Personal finances and investing for the physician: a Boglehead’s approach

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Disclosures

• I have no relevant financial disclosures
• I am not a financial advisor
• The information presented is for educational purposes only
Why is this even important?

• Doctors start their first real job relatively late in life
• Little or no financial experience
• High student debt load (average $200,000)
• We assume that financial advisors have our best interests in mind
• NOT ALWAYS THE CASE...

Who is a Boglehead?

• Disciple of John Bogle, founder of The Vanguard Group, the world’s largest mutual fund company
• $7.2 trillion in assets under management
• Created the first index fund available to retail investors
• Credited for driving costs down across the mutual fund industry

May 8, 1929 – Jan 16, 2019)
10 principles we believe in

• Live below your means
• Invest early and often
• Never bear too much or too little risk
• Diversify your investments
• Never try to time the market

• Use index funds when possible
• Keep costs low
• Minimize taxes
• Invest with simplicity
• Stay the course

#1 Live below your means

• Save at least 15% of your gross income every month
  • Emergency fund (6 months of living expenses) (fully fund first)
  • Retirement fund (10%)
  • Big-ticket items (5%)
• Develop a sensible household budget that accounts for needs & wants
  • Median US family income: $79,900 (2021)
#1 Live below your means

**Needs**
- Emergency fund
- Basic groceries, clothing, housing
- Basic transportation
- Health insurance
- Disability insurance
- Life insurance (term)
- Retirement fund

**Wants**
- Everything else!

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How much money do you need to retire?

- The Trinity study (1998) suggests a 4% safe withdrawal rate in a 50/50 stock/bond portfolio over a 30-yr period (the authors examined data from 1925-1995)

- Due to low bond yields, recent studies suggest a 3% safe withdrawal rate

- $2M portfolio gives you $60,000 per year (inflation-adjusted) for 30 yrs

- $4M portfolio gives you $120,000 per year (inflation-adjusted) for 30 yrs
#2 Invest early and often

- Money invested early in life is greatly more valuable than money invested late in life
- “Magic” of compounding

Ages 22-32

Tabitha

$50,000 at 10% becomes $1,850,746

Ages 40-50

Tonya

$100,000 at 10% becomes $665,746
#2 Invest early and often

- Work-around for physicians: live on a fellow’s salary for the first 3 years post-fellowship
- Average salary increases from $70,000 to $170,000/year
- Assuming you invest the extra income: $100,000 x 3 yrs x 5% annual rate of return (inflation-adjusted)
  
  =$1.2 M in 30 yrs
  =$1.5 M in 35 yrs

#3 Never bear too much or too little risk

- Investing = earning a return in exchange for shouldering risk
- 2 major classes of assets
  - Stock: ownership in a company
  - Bond: loan made to a company (or government)
- The higher the risk, the higher the expected return
#3 Never bear too much or too little risk

- Overall risk of a portfolio is determined by the stock/bond ratio
- Only applies to diversified portfolios – not individual stocks or bonds
#3 Never bear too much or too little risk

How much risk should you bear?

• Ability to take risk

• Willingness to take risk

• Need to take risk

Ability to take risk is determined by your investment horizon

• <5 years
  - Treasury bills
  - Certificates of deposit
  - Money market

• 5-10 years
  - Bonds

• >10 years
  - Stocks
#3 Never bear too much or too little risk

- Willingness to take risk: how much loss can you live with?

<table>
<thead>
<tr>
<th>Asset Allocation Percentage</th>
<th>Exposure to Maximum Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock/Bond</td>
<td></td>
</tr>
<tr>
<td>20/80</td>
<td>5%</td>
</tr>
<tr>
<td>30/70</td>
<td>10%</td>
</tr>
<tr>
<td>40/60</td>
<td>15%</td>
</tr>
<tr>
<td>50/50</td>
<td>20%</td>
</tr>
<tr>
<td>60/40</td>
<td>25%</td>
</tr>
<tr>
<td>70/30</td>
<td>30%</td>
</tr>
<tr>
<td>80/20</td>
<td>35%</td>
</tr>
<tr>
<td>90/10</td>
<td>40%</td>
</tr>
<tr>
<td>100/0</td>
<td>50%</td>
</tr>
</tbody>
</table>

Sweet spot

#3 Never bear too much or too little risk

- Need to take risk: determined by your financial goals, time horizon, and the rate of return

US Financial Market Annual Returns and Inflation, 1926–2018

<table>
<thead>
<tr>
<th>Nominal Returns</th>
<th>Average Return</th>
<th>Average Compounded Return</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Automatic</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small-Cap Stocks</td>
<td>16.2%</td>
<td>11.8%</td>
<td>31.4%</td>
</tr>
<tr>
<td>Large-Cap Stocks</td>
<td>11.9%</td>
<td>10.0%</td>
<td>19.8%</td>
</tr>
<tr>
<td>Long-Term Corporate Bonds</td>
<td>6.3%</td>
<td>3.9%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Long-Term Government Bonds</td>
<td>5.9%</td>
<td>5.5%</td>
<td>9.0%</td>
</tr>
<tr>
<td>Intermediate-Term Government Bonds</td>
<td>5.2%</td>
<td>5.1%</td>
<td>5.6%</td>
</tr>
<tr>
<td>30-Day Treasury Bills</td>
<td>3.4%</td>
<td>3.3%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Consumer Price Inflation</td>
<td>3.0%</td>
<td>2.9%</td>
<td>4.0%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Real (Inflation-Adjusted) Returns</th>
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<th>Average Compounded Return</th>
<th>Standard Deviation</th>
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<tr>
<td>Small-Cap Stocks</td>
<td>13.0%</td>
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#4 Diversify

- Buy index funds that hold large segments of the market
- Broad diversification ensures average market returns
- Holding investments whose performance correlates poorly (e.g. stocks vs. bonds) maximizes returns while reducing total risk
#4 Diversify

How?

