe bonds like treasuries.

Charitable Contributions

I brought on Adam Grossman of [Mayport Wealth Management]() to help answers a couple of listener questions in this episode. The first one was about charitable contributions.

> *"Is there such thing as good or bad timing when making charitable contributions via mutual funds held in my Vanguard brokerage account. Based upon the information you've shared and with the blessing of my accountant, I've started making our annual contributions to charity via mutual fund shares that have already reached long-term capital gains. With the recent turn in the market striking at the month of the year that I always tend to make these contributions, I'm curious if there's such thing as better or worse timing when it comes to the ups and downs of the market in this situation."*

I asked Adam how he would answer this question from a client.

> *"I would say, first of all, this is a great idea because when you're giving directly out of a brokerage account, when you give appreciated securities, you're sidestepping capital gains taxes. And second of all, he mentioned waiting for the gains to become long-term. And that's very important. So those are two things that are terrific right up front. Now the other thing is that here as we speak, we're in the middle of a bear market. And so, ideally when you're giving out of a brokerage account, you want to give assets that are most highly appreciated and not things that are beaten down.*
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> *And so, at this time, while it's possible there could still be appreciated securities, what I would recommend is to wait until the market hopefully and inevitably I think will recover. And the nice thing about charitable giving is that there's flexibility unlike perhaps spending in retirement. There is no particular timetable generally for making charitable gifts. So, what I would recommend is to establish a charitable gift fund, donor advise fund. Wait until the market recovers and then make a larger contribution. Maybe a contribution which will satisfy several years of subsequent giving. And so, he can pick a high point, give some funds out of his brokerage account, and then those goes out from the donor advised fund in subsequent years."*

It is an interesting question. When we think about market timing and whoever says, "Don't time the market, it doesn't work, you can't time it effectively, etc." There are a million ways to time it that we don't think about, aside from going, "I think the market's going down. I'm taking my money out" and "I think the market's going up, so I'm putting money in". When you take your required minimum distributions, when you make your Roth IRA contribution early in the year, late in the year, what day of the month you decide to put your 401(k) contributions in? When in a bear market you decided to do tax-loss harvesting? When you time a Roth conversion? When you time a charitable contribution?

All these things have market timing elements and the problem is none of us have a functioning crystal ball. We don’t know if the market’s going up or down from today, but I can tell you what, I just tax loss harvested my entire taxable account yesterday. We’re recording this on March 17th. The market fell 10% yesterday, came up 5% today. Yesterday I tax loss harvested my entire account. So, I have nothing in that account aside from a muni bond fund that I’ve even held for a year. So, one consideration when making a transfer to a donor advised fund or a donation straight to a charity is they have to have appreciated shares that you’ve had for a year. I mean, if you’ve only had it for a month, you don’t essentially get to wipe those out by donating them to a charity.

So, make sure even if you have gains that you’ve had them for at least a year, they need to be long-term gains, I think is probably the most relevant rule associated with it. But as far as timing it, I guess when the market’s doing well, give more money to charity and when it’s doing poorly, give less. That’s the only way to market time it. Or if you have the cash, give cash at market bottom rather than appreciated shares. But as far as timing it, it’s just as hard to do it with that as it is with anything. Adam said,

> *“I would add to what you just said. I think you make an important point, which is that market timing is regarded as sort of a dirty word. And I would agree that in terms of people trying to prognosticate, the traditional Wall Street approach of “We think this will happen” or “We think Brazilian stocks are good”. All of that has generally been shown to be ineffective. But what you’re saying is an important distinction, which is that you certainly can use timing to your advantage. If something has already happened you can observe that the market is high or the market is low, now is a good time to take a certain action. So, market*

timing is not universally a bad concept. It's just strictly when you're trying to do prognosticating that it's a bad idea."

Risk Tolerance and Asset Allocation

"My question is regarding my risk tolerance. I find it that after the bear market that we've hit that I want to increase my stock allocation. I'm 80/20 right now stocks to bonds and I want now to go 100% in stocks. I felt like I wanted to sell bonds and buy more stock and I didn't feel like I wanted to sell off my stocks during this bear market. Is this really representative of my true risk tolerance now that I've gone through this bear market or do you think really, I should ride this out longer as bear markets might last longer and my true risk times are not found until later? My risk capacity is very high as well. I am a neurologist and my wife is a full-time anesthesiologist. We are on track to meet our financial goals. Our need for risk it's probably low. However, I assumed using a 5% real figure that we meet our goals. However, increasing to 100% stock allocation would likely also help us meet our goals. Please let me know your thoughts about my risk tolerance, especially given in the context of my high-risk capacity."

I think this is really a deep question, a lot to unpack here. I asked Adam when he found his risk tolerance in a bear market.

"I think this is a great question and he's really asking all of the right questions. What is my risk capacity? How much can I afford? How much risk do I need to take? And then the last question is "How much risk can I emotionally tolerate?" And the first two questions have a mathematical answer. You can work those out with the calculator, but it's the last one that he's really asking about. And it's really only I think

through hard experience that you learn what your risks tolerance is, your emotional tolerance. And what I would say is that the listener probably has half of his answer at this point. If the S&P is down 25% or 30% as we speak, but historically in modern times, at least the S&P has seen losses of about 50%. I would say that the listener is probably halfway there and if you're feeling okay so far, then I think that tells him something. But if it gets to be down 40% or 50% then I would say he would have a more complete answer.

The other thing I would add is that asset allocation doesn't need to be uniform across all accounts. And sometimes that can make people feel like their hands are tied. But if you view it as being an asset allocation for your retirement account, for example, and an asset allocation of your taxable account and so forth, then that gives you more flexibility and maybe you feel like, "Okay, now I'm free to take a lot more risk in my retirement account." It's a lot but maybe he's comfortable with that if he knows that his taxable account is much less aggressive, and maybe he also has an emergency or a cash account in addition to that, which is less aggressive even than that."

This is in response to something I've been saying for years, where I tell people, "You don't really know what your risk tolerance is until you lose real money that you used to own, that you decided to put into investments rather than spending it on a vacation to Paris or a kitchen renovation or a Tesla. You put it in the market and you lose it." A lot of people read these investment books or they read blogs and they say, "Oh, I wouldn't have panicked. Boy, if the market dropped 30%, I'd sure be thankful and I'd put a bunch more money in". But I don't think you really know if that's true until you go through it. I've always told people to err on the conservative side of asset allocation until you go through your first bear market.

So, I guess at this point, maybe he's halfway through the bear market, maybe halfway through the drop, but who knows? We don't really know how deep it goes, but perhaps more importantly, we don't know how long it's going to last. We don't know if this is going to be a quick drop in recovery like you saw at the end of 2018 and frankly in 2008 or we don't know if it's going to be a long, slow, multi-year grind like you saw in 2000 to 2002. We don't really know how long this one is going to go. We do know how it ends. I mean, we've seen this movie before. We know how it ends. It ends with another bull market on the other side of this long before you need this money in retirement. But we don't really know exactly what it's going to do between now and then.

So, I guess I'd still be a little bit on the cautious side and realize that you haven't been through the bear market yet. You've certainly been through his opening throws. But I think at this point it's a good time to learn to stick with your plan, which is the most important thing in a bear market rather than trying to take advantage of stocks on sale. I'd really caution a lot of people out there, I'm hearing starting to talk on the Facebook groups and forums about taking dry powder and putting it into the market. I start wondering, "Well, where's this dry powder coming from?" I mean fine if it's your monthly earnings that you would be investing anyway. But what if it is your emergency fund? I don't think this is the time to be putting your emergency fund into stocks. It's for emergencies. This is one of those times when you may very well have use of that emergency cash.

I think it's an interesting time we're living through and those who haven't been through a bear market before are going to learn a lot in the next few months about themselves and their risk tolerance and about the investing world now that they're paying a lot of attention to it.

I asked Adam what his thoughts are of the first opening weeks of this bear market? What are the impressions he has taken away from it?

