10 Things That Matter Most In Personal Finance

We spend a great deal of time on this blog discussing the minutiae of personal finance and investing. Examples include trying to decrease your portfolio expense ratio by 10 basis points, how much DFA access is worth, which riders on a disability insurance policy are worth the price, how best to invest in real estate and whether or not to tilt a portfolio to small and value stocks. But the truth is that people who are having financial difficulties aren't worried at all about these kinds of issues. Folks who read financial blogs tend to be "maximizers" rather than "satisficers." A maximizer will pay every penny of tax he owes to the IRS, but refuses to leave even a 1 cent tip. A satisficer isn't going to keep track of his charitable miles just to knock $50 off his tax bill. The truth is that in personal finance, there are only a few things that really matter a lot. In this post, I'm not only going to be presumptuous enough to state what those things are, but I'm actually going to rank them from most important to least important.

1. Get Married and Stay That Way

The single worst thing you can have happen to you financially is to get divorced. Not only do you lose half of your assets, but a typical physician usually loses a huge chunk of his income for at least a few years afterward. Staying single isn't a bad second choice, and two don't live as cheaply as one (they do live as cheaply as 1.4 however), but studies generally show that married people are happier, are wealthier, and live longer than single people. One house, one spouse, happy wife, happy life and all that. We all know people who are financially mismatched. A spendthrift spouse has prevented many a high-earning, frugal investor from becoming financially secure.

2. Make a High Salary

People often like to downplay the impact that a high salary has on your personal finances. While it is true that a high-earner can be just as broke as a low-earner, the fact remains that those with high salaries are far more likely to build real wealth and enjoy financial freedom. In many respects, doctors have already won the money game by virtue of their high salary. They have a number of factors working against them, but don't discount this big advantage, even for a modestly paid physician. Likewise, don't discount the benefit of being a doctor making $500K a year instead of $150K a year. While both are nice salaries, they're really not in the same class with respect to spending power and eventual wealth accumulation. Even within your life, whatever it may be, you have significant control over your salary. It may require you to move to another city, work longer hours, or take more call, but income provides the raw material with which to build wealth, and boosting it never hurts.

3. Ensure Career Longevity

More important than your peak earnings, is how long you can maintain them. Longevity is a buzzword in my burnout-inducing field of Emergency Medicine. While busting your tail for 15 years for $350K a year is one option, it turns out that working for $200K for 30 years is a far better option for many reasons. You earn more money for one, and pay less in taxes despite earning more money. You also leave more time for your money to compound, and less time on which you need to live on it (enabling you to spend more in each year of retirement.) You also end up with a much larger social security benefit. Figure out what you want to do most days for the rest of your productive life. If it is something you would do for free, so much the better. But even if you are like most of us, and wouldn't practice medicine for free, practicing it in a way that ensures you career will last as long as possible will help build wealth.

4. Insure Against Catastrophe

One of the dumbest things you can do in personal finance is to carry inadequate insurance. Malpractice, personal liability, disability, and if people are depending on your income, term life insurance are absolute musts. Lots of financial devastation occurs due to failure to insure.

5. Live Well Below Your Means

This, the cardinal rule of personal finance, comes in at a measly number five on my chart. You may have noticed I have inserted an extra word into the phrase that isn't usually found there. Living below your means doesn't build wealth, at least not at any kind of a reasonable rate. The key is to live well below your means. I throw out the number 20% of gross income toward retirement a lot, but the truth is that 20% is just a ball park figure. If you're 15%, you'll probably be okay. But making $20,000 a month and spending $19,800 of it isn't going to cut it if you want to get serious about building wealth. I know lots of wealthy people, but I don't know any who didn't follow this rule. Housing, as most people's largest expense, is the biggest culprit. Limiting your mortgage to 2X your gross income will make a big difference.

6. Don't Sell Low

One of the biggest tragedies I routinely see is a doctor in his 50s who encounters a bear market, panics, and trades all of his stock for bonds. Investor behavior trumps so many of the other important aspects of investing, including keeping expenses low, asset allocation, and tax-efficiency. Especially if done late in your career, overestimating your risk tolerance will sink your wealth faster than Joe Hazelwood's bartender.

