10 Biggest Financial Mistakes Doctors Make

[Editor’s Note: The following was originally published as one of my recent columns for ACEPNow. Don’t be fooled into thinking that a high-income makes you immune from financial consequences. Learn from and avoid the mistakes of others and you’ll be on the right path to achieving your financial goals.]

Q. In medicine, it is best to learn from the mistakes of others, as evidenced by morbidity and mortality conferences. What are the big mistakes doctors make when it comes to their finances?

A. Physicians earn relatively high incomes, but that doesn’t make them immune to financial missteps. Avoid these 10 errors:

10 Biggest Financial Mistakes of Doctors

1. Financial Illiteracy

The biggest mistake doctors make is simply not paying sufficient attention to their finances. In our 401(k) world, we each have a second job as a pension fund manager, whether we like it or not and whether we’ve been trained to do it or not. You (together with your partner) are your family’s chief financial officer(s). Your family is like a business, with various sources of income and various expenditures. If you manage it well, it will be profitable and will support you long after you’ve stopped working. If you do a poor job, you will reap the consequences. The cavalry isn’t coming. It’s up
2. Growing Into Income Too Quickly

This is a real problem for emergency physicians, who generally hit their maximum lifetime income shortly out of residency. If their spending grows just as quickly as their income, they have missed out on the very best way to build wealth as a doctor—that is, living like a resident for the first two to five years out of residency and using the difference between attending and resident incomes, and the accompanying lifestyle, to pay off student loans, save for a down payment on a dream house, and catch up to their college roommates with their retirement savings.

3. Not Saving Enough

Even after the “live like a resident” period, a typical physician should save approximately 20 percent of their gross income for retirement. No amount of fancy investing can make up for inadequately funding the portfolio. An adequately funded portfolio, on the other hand, can make up for a plethora of investing mistakes.

4. Inadequate Insurance

Physicians should insure well against financial catastrophes, such as professional and personal liability, illness, injury, disability, death, and loss of expensive property. Too many physicians with family members relying on them financially carry inadequate term life and disability insurance. Too many doctors only carry the state-required minimums on their auto liability policies. Bad things happen regularly, and they can happen to you.
5. Mistaking Whole Life Insurance for an Investment

Nearly every physician will have whole life insurance pitched to them at some point in their career. All too often, the physician falls for it. Although there are some niche uses for this insurance product, it was inappropriately sold to the vast majority of physicians who have purchased it. The ongoing high premiums prevent these doctors from utilizing better investments, paying off their student loans, and sometimes even carrying an adequate amount of term life insurance! Treat the purchase of whole life insurance like you would evaluate a potential spouse. It’s either until death do you part, or it’s going to cost a lot of money to get out.

Treat the purchase of whole life insurance like you would evaluate a potential spouse. It’s either until death do you part, or it’s going to cost a lot of money to get out. Click To Tweet

6. Choosing the Wrong Adviser

Most physicians want and need at least some assistance from a high-quality financial adviser. However, the key is to get good advice at a fair price. Good advice comes from a competent fiduciary, fee-only adviser who understands the unique financial situations physicians find themselves in. A fair price is a four-figure amount per year. If you are paying more than that, know that high-quality advice is available for less than you are paying. Keep looking until you find it, even if your current adviser is a good friend or family member.

7. Not Understanding Their Retirement Accounts

It is critical you become an expert in the retirement accounts available to you. If you are an employee or in a partnership,
actually read the 401(k) plan document the employer is required to provide you if asked. Know how the plan works, whether there is an employer match, what the investment options are, and what fees you can expect to pay. Your employer may provide other retirement accounts such as a 403(b), 457(b), or defined benefit/cash balance plan. Also become familiar with a personal and spousal backdoor Roth IRA and a health savings account. Independent contractors and those who moonlight should use an individual 401(k) instead of a SEP-IRA and can even consider using a personal defined benefit/cash balance plan. These retirement accounts lower your taxes, boost investing returns, facilitate estate planning, and, in most states, protect your assets from creditors.

8. Buying Individual Stocks

Investing in individual stocks is an example of uncompensated risk. Any risk that can be eliminated through diversification is by definition uncompensated. Mutual funds provide diversification (plus liquidity and professional management) and therefore less risk than individual stocks. Physicians are very unlikely to select stocks well enough to beat the market averages in the long run and are generally best served by using low-cost, broadly diversified mutual funds.

9. Using Actively Managed Mutual Funds

The literature is quite clear that, over the long run, a low-cost, passively managed (index) mutual fund will outperform 80–90 percent or more of its actively managed peers. Trying to beat the market is a loser’s game; you actually win by not playing. Each year, some mutual fund managers will beat the market, but you are just as unlikely to succeed at choosing those managers a priori as they are to repeat their past
10. Getting Burned by Exotic Investments

Physicians, as accredited investors by virtue of their high income, can invest in many investments not available to the general public. Each investment must be evaluated carefully on its own merits. A physician need not stray from boring old stock and bond index mutual funds to succeed financially, but should you do so, the principles of cautious due diligence and diversification still apply. If it sounds too good to be true, it probably is. Remember that business school professors refer to bad investments as “deals that can only be sold to doctors.”

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Learning from and avoiding the mistakes of others can speed you along your way to achieving your financial goals. Make sure you help your colleagues and trainees by sharing your mistakes with them.

What advice would you pass on to colleagues and trainees to help them avoid costly mistakes? Comment below!

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Cash Balance Plans - Podcast #78
What is a cash balance plan? A cash balance plan is a defined benefit plan. There are two basic types of retirement plans. There are defined contribution plans like your typical 401k and your Roth IRA. They are considered a defined contribution plan because you put a certain amount of money into it and how the investments perform is what you get out of it. With a defined benefit plan, this is like a classic pension that your father or your grandfather had when he worked in the mill, basically all the investment risk is on the company. Yes, you have to put money in that is taken out of your paycheck but the company promises you a certain amount after 20 or 30 years working there. All the risk is on the employer.

A cash balance plan is a type of defined benefit plan. But in reality it is a defined contribution plan masquerading as a defined benefit plan. It is another IRA masquerading as a pension. You have to follow all the pension rules but if you are a high earner, especially in the last half of your career, you can really put a lot of money into these things, all tax deferred. So it behooves you to learn about this type of plan and see if it is right for you.

Before we get into this week’s episode I want to remind you that if you have any questions for the podcast you can record them here. It will be awesome to get some fresh voices on the podcast. If you have the question chances are that many of the other readers and listeners do too. Answering colleagues’ questions and helping them get this financial stuff right is the part of this job I enjoy the most!
Putting you in touch with the good guys in the financial industry is also very important to me. Adam Grossman is one of those guys. If you are wanting more help with your financial planning reach out to Adam.

Podcast #78 Sponsor

This episode is sponsored by Adam Grossman of Mayport Wealth Management. Adam is a Boston-based advisor and works with physicians across the country. Unlike most other advisors, Adam offers straightforward flat fees for both standalone financial planning and investment management. Whatever stage you’re at in your career, Adam can help you get organized with a personalized financial plan and can help you implement it with a low-cost index fund portfolio.

Adam is a CFA charterholder and received his MBA from MIT, but more importantly, you’ll benefit from Adam’s own personal experience with many of the same financial obstacles and opportunities that face physicians.

To learn more, visit Adam’s website mayport.com/whitecoat to download a free e-book especially for physicians.

Quote of the Day

Our quote of the day today comes from Morgan Housel who said,

Good investing is about earning pretty good returns that you can stick with for a long period of time. That’s when compounding runs wild.

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Cash Balance Plans

As I stated in the beginning a cash balance plan is a defined contribution plan masquerading as a defined benefit plan. You have to follow all the pension rules that determine how much money you can put into it. That depends on how many employees you have in the company, how many partners you have, how much money they are putting in, how old you are, etc. Those kinds of things dictate exactly how much money can be put into a defined benefit cash balance plan.

