Don’t OVERESTIMATE Yourself

Common mistakes can threaten your retirement nest egg.

By Steve Finkelstein, C.F.P., and Joel Greenwald, M.D., C.F.P.

Your quality of life in retirement is a direct result of the quality of your preparation. Do you have confidence in your plan? Do you have enough in savings? Has your plan been stress-tested to determine whether you’ll still have enough to live on if the stock market declines? Is your portfolio’s valuation on track to meet its projection? If you answered “No” or “I don’t know” to any of these questions, you may be gambling with your future.

Physicians aren’t that different from anyone else when it comes to planning for retirement. Some are complacent because they think they will practice until the day they die. Others, having had to pay off student loans early in their careers, choose to spend now and risk having to play catch up later on. Yet others are too busy with their practices to devote the necessary time to planning, or they insist on doing it themselves rather than enlisting the help of a financial advisor.

A number of physicians have retirement plans that may not be as solid as they think. Take for example T.F., a 58-year-old internist with an annual income of $150,000. He recently paid off the mortgage on his primary residence, and his youngest child is starting her senior year of college. T.F.’s wife has been a stay-at-home mom for more than 20 years.

T.F. always planned to retire at age 60 and is eager to enjoy more free time and devote himself to his passion, raising orchids. To date, he has $1 million in his practice’s 401(k) plan, $500,000 in a taxable brokerage account, and a house worth $500,000. T.F. plans to contribute $20,000 annually (the maximum allowed for someone his age) to his 401(k) for each of the next two years. T.F. and his wife also expect to receive Social Security benefits.

T.F. recently used an online a retirement-planning calculator to project his financial health in retirement. Assuming an estimated average of a 9 percent rate of return on his portfolio, T.F. appeared to be on track to retire at age 60 and be able to continue his current monthly spending of $8,000. He calculated that he and his wife could maintain this rate of spending until age 92.

Flawed Assumptions

T.F. was likely pleased with the online calculator’s projections. But those projections are potentially flawed because of the means by which he arrived at them. T.F.’s estimated 9 percent return assumes a steady, annual return without consideration of a year that may yield a 24 percent return or one that might yield a negative 14 percent return. Rather than assume a steady rate of growth, he needs to factor in fluctuations that may affect his bottom line over many years.

If you run the numbers using a Monte Carlo scenario, which allows one to consider multiple factors, you’ll find T.F. and his wife have less than a 40 percent chance that they will be able to continue spending the way they have been until age 92 without running out of money. When using a Monte Carlo simulation, you want to see a 90 percent or
greater chance of success in order to feel comfortable.

A Monte Carlo scenario or simulation is a statistical tool that considers investment returns, market volatility, and correlations between asset classes, rather than assuming an average return on a portfolio. The Monte Carlo simulation, which is incorporated in a number of retirement planning programs such as MoneyGuidePro and FinanVare, is based on probability. For example, it is probable that a person will have to endure at least one severe bear market during which stock prices will decline by at least 40 percent during their retirement years.

Any investment comes with a risk-reward relationship, and a Monte Carlo simulation can demonstrate a realistic possibility of loss, gain, growth, and stability. It allows for variation in your savings habits and lifestyle and assumes you may change the stock and bond composition of your portfolio, adjust your retirement age, opt for partial rather than full retirement, and more. Projections based on any straight-line return assumption may look good at first glance; but put simply, they will overestimate your retirement plan’s chance of success.

Another error in T.F.’s assumption was to consider the value of his primary residence as an asset that would provide income in retirement. A house is a use asset, not an investment asset. If T.F. were to sell his primary residence, he would most likely end up buying another home and not using the proceeds from the sale of the first house to fund living expenses in retirement.

Avoiding Common Mistakes
A retirement plan is only as good as the assumptions you’ve built it on. Unfortunately, most financial plans are based on faulty assumptions. In T.F.’s case, he was assuming a straight-line positive annual return on his investments throughout his retirement years. The following are additional reasons why physicians and others often come up short in the end.

Saving too little. Often doctors get a relatively late start on saving for retirement because of the time they spend in school, in residency, and paying off the debt that’s generated during their training. A wise plan during one’s wealth accumulation years is to devote 20 percent of pretax income to retirement savings, especially if you want to retire before age 65. An acceptable level of savings is 10 percent of pre-tax income. Sound high? Think of the trade-offs: a few fancy dinners out a month versus the trip to Italy you always wished to take in your golden years. Consider your retirement dreams and plan accordingly.

By having funds automatically withdrawn from your paycheck into your 401(k) or other pre-tax retirement plan, it will ensure that those funds are invested and that you will save rather than spend.