Single-fund

• Buy a single fund that is in itself diversified (i.e. target retirement fund)

Multiple funds

• Buy a few index funds that cover the entire market (i.e. Total US Stock, Total International Stock, Total US Bond)

3 fund portfolio

Stocks (60%)

• Total US stock market (60%)
• Total international stock market (40%)

Bonds (40%)

• Total US bond market
#5 Never try to time the market

- Between 1982-2007, the US stock market provided an annual return of 12.3%
- The average equity fund earned an annual return of 10.0%
- ...but the average investor earned an annual return of only 7.3%

Mistake #1

- Attempting to predict the future direction of the market
  ✔ Fool’s errand

Mistake #2

- Investing in yesterday’s winners
  ✔ Regression towards the mean
#5 Never try to time the market

- Asset allocation determines 90% of a diversified portfolio’s return
- People who chase after performance ultimately lose money from poor market timing and increased transactional costs
- Rather, periodically rebalancing your portfolio ensures that you are selling “high” and buying “low”

#6 Use index funds when possible

<table>
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<tr>
<th>Index funds</th>
<th>Active funds</th>
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</thead>
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<tr>
<td>Match the market benchmark</td>
<td>Try to outperform its benchmark</td>
</tr>
<tr>
<td>Buy the entire benchmark</td>
<td>Hand-pick individual stocks/bonds</td>
</tr>
<tr>
<td>Extremely diversified</td>
<td>Less diversified</td>
</tr>
<tr>
<td>Highly tax efficient (few trades)</td>
<td>Less tax efficient (more trades)</td>
</tr>
<tr>
<td>Low expense ratio (&lt;0.2%)</td>
<td>High expense ratio (0.75-1%)</td>
</tr>
</tbody>
</table>
#6 Use index funds when possible

![Graph showing probability of an active equity fund beating the market over different time periods.](image)

#7 Keep costs low

- **US Stock Market (index):** 12.3%
- **Average Fund (active):** 10.0%
- **Average Investor:** 7.3%

Cost of Funds

Market Timing
#7 Keep costs low

- An expense ratio of 1% might not seem like much, but if compounded over a lifetime, it is enormous!
- 1% expense ratio over 50 years will reduce your total net return by 40%

#8 Minimize taxes

- Take advantage of tax-deferred plans:
  401(k): $19,500/individual + $6500 catch-up if ≥50 yrs
  IRA: $6000/individual + $1000 catch-up if ≥50 yrs
  HSA: $3600/individual, $7200/family + $1000 catch-up if ≥55 yrs
- Allows immediate tax deductions up to the full amount of your contribution
- Monies in these plans are not taxed as income until withdrawn
#8 Minimize taxes

• Take advantage of tax-exempt plans:
  ROTH 401(k): $19,500/individual + $6500 catch-up if ≥50 yrs
  ROTH IRA: $6000/individual + $1000 catch-up if ≥50 yrs
  • No immediate tax deduction but earnings grow tax-free
  • Ideal for new physicians because we start out in a low tax bracket but end up in a high tax bracket in the future
  • Phase-out if income >$140,000 (single) or >$208,000 (married)

#8 Minimize taxes

Work-around (backdoor ROTH IRA)

• Open a traditional IRA
• Make a nondeductible contribution to the traditional IRA
• Convert the traditional IRA into your Roth IRA (income thresholds do not apply to conversions)
• Repeat this process every year
#9 Invest with simplicity

Advantages of a simple portfolio:

- Low costs
- Easy to analyze
- Simple to rebalance
- Simple tax-preparation
- Simple record-keeping

#10 Stay the course

- Once you have set your long-term investment goals, established an asset allocation and invested assets, stick to your plan
- Tune out all the media noise
- Doing nothing is often the best course of action
Concluding remarks

• Good financial and investment planning is important for late career starters such as physicians

• Consider implementing the Boglehead philosophy

• Living below your means and investing early practically guarantees a secure retirement

• Consider living on a fellow’s salary for the first few years post-training

• Asset allocation determines 90% of a diversified portfolio’s return

Happy investing

To Vivay, "Stay the Course!"

John Bogle
Bibliography

1. www.bogleheads.org
2. www.whitecoatinvestor.com
3. www.vanguard.com

Practice succession planning

Nick Hernandez, MBA, FACHE
Founder & CEO
Four Myths of Succession Planning

- There is plenty of time
- It’s easier to just sell it
- A successor will be ready when I’m ready
- Giving up ownership means losing control and income

Contemplating Succession Planning

- Selling to an outside party
- New patients
- Website
- Cosmetic
- Revenue and procedural volume
- Accounts receivable
- Staff
- Planning your exit strategy