If you are a very high earner and especially if you’re in the last half of your career, 50 plus, you can really put a lot of money into these things, maybe two hundred thousand dollars a year. And that is all tax deferred. Just like a 401k contribution you don’t pay taxes on it now, it goes into that tax protected, asset protected account, and can be pulled out later in retirement, when you have a lower marginal tax rate and spent at that point. It is a great way to catch up on retirement savings.

But because a cash balance plan has to masquerade as a pension there are some rules with it. For example the amount you can put into it is heavily regulated by lots of complicated rules. That is why it is not really a do it yourself project, you’re going have to hire somebody to do it for you. Other rules include if there is a shortfall, the employer has to make it up.

In a typical doctor cash balance plan you are not only the beneficiary of the plan but you are the owner of the business. So you have to make it up when there is a shortfall. That might mean in a down market year you actually have to contribute more into the plan than your typical annual amount. So you want to make sure you have the income flexibility to be able to do that, even in an economic downturn. You don’t want this plan to be committing you to make huge amounts of contributions, although there is some flexibility there, some
things you can do if you really get in a fix. But that is the general rule. That is not necessarily a bad thing because it forces you to buy low. When the market is down, you have to put more money into the plan. That is a good thing, just like rebalancing. It is something that helps you in the long run. But be aware that is an issue.

What happens if the market is doing particularly well? Typically these things only credit you for five or six percent a year. And so if the market does really well the extra earnings in the plan actually go into a side fund within the plan. That money is available for the first part of a downturn. When you start losing money the first thing you do before you have to contribute extra dollars into the account is you take it out of the side fund. Now this is all kind of a masquerade because you own the side fund, you own the regular fund, and you are the guy who is responsible for making up the shortfalls. It is all kind of a game played within the pension system but that is the bottom line how it works.

Some doctors combine it with a 401k profit sharing plan. You put fifty five thousand dollars into the 401k, maybe you put another 30, 50, 200 thousand dollars into the cash balance plan and that allows you to really defer a lot of money. The cash balance plans do cost more than a 401k. There is additional expenses associated with them, they might cost twice as much. You have to pay an actuary every year to run some calculations and do some paperwork for the IRS. You can even get a solo defined benefit plan. I know Schwab offers that, I think some other places do as well. I don’t think Vanguard does. But those are the basic options for a defined benefit plan. If you are saving a ton of money into a taxable account and you would rather get some tax protection and asset protection for some or all of that, then I think it’s worth looking into a cash balance plan. For a typical doctor making 200 or 300 thousand dollars and maxing out Roth IRAs, a solo 401k or a 401K at their employer, and maybe investing a little
bit of money in a taxable account, I don’t think it necessarily makes sense to go looking for a cash balance plan. But for a very high earner in the last half of their career this may be a great option.

A cash balance plan is a type of defined benefit plan. But in reality it is a defined contribution plan masquerading as a defined benefit plan. It is another IRA masquerading as a pension.

Q&A from Readers and Listeners

Children Earning Income for a Roth IRA Contribution

This reader wanted to know what are the 100% legal and unlikely to trigger an audit ways for his 3 month old baby to earn income so he can contribute to a Roth IRA to start his retirement savings? Remember earned income must be earned. That means you have to do some sort of work to do it. There is very little work that a 3 month old can do. Now as your kids get to be 8, 10, 12, 15 you can hire them to work in your business. Maybe if you are renting apartments you can hire them to turn the apartment, to clean it, to paint it. That sort of thing. If you got some other business maybe you can hire them to do some clerical work. But you have to have a business. If you are a W2 employee you cannot do this. You have to actually have some legitimate needs and some legitimate work that is done and you have to pay them a legitimate price to do it. And so for a 3 month old the only thing I can think of is modeling. That is what I pay my kids to do. That is why their pictures are all over the WCI website
and I actually keep a time card. They fill out all the paperwork, they get W2s and W3s and fill out everything that has to be filled out, including immigration, that shows that they are legitimately in this country. You have to treat them like any other employee and then of course you have to pay them a reasonable amount. Now luckily child models command a very good hourly salary. If you look online you see that child models get paid up to 100 dollars an hour. So that is what I pay them. But if you start trying to pay your kid thirty thousand dollars a year for modeling that might not fly with the IRS.

Three Important Tips for Young People to Know about Money and Taxes

This reader does a podcast for high school and college students. Over 95 percent of the students said they wish they were taught more about money and taxes. He wanted to know what are three important tips for young people aged 13 to 22 to know about money and taxes. When I hear young people I was thinking my 9 year old and my 3 year old. People that are 13 to 22, they have to know it all. I think the thing to do is to teach people the basics early on and the best way to do that is by example. If they see you managing money well and not having financial stress they are likely to make similar decisions. If they see you not spending all your money they are likely to make similar decisions. If they hear you talking about taxes and investments and savings they are likely to become financially literate. I think the best thing you can do is model good behavior for them.

Other things to focus on:

1. Help them to understand where money comes from. I am talking about the fact that if you want to get paid you need to put in some work. Teach them the connection
between work and money. That can be through commission or allowance initially then them getting a job.

2. A lesson on debt. It is hard to understand these large sums of money. Think about a medical student is borrowing four hundred thousand dollars for their education and they have never made more than twenty thousand dollars in their entire life. That four hundred thousand dollars is like Monopoly money. They do not understand just how much work and sacrifice it is going to take to pay off four hundred thousand dollars in after tax money. It is going to take years. I think it is important to help them understand that debt is not mandatory, it is not normal, and it is not something that has to be done in all but extreme circumstances. Giving them a realistic understanding of how debt works is helpful.

You can teach kids about all kinds of things and they learn best by doing. My kids all have retirement accounts and bank accounts. They have a bank account at the local credit union. They have a 529 account for their college. They have UTMA accounts, which is money that I’m putting together for their 20s. They have Roth IRAs for any money they earn. They do some babysitting for a neighbor, that money goes into a Roth IRA. I give them a daddy match so they get the same amount of money from me to spend. But anything that is a legitimate earned income goes into the Roth IRA. And then when those statements come every month or every quarter I hand it to them. They realize that they are not making much money in the credit union savings account and that their 529s are doing pretty well. They get to learn about asset allocation. They get to learn about savings, they get to learn about investments, they learn about mutual funds. I’m still talking about my 9 and 11 year old here. I’m not talking even about my teenager. By the time they walk out of the house they are going to know more about money than most adults do. I think that is the way you teach young people about money and taxes. It all starts at
home. You can do it as well with other family members or
friends. I do some volunteer work with a youth group and I
talk to them about money, investing, jobs and those kinds of
things as well.

The Best Mortgage Loan

This question came from an Army pathologist who is a civilian
now. He wanted to know which mortgage loan would be best for
him. A conventional home loan, a physician loan or a VA loan?

The best deal is almost always going to be a conventional
loan. That is because it has stricter guidelines. You have to
put 20 percent down to get a conventional loan if you do not
want to pay private mortgage insurance. Because you are
willing to meet all those requirements you usually get the
best deal on the loan. There are a lot of people that are
competing for your loan and you can get the very best rates
and terms on that loan.

A conventional mortgage loan is almost always better than a
physician mortgage loan. The physician mortgage loans are for
doctors who do not want to put 20 percent down, because they
have a better use for their money like maxing out retirement
accounts or paying off student loans, but without having to
pay PMI. You put down 5 percent or 10 percent, you don’t pay
PMI and you get a halfway decent loan. It is not as good as
what you can get get with a conventional loan though if you
are willing to put 20 percent down.

