Bill Sweet - Ritholtz Wealth Management - Transcript

Tim Mullooly: Welcome back to Living With Money. This is Tim Mullooly. On today's episode, I am joined by Bill Sweet. Bill is a CFP and he's also the CFO of Ritholtz Wealth Management in New York city. Bill, thanks for coming on the podcast.

Bill Sweet: Hey, very, very excited to be here. We are big, big fans of the pod and the work that you and your firm do. I mean, Ben Johnson, Jeff Christine from Morningstar, Doug Boneparth, Wes and Ryan. This is a very, very good company here, and I'm happy to be here, Tim.

Tim Mullooly: I appreciate that, and obviously big fans of the Ritholtz crew. I've had a handful of people on from the firm before, so happy to have you-

Bill Sweet: Yeah, those are my people. Definitely.

Tim Mullooly: Yeah, exactly. Let's just start with a quick background about you. I always like to ask the guests dig back in the memory bank. Your relationship with money growing up, do you think that that formed, influenced your opinions on like how you view your own money today?

Bill Sweet: Oh yeah, definitely. I have, like a lot of Americans, well, I think 7%. My dad was in the army. So just like everyone else, I was born overseas now. I was born in Germany, bounced around across the United States. I think I got to see a lot of the country as a young child that we didn't live anywhere for more than two years. The longest I ever lived anywhere was four years in college until I got out of the military and moved out. That was the formative experience of my youth was being a part of the United States army and getting to see the world from Germany. Like the thing that I was talking about online just this week was 30 years ago, the Berlin Wall fell down and I got to see that in 1987 as a young man.

Yeah, and get to see it at checkpoint Charlie. I have that stamp on my passport. But dad was a saver to the point of just finances and money and wealth and all this sort of stuff that we find this industry we find ourselves in today and what we think about on behalf of our clients. I got to see a very middle class existence where dad was a very smart individual, but on a single salary, raised a family of four. All four of us today have successful careers, have started businesses, own houses. I think he did that through the value of education. He just kind of instilled in all four kids that you will go to college.

Three of us graduated, one of us didn't. That I think was a formative experience. My dad today is not a wealthy person, but I think that he's done better than just about anyone else given that, I think his starting salary in the army was like $12,000 a year granted in 1977, maybe that was a bit more, but yeah. But I think that was it for me, man.

Tim Mullooly: Yeah. Do you think that, so you said you got to observe like a middle class type lifestyle, obviously middle-class in like New York is different than middle-class in the Midwest. Even when you were growing up, obviously you were young, but did you notice like just the differences in being in different areas of the country? Like money meant different things in different places?

Bill Sweet: Yeah, so again, it's limited to army bases, and so where I lived, we lived in Kansas, we lived in Oklahoma, we lived in actually suburban California about an hour outside of San Jose at Fort Ord and the Monterey Bay area. That was probably like the ritziest place that I ever lived. But certainly, and so just relate to it, we live in a different world here today. I think it might be what you're getting at. I have a two and a half year old. He doesn't want for anything. I think it's just maybe the curse of some level of success that you spoil your kids. I remember going to the amusement park was like that that happened like twice my entire time until I maybe got to high school and moved to New York. We had to bring the bag lunch.

We had to bring the banana and the sandwich and the whole thing because a family of four, on one salary, I don't think my dad could afford all of that. But that's okay, because again, I think it instills in you the value of the dollar. For me anyway, it's about waste. I think you mentioned my role at the firm at Ritholtz, the thing that I get most upset about is when I see waste at the firm. That's the thing that drives me up a wall because I cannot ... the opportunity set that we have to serve our clients is a privilege and it's not a right. Just that the little thing of like throwing a paper clip away might be a little insane.

But that you're going to a recycling bin at least, but saving that dollar and just making it work in the Ben Franklin style that you save a penny, it's as good as earning it.

Tim Mullooly: It's always interesting hearing from people the lessons that they learned growing up and how it impacts how they are today, and a lot of times, it's like a direct correlation from my parents were like this and this is pretty much how I am today. It's always interesting hearing how that happens for people and how connected it is.

Bill Sweet: Especially like in relationships. I think you and I, we've worked with a lot of couples hopefully, and figuring out how to triangulate, stereotypically you'll have a saver and a spender, right? The yin and the yang. It's just sort of the law of attraction. Exactly. And you have to figure out as a financial advisor, how do you give them advice that's going to benefit that specific client if that is the case? I guess too, like I had a pretty wealthy guy in Tuxedo Park where he used to work. He told me that the sort of miserliness or whatever you want to call it, just sort of conservation of resources. He postulated, he said that the wealthiest people where he lived were the biggest tightwads. The ones who wrote the smallest checks and whatever else.

But he said that they wouldn't have got to where they were in life if they didn't think about the world that way, and especially if you're thinking about the world of compounding like we do and how money can grow over time, that's the most precious thing. It's really time in the markets, it's not sort of timing the markets, just to use a phrase. Time value of money is really the key, key concept that I'd like to instill with my folks.

Tim Mullooly: Yeah, absolutely. You mentioned Tuxedo Park. I was going to ask what your career was like before you joined Ritholtz Wealth Management. What were you up to before then?