> *"A thought that occurred to me is that just as every bull market looks a little bit different and every bubble in particular looks a little bit different and that's how it snookers people, right? Because they say to themselves, "Oh, this time it's different". I remember with the tech stock boom in the 90s that people would say, "Oh, well, earnings don't matter. It's only about eyeballs. They're just selling electrons". People can tell themselves stories that on the way up makes them feel like, "Oh, this time is different". And similarly, every time there's a downturn, it looks different. And the problem is that makes it similarly scary. So just as on the way up, there is a reason to get extra excited, on the way down because it's different each time, there are reasons to be fearful and more fearful maybe than we need to be because we haven't seen this exactly before.*
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> *In this case we can remember 2008 but that was a purely financial crisis. That was a banking crisis. Here, this is a health scare and you're talking about a virus and it's really like a made for TV kind of thing and people don't know where that ends. And I don't think that Americans are used to being quarantined in their homes. And so, the level of fear is probably greater than it will need to have been with the benefit of hindsight six months or a year down the road. But I think your advice is exactly right, which is to take it incrementally. If you do have dry powder, true dry powder that you don't need for an emergency fund or anything else, put it in slowly. Don't rush to jump in with both feet."*

Glide Paths

> *"I have a question regarding a glide path regarding my son. He is five years old, but right now I have a 529 which is*

100% stock. I don’t know if you have a recommendation for a glide path of actually decreasing the stock allocation for him. Do you think maybe when he’s in high school, maybe going 50% stock – 50% bonds and then going more bonds until he graduates? Or maybe I hate to say it, but timing of the market where you have there is a bear market or something actually increasing the stock allocation at that time or rebalancing to more stocks. I know what your feelings are and sort of related to is my own retirement for me and my wife. Do you think that it was reasonable before retirement, maybe 10 years to actually increase the bond allocation from stocks or maybe it’s five years? I actually was planning for me and my wife just to follow the Vanguard targeted retirement fund actually so the 2045 is when you’re planning to retire. I don’t know if it’s that that’s just too simple or that that’s a very reasonable.”

We started out talking about 529 glide paths, we ended talking about retirement fund glide paths. Why don’t we start with the 529 issue? What does Adam think is an appropriate glide path for a 529?

“The tricky thing about 529 is that as everyone knows, they’re limited to educational uses. And so, the struggle that every family has is “How much should I put in?” Because while you might know how old your children are, so you know your timetable, you don’t know where they will go to school, you don’t know what the rate of inflation for tuition will be over that time period. And you don’t know if they’ll go to grad school or if maybe on the other hand, they’ll get a scholarship. And so, it’s very hard to know how much to be saving for 529. And the questions that I think people should ask as you think about both, how much to save and a glide path to guide your risk tolerance is maybe three questions.

One is “Do you have more than one child or do you plan to have more than one child?” The second is, “Are you planning *to send your child to private school for K through 12?" Because you can now use 529 funds in part for K through 12. And then the third question is "Do you have sufficient resources outside of your 529 to make up a shortfall?" So, if your 529 lost money or if you came up short with your savings, do you have other ways to pay those bills? And I think those questions will help the listener to think about what the risk tolerance should be in their account, both overall and as they get closer to college. And if you answered "yes" to all of those questions then you would have more flexibility. If you have multiple children and maybe your account is down as one of the children is approaching college, you can use cashflow from your household to pay the bills and leave those funds for other children. But those are the questions to ask. If he answered "no" to all of those questions, then I think you would want to be much more cautious.*

All that said, I think that a good rule of thumb is as follows, which is that as you approach middle school, I would take your asset allocation way down, your risk level way down. So, if you wanted to be 80% or 90% or 100% in stocks from the day that you started saving, when your child was, say it, toddler and infant, that's fine. But say when they get to sixth grade, I would take it down to 90% and then take it a step by step 10 percentage points down for each year so that the result would be between sixth grade and 12th grade, you could go from 90% stocks to 30% stocks. And so, at that point you'd be entering college with a four-year time horizon with 30% stocks. And I think that's a good all-purpose approach.

Again, if you have one child or if this is your last child and you don't have other funds to fill in a gap, then maybe you want to get to all cash and zero stocks by 12th grade so that you're not taking any risk."

I think that's exactly right. You have to look at those things and decide how they would affect you. I mean, we're in a bear market. Ask yourself what you would have thought if this all hit in July of the year your kid graduated from high school. How much would you want in stocks in that situation? That's what you need to be asking yourself now that 30% of your stocks have disappeared. If you have a way to overcome that through cash flow or through other resources or whatever, then you can obviously be a lot more aggressive.

I've always been a big fan of being aggressive with 529s and college savings in general because I look at all the other ways that college can be paid for. You can choose a cheaper school, you can use scholarships, you can use your cash flow, the child can work, you can use cash that you have for something else and then roll this money toward your next child in three or four years after the bear market.

I just think there's so much flexibility there that you don't have with retirement that I almost like being more aggressive with 529 money than retirement money. But I agree it's a totally individual thing and the main thing is asking yourself "What would the consequences be?" And if the consequences would be huge because you're now retired and you're planning for your kid to go to a school that costs $100,000 a year and you're planning on paying for the vast majority of out of this 529, you really don't have much capacity to take risks there.

The other part of this question was about retirement bond allocation and glide paths. When do you reduce your allocation? If you reduce your allocation, how does that relate to what the target retirement funds are doing?

> *"Well, I think this comes back to some of the questions about risk tolerance that we discussed, which is that you need to ask yourself those three questions, which is "How much risk*

can I afford?" If you're 100% stocks and your deep into retirement, then that's the worst possible situation. So, figuring out how much risk you can actually afford and then "How much risk do you need to take?" How much help do you need from the stock market to get to where you're going? And then the last part is the emotional part. But I think when it comes to retirement, those first two questions are almost much more important, especially as you come into those final years in that glide path to really be doing the math. And the good part is that one of the truisms about financial planning is that with each year that you get older, you by definition get closer to your goals. And so, the planning becomes easier.

So, say someone is 55 and they plan to retire at 65. You can pretty well have a good idea at that point of what your spending needs are and what your assets are, at least at that point. And you can start to work out how much you will need to get you through a period of a stock market downturn. And that's the way I think about it is "How much risk can you afford?" is the first question. If you need $100,000 a year for example, for spending, then if a typical bear market is two or three or maybe five years, then you might want to have $500,000 outside of stocks. And so that's at a bare minimum. And then on top of that you would think about your kind of emotional tolerance. But I think that the math there is pretty easy. And so, you just want to look at a chart of stock market history and see, "Well, how long had those downturns been?" And what you want to avoid is put yourself in the fall of 2007 or in the spring of 2000 or frankly in the winter of 2020 here. And think about if this were the day you retired and the market did what it just did, how would that impact you and how can you prepare yourself with asset allocation to avoid that worst-case outcome?"

Bond Tent

There is a term that has become popularized over the last year or two, a bond tent, to help mitigate sequence of returns risk. I asked Adam what he thought about this.

> *"I think that it's an interesting concept, but I think the best way to say it is that they tried to get a little too precise with things. And the reality is that you want to have a plan that you could recite standing on one foot. If your spouse said to you, "What's our plan?" you could just recite it. And that it doesn't require a degree in financial planning to work out. And I think a bond tent is interesting if you have a real financial proclivity, if you view managing your money as more of a hobby and something you enjoy, then it's an interesting theory. But I think for the vast majority of people, it's maybe a little too complex. And especially if you're talking about a multiple decade plan, a lot can change. And you also have longevity risk and I know generally in a couple, there'll be one spouse who enjoys this stuff and one spouse who couldn't be bothered. If the spouse who design the plan goes first, then the other one is left to manage a bond tent, I'm not sure I'd want to put someone in that position, but it's an interesting concept."*

I like that perspective on it. For those who have no idea, a bond tent is this idea of reducing your risk for perhaps the first five years before you retire and five years after retirement. So, you increase the percentage of bonds in your portfolio significantly for that 10-year period to reduce sequence of returns risk. Essentially the possibility of having really crummy returns early in your retirement, even though your average returns in retirement are okay. And then in actually increasing your risk as you move throughout your retirement to try to compensate for longevity risk, the risk of out living your money. It's become somewhat popular over the last couple of years to talk about this. It's interesting, everyone’s still trying to figure out what to do about it, but there’s no doubt that Adam is right, that this definitely makes things more complicated at a time in which maybe your mental faculties are starting to decline, which could be an issue.