A VA loan is generally not that good of a loan. You would
think it would be this great service for our veterans but it
has got a pretty high fee associated with it. The terms are
not always that good. Like a physician loan you don’t have to
put 20 percent down on it though. In this doctor’s case
because he was disabled in the military, he gets out of that
finance charge. So it is possible the VA loan is a better loan
for him than it is for most people. But it is easy to compare
to the conventional loan. If the rates dramatically better, the terms are dramatically better, than sure go with the VA loan but otherwise in this situation with a 20 percent down payment I would probably just do a conventional mortgage loan.

**Getting Better Returns in a 529 Account**

This reader’s 529 account in Rhode Island has achieved 2 percent growth over the last year and he was wondering if I had any guidance or experience on the best way to reallocate this type of investment for a better return. I can’t promise anyone higher returns. I can give them a more aggressive or less aggressive asset allocation than what they are in and if the market does well, the more aggressive one will give you higher returns. If the market does poorly the less aggressive one will give you higher returns. But I don’t have a crystal ball. I just can’t answer that question.

But there are a few things I can discuss. First of all keep in mind that Rhode Island has two 529 plans. This is not unusual, a lot of states have two 529 plans and when they do, there is one that basically has no load funds in it and low expenses. This is the one that do it yourselfers use. And there is one that is sold by commission salesmen masquerading as financial advisers.

The one that is bought rather than sold, the one the do-it-yourself investors use is called College Bound saver and the one that is sold by salesmen masquerading as advisers is College Bound 529.

A couple other things to keep in mind:

1. Expenses matter. Know what the expenses are in your investment accounts. Understand what your expense ratios are on those mutual funds and understand what you are actually invested in. In this docs case he is basically in a target retirement or lifecycle type investment which is a reasonable thing to do. However, it sounds
like he wants to take on a little bit more risk and be a little bit more aggressive if he’s frustrated that he didn’t get the market returns in the last year. And so I suggested a little change in the allocation rather than being in this target retirement type mutual fund of funds. Put a third into a total stock market fund, a third into a small mid-cap fund, and a third into an international fund. That would then be a 100 percent stock portfolio in that 529. Obviously there is risk there. I feel like you can take a lot more risk in 529s than you can with your retirement money even though the time horizon is shorter. The reason why is because the consequences are so much less. There are other ways to pay for college. They can take out loans, they can go to a less expensive school, they can work during the summers and while they’re in school, you can cash flow some of it from your current earnings. There is just so many other ways to pay for college, I don’t feel like you have to be super careful with it.

2. Just because you live in a state doesn’t mean you have to use their 529. Look at the 529 carefully to see what kind of tax benefits it offers you. In Rhode Island, you only get a deduction for the first thousand dollars you put into a 529 per kid. So if that is the case and you want to save ten thousand dollars a year, why not put a thousand dollars into the Rhode Island plan, max out your tax benefit there, and put the other nine thousand into a better plan like the one in Utah or Nevada or California or New York. Those ones are known for rock bottom expenses and nice Vanguard or DFA mutual funds. Get whatever your state is going to give you as a tax deduction and go elsewhere with the other money if you’re in a higher cost state plan.

Staying in a Bad Job Just for PSLF

A child psychiatrist with 350,000 thousand dollars in student
loans is going for public service loan forgiveness. She is five and a half years in but deeply deeply unhappy in her nonprofit job. She can’t find another nonprofit job nor nonclinical opportunity that would qualify. She is toying with the idea of going for profit at least temporarily to see if private practice is a better fit for her. She wanted to know what I would do. Wait it out in the nonprofit? Try for profit and potentially lose out on some public service loan forgiveness years? Go for profit and never look back?

It sucks to have a job you don’t like and feel like you’re stuck there with the handcuffs on because you really need the public service loan forgiveness. But she only makes two hundred thousand dollars a year and she owes three hundred fifty thousand dollars in student loans. That is a lot of money and she has the possibility of getting that all forgiven in just four and a half more years of working there.

It reminds me of the job I had when I came out of residency. I would see up to six patients an hour. I did little of what I was trained to do. I worked the equivalent of one point five full time equivalents for 120,000 dollars per year nights, weekends, holidays, and evenings. My employer dictated I live in a state I didn’t want to live in. My employer sent me for up to five months at a time to a country where people were trying to kill me, didn’t let me off a half mile by half mile compound, and forced me to do exercise, dumb training, and wear a camouflage uniform. When I came home my second child didn’t know who I was. Deeply unhappy described how I and most of my colleagues felt about that job a great percentage at the time. But at the end of my four years my “student loans” were forgiven. So when I look at 350,000 dollars as a child psychiatrist, I think it may just be worth sucking it up and stay in an job you don’t like for another four years. It is just a lot of money. Of course keep in mind you could also check with some other options for a public service loan forgiveness eligible jobs, military jobs, those kind of
contract positions are usually also eligible as long as you’re directly employed by them. I wouldn’t do something I was unhappy doing for 20 years but I might do it for four. It is a difficult situation she is in. I empathize with her a great deal but I think in my case I’d really be considering sticking it out especially since there’s a decent chance that she is not going to like it any better in the private sector.

**Ending**

I hope that you find these Q&As from readers and listeners.
Full Transcription

[00:00:00] This is the white coat investor podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high income professionals stop doing dumb things with their money since 2011. Here’s your host Dr. Jim Dahle.

[00:00:19] Welcome to the Whitecoat investor podcast number 78 – Cash balance plans. This episode is sponsored by Adam Grossman of Mayport Wealth Management. Adam is a Boston based adviser and works with physicians across the country. Unlike most other advisers Adam offers straightforward flat fees for both standalone financial planning and investment management. Whatever stage you’re at in your career Adam can help you get
organized with a personalized financial plan can help you implement it with a low cost index fund portfolio. Adam is a CFA Charter holder and received his MBA from MIT. But more importantly you’ll benefit from his own personal experience with many of the same financial obstacles and opportunities that face physicians. To learn more visit Adam’s website Mayport dot com slash white code to download a free eBook especially for physicians.

[00:01:06] Our quote of the day today comes from Morgan Housel who said good investing is about earning pretty good returns that you can stick with for a long period of time. That’s when compounding runs wild.

[00:01:16] If you’ve got questions for us for the podcast you can record them at speak pipe dot com slash Whitecoat investor. That link is also found on the podcast page on the main website but it would be awesome to get some other fresh voices on the podcast. If you can leave us a message that would be great. We’ll pipe it into the podcast.

[00:01:34] Our first question today comes from Steve on Twitter. He says I have a 3 month old son. What are the 100 percent legal and unlikely to trigger an audit ways for him to earn income so I can contribute to a Roth IRA to start his retirement savings? Let’s say with and without access to an LLC.

[00:01:53] Well here’s the deal. Earned income must be earned. That means you have to do some sort of work to do it. There’s very little work that a 3 month old can do. Now as your kids get to be 8, 10, 12, 15 you can hire them to work in your business. Maybe if you are renting apartments you can hire them to turn the apartment, to clean it, to paint it. That sort of thing. If you got some other business you know in your practice maybe you can hire them or do some clerical work. But here’s the deal you’ve got to have a business. If you’re just a W2 employee this isn’t going to work. You have to actually
have some legitimate needs and some legitimate work that is done and you have to pay them a legitimate price to do it. And so when you get down to something like a 3 month old the only thing I can think of is modeling. That’s what I pay my kids to do, to be models, that’s why the pictures are all over the white coat investor website and I actually keep a timecard. They fill out all the paperwork, they get W2s and W3s and fill out everything that has to be filled out, including immigration kind of stuff that shows that they are legitimately in this country. You know you got to treat them like any other employee and then of course you have to pay them a reasonable amount. Now luckily child models command a very good hourly salary. If you look at surveys and you look at stuff on the Internet you see that child models get paid up to 100 dollars an hour.