Bill Sweet: Yeah. Coming into college, I decided that I wanted to be in the military, be in the army too. It was just something that was a part of my life. When I was sort of in college, band of brothers, all of that stuff was very much in the zeitgeists in the culture 50th anniversary of D day. Obviously since I grew up in it, I felt like that was something I wanted to do. That in conjunction with getting accepted to RPI, Rensselaer Polytechnic up in Troy, New York, my dad said, again, back to like financial resources. He's like, "Look, this is the amount of money I have saved for you." I think it was somewhere in neighborhood of $19,000 in a 529 plan. And he's like, "You can use that to go to four years of state school or you can go to a private school or whatever and figure it out."

That was it. That's what I had to work with. I got accepted at RPI. I think first year tuition was somewhere around $37,000, $38,000, I think it's in the high 60s today. He said, "Figure that out." Applied for an RTC scholarship, just due to, again, compound learning. I got pretty good grades, was pretty good kid. I ran track so I was physically fit, got accepted for scholarship and that Uncle Sam paid my way through college. In this sort of great debate or discussion or political thing that's going on in the body politic today about student loans and just how sort of toxic or problematic that can be. Great path exists. If you're willing to give four years of your life to Uncle Sam, they will pay your full freight and college. They'll give you a job when you're done, you get a degree, free healthcare and they will send you around the world.

That was the path that I chose banged out at computer and systems engineering degree and I was a US army officer for about six years on active duty beginning in 2002

Tim Mullooly: Now, I had talked to Wes Gray from Alpha Architect about his time in the military. He had a lot of great lessons and things to share from his time. I wanted to ask the same thing to you. I'm sure there are plenty of life lessons and things that you brought back. If you could pick like one or two things, what would you say are like the most important things that you either learned about yourself or learned about dealing with others, being a captain in the army for like you said, six years

Bill Sweet: Conceptually, and this dates back thousands of years. This is an American army innovation, but they take 22-year old kids, and that's what I was. Put a second Lieutenant butter bar on them and then they put them in charge of ... I was in charge as a 22 year old of $12 million of United States government equipment being four M1 Abrams tanks. And I had 15 soldiers reporting directly to me and my chain of command, and I was responsible for their life, their morale, welfare, education and personal hygiene, a whole ball of wax. Right?

Tim Mullooly: Yeah. Thinking back to when I was 22 years old, that seems completely overwhelming.

Bill Sweet: Thinking back for me, that's the thing. For me too, it's overwhelming. That responsibility is overwhelming. It is on inspiring. They don't set you up for failure, right? You have a platoon Sergeant that is your sort of direct ... that's a person that you lean on for experience. That's somebody who's been around the army for 14, 15 years. But they do that on purpose because they need to weed out the folks that cannot handle that. Because if you graduate, if you do well as a platoon leader, you get a second platoon leader, you move on to

XO, you move on a company command, you move on to battalion command, you move all the way up the ranks to general officer, God-willing over a 30 year career, you need to be able to handle people, you need to be ethical, moral, responsible, you need to be a good judge of character, you need to be a good decision maker.

I don't think there's any way to do that other than experience. Experience is the best teacher. That's number one. Again, no shade to anybody who has a different career, but that is a different ball game, to be in that position, to be boots on the ground in a forward deployed unit on the front lines of freedom. Literally, to have your soldier look to you and say, "Sir, what do I do? This happened, what do I do?" There's no substitute for that. The point that I make for the veteran's hiring initiative that I've been a part of for the last year or so is that you get a Masters degree in getting stuff done and there's really no better way to find leadership and learn those lessons than to hire somebody who's been in that position and booted up.

I'd say that's probably number one, but then secondary to that, I think I just learned how to effectively manage people, I think. I'm no expert, I'm no guru, but I think that I just ... a lot of mistakes that I see in organizations, and seeing a lot of it play out on the world stage right now, unfortunately, about leadership and about how important these jobs are and the pedestal that we put people on, they really need to be worthy of that. It starts with just simply listening to people. I think that that sort of skill, and it sounds so cliche and so just trope, but it's very real that if you can't sort of put yourself on the level of your soldier and understand what he's going through or she's going through or your client who might have lost a loved one and just wrap your head around that and just be present and be engaged in that moment, I think that is one of the key lessons of leadership that you get out of being an army officer, especially a young one.

Tim Mullooly: Yeah, I feel like there really isn't any other industry where you can get that type of experience. You had mentioned the hiring veterans initiative that you've been working for the last year or so and you were on CNBC. For the listeners out there who might not have tuned into that clip, can you briefly talk about what you've been working on in terms of trying to get more companies to hire veterans and the benefits of hiring veterans and why it's such a passionate thing for you?

Bill Sweet: I guess just from a perspective wise, my kind of path in the industry is kind of weird. I think it's really difficult, Tim, to sort of come out of the military, come into the army, come out of the Navy, come out of the Marine Corps and figure out how do I get a job? That seems probably sort of strange or try to whatever else.

Tim Mullooly: It's probably a completely different lifestyle.

Bill Sweet: Yeah. The army and the military, they don't just give you a job, they don't give you, "Hey." They give you your identity. You're literally wearing a uniform that says United States army on it and you have a rank on your shoulder that tells you how you fit into the organization. Where you are in the chain of command is very much something that you figure out how to navigate. Somebody coming out of the army or military is, in a lot of ways, they're naked, because they don't know. You don't know how to get started. I give a lot of credit to just three folks, obviously West Gray who I would say is a Titan in our circle of RIA folks.

Tim Mullooly: Absolutely.