Ending

It was great having Adam on and getting a second opinion on several of these questions. For those who are interested in getting to know more about Adam, maybe even hiring him if you need help putting together a financial plan or managing your investments, you can reach him at adam.grossman@mayport.com. If you have questions you would like answered on the podcast, you can record those at our speakpipe.

Full Transcription

Intro:
This is the White Coat Investor podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high-income professionals stop doing dumb things with their money since 2011. Here’s your host, Dr. Jim Dahle.
Dr. Jim Dahle:

This is White Coat Investor podcast number 153 – "Is tax loss harvesting all that is cracked up to be?" This episode is sponsored by Bob Bhayani at drdisabilityquotes.com. Bob is a truly independent provider of disability insurance planning solutions to the medical community nationwide and a longtime WCI sponsor. He specializes in working with residents and fellows early in their careers to set up sound financial and insurance strategies. He has been extraordinarily responsive to me anytime any reader has any sort of an issue, so it was no surprise to get this feedback about him recently from a reader. Bob was generous enough to come speak to us in our residency last week. Bob was knowledgeable, straightforward, and answered all of our questions. I wouldn't hesitate to recommend him to anyone and his place on your recommended page is well deserved. If you need to review your disability insurance coverage to make sure it meets your needs or if you just haven't gotten around to getting this critical insurance in place, contact Bob Bhayani at drdisabilityquotes.com, today. By email, at info@drdisabilityquotes.com, or by calling (973) 771-9100.

Dr. Jim Dahle:

All right, let's do a quote of the day. This one comes from one of my favorite docs, William Bernstein. "You are engaged in a life and death struggle with the financial services industry. If you act on the assumption that every broker, insurance salesman and financial advisor you encounter is a hardened criminal, you will do just fine".

Dr. Jim Dahle:
Well, we are all welcome to week four or five of this battle here against the coronavirus. Our families had been on lockdown. We have been using maximum personal protective equipment at work now for several weeks. Although I'm recording this on March 17th and it's all pretty brand new and I'm recording it, by the time you listen to this, I'm sure we're going to be knee deep in it. So, let me just tell you. Thank you. What you do matters. What you're doing is saving lives. In fact, everything we're doing these days is saving their lives. Every time we wash our hands, we might be saving somebody's life. So, I appreciate what you're doing and I know a lot of other people do too.

Dr. Jim Dahle:
If you are going stir crazy sitting in your house while doing this social distancing, you might want to check out our latest product, the continuing financial education 2020 online course. We subtitle this, the latest and physician wellness and financial literacy. It is a CME eligible course with over 30 hours of material that will teach you how to be well, how to not burn out, how to combat burnout, how to negotiate, how to invest, how to lower your taxes, all the kinds of things that white coat investors need to know to maximize their careers and their financial lives. A lot of this material was recorded at the recent conference, but there's some in there that was not even presented at the conference.
Dr. Jim Dahle:
There are over 30 hours of material in this course and it is eligible for CME. That means you can buy it with your CME funds. That means you can write it off if you're self-employed. Okay, so this is essentially the pretax dollars you're able to buy this with. The course goes for $649 but from now through April 20th we have it on special sale. This is a special promotional discount price of just $549. So, it's a $100 off from now through April 20th at Midnight Mountain Time. So, I'll be sure to check that out. There'll be links in

the show notes. You can also find it. It’ll be prominently displayed on the whitecoatinvestor.com website.

Dr. Jim Dahle:
So today we’re going to go through a bunch of your questions. If you would like to leave a question for us here at the White Coat Investor, you can do so at whitecoatinvestor.com/speakpipe and if you do that, you’ll find that you can record for up to a minute and a half. Don’t feel like you’ve got to fill the whole minute and a half, but up to a minute and a half a question and we will play it on air and answer your question. So, feel free to do that. Let’s take our first one. This is from an anonymous listener.

Speaker 1:
Hi, Dr. Dahle. Thanks for all that you do for being a champion for physician financial literacy. I’m a third-year family medicine resident trying to optimize my portfolio before graduation. I’ve been listening to a popular financial guru and he constantly recommends growth stock mutual funds with a history of success. This doesn’t make a ton of sense to me as Jack Bogle recommends index funds that are low cost as the best way based on his research to grow your portfolio. In addition, past success does not equate to future success and growth stocks have seemed to continually lag value stocks over their lifetime. So, is this growth stock mutual fund focused investing a strategy that we should maybe look more into or is this gentleman just likely not giving the best financial advice?

Dr. Jim Dahle:
Okay. We all know who we’re talking about here. We’re talking about Dave Ramsey, right? He tells you to invest in good growth stock mutual funds for the long run. Well, why growth stocks? Why does he always say that? Well, I don’t know if it’s this idea that he thinks growth stocks grow more than anything else. While that actually has been true the last few years, growth has outperformed value and it probably was

pretty true while Dave Ramsey was kind of coming of age in the financial services industry in the 90s when gross stocks also did very well. In the long run, the data is pretty clear that value stocks outperform growth stocks. And nobody really knows if that is a risk story because value stocks are riskier or if it's simply a behavioral story in that people ignore value stocks. You would just much rather invest in the leaders in the Apples and the Googles and the Walmarts instead of the Kmarts and the Sears.

Dr. Jim Dahle:
But the fact is that you're able to buy dollar of earnings much cheaper using a value stock than you are a growth stock. And so, in general, people are going to tilt their portfolio one way or another toward growth stocks or toward value stocks. They typically do it toward value stocks, not growth stocks. So, I have to disagree with Dave Ramsey's advice there. In fact, there's a lot of Dave Ramsey advice I agree with. I have a blog post on the website that's about 22 things that Dave Ramsey gets wrong and right because he does get a lot of things right. But particularly with investing, there's some things he does that I think you should find concerning. Not the least of which is referring you to commission salesmen masquerading as advisors. I really don't like that method of paying for financial advice and I'm not a big fan of actively managed mutual funds and certainly not this idea that you should preferentially invest in growth stock mutual funds.

Dr. Jim Dahle:
The Dave Ramsey portfolio. He talks about growth and aggressive growth and he talks about international. So, it was basically an all equity portfolio, heavily tilted toward growth and I think you're far better off with a typical index fund-based portfolio, lower costs, less manager risk. You get a more balanced portfolio between value and growth. If you want to tell your portfolio one way or another, realize that this is a decades long decision. This is something you commit

to for your whole life because it might take multiple decades for any sort of value stock premium to show up.

Dr. Jim Dahle:

All right, let's take our next question. This one comes from Dean from the Upper Midwest. Let's take a listen.

Dean:

Hello, Dr. Dahle. My name is Dean from the Upper Midwest. My question is regarding the consequences of tax loss harvesting. I understand the immediate benefits for the tax year of taking a capital loss. However, by taking a capital loss now aren't we as a result in a way lowering our cost basis for the future and thereby setting ourselves up for more capital gains down the road? So, I guess this is the rationale that long-term capital gains might be realized perhaps at a lower percentage with lower income in retirement or is it that a capital gains might be wiped out when inherited by my eventual beneficiaries upon my death? I just want to understand if tax loss harvesting is really all that is cracked up to be or am I thinking about this in a wrong way? And by the way, I get the sense that you are generally humble in praise that has given to you. But honestly, I think that you have been a catalyst in revolutionizing how doctors and other high-income earners handle their money and think about their money really in a positive way. Breaking preconceived notions of what doctors are supposed to do with their money. And for that really a big thank you and I think I can speak on behalf of many of us.

Dr. Jim Dahle:

All right, let's talk about tax loss harvesting. This is a really important subject. I actually named the podcast after this one. If you've been hemorrhaging money in the markets, like most of us, you may want to do some tax loss harvesting. This is a great way in which you can get uncle Sam to share the pain of your losses. Now remember, it does not work in retirement accounts. You can't do this in your 401(k) or your 403(b) or your cash balance plan or your Roth IRA. This is only in a taxable or a nonqualified or brokerage account. So, make sure if you're going to do it, that you're only doing it in that account. And what you most need to be careful of when tax loss harvesting is avoiding a wash sale. So that is when you sell something and then you buy it within 30 days, either before or after the date you sell it. If you do that, it's a wash sale and you cannot use that tax loss.