[00:03:15] So that’s what I pay them. I pay them $100 dollars an hour. But you’re not going to able to pay your 3 month old to clean your office. You know it’s just not going to work. So you’ve got to be a little bit careful with that and I wouldn’t go crazy with it either. You know you start trying to pay your kid thirty thousand dollars a year for modeling that might not fly with the IRS.

[00:03:34] Next question comes from Dr. Mulik, also on Twitter, who says I do a podcast for high school and college students. I’ve a huge stack of their questions on my desk and over 95 percent of them said they wish they were taught more about money and taxes. What are three important tips for young people aged 13 to 22 to know about money and taxes.

[00:03:54] You know when I hear young people I was thinking like you know my 9 year old, my 3 year old. You know people that are 13 to 22, they got to know it all. I mean by the time you’re 22 you’ve been an adult for four or five years. You got to know this finance stuff if you’re going to win at adulting right? But I think the things to do is to teach people the basics early on and the best way to do that is by example if
they see you managing money well and not having financial stress they’re likely to make similar decisions. If they see you not spending all your money they’re likely to make similar decisions. If they hear you talking about taxes and investments and savings they’re likely to become financially literate. And so I think the best thing you can do is model good behavior for them.

[00:04:38] Other things that you probably ought to focus on. One – help them to understand where money comes from. And I’m not talking about you know our fractional banking system where you put your money into a bank and the bank lends out even more money based on your deposit. I’m talking about the fact that if you want to get paid you need to put in some work. Teach them the connection between work and money. All right. And then maybe by paying them commission, some sort of allowance and maybe by getting them a job encouraging them to work and those sorts of things. So I think that’s the number one lesson.

[00:05:11] Number two lesson that I think young people should get is about debt. It’s just hard to understand these sums of money. I mean think about a medical student is borrowing four hundred thousand dollars for your education and they’ve never made more than twenty thousand dollars in their entire life. That four hundred thousand dollars is like Monopoly money. They don’t understand just how much work and sacrifice it’s going to take to pay off four hundred thousand dollars in after tax money. It’s going to take years, years of their life that really is going to exact a price from them. And so I think it’s important to help them understand that debt is not mandatory, it is not normal, and it is not something that has to be done in all but extreme circumstances. And so I think given them a realistic understanding of how debt works is helpful.

[00:05:57] But you can teach kids about all kinds of things and they learn best by doing. My kids all have retirement
accounts and bank accounts. They’ve got a bank account at the local credit union. They’ve got a 529 account for their college. They’ve got UTMA account which is money that I’m putting together for their 20s. They’ve also got Roth IRAs for any money they earn. They go shovel for the neighbor. They shovel off their porch. They do some babysitting that money goes into a Roth IRA. I give him a daddy match so they get the same amount of money from me to spend. But anything that’s a legitimate earned income goes into the Roth IRA. And then when those statements come every month or every quarter I handed to them and they look at them and they realize that they’re not making much money in the credit union savings account and that their 529 are doing pretty well. And so they get to learn about asset allocation. They get to learn about savings, they get to learn about investments, they learn about mutual funds. And I’m still talking about my 9 and 11 year old here. I’m not talking even about my teenager. And by the time they walk out of the house they are going to know more about money than most adults do. And so I think that’s the way you teach young people about money and taxes. It all starts at home. You know you can do it as well with other family members or other friends. You know I do some volunteer work with a youth group and you know I talk to them about money and investing and jobs and those kinds of things as well. And started some investment accounts for nieces and nephews, 529 accounts for them and try to use those to teach them about investments and about match and about money and about those sorts of things.

[00:07:25] Lots of things you can do there. All right. Speaking of loans make sure you’ve checked out our student loan refinancing resources. We have the best links on the Internet the best deals on the Internet for refinancing student loans. They can be found on the main website. If you go to the tabs at the top under recommending the first link is student loan refinancing. So go check that out if you need to refinance student loans and you’re looking for a good deal from a highly regarded company. Also if you need advice, if
you’re in a complex situation with your student loans for instance you have a really large student loans, you are thinking about going for public service loan forgiveness. You’re married to another decent earner. You’re not sure which income driven repayment plan you should be in or how you should file your taxes or whether maybe the 20 year or 25 year forgiveness programs available under pay or repay might actually work for you. You’re the type of person that ought to get advice about your student loans. And I’ve got three or four people listed there on the student loan advice page under that same tab that recommendations tab that can help you with your student loan. So check that out if you’re dealing with student loans.

[00:08:35] All right next question this one comes in by e-mail. I love your website. Great work. I found it two years ago but was already frugal and had some financial savvy. That’s great. I was an Army pathologist but a civilian now. I’m nine years out of residency with no debt and with savings, so that’s great. I have an excellent credit score. Don’t care. Hope you don’t either. I could put down 20 percent on a home if I chose. OK. So maybe the credit score does matter for this Doc since he’s going to buy a home. My question is What do you think would be the best home loan in that situation? A conventional home loan, a physician loan or a V.A. loan? I have a disability rating that absolves me of the finance charge. Thanks for all your guidance. We’ve messed up many things financially but are now moving in a better direction.

[00:09:15] OK well here’s the deal with mortgages right. The best deal is almost always going to be a conventional. That’s because it has stricter guidelines. You have to put 20 percent down to get a conventional loan. If you don’t want to pay private mortgage insurance. And so because you’re willing to meet all those requirements you usually get the best deal on the loan. So a conventional mortgage loan is almost always better than a physician mortgage loan. Now these physician
mortgage loans are for docs who don’t want to put 20 percent down because they have a better use for their money like maxing out retirement accounts or for you know paying off student loans that sort of thing, without having to pay PMI. So you get to put down 5 percent or 10 percent, you don’t pay PMI, and you get a halfway decent loan.

[00:09:57] It’s not as good as what you can get get with a conventional loan though if you’re willing to put 20 percent down. There are a lot of people that are competing for your loan and you can get the very best rates and terms on that loan. And so that’s almost always best. A VA loan is generally not that good of a loan. You’d think it would be this great service for our veterans but it’s got a pretty high fee associated with it. The terms aren’t always that good. Kind of like a physician loan you don’t have to put 20 percent down on it though. In this Docs case because he was disabled in the military. He gets out of that finance charge. So it’s possible the VA loan is a better loan for him than it is for most people. But it’s easy to compare, just compare it to the conventional loan. If the rates dramatically better, the terms are dramatically better, than sure go with the VA loan but otherwise in this situation with a 20 percent down payment I’d probably just do a conventional mortgage loan.

[00:10:50] Next question pertains to 529 accounts. We have an infant. We’re currently contributing into a 529 account in Rhode Island. That account has achieved 2 percent growth over the last year it’s been open and which given the large growth in other investing spaces seems poor. I realize the short term is not the focus point for this type of investment but the account does allow for asset exchange to other funds. And I’m wondering if there’s any guidance or experience on the best way to reallocate this type of investment? If the best course is let it ride, that’s great, less work for me. But if we’re losing out on gains it could be realized with a simple change in allocation that I would prefer not to be. Looking for any
advice. Thanks for all the great content. Don’t use my name. All right. I usually don’t use names on people that e-mail me questions.

[00:11:33] But this is an interesting question right. This doc is like I want higher returns. OK. I can’t promise you higher returns. I can give you a more aggressive or less aggressive asset allocation than what you’re in and if the market does well the more aggressive one will give you higher returns. If the market does poorly the less aggressive one will give you higher returns than what you’re in now without a crystal ball. I just can’t answer that question.

[00:11:56] But we can do a few things we can talk about. First of all keep in mind that Rhode Island has two 529 plans. This is not unusual, a lot of states have two 529 plans and when they do, there’s one that’s basically gotten no load funds in it and low expenses. This is the one that do it yourselfers use. And there’s one that’s sold by commission salesmen masquerading as financial advisers. Rhode Island is the same way they have two 529. I think the one that is is bought rather than sold, the one the do it yourself investors use is called College Bound saver and the one that is sold by financial advisers or rather salesmen masquerading as advisers is college bound 529. I couldn’t tell from what this doc posted in the first e-mail which one he was using. But it turns out he was in the right one anyway thanks to a follow up e-mail.