Bill Sweet: I met with him in 2015. He gave me a lot of awesome advice on how to break into this fear. I think in another world I would have like worked for them for a year, probably for no pay, but hopefully, just worked my way up just because what a tremendous organization Alpha Architect is, Jack and Patrick and all those guys, Ryan, all the guys down there. Juan Palso and Chris Mendez who I met for the more in New York city, they're sort of driving this train to create this pipeline by which we can reach out to veterans who are ending their time in service or potentially retiring and find ways to sort of plug them into finance. Because if you think about a lot of the skills of military, I mentioned leadership before, attention to detail, discipline, integrity. These are all things that sort of come baked in from military service that I certainly think the vast majority of our industry would benefit from.

That's an initiative from CFA society. What I'm sort of mentioning a veterans on Wall Street, these are great organizations. They're supported by some big names, frankly. I think that there is a lot of this sort of feeling of "Hey, we want, we want to give back."

You see it a lot. You see in NFL games, you see it, people sort of thinking the soldier on the street for their service. But it's not tangible. What can you actually do to help somebody? Well, you can give them a job. There's really no sort of more powerful thing there. I think like the biggest hurdle there though is experience. A military veteran was going to come into your organization, Mullooly Asset Management, for example, with a lot of life experience, but they're not going to probably understand the financial markets. They're not going to be able to comment on tax rates.

Tim Mullooly: Yeah. I was going to ask, is there any way that you can prepare for that within the military or is that on the companies, once your duty is served and you're transitioning into everyday life again, is that when you get the financial knowledge or like for you, being a tax expert, was that something that you worked on in the military or is that something that you picked up afterwords?

Bill Sweet: No, a little bit. Just to answer the first question first, it's hard. What I sort of said to the CNBC audience and Acorns and CNBC are doing this really neat initiative, invest in you to connect to different demographic groups to sort of help them out. So Tyrone has been a part of that from what I understand, Doug Boneparth certainly, some folks that you've had on the show that are great folks in our industry, but it's just sort of help people think about that. There are functions in the army, in the military that do directly translate. Finance is one, like there are finance and accountants, believe it or not, that are in the army. Attorneys, certainly too. A lot of medical professionals. It doesn't exactly translate to our industry, but obviously there's a huge 20 something percent of the American economies in healthcare.

It's really a case of, if you're in the combat arms, like I was, identifying, okay, what can I do there? So you mentioned tax assistance. In the military, Tim, you don't volunteer for tasks, for duties, you get volunteered. What happened to me was I got assigned to be the tax assistance officer. So I was helping GIs from Idaho, from Illinois navigate some tax questions, and what did I do? You have the reference library, but 10, 15 years ago, you've Dr. Google and you just dial it up. I think I found out as somebody that sort of studied to use EMJ and legal aspects, that really like the world is at your fingertips online and nobody ever bothers to read the original text.

Just going to Illinois website and finding out what does that person who's stationed at Fort Knox, Kentucky have to file a tax return and just helping them answer that question. That led to me, when I was looking for something to do after the military, I filed tax returns for people through a small business in New York. That was how I got smart on finance.

Tim Mullooly: I know Josh has called you the resident tax expert at Ritholtz Wealth Management. You're also the CFO. What does that entail on a day-to-day basis? Are you helping clients with tax problems or is it more on a corporate level, like at the higher level for the firm?

Bill Sweet: Yes, so all of the above. We're a client focused firm. We have this image and we do, obviously Josh is tremendous. His level of communication, the way that he communicates with people is unique. I think it's extremely powerful. But we manage over $1 billion of client assets and the clients are really the lifeblood of our firm and that's our focus. I have 50, 55 households, the relationships, some of which have been with me for 10 years that I've brought into the firm. I think that will always be sort of the primary focus. Secondary to that, I help other advisors.

We have a lot of awesome, smart people, but specifically with any tax focused questions, should I execute a Roth IRA conversion? What do I do about QCD? What do I do about this limited partnership? Just whatever the case may be, I try to bring an additional ammunition or additional expertise and really the ability though to research and bring in other resources when there's a very specific tax question that can get nasty. I'm not a CPA. I didn't go that road, but I think that I sit at a pretty neat intersection of tax and investment management to sort of help with that.

Think tax loss harvesting, think about what to do with low basis shares, donor advised funds, all that sort of good stuff. That's a big part of it. But then, yeah, you mentioned since January, 2018, I've been responsible as well for the primary financial operation of the firm. We're still relatively young and still small. We have 30 or so folks. So, I perform a lot of the HR functions. I get a lot of the bookkeeping done, although that's relatively automated these days, which is nice that it just requires some checking, make sure that the firm taxes are filed and just move the financial operations of the firm at large. So really, those three focus areas and I really enjoy them all, frankly.

I think as the firm continues to grow, obviously that sort of internal financial management role is going to be the predominant factor. But I'm very privileged and I think I always want to keep my finger at the pulse of talking to clients because that's our primary business and it has to be because the minute that we lose focus of that, I think we lose focus of who we are.

Tim Mullooly: Yeah, absolutely. There was big changes in the tax code a year or so ago. You said you answer a lot of questions for advisors and also for clients in general. 2019 is coming to a close so people will be getting ready to file those taxes. Are there still questions that are up in the air? People still confused about things that happened in the tax code in 2018 that you're still finding problems with, with people in their taxes?