Dr. Jim Dahle:

So why is a tax loss useful? Well, you can take up to $3,000 per year in capital losses and offset your ordinary income with that loss. So, it actually lowers your tax bill. Any other losses are placed against your capital gains. So you can use them in any limit, not just $3,000 a year, but hundreds of thousands of dollars a year if you want, toward any capital gains taxes you owe, whether those are capital gains on a property that you sell or a small business you sell or mutual fund that you sell for gains now or later in life. So, there's a lot of benefit there in that you can use this to lower your taxes. And if you don't use all of the losses in one year, you get to carry them forward and you can carry them forward for years and years and years and years.

Dr. Jim Dahle:

Now, thanks to this recent bear market, I now have hundreds of thousands of dollars in tax losses. So obviously if I was only able to use $3,000 a year, I've got more than enough to last the rest of my life, but I fully expect to be able to use it to offset other things including being able to spend from that taxable account, totally tax-free in retirement for instance, or just simply being able to reposition a portfolio without having to worry about the capital gains taxes that are due.

Dr. Jim Dahle:

Now it is true that in a lot of ways you are just deferring tax, not that there isn't any value to that. There is value in paying tax in 20 years instead of paying it now. But if you tax loss harvest, you are lowering the basis on the investment and will owe more in taxes later when you sell it.

Dr. Jim Dahle:
However, there are a couple of ways in which that’s helpful. First of all, you get a delay of the taxes, which is not as good as avoiding them completely, but it’s better than nothing. It is not the same thing to have to pay taxes now versus paying taxes later. Second, if you give anything to charity, instead of giving cash, you could give appreciated shares and then flush those gains right out of your portfolio. This is what I do every year. I tax loss harvest the losses and when I have shares that have appreciated when I’ve held them for at least a year and I have a positive gain in them, I use those for my charitable contributions. And you can do that either through a donor advised fund or you can give it directly to the charity so long as they have a brokerage account and they can handle that sort of a contribution. If you do that, you get the full deduction for the entire contribution off your taxes when you itemize, right? It’s a charitable contribution but you don’t pay the capital gains taxes and neither does the charity. It’s really a great deal. So, you get the tax loss, you don’t pay the gains. So, that’s one way in which you don’t pay it at all and tax loss harvesting can be really, really valuable.
Dr. Jim Dahle:
The second way is if you die. When you die your heirs get a step up in basis at death. So, their basis is essentially whatever it was worth when you died. And so, if you have a really low basis because you did a bunch of tax loss harvesting, that’s okay because nobody ever pays those gains back. So, in those situations it really can be super beneficial to tax loss harvest. But even if you end up selling those shares later and paying those capital gains, just deferring it is helpful. And of course, you can take $3,000 of it each year against your ordinary income and that’s helpful as well.

Dr. Jim Dahle:
Our next question comes in by email. This one says, “We

recently converted a pension for my wife’s previous employer to a rollover IRA with fidelity. I was hoping to be able to convert this to a Roth IRA within the 2019 tax year, but it has taken longer than expected. My question is whether or not I can still claim this on 2019 taxes. I am a new grad with only half a year of income in 2019 so the tax difference will be significant compared to 2020. Any insight is appreciated”.

Dr. Jim Dahle:

I got bad news for you. Conversions are taxed in the year that you do them. So, if you do a conversion on January 2nd, 2020 you pay taxes on it for tax year 2020. They’re due by April 15th, 2021. If you do a conversion, a Roth conversion in December of 2019, December 28th of 2019 you pay taxes on that in 2019. It’s just the year of the conversion. You got to get that conversion done before the end of the year if you want to pay taxes on it and it sounds like you unfortunately, miss the date. Sometimes people get confused because you are allowed to contribute to an IRA until your tax due date of the following year, usually April 15th. And so, that confuses a lot of people, especially when we start combining these two steps like you do in the backdoor Roth IRA process.

Dr. Jim Dahle:

Remember the backdoor Roth IRA is a two-step process. Step one is the contribution and you can make that until April 15th of the next year and that is reported on the previous year’s taxes, right? If you make a 2019 contribution on April 1st of 2020 that’s reported on your 2019 taxes on form 8606, but if you converted it the next day to a Roth IRA on April 3rd of 2020 that conversion step is reported on your 2020, 8606. And so, that can kind of make your tax forms a little bit more complicated. It’s definitely far easier to just do both steps in January of that calendar year, and that’s what I recommend people do. But you can do it up until April 15th of the next year. Just realize it makes your paperwork just a little bit more complicated. But when you understand that it’s not really one process, it’s two processes, then it’s a little bit easier to remember which tax forms you have to report those on. I hope that's helpful.

Dr. Jim Dahle:
All right. Our next question comes from Kyle from Pittsburgh.

Kyle:
This is Kyle from Pittsburgh. I have a student loan/PSLF question. Is there any data on percentage of PSLF qualifying jobs after residency or fellowship? I've heard of several 501(c) three hospitals paying the physicians in a way where it would not qualify for PSLF. How common is this? With current loan interest rates the stomach acid and sleepless night risk premium is looking less and less appealing. I would appreciate your input. Thanks.

Dr. Jim Dahle:
Okay, this is a great question and I didn't really have the answer. My sense is that it's less than a lot of medical students think. If you ask medical students in their post-graduation survey of whether they're going for public service loan forgiveness, something like 45% to 50% of medical students will tell you they are going for public service loan forgiveness. Now in some specialties and some states, far less than 45% of the jobs are at a 501 (c) three or a government employer, a job that would actually qualify for public service loan forgiveness. For example, in emergency medicine in the Wasatch Front area here around Salt Lake City, the only job that qualifies is being employed at the University. Those guys are employees of the University and their job would qualify. But if you work at the VA, you don't qualify because that job, they contract with the VA to provide services.

Dr. Jim Dahle:
Same thing with the big Inner Mountain health system here in the Valley. The emergency docs that work there are a separate private for-profit group that contracts with the hospital. So that job doesn't qualify for public service loan forgiveness. Remember, you must be directly employed by the hospital for the job to qualify and the hospital has to be a nonprofit. It

has to be a 501(c)(3). So, I didn't really know the answer. So in between the time I got this question and the time that I answered on the podcast, I actually put a Twitter survey out there. So, let's take a look at what this Twitter survey shows.

Dr. Jim Dahle:

Okay, so here it is. This is a question I put out on Twitter. I gave them four options. If you're a doc, are you directly employed full time by a 501(c)(3)? IEE would your job have held by a new indebted grad qualify for public service loan forgiveness? And I got 250 votes. 45% of them said yes, 22% said no. The rest said they just pretty much wanted to see the answers. So according to that Twitter survey, it's only 250 people. It looks like almost 2/3 of the jobs qualify for public service loan forgiveness. That seems a little high to me, but certainly, it's a significant percentage. If you really want a job in most specialties, you can find a job. It might be working for the VA or even the military, but more likely it's going to be being directly employed by a nonprofit hospital. And there are so many jobs that are employee jobs in every specialty these days. If you really need a job that's public service loan forgiveness, it probably shouldn't be that hard for you to find it.

Dr. Jim Dahle:

All right, let's take the next question from Charles.

Charles:

Hey, Dr. Dahle. I love listening to all the good information you have for us. I had a question about backdoor Roth IRAs and the pro rata rule. I know we're told you want to avoid the pro rata rule and everything needs to be zeroed out, but I'm wondering if that's possible or what would happen if you were to contribute to an IRA, an existing IRA that had say $50,000 and you put your $6,000 in, but you didn't take your tax deduction and then only converted over $6,000 from that into a Roth. I mean, is that even allowed or do you get taxed on everything as if you transferred everything over? Just wondering what happens if you break the pro rata rule. Thanks.