[00:12:47] A couple other things to keep in mind. Number one expenses matter. So know what the expenses are in your investment accounts. Understand what your expense ratios are on those mutual funds and understand what you’re actually invested in. You know each mutual fund invests in different types of asset classes and in this doc’s case he is basically in a target retirement or lifecycle type investment which is you know a reasonable thing to do. However, sounds like he wants to take on a little bit more risk and be a little bit
more aggressive if he’s frustrated that he didn’t get the market returns in the last year. And so I suggested a little change in the allocation rather than being in this target retirement type mutual fund of funds. I suggest the team I want to put a third into a total stock market fund that he has there, a third into a small mid-cap fund, and a third into an international fund that would then be a 100 percent stock portfolio in that 529. Obviously there’s risk there. The market turns around he’s going to lose money but in a 529 I feel like you can take a lot more risk than you can with your retirement money even though the time horizon is shorter. And the reason why is because the consequences are so much less. There are other ways to pay for college. They can take out loans, they can go to a less expensive school, they can work during the summers and while they’re in school, you can cash flow some of it from your current earnings. There’s just so many other ways to pay for college. I don’t feel like you got to be super careful with it because if you take a big loss right as they enter college is just not that big a deal. Cash flow the first year or two and give the market a couple of years to recover and then use the money to pay for their third and fourth year or keep cash flowing it if there is a long bear market and use that money for their sibling. I mean there’s just so many options and so much flexibility with college. I feel like you can take a little bit more risk there and it sounds like this doc wants to anyway.

[00:14:33] The other thing to keep in mind is just because you live in a state doesn’t mean you have to use their 529. Look at the 529 carefully see what kind of tax benefits it offers you. In Rhode Island, you only get a deduction for the first thousand dollars you put into a 529 per kid. So if that’s the case and you want to save ten thousand dollars a year why not put a thousand dollars into the Rhode Island plan, max out your tax benefit there and put the other nine thousand into a better plan like the one in Utah or Nevada or California or New York. You know those ones that are known for rock bottom
expenses and nice Vanguard or DFA mutual funds. So that’s something to consider as well especially if you’re in a higher cost state plan. Get whatever your state is going to give you as a tax deduction and go elsewhere with the other money.

[00:15:20] All right next question. Can you talk about cash balance plans on the podcast? What is a cash balance plan? A cash balance plan is a defined benefit plan. Remember there’s two basic types of retirement plans. There are defined contribution plans like your typical 401k, your Roth IRA, that sort of stuff is considered a defined contribution plan because you put a certain amount of money, a certain contribution, into it and that’s the part that’s fixed and however the investments perform that’s what you get out of it. With a defined benefit plan, this is like a classic pension that your father had or your grandfather had when he worked in the mill and basically all the investment risk is on the company. Yes you had to put money and it’s taken out of your paycheck but they promise you a certain amount after 20 or 30 years working there. And so all the risk is on the employer. What a cash balance plan is a type of defined benefit plan. But in reality it’s a defined contribution plan masquerading as a defined benefit plan. It’s another IRA masquerading as a pension. That’s what it is. And so you’ve got to follow all the pension rules and those determine how much money you can put into it. And that depends on how many employees you’ve got in the company, how many partners you have, how much money they’re putting in, how old you are. All those kinds of things dictate exactly how much money can be put into a defined benefit cash balance plan.

[00:16:52] But if you are a very high earner, you know you’re ophthalmologist making six hundred thousand dollars, or a plastic surgeon making a hundred thousand dollars. And especially if you’re in the last half of your career 50 plus, you can really put a lot of money into these things like maybe two hundred thousand dollars a year. And that is all tax
deferred. Just like a 401k contribution and you don’t pay taxes on it now it goes into that tax protected, and asset protected account, and can be pulled out later in retirement. When you have a lower marginal tax rate and spent at that point it’s a great way to catch up on retirement savings.

[00:17:27] But because it has to masquerade as a pension there are some rules with it. For example you know the amount you can put into it is heavily regulated by lots of complicated rules. That’s why it’s not really a do it yourself project, you’re going have to hire somebody to do it for you. But other rules are: If there’s a shortfall the employer has to make it up. And in a typical Dr cash balance plan you’re not only the beneficiary of the plan but you’re the owner of the business. And so you have to make it up when there’s a shortfall. And so that might mean in a down market year you actually have to contribute more into the plan than your typical annual amount. So you want to make sure you have the income flexibility to be able to do that even in an economic downturn. So you don’t want this plan to be committing you to make huge amounts of contributions although there’s some flexibility there and you can close the plan and there are some things you can do if you really get in a fix there. But that’s the general rule. That’s not necessarily a bad thing because it forces you to buy low. Right. The market’s down. You’ve got to put more money into the plan. That’s a good thing. It just you know just like rebalancing. It’s something that helps you in the long run. But be aware that that’s an issue.

[00:18:39] What happens if the market is doing particularly well? You know I mean typically these things only credit you for five or six percent a year. And so if the market does really well the extra earnings in the plan actually go into a side fund within the plan. And so that money is available for the first part of a downturn. You know you start losing money the first thing you do before you have to contribute extra dollars into the account is you take it out of the side fund.
Now this is all kind of a masquerade because you on the side fund you own the regular fund and you’re the guy who is responsible for making up the shortfalls. And so it’s all kind of a game played within the pension system but that’s the bottom line. That’s how it works. And so what stocks do is they combine it with a 401k profit sharing plan. You put fifty five thousand dollars into the 401k, maybe you put another 30, 50, 200 thousand dollars into the cash balance plan and that allows you to really defer a lot of money. The cash balance plans do cost more than a 401k. There’s additional expenses associated with them might cost twice as much, for instance. You have to pay an actuary every year to run some calculations on and do some paperwork for the IRS. You can even get a solo defined benefit plan, a personal defined benefit plan. I know Schwab offers that, I think some other places do as well. I don’t think Vanguard does. But those are the basic options for a defined benefit plan. So if you’re saving a ton of money into a taxable account and you’d rather get some tax protection and some asset protection for some or all of that then I think it’s worth looking into a cash balance plan. For a typical Doc making you know 200 thousand dollars three hundred thousand dollars and Maxing out Roth IRAs and a solo 401k or a 401 K at their employer and maybe investing a little bit of money in a taxable account. I don’t think it necessarily makes sense to go looking for a cash balance plan.

[00:20:32] All right next question, I thought that if you were to convert retirement account money into a Roth that you had to convert the whole account. Is it possible to convert variable sums each year as you wish. Yes you only have to convert as much as you want. You can spend 10 years converting one IRA to a Roth IRA if you want. And a lot of people do that in those years between retirement or when they cut back and when they start taking Social Security to move money into a Roth IRA. So they don’t have to pay required minimum distributions on it. And to give them some tax diversification in retirement. You certainly do not have to convert the whole
Next question. I’m a child psychiatrist. When you’re out of fellowship with 350,000 thousand dollars in student loans and I’ve been planning on applying for public service loan forgiveness when I qualify. I’m five and a half years in. My husband is another Doc with slightly less loans refinanced at two and a half percent that will pay off in about five years. I am deeply unhappy in my nonprofit job. I’ve looked endlessly at other nonprofit jobs and I can’t find anything better. I’ve even looked into nonprofit, nonclinical opportunities but they pay significantly less than I make now around two hundred thousand dollars. I’ve been toying with the idea of going for profit at least temporarily to see if private practice is a better fit for me. I don’t want to keep the loans pending such a high interest rate but I am afraid to refinance if I am unhappy in the private sector as well. What would you do? Wait it out in the nonprofit? Try for profit and potentially lose out on some public service loan forgiveness years ago? Go for profit and never look back?