Bill Sweet: One of the biggest things is this sort of 20% QBI, the qualified small business deduction. I think it's going to be a couple of years before that actually ... Some of the sort of the questions around the edges get settled. Tim, the way that things sort of work is the IRS will ... they will examine somebody and they'll agree or disagree, and if they choose to disagree then that will end up in tax court. I think there are a lot of questions relating to that that are still a little bit unanswered. Just depending on who you talk to.

Tim Mullooly: Is it like with you were saying with the army, the only way to get the experience is to do it? Is it the same way with the tax code? It's like this is so new, but as the years go on you're going to ... all those questions will be ironed out as you get farther away from the changes in the code?

Bill Sweet: Yeah, I think so. But frankly, some of the questions aren't answerable. The Congress in my ...

Tim Mullooly: Is it too vague?

Bill Sweet: Yes, in my professional opinion, the bill was rushed. It was not sort of well thought out, some of the implications relating to QBI, some of the implications relating to opportunities zone, opportunity funds and we are not going to know. The IRS has published what they think about a couple of the questions, but there are some just to use of Rumsfeld in turn. There's an unknown unknowns about that, that are I think going to come up as I said, over the next couple of years. I can't think of anything super specific at this time. I think probably the thing that we've explored a little bit in the last year or so has been just sort of reclassifying organizations, like I said, to qualify for that QBI deduction that are in industry or not in industry.

Some of the limits, there's this sort of 10% limit that if ... 10% of an organization's income comes from a non-exempt industry, so accounting or finance where we are, that's one of them. Will that limit be tested as far as what qualifies for the deduction or not? I think one that I've certainly spent a lot of time thinking about relating to some of our folks is there's historic catchall provision of a business that relies on the skill or expertise of the individual. The IRS gave a couple of examples. I think what they're trying to get at was like endorsements. I don't know of a good example, but Gordon Ramsey goes out and sponsors some spatula, like that I think is what is very clearly something that doesn't qualify for the QBI.

But what if he's in this spatula creation industry? What if he's manufacturing them? Does that count or does it not? As I said before, those questions are pretty much an answerable. I think if you get five CPAs, you might get four different answers. Those things at the edges are going to take a little while to sort of mature out. But I think on the whole, I ended up being very positive of the tax changes on the whole because, and this played out in my experience, middle-class, let's say anywhere between 50 or about $250,000 of income, they've got about a three or 4% tax cut, right? So relative to what they were paying in the prior year. Concentrated in those income tax States, like the state and local tax deduction definitely hurts folks in New York, New Jersey, like you and me.

But on the whole, there still ended up being a reduction. Just to mention just one quick thing to wrap up before I put everybody to sleep, I haven't seen a lot of AMT cases for 2018 just thinking about it. AMT, really the only time I've seen alternative minimum tracks triggered is for a large exercise of incentive stock options, which is still something that needs to be navigated, but for the most part, that went away by and large. And so I think that does benefit taxpayers as a whole.

Tim Mullooly: Last year, there were a bunch of articles that came out once people started getting their tax returns or tax refunds, I should say. People were expecting, I guess larger returns or they were mistaking how much they was coming out of their paycheck each time versus what they were going to get back in a refund. What did you make of all of that? I guess people just misunderstood that a tax cut doesn't necessarily mean you're going to get a bigger tax refund.

Bill Sweet: Yeah. People aren't wrong. I think that people were righteously indignant, or whatever ways you want to use early on. What ended up happening was I think, and I'm pulling up the data right now. I'll look for it while we're chatting. There was generally, just about across the board, roughly about a 2.9%, 2.8% tax cut across the board. But what happened, Tim, was the tax tables that were released early in the year in February, March, for a lot of people, especially in New York, New Jersey, high tax, high state income tax States, ended up decreasing their tax withholdings at a rate that surpassed decrease in their actual income tax. Your tax rate, your actual tax paid to the United States treasury is determined on form 1040 at the end of the year.

Your job, your employer is in the business or they're trying to estimate that. So they are doing a tax withholding, you're standard tax payer that gets a W2 making $50,000 a year, probably has $6,000 withheld from their paycheck during the course of the year. What happened was if that taxpayer owed $7,000 on their tax return, they were $1,000 short. Even their tax paid from 2017 to 2018 decreased, let's say hypothetically by 1500 bucks, they might have owed the IRS a thousand dollars at the end of the year that they didn't the year before. That discrepancy is what really got a lot of people, for lack of a better word, POd.

Tim Mullooly: Right, exactly.

Bill Sweet: I can't blame them.

Tim Mullooly: Yea. No, I agree. People don't have a thorough understanding of how these tax laws and tax codes work. Pretty much the only interaction some people have with their taxes is if they get refund or if they owe money. If you tell someone you're going to get a tax break and then they end up owing money the next year, they're going to be like, "What the heck?"

Bill Sweet: That's 100%. People, I think got, again, I wouldn't say duped, because at the end of the day, in my opinion, everybody is responsible for managing their own tax return, right? But I think it goes to this gap. I have a pretty good tweet thread. I'll shoot it to you if you want to link to it in the show notes about how much people rely on the tax refund. For an average for your average American, it's like two and a half times their average monthly income, something ridiculous like that. That ends up being the down payment to buy a car, that ends up being the family vacation, that ends up being the 529 college savings plan contribution. In that context, I think if you mess around with people's refunds, they're going to be mad. I can't really blame them for that.