Dr. Jim Dahle:
Okay, so what happens? How does the pro rata rule really work? If you have this $50,000 IRA and you put $6,000 into it and you convert $6,000 of that IRA to a Roth, it's going to be prorated. That's what the pro rata rule means. So, you'd divide the $56,000 total. You divide $6,000 by $56,000 and that gives you the percentage of your conversion that is going to be tax freeze. That's going to be a very small percentage. It'd be like 10%. So, in reality, only like $600 is going to be a tax-free conversion. The other $5,400 is going to be taxable income to you in that year. And that's why you do not, when you were trying to do a backdoor Roth IRA, you do not put your $6,000 contribution into some existing IRA. It's like putting cream in your coffee. Once you put it in there, you can't get it back out. So, take care of that IRA first, roll it into a 401(k) or just plan on converting the whole thing to a Roth IRA and then put another $6,000 into that or another traditional IRA and then move that to a Roth IRA so you can get the tax free Roth conversion that is part of the backdoor Roth IRA process.
Dr. Jim Dahle:
All right. Our next question comes from Bill.

Bill:
Hi there. This isn't really much of a question, just a general comment and observation and hopefully a helpful reminder for other people as well. Just how in these uncertain times there are different risks with various asset classes. I know people often say that bonds are for stability, but just notice that VTEB, Vanguards municipal bond ETF is down over 6% just in one day alone. So hopefully a helpful reminder for other investors as well to just stay the course rather than trying to time the market and if you need funds to stick it into a high yield savings account or money market. Thanks for all that you do.

Dr. Jim Dahle:

Okay. That wasn't really a question. That was an observation. Yes, the Vanguard tax exempt bond fund recently dropped 6% in a day. It turns out that bonds have risks and that day that bond dropped dramatically. To be fair was a day the stock market went up 10%. We've had some very volatile days in this bear market lately and you know what? Stocks and bonds both go up and down and they don't always go in opposite directions. They are uncorrelated assets, not negatively correlated assets. If you look at their correlation, it's about zero. So yes, bonds often do well when stocks do poorly, but there is no guarantee. It is entirely possible for bonds and stocks and gold and real estate to all fall in the same day or the same month or the same year. So, keep that in mind. There are no guarantees and bonds have risks. If you want the very, very safest bonds that don't have much volatility, stick with very short-term bonds and very safe bonds like treasuries.

Dr. Jim Dahle:
All right, I have a special guest on for the next few minutes on the podcast. I have Adam Grossman. Adam Grossman is a Boston based fee only financial advisor at Mayport Wealth Management. And if you're interested in more information on that, you can find it at the simple URL – mayport.com.
Dr. Jim Dahle:
Adam is a chartered financial analyst, also has an MBA from the MIT Sloan school and founded Mayport on the belief that quality investment advice can be delivered for a reasonable flat fee rather than 1% of assets most firms charge. His mission is to create for you a financial plan that will meet both your short-term and long-term goals so that you can focus on your career and your family with the comfort of knowing that you have a solid plan in place. His investment approach emphasizes simplicity, low cost and tax sensitivity. So, it's great to have him on the podcast in the middle of a bear market in the middle of a pandemic and we're going to talk a little bit about him very briefly and then we're going to answer some listener questions together.

Dr. Jim Dahle:
So, first question for you, Adam. First of all, welcome to the White Coat Investor podcast.

Adam Grossman:
Thank you Dr. Dahle. Pleasure to be with you.

Dr. Jim Dahle:
Tell the listeners why you decided to become a financial advisor. Was it because of times like this in a bear market when you really want to help people out or what was it that motivated you?

Adam Grossman:
It was a series of experiences through the course of my childhood and then into adulthood that all seemed to be leading me in the same direction. There are many experiences, but I'll tell just a couple of stories. When I was in my early twenties and started working, my dad hooked me up with his financial advisor. He was a traditional broker, one of the big firms. And what I found was that he would call me with different ideas, buy this stock or buy that stock. But he never asked me any questions. What are you trying to accomplish? Are you single? Are you married? Do you have children? What are you saving for? Do you want to buy a house? In fact, the only thing I can ever remember him recommending to me was that, "Gee, if you want to buy a new car, don't take the loan from the auto dealership. Instead, what you should do is borrow a margin against your account".
Adam Grossman:
So, what I learned in hindsight was that my account was full of tech stocks and this was in the late 90s and I had borrowed on margin. And so that did not end well after the tech boom ended in early 2000. So that was the first experience. It made me think, "Gee, there must be a better way here". Later on, after I had achieved some financial success, I went looking for a financial advisor for myself. And yeah, I remember coming upon one guy who he seemed smart and capable, but he

said, “My minimum was $5 million and the fee is 1.5%”. So, you can do the math. And I thought, “Well, geez, that’s quite a lot”. You could hire, it’s a full-time employee practically for those fees. And so, I started putting those experiences together and thought, “Well maybe there’s an opportunity here to get into this field and to try and help people and deliver the services that I myself have been looking for”.

Dr. Jim Dahle:
So, what is your fee structure and why did you choose that fee structure?

Adam Grossman:
The AUM fee has always been the standard, the kind of 1%. And in working for a few other firms where there were smart and good people and well-intentioned, I felt like everything was good about the service except the fee structure. And if you have, say, $5 million after a lifetime of savings, even if the fee is a little less than 1% if you’re paying $30,000 or $40,000 that really eats into your savings. If the bond market return is 5% and the stock market, on average returns 10% but you’re giving 1% away to your advisor, I just felt like that didn’t make a lot of sense. And so, I went with a flat fee structure and also, we’ll work on an hourly basis and it’s really entirely up to the client. But I feel like both of those at least give the client the opportunity to keep more and to have a fair balance.

Dr. Jim Dahle:
So, what percentage of your clients do you think choose a flat fee versus an hourly rate?

Adam Grossman:
Three quarters of them seem to choose the flat fee and about a quarter like the hourly. The way that people have described it to me is when they choose the flat fee they say, “So, this is great. I can call you every morning and there’s no additional cost”. And people who prefer the hourly say that, “This is

great. When you’re not doing any work, you’re not billing me and I only pay for the time that I use”. So, it’s really just up to the individual.

Dr. Jim Dahle:
So other than the fee structure, although I suppose that’s becoming more and more common these days, it’s still very unusual if you look at all people calling themselves financial advisors. What’s unique about your firm besides that?

Adam Grossman:
Well, I don’t know that I’m the most unique person. I think there are lots of people who are qualified out there. But maybe one difference is that because I had an earlier career, I was in technology for the first several years after college and had some financial success with that business. So, I’ve been on the other side of the table. And so as a result, I’m familiar with some of the things that high-income professionals like my clients deal with – How to set up a charitable gift fund, the pros and cons of establishing an irrevocable trust, how to handle gift to the family members and maybe more importantly how to handle loan requests from family members or friends. And so, because I had been on the other side of the table, because I’ve been a Guinea pig and trying many of these things for myself and my own family, maybe that makes me a little bit different from other advisors.

Dr. Jim Dahle:
All right, let’s get into some of the listener questions. We’ve got Kevin from North Carolina on the Speak Pipe. He’s got a question about charitable contributions. Let’s take a listen to that.
Kevin:
Hi, Dr. Dahle. My name is Kevin. I’m an anesthesiologist in private practice in North Carolina. I’m about 10 years out of fellowship. I’ve learned so many great things from your podcast, your blog, your books, and I’ve shared many of them

with my fellow physicians. I’m interested in knowing tonight, however specifically whether there is such thing as good or bad timing when making charitable contributions via mutual funds held in my Vanguard brokerage account. Based upon the information you’ve shared and with the blessing of my accountant, I’ve started making our annual contributions to charity via mutual fund shares that have already reached long-term capital gains. With the recent turn in the market striking at the month of the year that I always tend to make these contributions, I’m curious if there’s such thing as better or worse timing when it comes to the ups and downs of the market in this situation. As always, I look forward to your responses whether to my questions or to others. Thanks for making my ride to work in the morning so profitable.

Dr. Jim Dahle:
All right, Adam, do you want to take a stab at this one?