I’m so sorry you’re in this situation. It sucks to have a job you don’t like and feel like you’re stuck there with the handcuffs on because you really need the public service loan forgiveness. But you only make two hundred thousand dollars a year and you owe three hundred fifty thousand dollars. In student loans. That’s a lot of money and you have the possibility of getting that all forgiven in just four and a half more years of working there. It reminds me of the job I had when I came out of residency. I would see up to six patients an hour. I did little of what I was trained to do. I worked the equivalent of one point five full time equivalents for 120,000 dollars per year nights, weekends, holidays, and evenings. My employer dictated I live in a state I didn’t want to live in. My employer sent me for up to five months at a time to a country where people were trying to kill me, didn’t let me off a half mile by half mile compound, and
forced me to do exercise, dumb training, and wear a camouflage uniform. When I came home my second child didn’t know who I was. Deeply unhappy described how I and most of my colleagues felt about that job a great percentage at the time. But at the end of my four years my student loans were forgiven. So when I look at 350,000 dollars as a child psychiatrist. I think it may just be worth sucking it up and stay in an job you don’t like for another four years. Would I get out as soon as I had that public service loan forgiveness. I probably would. And I’d go try a private sector job I’d go try something else and see if I can find something else that’s going to make me happy. You do have the benefit of having a husband that’s a physician. I think an anesthesiologist who makes pretty good money and is going to wipe out his student loans and certainly you ought to be looking at all your money together you know. It’s our money once you get married, it’s our loans, it’s our income and maybe it’s not that big a deal given that other income to pay off that 350,000 dollars in student loans. But I think in this sort of a situation I try to stick with it and stick with the plan and try to get those loans paid off. It is just a lot of money. Of course keep in mind you could also check with some other options for a public service loan forgiveness eligible jobs, military jobs, those kind of contract positions are usually also eligible as long as you’re directly employed by them. I wouldn’t do something I was unhappy doing for 20 years but I might do it for four. Especially if they were basically giving me the equivalent of six years of pay. I mean think about as you’re making 200,000 dollars a year you know for four years and they’re going to Forgive 350,000 dollars in loans because of it. That’s like a pretty significant boost to your pay. It’s a pretty good raise. So you know it’s a difficult situation you’re in. I empathize with you a great deal but I think in my case I’d really be considering sticking it out especially since there’s a decent chance that you’re not going to like it any better in the private sector.
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Should You Put Rental Properties in an LLC?

[Editor’s Note: Today’s WCI Network post was originally published on Passive Income MD. It answers an important question that I get frequently. While the question can be
answered in one word (yes), it’s good to understand the reasoning behind it. Although I never got around to putting my accidental rental property in an LLC, all the real estate investments (mostly syndicated) I’ve had since have been inside one, for good reason. PIMD included this disclaimer with the original post and I echo it here: I am not an asset protection, legal, financial, or tax expert. I can only tell you the things I’ve learned when researching whether an LLC is the appropriate structure for holding my own rental properties. Please consult a professional before making any decisions in this arena.

Should you form an LLC and put your rental properties in it?

If you have rental properties or are looking to purchase some, the question of whether or not to form a Limited Liability Company (LLC) has probably come up at some point. I see this question posed quite often on related forums, as well as on the Passive Income Docs Facebook Page. LLCs can be a great way to protect yourself and your assets, and as an owner of several rental properties in various states, I’ve pondered this question myself.

Unfortunately, it’s never completely cut and dry. There are many factors at play, particularly asset protection and taxation issues, that need to be considered before making this decision. For some, it may be better to simply increase your insurance coverage. But finding unbiased advice on this question can be difficult.

If you ask an entity lawyer whether you should form an LLC, they’ll say yes. If you ask an insurance agent whether you should increase your liability and umbrella insurance instead, they’ll say yes. The old saying, “Never ask a barber if you
need a haircut,” seems to hold true. So, should you put your rental properties into an LLC? Well, the answer is . . . it depends. Once you’ve weighed the options, the answer to your situation will hopefully become more clear. So let’s try to break it down a bit with a classic advantages/disadvantages list—one for the LLC, and another for simply increasing your insurance coverage.

**Advantages of an LLC**

**Asset Protection**

One of the major reasons LLCs were created in the first place was to limit personal liability. This is probably the main incentive for investors to have rental properties in an LLC. The risk of a lawsuit is hypothetical, but every one of us in the medical field knows to take the threat of a lawsuit seriously. The last thing anyone wants is for a tenant in a rental property to have an issue, even if it’s out of your control, and have them go after your personal assets.

**Tax Advantages**

LLCs can be designated as different types of tax entities, but I would venture to say that if you’re reading this, you would likely have it taxed as a “pass-through” entity. This means that the income and capital gains from the LLC pass directly to the owner. Taxes are then paid as an individual. However, the owner still gets to enjoy the protection afforded by the LLC. The recent changes in the tax law have made some adjustments to how pass-through entities are taxed. Whether that is to your advantage, specifically, is something you should discuss with your CPA.

**Anonymity**

When you own rental property, the name on the deed (yours) is public knowledge. In a very bad scenario, they could see you’re a high-income professional with M.D. status. This
knowledge may determine their behavior. This is exactly why many of my colleagues say they will never put an M.D. vanity plate or hospital bumper sticker on their car in case they get into an accident. If you have a holding company in a state that allows for total anonymity like Wyoming or Nevada, it’s even more difficult for anyone to figure out who the owners actually are.

Disadvantages of an LLC

Cost

There is a cost to forming and maintaining the entity you create. There may also be an additional cost for tax preparation. I’ve talked to lawyers who will charge $600 for an entity creation and others that will charge $2,000. Then there’s always LegalZoom which will do it for a couple hundred but who knows whether it’s good enough. I’ve found that just to maintain any of my California LLCs, it’s about $800 a year for each one. Is the cost worth it? Well, that leads me to the next point.

Unclear Asset Protection

Unfortunately, simply have the letters “LLC” on the deed doesn’t necessarily fully protect the owner. There are situations where it does protect well... and there are times when it doesn’t. Again, it’s not fully clear what those situations might be. What’s in your operating agreement may help, but that depends on who helps create the entity. The only way you’ll know for sure is when a suit arises.

Trouble Getting Financing

Good luck trying to get a loan when purchasing a single family home (or a duplex/tri/quad) under the name of the LLC. As far as I know, almost all lenders will not let you borrow in the
name of the LLC. Instead, they want someone personally liable. This may require you to buy the property entirely in cash, or you can try to deed the property to the LLC after purchasing in your own name. Which, again, leads right to my next point.

**Due-on-Sale Clauses**

It’s quite possible that if you try to convert ownership over to an LLC, your lender will view that as a complete change of ownership and ask for full repayment of the loan. I’ve talked to many investors who say they’ve done this conversion with no issues, but there’s no guarantee that the bank won’t ask for full repayment of the loan. At that point, you’re left to either pay it off in cash, refinance (which might be difficult—see my above point), or sell the property.

**Insurance**

There is another option altogether, which is to protect yourself with liability and umbrella insurance. Sure, tenants can sue you personally, but if you have enough insurance to cover, then you’ll likely be just fine. However, as always, there are some advantages and disadvantages.

**Advantages of Increasing Insurance**

**It’s Simpler**

We all have to get insurance for the property anyway. While you’re at it, you just have to make sure the policy covers the proper limits, add umbrella insurance, and you’re done.