I think it just goes to this disconnect that most people have. And again, I don't blame them because people are busy, they're living their lives, they have a career. If they're not in finance, they don't think about this shit every day, right? You and I are steeped in this. We drink it every morning for breakfast. But your average guy that goes to the office every day that's got a couple of kids, you're right, he thinks about it once a year. If there's one thing that I could definitely fault, whatever the system is that we exist in, it's just how messed up the W4 tax withholding processes. You select a single or married, but people that have two jobs, and increasingly couples are working two jobs, they should probably check the box for single or married at a high rate. Most people don't or they forget, or if they had a tax deduction the prior year, they don't have to worry about it.

You end up putting the exemptions in like what does married four mean? What exactly does that translate to? Well, it means you're married, you probably have four kids. That's the way to explain it. Sometimes that's right thing to do for somebody that, for example, has a high mortgage that they're paying a lot of taxable mortgage interests that they can deduct. I think reforming that would make a lot of sense to maybe do a percentage wise. Let's say somebody's earning $100,000, if their tax withholding was 10%, you would know that's $10,000 and maybe you could go back and look up last year's tax return and be like, "Well, my tax last year was 9,000, so 10% withholding is great. Make it simpler and a little bit easier to understand.

But unfortunately, there's no political for something like this. The IRS budget just shrinks every year, especially if you adjust for inflation, and unfortunately customer service suffers, which is one of the things that really pushed me out of being in the tax world.

Tim Mullooly: Yeah. Do you think that maybe having it be almost mandatory for people to reevaluate their tax withholdings on a yearly basis would help or hurt people in terms of their expectations for a refund or owing money?

Bill Sweet: Oh, there's no doubt. Absolutely.

Tim Mullooly: You said it. You do it once. Most people do it once when they start their job and then they never check it again.

Bill Sweet: They forget about it. Yeah.

Tim Mullooly: It's like, "Oh, I don't know how much I'm withholding."

Bill Sweet: Frankly, Tim, I was really glad that the TCJA, the Tax Cuts and Jobs Act of 2018 happened when I was mostly out of the tax industry because it was a nightmare for accountants to tackle this, to explain on a client by client basis, here's what happened, here's what's going on. You expected a $5,000 refund, it's a $1,000, and people were disappointed. I don't know if there's a substitute to being proactive, but unfortunately, and this is not a criticism, it's just an observation of the tax industry, everybody's looking in the rear view mirror. Maybe right now they're focused on tax for 2019, but it's the late November, right? The year's mostly over. If you go change your-

Tim Mullooly: Right, how much can you do about it?

Bill Sweet: Exactly. It's almost too late.

Tim Mullooly: Yeah. It's tough. Obviously it's getting towards the end of the year. This is a popular time for people to take their RMDs, required minimum distributions.

Bill Sweet: Sure.

Tim Mullooly: We hear a lot of times, a lot of years, some clients call in and say, "Well, I don't want the RMD or I don't need it right now, or I don't want to have that extra tax for this year." Is there anything that people can do to, not take a loophole or kind of escape the tax, but kind of like shift it or put the money somewhere else where they won't absorb that tax hit for the year or is it inevitable?

Bill Sweet: Required minimum distribution is what you're referencing and it's required. That's the underline exclamation point. If you're over 70 and a half, God willing, we all make it that far and we're taking distributions and a lot of our clients are too, it's something you have to navigate. A couple of things you can do to sort of help with it. The first thing is if you are actually over 70 and a half, and unfortunately you have to be like physically a day older than 70 and a half for this to be possible per this really obscure rule in the internal revenue code, you can do a QCD, a qualified charitable distribution. If there's a charity of 501(c)(3) that is really meaningful to you. It can be a church or synagogue in your local area. Can be cancer research foundation. I'm a big fan of local libraries.

I was a board member, my local library for about five years and just really believe in the power that that has for education for kids. The money can go right there and that's a way to duct the tax, right? So the charity gets 100% of your RMD. You don't have to pay the tax and it's a win-win, right? The only loser is the IRS, which is fun. There's a massive federal budget deficit, your RMD isn't going to make a big difference. That's number one.

Tim Mullooly: It's funny. When we tell people that, they're like, "Oh, we really don't want this RMD." And then it's like, "Well, you can donate it to charity." They're like, "Well no, I don't want to do that either." You can't have both.

Bill Sweet: You can't have RMD and needed to or whatever it is. There's a tax metaphor in there somewhere. But no, I guess the other option, so for somebody that's under 70 and a half, QCD is not possible. From there, you can make a donation to a charitable organization, so same sort of theory. It's just with the new TCJA, the tax code standard deduction, 2019, $24,400. If you don't have that amount of itemized deductions, you're not going to get a tax deduction for the donation, which again is okay. Probably shouldn't do a donation just for a tax break. But the other thing to think about, and this is like next level, the galaxy brain stuff, but it actually does work. It requires some planning. You can't duck the tax. Get that out of your mind.