Adam Grossman:
Sure. I would say, first of all, this is a great idea because when you’re giving directly out of a brokerage account, when you give appreciated securities, you’re sidestepping capital gains taxes. And second of all, Kevin mentioned waiting for the gains to become long-term. And that’s very important. So those are two things that are terrific right up front. Now the other thing is that here as we speak, we’re in the middle of a bear market. And so, ideally, when you’re giving out of a brokerage account, you want to give assets that are most highly appreciated and not things that are beaten down.
Adam Grossman:
And so, at this time, while it’s possible there could still be appreciated securities and Kevin’s count, what I would recommend is to wait until the market hopefully and inevitably I think will recover. And the nice thing about charitable giving is that there’s flexibility unlike perhaps spending in retirement. There is no particular timetable generally for making charitable gifts. So, what I would recommend is to

establish a charitable gift fund, donor advised fund. Wait until the market recovers and then make a larger contribution. Maybe a contribution which will satisfy several years of subsequent giving. And so, he can pick a high point, give some funds out of his brokerage account, and then those goes out from the donor advised fund in subsequent years.

Dr. Jim Dahle:
Yeah, it's an interesting question, right? And when we think about market time and whoever says, "Don't time the market, it doesn't work, you can't time it effectively, etc." There are a million ways to time it that we don't think about, aside from going, "I think the market's going down. I'm taking my money out" and "I think the market's going up, so I'm putting money in". When you take your required minimum distributions, when you make your Roth IRA contribution early in the year, late in the year, what day of the month you decide to put your 401(k) contributions in? When in a bear market you decided to do tax loss harvesting? When you time a Roth conversion? When you time a charitable contribution?
Dr. Jim Dahle:
All these things have market timing elements and the problem is none of us have a functioning crystal ball. We don't know if the market's going up or down from today, but I can tell you what, I just tax loss harvested my entire taxable account yesterday. We're recording this on March 17th. The market fell 10% yesterday, came up 5% today. Yesterday I tax loss harvested my entire account. So, I have nothing in that account aside from a muni bond fund that I've even held for a year. So, one consideration when making a transfer to a donor advised fund or a donation straight to a charity is you've got to have appreciated shares that you've had for a year, right? I mean, if you've only had it for a month, you don't essentially get to wipe those out by donating them to a charity.
Dr. Jim Dahle:
So, make sure even if you have gains that you've had them for

at least a year, they need to be long-term gains, I think is probably the most relevant rule associated with it. But as far as timing it, I guess when the market's doing well, give more money to charity and when it's doing poorly, give less. That's the only way to market time it. Or if you have the cash, give cash at market bottom rather than appreciated shares. But as far as timing it, it's just as hard to do it with that as it is with anything. Any other purchase or sale order gift I would say.

Dr. Jim Dahle:
Any other comments you have about charitable contributions?

Adam Grossman:
Well, I would add to what you just said. I think you make an important point, which is that market timing is regarded as sort of a dirty word. And I would agree that in terms of people trying to prognosticate, the traditional Wall Street approach of "We think this will happen" or "We think Brazilian stocks are good". All of that has generally been shown to be ineffective. But what you're saying is an important distinction, which is that you certainly can use timing to your advantage. If something has already happened you can observe that the market is high or the market is low, now is a good time to take a certain action. So, market timing is not universally a bad concept. It's just strictly when you're trying to do prognosticating that it's a bad idea.

Dr. Jim Dahle:
For sure. Okay, let's take the next one. This one's also related to the bear market, so I think it's very timely. Let's take a listen to this question about risk tolerance.

Speaker 2:
Hi, Jim. Thank you so much for all your advice. I love the podcast as well as the blog and you've helped me recover from being screwed by Northwestern Mutual. So, thank you. My question is regarding my risk tolerance. I find it that after the bear market that we've hit that I want to increase my

stock allocation. I’m 80/20 right now stocks to bonds and I want now to go 100% in stocks. I felt like I wanted to sell bonds and buy more stock and I didn’t feel like I wanted to sell off my stocks during this bear market. Is this really representative on my true risk tolerance now that I’ve gone through this bear market or do you think really, I should ride this out longer as bear markets might last longer and my true risk times are not profound until later? Just to the side of my risk capacity is very high as well. I am a neurologist and my wife is a full-time anesthesiologist. We make a 100k a year. We were also on track to meet our financial goals. Our need for risk it’s probably low. However, I assumed using a 5% real figure that we meet our goals. However, increasing to 100% stock allocation would likely also help us meet our goals. Please let me know your thoughts about my risk tolerance, especially given in the context of my high-risk capacity.

Dr. Jim Dahle:
Okay. I think this one’s a really deep question. I think there’s a lot to unpack here. Do you have any comments about this, about when you found your risk tolerance in a bear market?

Adam Grossman:
I think this is a great question and he’s really asking all of the right questions. What is my risk capacity? How much can I afford? How much risk do I need to take? And then the last question is “How much risk can I emotionally tolerate?” And the first two questions have a mathematical answer. You can work those out with the calculator, but it’s the last one that he’s really asking about. And it’s really only I think through hard experience that you learn what your risks tolerance is, your emotional tolerance. And what I would say is that the listener probably has half of his answer at this point. If the S&P is down 25% or 30% as we speak, but historically in modern times, at least the S&P has seen losses of about 50% I would

say that the listener is probably halfway there and if you're feeling okay so far, then I think that tells him something. But if it gets to be down 40% or 50% then I would say he would have a more complete answer.

Adam Grossman:
The other thing I would add is that asset allocation doesn't need to be uniform across all accounts. And sometimes that can make people feel like their hands are tied. But if you view it as being an asset allocation for your retirement account, for example, and an asset allocation of your taxable account and so forth, then that gives you more flexibility and maybe you feel like, "Okay, now I'm free to take a lot more risk in my retirement account. Maybe those firm wants to go to 100%". It's a lot but maybe he's comfortable with that if he knows that his taxable account is much less aggressive, and maybe he also has an emergency or a cash account in addition to that, which is less aggressive even than that. And so those would be my thoughts on that.

Dr. Jim Dahle:
Yeah, I think it's in response to something I've been saying for years where I tell people, "You don't really know what your risk tolerance is until you lose real money that you used to own, that you decided to put into investments rather than spending it on a vacation to Paris or a kitchen renovation or a Tesla or whatever and then you lose that money. You put it in the market and you lose it". And a lot of people read these investment books or they read blogs and they say, "Oh, I wouldn't have panicked. Boy, if the market dropped 30%, I'd sure be thankful and I'd put a bunch more money in". But I don't think you really know if that's true until you go through it. So, I've always told people to err on the conservative side of asset allocation until you go through your first bear market.

Dr. Jim Dahle:
So, I guess at this point, maybe he's halfway through the bear

market, maybe halfway through the drop, who knows? We don't really know how deep it goes, but perhaps more importantly, we don't know how long it's going to last. We don't know if this is going to be a quick drop in recovery like you saw at the end of 2018 and frankly in 2008 or we don't know if it's going to be a long, slow, multi-year grind like you saw in 2000 to 2002. We don't really know how this one is going to go. We do know how it ends. I mean, we've seen this movie before. We know how it ends. It ends with another bull market on the other side of this long before you need this money in retirement. But we don't really know exactly what it's going to do between now and then.

Dr. Jim Dahle:
So, I guess I'd still be a little bit on the cautious side and realize that you haven't been through the bear market yet. You've certainly been through his opening throws. But I think at this point it's a good time to learn to stick with your plan, which is the most important thing in a bear market rather than trying to take advantage of stocks on sale. I'd really caution a lot of people out there, I'm hearing starting to talk on the Facebook groups and forums about taking dry powder and putting it into the market. And I start wondering, "Well, where's this dry powder coming from?" I mean fine if it's your monthly earnings that you would be investing anyway. But what if it is your emergency fund? I don't think this is the time to be putting your emergency fund into stocks. It's for emergencies. This is one of those times when you may very well have use of that emergency cash.
Dr. Jim Dahle:
So, I think it's an interesting time we're living through and those who haven't been through a bear market before are going to learn a lot in the next few months about themselves and their risk tolerance and about the investing world now that they're paying a lot of attention to it.
Dr. Jim Dahle:
What are your thoughts so far of the first opening weeks of

this bear market? What are the impressions you've taken away from it?