Investing only in pretax plans. Be wary of putting your savings exclusively in pre-tax retirement plans. Many physicians find the tune of “tax-free” to be an attractive melody. Tax deduction and tax-deferred growth are important, but if you put all of your retirement savings in IRAs, 401(k)s, and other pre-tax vehicles, your nest egg is subject to taxation on withdrawal, and you incur the risk of the vagaries of income tax rates during retirement. A blend of pre-tax and taxable retirement funds will ensure you get the best from both worlds. A Roth 401(k) is a good complement to a traditional 401(k). If this option isn’t available in your practice’s retirement plan, you might want to lobby for one.

Failure to diversify. You’ve heard it before, but the importance of asset allocation cannot be overemphasized. Keep in mind that stocks are the only assets that yield a true return against inflation. Your retirement portfolio should naturally include both stocks and bonds. As you approach or if you are in retirement, you may want to reduce the amount of exposure to stocks in favor of more capital preservation assets such as bonds and cash, as they will reduce the volatility of the portfolio. Volatility is the enemy when you are taking money out of a portfolio in retirement. A

The 12 Immutable Laws of Investing

Let’s say you’re able to steer clear of some of the most common mistakes people make when planning for retirement. But how do you make the most of the dollars you have in your retirement accounts? The following “laws of investing” can help you plan your investment strategy.

1. Clearly define your investment objectives (retirement, children’s college, new home)
2. Understand your risk tolerance
3. Make an investment blueprint and stick to it
4. Set up an automatic investing plan
5. Invest in a tax-efficient manner
6. Pay attention to the expenses on your investments
7. Don’t pay too much attention to the expenses on your investments
8. Diversify
9. Stay focused on the long term and keep the media’s messages in perspective
10. Monitor investment results
11. Consolidate your holdings
12. Make sure your financial advisor acts in your best interest
parent-teacher associations, school boards, and committees, where we serve as advocates for health issues and political causes.

Being a doctor’s spouse or partner is no longer something we have to apologize for. We are proud of our association with our loved ones’ careers, and we feel we have much to offer on behalf of medicine. And along the way, we’ve become a support system for one another as we cope with the pressures that practicing medicine places on our spouses—pressures that spill over into our own lives.

In the book *The Medical Marriage—a Couple’s Survival Guide*, authors Wayne and Mary Sotile paint medicine as the career path of choice if you want your marriage to fail, to become addicted to drugs and alcohol, to become depressed or suicidal, or to end up hospitalized for psychiatric illness. Studies have also pointed to decreased life expectancy and higher rates of stress-related illness for doctors as compared with the general population.

Many of us were there during our loved one’s time in medical school. We saw them through residency matches and training, and finally the decision about where they would practice. Anyone who has endured this journey knows the personal and family sacrifices it takes to cross that finish line. And we know full well that the life of a practicing physician is not easy.

Physicians must keep up with the latest developments in their field and see more patients in less time. Those demands take a particularly hard toll on women, who still often find themselves feeling as though they must uphold their professional commitments plus run the household.

Of course, there are exceptions to the generalizations I’m making, and our culture as a whole is evolving—along with gender roles. But in order to make our spouses’ or partners’ lives a little easier, we doctor’s husbands and wives and partners—whether we are physicians ourselves, members of other professions, or stay-at-home moms and dads—had better be capable of change.

I consider the friends, both male and female, I have made through the MMA Alliance an integral part of my support network as I’ve made the transition from Canada to Minnesota and from paramedic to doctor’s husband. We are proud of our loved ones’ accomplishments; but we don’t define ourselves by their careers. We are their partners and have as much a vested interest in medicine as they do. And as we contribute to the health of our communities through our activities with the alliance, we can support each other as we redefine what it means to be a physician’s wife or husband or partner.

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prudent allocation strategy is based on a number of factors including your tolerance for risk, expectations on rate of return, dependence on your portfolio for income, and life expectancy.

**Overestimating your purchasing power.** Don’t underestimate the power of inflation. At only 3 percent a year, a car that costs $30,000 in 2006 dollars will cost $60,000 in 2030. If the bond portion of your portfolio is yielding 5 percent but inflation is 3 percent, your real return is only 2 percent. That means it will take 36 years to double your purchasing power. And that doesn’t take taxes into account. After adjusting for inflation and taxes, the real return on the bond portion of your portfolio may be zero.

**Underestimating your spending.** Once you reach retirement, you will likely spend 70 percent to 80 percent of what you did during your working years. With people retiring earlier and having a better quality of life as they age, the reality is that you may wish to maintain or even improve your lifestyle during the early years of retirement. If you plan to do such things as travel, make home improvements, and dine out more, you may need to plan on spending more in retirement, at least initially.

**Discounting longevity.** Another common mistake when planning for retirement is underestimating how long you will live. Perhaps the single biggest risk associated with retirement is the risk of living too long. When a couple reaches age 65, there is a 50 percent chance that at least one partner will live to age 90.

These mistakes are but a few that physicians and others make when developing their retirement strategy. Whether you’re just coming out of residency or, like T.F., are looking toward the day you ease out of practice, you need to prepare and make sure your plan is a sound one in order to avoid having your dream retirement turn into a nightmare.

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