But what you can think about doing is lumping, I mentioned a couple minutes ago, Roth conversions, lumping traditional IRA or 401k into a Roth conversion. You got to eat the tax. There's no really way around that. In the new tax code up to, I think it's $103,400 for a married couple, tax rate's 12%. It's not that bad, right? If you're stereotypical, you're getting social security, you're getting this, you're getting that, maybe a pension, maybe earning $60,000, you've got about $40,000 of room there at 12%. You're going to eat the tax there. The money's going to go at Roth, you have to start a five year clock. Again, big, big planning thing. You've got to sit down and think about this. But the idea is once that money gets distributed, that decreases the amount that's in your IRA that's subject to an R&D next year. Roths are not subject to RMDs. You get to keep the money less than 12% tax that you pay in this example, and then that money can then grow and grow and grow and either be distributed to you or to your heirs, completely income tax free.

That's one way to maybe mitigate the impact of future RMDs, but in the present, RMDs and RMD, it's required underlying explanation point or pay the 50% tax for not doing an RMD. But I wouldn't recommend that.

Tim Mullooly: Yeah, there's always that as an option, but not a great one. Yeah, so a big thing that we focus on here, and I'm sure that you guys do the same when you're constructing portfolios for clients, you hear a lot about asset allocation, but one thing I feel like some advisors just gloss over is asset location. Those are two different things.

Can you talk about the importance of asset location? Maybe give us one or two of the most common examples of poor asset location that you've seen over the years?

Bill Sweet: Yeah, sure. The theory, and I wish I had a whiteboard, so I could just illustrate this with a couple of really simple charts, is ...

Tim Mullooly: Visual whiteboards, picture this in your mind here guys.

Bill Sweet: Close your eyes unless you're driving and picture this. The maximum tax rate for investment income for ordinary income is about 40%, so it's 37% plus 3.8% Medicare surcharge plus another 0.09% Medicare. It's a big ball of wax. It's a big number, but it's 40%. The maximum tax rate for somebody earning more than $600,000 for capital gains is 24% 24.8 so it's close to 25 but you get the idea. That gap is pretty big. Then, it's not just for people that are earning a half million dollars or more. The gap for ordinary income versus capital gains for this hypothetical investor that's earning, let's say $100,000 their ordinary income rate is 12%, their capital gains rate is zero.

That's right, 0% for longterm capital gains. What you would want to do is if you could perfectly time all of this and we can't, but we can approximate it, is have anything that's earning ordinary income, put that into an IRA. That's the theory. IRA 401k qualified account. You're going to defer on any of the income. You don't have to pay the tax as that income accumulates as it matures as it piles up. But of course, you do have to pay the tax when you distribute the assets, but that's true whether it's coming from a stock, a qualified dividend or ordinary income, so take advantage of that. What would you do with non-qualified accounts? Let's see, your hypothetical investor happens to be a millionaire, $500,000 in an IRA, put all the bonds there. In the non qualified accounts, you'd want to put anything that's subject to capital gains or qualified dividends. Why? You're going to pay a lower qualified tax rate on those assets.

The control aspect is really important too, is that you can time when you would potentially realize capital gains for let's say a low tax year after retirement in theory. Hypothetically, you invest in a couple of low cost diversified ETFs. Those are extremely tax vision vehicles. Do that in non-qualified account. You invest let's say $200,000 that goes to 300,000. When you realize those gains, you're probably going to be able to pay a lower tax rate relative to those assets coming out of the IRA. So the idea is on a spectrum of efficiency, move your tax inefficient assets and the IRAs, move your tax efficient assets into non-qualified accounts and then you manage that. You just need to upkeep it on a yearly basis. I think the best way to do that is with software. The sort of the mind-meld that needs to happen to sort of make all this work and make it effective and make it all worth it is relatively complex even for smart people.

There are some unintended consequences to this that I would recommend that people think through, just like with everything else, talk to your fiduciary advisor, talk to your tax advisor before you make any decisions, but the theory is very true. Betterment and others have done some really good white papers, Vanguard as well, on how this adds value over time. Results can be mixed, mostly hypothetical, but I would give a lot to add 40, 50, 60 basis points to a client's annual turn, and that is possible vi these tax differentiation rates via asset location.

Tim Mullooly: This is important for anyone regardless of how old you are, but would you say that it's more important to get it right from the get go for like a millennial right now or someone just getting started investing? What would you say are the main things that are important to get right when you're just getting started with investing?

Bill Sweet: Getting started is tough, Tim because ultimately, I don't think your average investor that's starting out is going to be able to maximize contributions to their 401k at $19,000 a year. It goes up to $19,500, by the way, and about a month and a half, is not going to be able to maximize your contributions to Roth IRA. We're talking large sums of money, right? We're talking to at least $26,000, $27,000 $28,000, when median household income in the US is about 58 right? That's everyone, but I think the things to focus on starting out are just maximize tax efficiency. I'm a big, big proponent of Roth assets.

I just think the lack of brain damage of having the tax paid in the rear view mirror, hypothetically for your starting out investor, they're going to be at the lowest possible tax rate they are in their twenties because they've got a big career in front of them. So, they have the maximum enough time for those assets to compound tax-free. That might not always be the right mathematical answer, just depending on income tax rates and everything else. But I think behaviorally, just stuffing money into Roth, if the 401k or IRA is the right thing to focus on upfront. Frankly, I would recommend tackling the tax asset location problems under the guidance of a competent advisor that can work with your tax professional. It's not to say that's for rich people, that's for old people. It's not what I'm saying. I'm saying it's complex and the implications of which are not immediately obvious. I would recommend working with a professional.