Adam Grossman:
A thought that occurred to me is that just as every bull market looks a little bit different and every bubble, in particular, looks a little bit different and that's how it snookers people, right? Because they say to themselves, "Oh, this time it's different". I remember with the tech stock boom in the 90s that people would say, "Oh, well, earnings don't matter. It's only about eyeballs. They're just selling electrons". People can tell themselves stories that on the way up makes them feel like, "Oh, this time is different". And similarly, every time there's a downturn, it looks different. And the problem is that makes it similarly scary. So just as on the way up, there is a reason to get extra excited, on the way down because it's different each time, there are reasons to be fearful and more fearful maybe than we need to be because we haven't seen this exactly before.

Adam Grossman:
And so, in this case, we can remember 2008 but that was a purely financial crisis. That was a banking crisis. Here, this is a health scare and you're talking about a virus and it's really like a made for TV kind of thing and people don't know where that ends. And I don't think that Americans are used to being quarantined in their homes. And so, the level of fear is probably greater than it will need to have been with the benefit of hindsight six months or a year down the road. But I think your advice is exactly right, which is to take it incrementally. If you do have dry powder, true dry powder that you don't need for an emergency fund or anything else, put it in slowly. Don't rush to jump in with both feet.

Dr. Jim Dahle:
I think that's a good idea. Okay. Let's take another question off the Speak Pipe. This one's about glide paths. Let's take a listen.

Speaker 2:
Hi Jim, last question, I swear. I also had a question regarding a glide path regarding my son. He is five years old, but right now I have a 529 which is 100% stock. I don't know if you have a recommendation for a glide path of actually decreasing the stock allocation for him. Do you think maybe when he's in high school, maybe going 50% stock – 50% bonds and then going more bonds until he graduates? Or maybe I hate to say it, but timing of the market where you have there is a bear market or something actually increasing the stock allocation at that time or rebalancing to more stocks. I know what your feelings are and sort of related to is my own retirement for me and my wife. Do you think that it was reasonable before retirement, maybe 10 years to actually increase the bond allocation from stocks or maybe it's five years? I actually was planning for me and my wife just to follow the Vanguard targeted retirement fund actually so the 2045 is when you're planning to retire. So, I don't know if it's that that's just too simple or that that's a very reasonable. Your thoughts would be great. Thanks.

Dr. Jim Dahle:
All right, lots of questions in there. We started out talking about 529 glide paths, we ended talking about retirement fund glide paths. Why don't we start with the 529 issue? What do you think is an inappropriate glide path for a 529?

Adam Grossman:
The tricky thing about 529 is that as everyone knows, they're limited to educational uses. And so, the struggle that every family has is "How much should I put in?" Because while you might know how old your children are, so you know your timetable, you don't know where they will go to school, you don't know what the rate of inflation for tuition will be over that time period. And you don't know if they'll go to grad school or if maybe on the other hand, they'll get a scholarship. And so, it's very hard to know how much to be

saving for 529. And the questions that I think people should ask as you think about both, how much to save and a glide path to guide your risk tolerance is maybe three questions.
Adam Grossman:
So, one is “Do you have more than one child or do you plan to have more than one child?” The second is, “Are you planning to send your child to private school for K through 12?” Because you can now use 529 funds in part for K through 12. And then the third question is “Do you have sufficient resources outside of your 529 to make up a shortfall?” So, if your 529 lost money or if you came up short with your savings, do you have other ways to pay those bills? And I think those questions will help the listener to think about what the risk tolerance should be in their account, both overall and as they get closer to college. And if you answered “yes” to all of those questions then you would have more flexibility, right? If you have multiple children and maybe your account is down as one of the children is approaching college, you can use cashflow from your household to pay the bills and leave those funds for other children. But those are the questions to ask. If he answered “no” to all of those questions, then I think you would want to be much more cautious.
Adam Grossman:
All that said, I think that a good rule of thumb is as follows, which is that as you approach middle school, I would take your asset allocation way down, your risk level way down. So, if you wanted to be 80% or 90% or 100% in stocks from the day that you started saving, when your child was, say it, toddler and infant, that’s fine. But say when they get to sixth grade, I would take it down to 90% and then take it a step by step 10 percentage points down for each year so that the result would be between sixth grade and 12th grade, you could go from 90% stocks to 30% stocks. And so, at that point, you’d be entering college with a four-year time horizon with 30% stocks. And I think that’s a good all-purpose approach.
Adam Grossman:
Again, if you have one child or if this is your last child and

you don’t have other funds to fill in a gap, then maybe you want to get to all cash and zero stocks by 12th grade so that you’re not taking any risk. Those are some thoughts.
Dr. Jim Dahle:
Yeah, I think you nailed the factors. I think that’s exactly right. You got to look at those things and decide how they would affect you. I mean, we’re in a bear market. Ask yourself what you would have thought if this all hit in July of the year your kid graduated from high school. How much would you want in stocks in that situation? That’s what you need to be asking yourself now that 30% of your stocks have disappeared. If you have a way to overcome that through cash flow or through other resources or whatever, then you can obviously be a lot more aggressive.
Dr. Jim Dahle:
I’ve always been a big fan of being aggressive with 529s and college savings in general because I look at all the other ways that college can be paid for. You can choose a cheaper school, you can use scholarships, you can use your cash flow, the child can work, you can use cash that you have for something else and then roll this money toward your next child that maybe becomes in high school in three or four years after the bear market or it comes into college in three or four years.

Dr. Jim Dahle:
I just think there’s so much flexibility there that you don’t have with retirement that I almost like being more aggressive with 529 money than retirement money. But I agree it’s a totally individual thing and the main thing is asking yourself “What would the consequences be?” And if the consequences would be huge because you’re now retired and you’re planning for your kid to go to a school that costs $100,000 a year and you’re planning on paying for the vast majority of out of this 529, you really don’t have much capacity to take risks there.
Dr. Jim Dahle:
All right. The other part of this question was about

retirement bond allocation and retirement and glide paths. When do you reduce your allocation? If you reduce your allocation, how does that relate to what the target retirement funds are doing? What would you say about that question, Adam?

Adam Grossman:
Well, I think this comes back to some of the questions about risk tolerance that we discussed what the prior call, which is that you need to ask yourself those three questions, which is "How much risk can I afford?" If you're 100% stocks in your deep into retirement, then that's the worst possible situation. So, figuring out how much risk you can actually afford and then "How much risk do you need to take?" How much help do you need from the stock market to get to where you're going? And then the last part is the emotional part. But I think when it comes to retirement, those first two questions are almost much more important, especially as you come into those final years in that glide path to really be doing the math. And the good part is that one of the truisms about financial planning is that with each year that you get older, you by definition get closer to your goals. And so, the planning becomes easier.
Adam Grossman:
So, say someone is 55 and they plan to retire at 65. You can pretty well have a good idea at that point of what your spending needs are and what your assets are, at least at that point. And you can start to work out how much you will need to get you through a period of a stock market downturn. And that's the way I think about it is "How much risk can you afford?" is that first question. If you need $100,000 a year for example, for spending, then if a typical bear market is two or three or maybe five years, then you might want to have $500,000 outside of stocks. And so that's at a bare minimum. And then on top of that, you would think about your kind of emotional tolerance. But I think that the math there is pretty easy. And so, you just want to look at a chart of stock market history and see, "Well, how long had those downturns been?"

And what you want to avoid is put yourself in the fall of 2007 or in the spring of 2000 or frankly in the winter of 2020 here. And think about if this were the day you retired and the market did what it just did, how would that impact you and how can you prepare yourself with asset allocation to avoid that worst-case outcome?

Dr. Jim Dahle:
There's a term that's become popularized over the last year or two, a bond tent to help mitigate the sequence of returns risk. Are you familiar with this term and what do you think about it?

Adam Grossman:
I think that it's an interesting concept, but I think the best way to say it is that they tried to get a little too precise with things. And the reality is that you want to have a plan that you could recite standing on one foot. If your spouse said to you, "What's our plan?" you could just recite it. And that it doesn't require a degree in financial planning to work out. And I think a bond tent is interesting if you have in a real financial proclivity, if you view managing your money is as more of a hobby and something you enjoy, then it's an interesting theory. But I think for the vast majority of people, it's maybe a little too complex. And especially if you're talking about a multiple decade plan, a lot can change. And you also have longevity risk and I know generally in a couple, there'll be one spouse who enjoys this stuff and one spouse who couldn't be bothered. If the spouse who design the plan goes first, then the other one is left to manage a bond tent, I'm not sure I'd want to put someone in that position, but it's an interesting concept.