7. Buy and Hold a Reasonable Portfolio

I'm continually surprised to see how many people hold an unreasonable portfolio. Most of these are a collection of investments, some individual stocks here, some mutual funds that were hot a few years ago there, and over in the corner a couple of privately traded REITs. There is no overriding plan or asset allocation. Sometimes people aren't taking on enough risk, with their money all in bank accounts, CDs, or whole life insurance. Other times they're taking on way too much, with their entire 401(k) in company stock or with heavy investments in hedge funds, penny stocks, or even a few "blue chips" like Enron or Worldcom. It is so easy to have a reasonable portfolio, it just seems silly not to have one. If you're not sure what a reasonable portfolio looks like, take a look at these [150 portfolios better than yours.]

8. Be Uncomfortable With Debt

This one is a little bit of a pet peeve of mine. I am often contacted by residents who owe $450K in student loans but seem to act like it is no big deal. Almost invariably, these residents are in pediatrics, psychiatry, or another relatively low paying field and plan on living in an area like NYC or the Bay Area. Another common thing is a doctor who is carrying mortgages on his big fancy house, his second home, and his cabin. While some debt is necessary, and a little leverage can be helpful at times, all of the financial secure people I know have a healthy respect for debt, and most of them freed themselves from its shackles years ago. It is a big deal to owe $200K in student loans at 8%, much less $400K. It is a big deal to owe $500K in a mortgage, much less $2 Million. It's not okay to buy cars on the installment plan, much less appliances. Credit cards aren't for credit. Get uncomfortable with debt and become wealthy.

9. Minimize Educational Costs

On a similar note, I see very few people who become wealthy while paying the highest possible price for their own education and that of their children. Don't get me wrong, education is great, and as a general rule, the more you learn the more you earn. But I don't know of anywhere in life where there is such a low correlation between the quality of the education and the price tag on it (well, except mutual funds, but that's an inverse correlation.) The education at George Washington University (ranked #52 by US News and World Report, tuition of $47,343) and Trinity University (#36 , $47,510) simply isn't ten to forty times as good as that at Brigham Young University (#62, $4,850) or Berea College (#76, $1,070).

Likewise, I was dumbfounded to discover that it is routine to pay $30K a year for private elementary school in the Bay Area. It is $8-10K where I live, and for most kids, no better than the excellent public school system. Housing might be the biggest expense, but education, done improperly, can be right up there. Imagine, if you will, that you want to send your 5 year old to George Washington ($47K per year) followed by an expensive medical school ($82K/year). Even if you pay for no expenses other than tuition, tuition stays flat (ha!), and you earn a real 5% on your money, you will need to save $2400 per month (per kid), in addition to whatever you're paying for his private kindergarten. It's even worse if you don't do it. How do you think these medical students are coming out of residency owing $500K?

While you might be a maximizer in many areas of your life, I encourage you to be a satisficer when it comes to education. We all know that your education has a whole lot more to do with what you put into it than the name on the front of the administration building.

10. Pursue Inexpensive Hobbies

There are lots of fun things to do in this world. Some of them are a lot cheaper than others. The ideal hobby is a job you love so much you'd do it for free. Then you get paid to play every day of your life. I'm not sure that job is out there for most folks, but a hobby that pays you is a nice second. Take this blog, for instance. I could have taken up wakeboarding instead ($120K boat, plus $2-5K in maintenance and operation costs each year), and perhaps I would have even made more friends (actually, that's pretty unlikely given that 80K people come by this site each month.) Hobbies like flying, boating, antique cars, and horse racing are going to put a far larger drain on your resources than knitting, mountain biking, basketball, or bridge. If there are two things you like to do equally well, do your wallet a favor and choose the cheaper one.

Well, what do you think? Did I get the top ten? Did I get the order right? Sound off about what I missed in the comments section!