Tim Mullooly: If someone asks you, they were young and they were just trying to make the most of the dollars that they did have to invest, is there like a hierarchy of accounts that they should hit first? Like definitely do the 401k first and then think about a Roth IRA, or is it going to vary for everyone or is there definitely like one thing you should do first, second, third?

Bill Sweet: Yeah, it always varies, Tim, and you know this. You work with, I'm sure a lot of folks in a lot of different walks of life, but just really sort of broad based advice for somebody thinking about it, you got to get started. You got to get started, you got to take 50 bucks, you got to stick it in a different account. That's step one. Then, Ben Carlson's written about this. He's been a saver his whole life. At the very start of the podcast we were talking about my dad, you just got to get the money somewhere else. That's step one. Once you have a cushion of cash and it can't ... it doesn't have to be a lot. The financial planning rules of thumb are three to six months. It just depends. It all depends. I probably wouldn't even go that far if you're starting out. After that, I think I would look at 401, right?

Because if you're getting a company match, if they're matching 4% of your contributions up to your first 4%, there's no reason not to take that pay raise. Maybe some people can debate you should do that before you start saving cash. It depends. I think it all depends. Then after that, once that match is reached, I would go Roth, man, whether in the 401k, whether in the IRA, it doesn't really matter because it's all the same money. I would start building that up. But I think the 401, for the most part, offers cost-effective low costs, low friction. Yeah. You don't have to trade, you don't have to pay commissions at TD or Schwab these days, but I think for the 401k, it's just lack of brain damage, right?

One account, you just flip the Roth's switch on, you just start pumping that thing full and you let it go. I look at my own transactions, I look at the history of my clients, the most successful advisors, or excuse me, clients that I have, scenarios that I have, they're the ones that have been around for the longest, right? Because they've been doing the same thing fundamentally, just adding money to the accounts in every market cycle, every month, every year, the money just goes in and it builds, and all of a sudden, you're looking back and Holy S, I've doubled my money. Wow. It's great to see.

Tim Mullooly: Yeah, it sounds boring, but that's what works.

Bill Sweet: Yeah.

Tim Mullooly: Boring is better I think.

Bill Sweet: Yeah, I tell clients this all the time, you're not far from Atlantic city. If you really want to get your thrills about investing, go to Vegas, go to Atlantic city, go into the casino, have fun. You get a drink usually for free.

Tim Mullooly: Yeah, you'll have way more fun down there.

Bill Sweet: A lot more fun. It's a lot more social than pushing buttons on your Robinhood app in the toilet or in Thanksgiving break. It is boring. It should be boring. You're dealing with long time periods and it's not entertainment. So much of what we do today's fast and do this and that. Earnings reports, I was on CNBC, they asked me to comment on Facebook earnings. I didn't know what to do. I was like ...

Tim Mullooly: Pass.

Bill Sweet: Yeah, can we talk about hiring veterans? They're great, but it's good. They offer an awesome service and they do this great thing where they bring in different voices. Josh is such a voice of sanity. Barry on Bloomberg interviewing the secretary of defense, this is like real life stuff. But ultimately, what it comes down to for us in our firm, and I'm sure Mullooly asset management too, our process is pretty rigid and it's pretty mechanical and you don't deviate from that because when we do, it almost always leads to bad outcomes. Standardize the process, customized the result, the advice that you're been to clients and that leads to better outcomes than trying to do 700 different things for 600 different people.

Tim Mullooly: Yeah, absolutely. I agree. The process just makes everything a lot simpler. Over the span of your career, the most important or impactful financial lesson that you've ever personally learned, what do you think that would be?

Bill Sweet: Yeah, get started. It doesn't matter the amount. It's really about habits. It's about small sums building up over time.

Tim Mullooly: When did you learn that? Because you said, for young kids, it's important to get started. Did you learn that at a young point or was that something you learned a little later on that you wish you might've learned earlier?

Bill Sweet: Again, fathers, parents have such a big role in our lives. It was really my dad being like, "You have to save this. You have to do this. You do not have an interruption." He made me pay for insurance, car insurance, and it was the most expensive thing, and I had to do it out of my own money. I've always had sort of two accounts in my personal sort of checking, operating cash. That's where all the money goes. But then there's a separate savings account that I've always had from day one at USAA. I got those two things open and those two are separate accounting wise. That lesson I think is really important, but that compound interest, I think it's, again, it's boring, Tim. You're right. It's not siding. It's not thrilling, but really the way to be financially successful is invest small amounts of money over time no matter what. That ends up compounding and building again and again and again. You just see it in your most successful, longest clients. They sell a business. That's usually how they get started.

Maybe they're lucky to have a pension, maybe they have some sort of inheritance, but from that point forward, it's really the slow, steady progress of time that matters. That to me is the most important thing.

Tim Mullooly: It's remarkable how everyone is always searching for that secret sauce to, to make it big or to be successful. Really, there's so much research and papers out there that point to what you just said is how people get successful, and yet, because it's so boring and because it's not exciting, people are like, "No, no, no, no, that can't be it. I got to do something else." It's crazy to think.

Bill Sweet: Yeah do a lot of things, but like my son doesn't sleep. He just will not sleep through the night. He doesn't. The observation that we had after reading seven books on the topic and 400 blogs was that if there was something that worked, we would know what it is. Nobody that's selling a newsletter on how to make money in the markets had secret sauce because they wouldn't be selling it for $40 a month.

Tim Mullooly: Right, exactly.