Dr. Jim Dahle:
Yeah, I like that perspective on it. For those who have no idea what we're bantering about here, a bond tent is this idea of reducing your risk for perhaps the first five years before you retire and five years after retirement. So, you increase

the number of bonds, the percentage of bonds in your portfolio significantly for that 10-year period to reduce sequence of returns risk. Essentially the possibility of having really crummy returns early in your retirement, even though your average returns in retirement are okay. And then in actually increasing your risk as you move throughout your retirement to try to compensate for longevity risk, the risk about living your money. It's become somewhat popular over the last couple of years to talk about this. It's interesting, everyone's still trying to figure out what to do about it, but there's no doubt that Adam is right, that this definitely makes things more complicated at a time in which maybe your mental faculties are starting to decline, which could be an issue.

Dr. Jim Dahle:
Adam, thanks for coming on the podcast today. For those who are interested in getting to know more about Adam, maybe even hiring him if you need help putting together a financial plan or managing your investments, you can reach him at adam.grossman@mayport.com. There's a form at mayport.com. You can put an email in there. You're going to hit him up on Twitter @AdamMGrossman and I'll bet you could probably even reach out to him in any other way that you like, whether it's calls or whatever and he'd be glad to answer your questions and schedule the time to talk about them. There's a big green button on his website in the upper right that you can schedule a call there. Adam, thanks for coming on the White Coat Investor podcast today and thanks for supporting our mission here.

Adam Grossman:
Thank you. It was a pleasure.

Dr. Jim Dahle:
That was great to have Adam on for a few minutes during the podcast. It's always good to get a couple of different opinions, right? It's just like sending your patients for a second opinion on some of these questions. So, it's fun to

listen to what somebody who actually does this for a living would say sometimes.

Dr. Jim Dahle:

I want to share a comment I got by email from Anne who said, “I was listening to your podcast this morning. I just want to thank you so much. From listening to years of your podcast and reading your articles, the recent downturn hasn’t affected me at all. It was actually a sense of relief as I knew it was coming. It was just a matter of time. You truly have changed my life and the life of my children. You are so appreciated. Thank you to Cindy too for helping make it all happen”. Well, Cindy, she says, “You’re welcome”. She certainly does hard on this podcast, so she deserves your thanks.

Dr. Jim Dahle:

Let’s take our next question off the Speak Pipe. Well, I think this will probably be our last question today. Let’s take a listen.

Speaker 3:

Hi Jim. It’s me again. I had another question. Again, thank you for helping me out financially and I’m also trying to teach my kids your wisdom. Hey Jackson, what should you invest in when you start working?

Jackson:

Fidelity.

Speaker 3:

Yeah. Good. So, thank you so much. I also had a question regarding tax loss harvesting. The tax loss harvesting I did with Fidelity, I found that ETFs as I was going from a mutual fund that I actually had to sell the mutual fund at 04:00 o’clock that’s when it goes through, but then for the ETF, I had to wait until the market opens at 9:00 AM. By the time I put it through, the work had actually gone up 2%. So, is this a problem in other brokerage firms other than Fidelity? And also, did I do something wrong waiting for the market to open and now losing 2% of the market going up because I had to go from mutual funds to ETFs? Any thoughts on that would be helpful. Thank you.

Dr. Jim Dahle:
Okay, here is a tax loss harvesting question. I guess this is the subject of the podcast, so we'll wrap up with this one as well. How do you tax loss harvest when you're using funds? How do you do it when you're using ETFs? Let me just talk about the nitty gritty details here. All right, if you are all in mutual funds in your taxable account, this is really easy, right? You make sure you look at the cost basis page and make sure you're actually in the red on what you're going to sell. You find something that is similar, i.e. highly correlated, but not substantially identical, right? You don't want to be trading the Vanguard total stock market fund for the Vanguard total stock market ETF, which is just another share class of that same fund. Those are identical, all right? You can't tax loss harvest those, but you could switch from the total stock market fund to the 500-index fund, for instance.

Dr. Jim Dahle:
So, the way you would do that is you would put in an order into vanguard.com to exchange 100% of your total stock market index fund for a 500-index fund. And that would take place at the price at 04:00 o'clock, right? The end of the day, the end of the trading day, 04:00 o'clock East Coast time, that's when the exchange takes place. Whatever your total stock market is worth at 04:00 o'clock that is how much 500-index you exchange it for. And so that's my favorite way to do it. That's one reason I like mutual funds is there's no having to worry about a volatile market going up and down in between the time you buy and you sell. It all takes place at the exact same time and it's all marked to market that day. So, with funds, I think it's very, very easy.
Dr. Jim Dahle:
The downside is if it takes a big dip during the day and then recovers at the end, you might've put that order in and then actually harvested a gain even or not gotten as much of a loss

as you wanted. And so that can be problematic just because you can't do it as you go along.
Dr. Jim Dahle:
With an exchange traded fund that is exchanged during the day, you can control for that. You know about where the market is when you put the order in, but in a really volatile market, that can be tricky, right? What if you sell at one price and then you end up buying at a higher price? You essentially just sold low and bought high when you thought you were just exchanging investments. You thought you were tax loss harvesting, you ended up losing money. So, you've got to be really careful when doing that. In fact, it's probably great to avoid doing it in a really volatile market like we've been having lately, but unfortunately, every time you start losing money, it tends to be really volatile, so it makes it difficult.

Dr. Jim Dahle:
It becomes particularly tricky when you're going from funds to ETFs or ETFs to funds. For example, I had to do this yesterday. I had my taxable account primarily in mutual funds and I had gone for already from the Vanguard total stock market index to the Vanguard large cap index to the Vanguard 500-index fund and now the market had dropped out underneath this again. I think it was down 10% or something yesterday. So, I really needed to go to an ETF because this is all happened in less than 30 days, so I can't go back to the first fund but I wanted to capture that loss. And so, I decided I was going to go to the iShares total stock market ETF. And so, what did I have to do in order to do that? Well, I had to buy the ETF while the market was open and then put it in an order to sell the fund at market close.

Dr. Jim Dahle:
And so, I waited until it was nearly market close. There were just a few minutes left, maybe 15 minutes left, which is not my favorite time to be buying and selling ETFs because the

market can be particularly volatile at that time. So, I bought the new shares, no problem, let me put in that order. Of course, it gives me the warning that I've got to have the money in the account by the settlement date, but that settlement date is still three days away. And then I put it in an order to sell a 500-index fund at the end of the day. And I don't know where I came out either slightly ahead or slightly behind. I think I actually lost money. I think I came out slightly behind because I think the market dropped in those last 15 minutes, another 1% or so. So, unfortunately, I ended up buying high and selling low to a certain extent there in order to capture that loss. So, you have to be careful.

Dr. Jim Dahle:

Likewise, if you're going from an ETF to a fund, it's the same story, right? You have to sell the ETF and then wait until market close before the mutual fund is marked to market. So, you have to be a little bit careful doing that. It may not be worth it in a really volatile market because the loss of that 1% like I had on that particular exchange, maybe more than you're actually getting from the tax losses that you are harvesting. So, just got to be a little bit careful with that.

Dr. Jim Dahle:

All right. This podcast was sponsored by Bob Bhayani at drdisabilityquotes.com. He's a truly independent provider of disability insurance planning solutions and he's been a long-time White Coat Investor sponsor. He's been very, very responsive to me whenever readers have any sort of an issue. So, if you need someone to review your disability insurance coverage or if you just haven't gotten around to getting it, contact Bob at drdisabilityquotes.com. Email him at info@drdisabilityquotes.com or just pick up the phone and give them a call (973) 771-9100.

Dr. Jim Dahle:

Be sure to check out that new course we have up continuing financial education 2020. It is eligible for CME. It is on a promotional price right now, just $549 through April 20th at midnight. Be sure to check out that out. Keep your head up, your shoulders back. You’ve got this. We can help. Please stay safe in the pandemic and we’ll see you next week on the White Coat Investor podcast.

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