**Cost**

Umbrella insurance is typically pretty cheap for the type of coverage you get. It’s a small fraction of what the primary insurance premium is. The concept of umbrella insurance is an add-on to cover you above and beyond your typical insurance.
Disadvantages of Increasing Insurance

Potential loss

If you’re sued with a property-structured LLC, the worst case scenario is you declare bankruptcy on the LLC and you lose the property. With only insurance as your protection, if the lawsuit exceeds your policy coverage, then you may have to pony up the money yourself and lose personal assets beyond just that single property.

Exclusions

Insurance policies often have exclusions which you have to account for. You really need to know what they will cover and what they won’t. Are you willing to take that risk?

What About My Properties?

It all comes down to a matter of risk tolerance. After all, isn’t that really what insurance is? You’re paying to mitigate risk and to sleep easier at night. When it comes to my rental properties, I pretty much have all of them under an LLC, and the ones that aren’t yet are in that process.

Through the LLC, my lawyers and I have created a structure that seems to offer me good protection. Of course, nothing is ever ironclad, but it helps to have some structure. In case you’re curious, here’s a very simplified representation of what I have set up.
In this simplified diagram, you can see that the holding company holds owner interest in each of the separate LLCs. The one big tip I will give you is that if you are planning to buy properties with an LLC, it is much easier if you have that entity created prior to taking ownership of the property. If you’re buying an apartment using a commercial loan or an investment property in cash, you will be able to directly buy it in the name of the LLC, otherwise, you have to convert it later.

I’m going through that process right now with some properties and it’s time-consuming and expensive to hire the lawyers to change over the deeds. I’ve had to pay extra for title insurance companies to continue with my policy. So, try to have the entities created beforehand if possible.

In my own case, the anonymity of the LLC under a holding company has definitely made me rest easier. In the area of
asset protection, one term that you’ll hear is “piercing the veil.” This means that when sued, the lawyers will do their best to keep tracing back the lineage of origin or ownership to see exactly who can be brought into the suit. If they can “pierce the veil” they can hold the owners of shareholder personally liable. So in my case, they may get to my holding company if they are able to get past the LLC, but that’s pretty much as far as they can go—the owner of my Wyoming holding company is not public.

How much did all that cost? I actually knew I would be forming a good number of companies and ended up doing an unlimited LLC formation plan. This cost me $6,000-$7,000. I invite you to tell me if that seems ridiculous or if it’s a good deal. But after forming 8 entities with more coming, I think I made the right decision (so far).

Beyond the LLCs, however, I also maintain a decent umbrella insurance policy. I believe that the best idea is to have both the protection of the LLCs and the coverage that insurance provides. Based on my assets, I currently have $3 million in umbrella insurance, but I’m continuing to evaluate that as I go.

By going with both approaches (LLCs and good insurance), I feel as well-covered as I can be. Yes, there will be lawyers who tell you it’s not enough. I spoke to one lawyer who pitched me a plan that would’ve cost me close to $30,000 to make my asset protection “totally ironclad.” Perhaps it would have been, but I wasn’t willing to pay that much and I felt that my current level was enough to put my mind at ease. Don’t be afraid to get a second opinion and learn from each expert’s advice. I’m still learning as I go, but for the moment, I can rest easy at night.

How about you? Do you hold your properties in an LLC? Or is
I find the subject of selling online businesses endlessly interesting. Although I haven’t just bought a few random sites from people I didn’t know, I’ve considered it in the past, and I think it may become an up and coming asset class. I own part of a couple other websites in the WCI network and regular readers here know that I considered very seriously selling this website a couple of years ago. If you ever wondered how to invest in online businesses this episode is for you. Gregory Elfrink, from Empire Flippers, walks us through the process of buying an online business and gives us the ins and outs of this asset class. Now don’t go investing 50% of your portfolio in online businesses but if this is interesting to you consider investing a smaller percentage.
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Quote of the Day

A big enough bonus can convince even honest, law abiding finance workers selling garbage products that they’re doing good for their customers. – Morgan Housel

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Introduction

Before we get into the interview with Gregory I want to say thanks for what you do. I know the work you do each day is not always appreciated by those you do it for. And a lot of people don’t appreciate the fact that you sacrificed a significant portion of your life and health to do it.

Regardless it is pretty interesting work. I had a fascinating heart rhythm, an arrhythmia in a young person in the ER just the other day. They had isorhythmic atrioventricular
dissociation, which I’d never seen before in all the years I’ve been practicing. It was kind of fun, I put it up on Twitter and got a lot of responses. I had the cardiology types who correctly identified it, and I had the orthopedic types who said, “it goes up, it goes down, looks like it’ll move keflex around the body.” And then of course I had the finance people commenting on it, who said it looked like a stock chart for something they didn’t really want to buy. But either way, it was pretty fun to see what people thought of that EKG. There is still lots of interesting stuff out there that you haven’t seen yet in your career. It is still intellectually stimulating and so it is awesome sometimes to have a job in clinical medicine.

**Main Topic**

But on to the main topic of this episode. Though we realized during our interview that Gregory and I grew up in the same neighborhood in Alaska, he now lives in Vietnam. The idea of being location independent is pretty foreign to most of my readers, but it is pretty awesome that he is able to live basically anywhere he wants in the world and continue to do his job because it is all online. If that sounds appealing to you now or in the future investing in online businesses may really be for you.

[Empire Flippers](#) is one of the top brokers for online businesses. They’ve sold 50 million worth of websites. That just doesn’t seem like very many to me for the number one, or close to it, business. But this industry really is that tiny, that 50 million gets you to number one spot. Online businesses are really not that old. They have just become an asset class in the last few years. The oldest online model, an affiliate site, or an AdSense site, have only been around for maybe 10 years, and really probably more like seven years when it comes to buying them as an asset. That gives you the backstory of why this is now just starting to happen, the sites are at
their maturation point.

Types of Online Business

There are many different types of online businesses or websites. Here is more specific information concerning the 11 most popular online business models. But for our purposes here we discuss 3 mains kind of online business models:

Content Sites:

Now these are sites like mine or Physician on Fire and Passive Income MD where the primary business model is producing content around a certain subject. You may click on a link in one of our articles and be sent to Amazon, and if you buy anything off of Amazon.com in the next 24 hours, there’s a cookie that Amazon has given that site owner that will give them a commission on anything you buy, at no extra expense to you. Amazon is the most famous one as far as affiliate programs go. But student loan refinancing and real estate crowdfunding companies work similarly. So content sites would include companies that make their income off affiliate deals and AdSense Google ads. Basically the site owner sells their products or services and doesn’t have to keep any inventory themselves.

E-Commerce Sites:

Ecommerce is like having a digital retail store. You buy a product, find a place to store and fulfill orders for that product, and promote the store through internet marketing strategies. This could be something like creating a Shopify store, where you source your own product and sell those through your Shopify store. Just like a traditional retail store, except for there is no offline component. This category would also include drop shipping sites, where you don’t hold the product yourself but the actual factory ships directly to the buyer. Amazon has a version of this too, Amazon FBA, which is basically a traditional e-commerce store, only all the
sales are happening on your Amazon product listing. And Amazon takes care of a lot of the more tedious and oftentimes painful parts of running an e-commerce business for you.

**Software as a Service Sites:**

These are the SaaS sites Gregory refers to in his interview. If you are familiar with sites like Mail Chimp, what I use to send out *our monthly newsletter*, it is a software as a service site. I pay monthly for it. These are currently a very, very hot business model because the recurring revenue is obviously very attractive. Apps would fall into this broad category as well.

In terms of what is the most common, definitely e-commerce and content sites.

**Why Invest in Online Businesses?**

Gregory gives his reason in this example:

> Let’s say you were really big into low cost index mutual funds, you don’t have to do anything with them. But you want to get into something a little bit more risky. If you’re the average Joe, it’s unlikely that you would ever have the amount of money you would need to put into a certain stock to either make that price go up or that price go down. But with a website the required money to make a significant difference in the revenue of a business is much lower.