Bill Sweet: Yeah, that observation. Tim, I don't think there's a substitute for learning the hard way. I don't. Nick Maggiulli dollars and data are great data scientist guy at the firm, he talks about this like there's no substitute to getting your fingers burnt. You have to try. That's how you find out. Michael Batnick wrote about this in this book, Big Mistakes, these lessons that we've all learned, but I don't know that they cannot ... I think they have to be internalized, Tim.

When we have clients that have done very well investing in the Apples or the Googles, the Amazons, give them the ability to reach out and touch some percentage of their portfolio because they will always want to scratch that itch, but just make sure you get an audited statement so you can show them how that's hurting them over time.

Tim Mullooly: Yeah, exactly. It doesn't need to be finance related. If it's a personal thing or something you learned in your professional career. What would you say is the best piece of advice that someone has ever given to you?

Bill Sweet: I'm going to take you back, Tim. I'm going to take it back to a young second Lieutenant suite. It wasn't just one person that said this. I can think of several, including my advisors when I was in ROTC. I can think of a very good battalion commander, Lieutenant Colonel Jay Dimmick who told me this when I was a young second Lieutenant. It's take care of soldiers. Again, that probably doesn't take care of your soldiers. It probably doesn't have like a direct corollary to where we are now, but the way that I always internalized it, and I had to learn this the hard way, I had to screw this up, is you have to care. You have to care about your client, you have to care in your heart.

Just a quick story that I can tell is that I was a second platoon leader tank company in Iraq. Our job was to be QRF, quick reaction force. We were at a small base, maybe about 50 soldiers and our four tanks were stationed right at the gate. If something went wrong outside the wire, if somebody got hurt, if there was an attack, we had to be out the gate in 30 seconds and it takes the M1A1 tank. It's a jet engine. It takes it about 25 seconds to get started up, right? So what does that mean? You have a very small amount of time to get that turbine engine up and running, get your gear on, get in the thing and get that 70 tons of American steel from Lima, Ohio out the door and onto the highway. Right? Obviously, that's a 24 hour a day mission. It's like running a fire brigade. I had created a schedule by which I had my soldiers, with my platoon Sergeant, I think it was two hour shifts, two hours, four hour shifts. It wasn't a long shift.

I just woke up one night, 2:00 in the morning, and I walked over and found out that there was nobody monitoring the radio. Of course, I lost my mind, grabbed my entire platoon out, shoot them up, down, left, right. That never happened again. I talked to my soldier who I did the yelling at primarily about six months later. We'd started this AAR from literally the war, what was it? And he said, "I had one negative experience." I said, "What was it?" He said, "Sir, it's when you chewed us all out and blah, blah, blah." I said, "Why? This was people's lives that we were responsible for. We had to do it." He told me, "Sir, the sleep schedule was too short." What he meant was the guys that were on shift and duty, that wasn't their only responsibility, so if they were on shift for two hours, maybe they had an hour and a half off to get some sleep or whatever else, 24 hours a day.

This Sergeant, he told me, "Sir, my guys were worn down, they couldn't sleep, they couldn't do whatever else, and we didn't feel like you really were able to listen to that." I was like heartbroken, right? Because I thought I was in the right. I thought I was doing something that was right. It was right to be blunt, I gave an order, and it wasn't followed, so there were consequences to that. The soldier didn't feel like he could come to me with a concern and that just devastated me, Tim. If you had a client that they lost their parent or something, they were going through a life event, and again, we get to know our clients, we know them very well. I'm sure you guys do too. If they don't feel like they can reach out and touch to you because you don't care about them, what are you there for? What do you actually do?

It's sort of a bit of a story, but I just internalize that, and from that moment forward, no matter where I was, no matter who was in charge of, when you're in charge be in charge, and part of being in charge is making sure that you care and you're directly involved with people that you know. I got to know my soldiers wives, their kids names. I had a little index card of memorize it all. I felt that brought me a more effective leadership than anything else that I'd done is taking care of your soldiers. That advice I was told, but again, just like our theme from before, I had to screw that up before I really knew what that meant.

Tim Mullooly: Wow. That really drives the point home, and like you said, that's experience that you had to get firsthand, but for the listeners out there, if you have to go through that in a different field yourself, just internalize what Bill just said there. That's a great piece of advice to pass along to everyone listening.

Bill Sweet: Yeah, and directly relating to our field. Right? If we're going to give people financial advice that, as a fiduciary advisor, you and I know is in their best interest, they have to know that it's coming from the heart. They have to know that you actually care about them. You can't fake it, Tim. You cannot fake it.

Tim Mullooly: Yeah, you can't.

Bill Sweet: You can't. So, you have to care and you have to go that extra mile, you have to respond to that email at 4:00 in the morning or whatever it is. I don't know that there's a way that you can just say that. I think you have to demonstrate it and that to me is effective leadership.

Tim Mullooly: Absolutely. Well, Bill, that was everything I had for you today. Thanks so much for coming on the podcast.

Bill Sweet: Thanks. A lot of fun. Love what you guys are doing. We've got a great respect for you and Tom and the whole crew. We're happy anytime that we get to engage, so thanks very much, Tim.

Tim Mullooly: Appreciate it. For the listeners out there, I'll link in the show notes to everything that we talked about here today and to Ritholtz Wealth Management so you can continue checking out all their great stuff. Thanks for tuning in to this episode, Living With Money, and we'll catch you on the next one.