

# SmartDeposit: Auto-Deposit, But Smarter

*To help make it easier to invest, we've created Betterment's SmartDeposit, an automated cash management tool that puts your excess money to work.*

I have a confession to make. I don't really stick to my budget. Sometimes I overspend, sometimes I oversave. And I'm not alone. Somewhere from 60% to 70% of us don't really track our monthly cash flow.

The problem is that dealing with uneven cash flow by holding a large amount of excess cash means it's not invested. Cash that's not invested in the market could cost you thousands of dollars in foregone returns over your lifetime.

To help make it easier to invest, we've created Betterment's SmartDeposit, an automated cash investment tool that puts your excess money to work. It is designed to help those of us who don't have time to budget ensure we're growing as much of our money as possible.

To be clear, making a budget can be very effective, especially if you get paid regularly. The key is setting up auto-deposits to invest money right when you get paid, or 'paying yourself first.' This makes your spending decisions easy—spend until you have no more money in your checking account after paying your bills and other needs.

But the fact is that, for many people, income and expenditures rarely happen at the same time. Some months we make more money than average, sometimes we make less. Some months we spend less, some months we spend more (see the table below).

	Expected	Unexpected
Income	Tax Refund	Bonus, Reimbursements
Expenditures	Monthly Rent	Healthcare Bills

For example, around 80% of us usually receive a tax refund from the Internal Revenue Service. In 2014, the average amount returned to taxpayers was about \$2,800, according to IRS data. But far too often we end up splurging and spending unexpected windfalls, rather than saving them.

Or, we sit on cash. One way of dealing with this income/expenditure misalignment is to carry large cash balances from month to month, 'just in case.'

This is particularly true of younger people who, because of their long time horizons, potentially stand to lose the most by not being invested in the market. A recent UBS study

found that people with the longest time horizons—ages 21 to 36—hold the highest amount of their wealth in cash (over 50%).

Holding too much cash is a tendency we see in a part of our customer base. Based on Betterment customer surveys, the average Betterment customer carries about \$13,000 in low-interest savings account balances, and \$16,000 in his or her checking account. That's a lot of excess cash just sitting there, doing practically nothing. For quite a while.

And it comes with an extensive opportunity cost. For example, if you keep \$12,000 in a cash savings account, rather than invest it in a Betterment 40% stocks Safety Net goal, over the next 20 years, you could miss out on an average expected gain of \$22,300. This is based on an expected annual excess return of 3.8% in a taxable Betterment account with a 40% stock portfolio.

SmartDeposit helps solve this problem, automatically bridging the gap between how much you are investing and how much you *could be* investing in order to avoid forfeited returns.

## How SmartDeposit Works

Let's assume you are a Betterment customer and sign up for SmartDeposit, which is included with your Betterment account. You have \$16,000 in your checking account, but you really only spend about \$4,000 monthly.

## Checking Account Ceiling

The first thing you would do is set your SmartDeposit checking account ceiling, or the maximum amount you want in your bank account at any time.

How much should it be? That is based on your individual circumstances. However, a good guide is to add together all of your mandatory expenses (e.g., rent or mortgage, utilities, and any other bills with a due date) and your discretionary expenses that may fluctuate (e.g., food, gas, health care bills, entertainment). That's your target monthly spend. Any more than that is likely excess cash and should probably be invested.

For example, if you spend \$4,000 monthly, you may feel like \$5,000 is probably more than enough to have in your checking account at any given time.

## Maximum Deposit Amount

Next, you can modify the maximum amount you want Betterment to automatically invest at a time. For example, if your maximum amount is \$500, Betterment will never transfer more than \$500 in any one transaction.

## You Relax, SmartDeposit Gets to Work

At least once a week, Betterment will monitor your checking account for excess cash above your threshold and then deposit it to your selected goal when appropriate. How do we make that call? Well, it's called SmartDeposit for a reason:

SmartDeposit takes into account all the upcoming Betterment automatic deposits you have scheduled in the following 30 days, and subtracts those off of your current checking balance. That way, it doesn't confuse savings for excess cash.

When a SmartDeposit is triggered, we'll email you prior to the SmartDeposit and give you the option to skip it. That way, we will not withdraw money that you may need for an expected expense.

Finally, SmartDeposit will double-check your balance right before it actually makes the withdrawal to confirm that you still have excess cash (including any upcoming automatic deposits) in your account.

## Common (Mis) Concerns

A common concern people have is that after they've invested money with Betterment, they might need to withdraw it again soon. There are usually two concerns here: how quickly they can get the money back in their bank account, and that they might need to pay tax if they do so. In both cases, Betterment helps to mitigate these concerns.

### **Not Liquid Enough**

Betterment withdrawals take four to five business days to arrive in your bank account. Consider your personal circumstances when deciding how much cash you really need on hand. It's likely that even in the most dire emergencies, you would be able to use another form of payment, such as a credit card (hopefully with airline miles or cash back), while you wait the short period of time for the cash to be deposited in your checking account.

## After-Tax Growth

The second misconception is around tax, often specifically short-term capital gains. Here are two ways Betterment seeks to lessen this concern:

The first is that [Betterment provides TaxMin](#), an algorithm that seeks to minimize tax lot selling. When selling, we choose the specific shares that are likely to minimize your tax burden. Specifically, we sell losses first, then long-term capital gains sorted from smallest gain to largest gain. This method has been demonstrated to greatly reduce the average tax burden compared to an industry standard first-in, first-out share sorting method. This works across goals, so if you have long-term shares anywhere, we can swap those shares to minimize taxes.

Of course, if you've used Betterment for less than a year, we won't have any tax lots that are long term yet. But we'll still pick the lowest-embedded tax lots to sell.

And this gets into the second misconception, which is that in this context tax is worth avoiding. We've written about [the perils of tax aversion](#) before, but it's worth repeating. When making withdrawals to pay for things, *tax is a sign of a good decision*. Tax only occurs on gains, so *paying tax because you have made money is a good thing*. If you pay more in taxes at Betterment than from a savings account, it's because you've made more money using Betterment than in your savings account. Savings account interest is taxed as ordinary income, so you aren't avoiding tax in a savings account. See an example:

	Savings Account <sup>1</sup>	Invested <sup>2</sup>
Pre-Tax Growth	\$120	\$456
Tax Owed	\$40	\$68
After-Tax Gain	\$80	\$387

As shown above, if you try to *minimize taxes*, you end up minimizing your after-tax gains as well. You pay more when you earn more, and often at a lower tax rate.

## Try It Out

Betterment is constantly innovating with new products and services designed to make investing easier for you and to help grow your wealth and ultimately achieve your goals. SmartDeposit is just one way Betterment puts your money to work and ensures you're maximizing your time in the market.