The other investment to compare with is real estate. Real estate gives you a little bit more control, because it’s a physical house, you can repair it, fix it up, and then hopefully sell it for more later. An online business is very similar to real estate, (only more volatile because things change all the time in the online business space) but you have more control over it than real estate. Here is his example:
Let’s say you bought a content site for $40,000.00, which roughly will get you a site making 1500 to $2,000.00 cash flow on that profit every month. You would be hard pressed to do that same deal in real estate, and you’d be even more hard pressed to do a test, like a two week test that we call conversion rate optimization, that tests your affiliate links and different colors, different fonts, and different placements that could lift that income up by 20% within the first month, which isn’t that uncommon with using conversion rate optimization.

So why invest in online businesses? There is great potential for higher returns.

**Why NOT to Invest in Online Businesses?**

You do need to have some kind of skill set. You have to learn a little bit about what you are buying. So there is a learning curve there. But maybe not a bigger learning curve than investing in real estate, and the cash on cash return could be awesome.

When you are looking at your [Personal Investment Plan](#) (you have one right?! If not, [take this course](#) and create one.) and trying to decide what percentage of your portfolio to invest in online businesses (if any) remember this: It should be absolutely okay if you lose everything. If you bought a content site with the main traffic source being Google, like Google organic traffic, and Google changes it’s algorithm, you might lose all that traffic overnight. Is that something that happens often? Not really, but it can happen, so you should always be okay with losing this money.

So why not invest in online businesses? Risk and the learning curve. But if you want aggressive growth and have the willingness to learn some of the skills that can get you a leg up, look more closely at this asset class. $40,000-$100,000 invested in an online business would be a pretty good starting
What is the Skill Set Needed?

If you are like me you don’t want another job. So I asked Gregory how do you get it to be more passive investment like rather than job like?

His response:

One of the cool things about online businesses in general is a lot of the work is pretty front loaded. Go back to a content site, you start a site, let’s say it’s about juicers, you put in all that work, you get 50-80 articles on there, it’s starting to rank in Google, you’re starting to make some money. You get it up to that $2,000.00-$5,000.00 per month selling juicers and other related products around that niche, then you stop working on it. You go on a vacation or whatever, and that money still keeps coming in. Just because you stop working on it doesn’t mean Google isn’t sending traffic to it over and over again. So you could theoretically have this huge website with thousands of articles that are pulling in this organic traffic on a daily basis, making sales for you, more or less hands off.

Sounds great right? Well, there is some maintenance. According to Gregory:

You’ll want to update the articles, if you see something weird happen with your traffic you should probably investigate that. But overall, there’s not that much to go into maintaining a content business, or even in some cases an e-commerce business, if you get the logistic side down. If you’re looking at buying a business, that seller is going to tell you what those skill sets are. They usually have standard operating procedure, kind of like an operator’s manual that the investor can look at, and that allows the investor to say like, “Okay, well, am I willing to do this,
With this kind of investment, especially in the content site, once you buy the site, unless you want to grow it can be maintained with minimal effort. Of course if you want to scale the business, ask any blogger, there is going to be a lot more work involved.

What Kind of Multiples Should You Expect?

In this industry multiples are talked about in two different ways. 2-4X is for annual earnings before interest, taxes and amortization. 20-50X is monthly. Online businesses can be valued on either. At Empire Flippers, they are valued on a monthly multiple, because it lets the investors see a little bit better, and also lets them evaluate the business better. Gregory said right now they are seeing 25-35X of monthly net income.

When I considered selling this business I was surprised just how low the multiples are. You are selling for basically what you’ll make in profit in the next two years. I came to the thought that well, shoot, if I’m selling it for that small amount of money, I can just hold onto it, make that money over the next two years and still own the thing. I mean, these are incredibly low multiples compared to a brick and mortar business, or compared to a real estate property. So I asked him why does anybody sell with that kind of a multiple?

I got various reasons. One guy use the money from selling his sites to leverage himself into a more lucrative market. Another guy sold his business to adopt a child. The coolest story he shared was actually about a Cambodian, he sold his business for around $250,000.00. That’s a lot of money for anyone, but that’s generational wealth income for this guy in Phnom Penh, Cambodia. So now he started teaching all these
other Cambodians how to create these affiliate sites in the American market.

Gregory says:

*The multiples are lower compared to a traditional business but I would say the cash flows tend to be much, much stronger than a traditional brick and mortar business.*

The multiples may be lower because of the risk and/or because this asset class is relatively new. Or because there is very little financing in this industry.

**What is the Process for Buying an Online Business from Empire Flippers?**

Most of the scams and illegitimate opportunities when it comes to buying an online business happen at the sub $40,000.00 range. The reason why is just because it’s much easier to fake traffic and sales at that level. So Gregory recommends starting at 40k. You can obviously start much lower than that. There’s nothing wrong with buying a sub $40,000.00 business, just if you’re in that range, be extra careful with your due diligence.

The process depends on if you decide to go with a broker, like Empire Flippers or if you decide to go with a private sale. On a private sale you find the site yourself, and you reached out to that site owner, you asked them if they are interested in selling, and they say yes or no, and that process starts.

If you come to a place like Empire Flippers, you can click on their marketplace, and they have all these online businesses that are for sale that they have vetted. They use a deposit system where you put down a 5% refundable deposit, that way they are only bringing potential buyers to their sellers, who are actually interested in the business and have some skin in the game, even though they always refund the deposit.
Empire Flippers gives you more substantial private information about the business, such as the URL, the P&L, and any other sensitive information that they keep from the public eye. You can get that so you can start your due diligence. You can start asking their salesmen questions and their business analysts will respond with answers, they’ll talk about what the seller might be willing to take, etc. And eventually a potential buyer will get on a buyers-seller conference call, where one of their business analysts helps that buyer negotiate the deal with the seller, and answer any other outstanding questions.

Once you come to a price that you agreed on, you sign what’s called a APA, asset purchase agreement, and that any other kind of contractual stuff you want in the deal, such as support or certain privileges, if they have a special deal with a manufacturer or things like that. And once that’s all signed, the money is sent in to Empire Flippers. They hold on to the money acting as escrow while they help you actually migrate that business over to you as the buyer. So if you bought an affiliate site, they would help migrate that site over to your hosting and would help you change all the affiliate links.

Using a broker you get what they call revenue verification, so that is a brief window or period, usually about two weeks, but it can be extended based off negotiations between the seller and the buyer. And that’s where they hold onto the money that the buyer has sent to them, and they hold onto the domain of the seller so that way they have a bit of leverage to make sure everyone’s doing what they said they were going to do. And it gives the buyer time to look at their traffic analytics, or their P&L, and their income dashboard with whatever monetization they have to make sure that yes, everything the seller has told you is true, you are seeing the traffic coming in, everything is correct, etc. And after that verification period, the buyer will tell them, “Go ahead,
release the funds, everything is correct.” And they will release the funds to the seller, minus their commission, and that’s the whole process in a nutshell.

**What is the Process for Selling an Online Business with Empire Flippers?**

You submit your basic information, like date created, when was it first profitable, your contact information, etc. And you pay a $297.00 listing fee. Unless you are a repeat seller, then you only pay $97.00, and that covers the cost for their team to do the actual vetting part, making sure the business is legitimate. They will collect information, such as access to your analytics, profit and loss statement, and ask you any kind of questions. And verify your identity.

That usually takes a two week period. It can be a little bit longer depending on the complexity of the business. But content sites tend to be a little bit faster when it comes to vetting. They will tell you what they think it is worth, giving you a price point that they think it will sell on their marketplace, and then you will talk to your vetting specialist and say either, “Yes, I think this is the right price,” or, “No, I think this is wrong and here is why.”

Once that is all agreed on it goes live on their marketplace, they promote it out to their database of 80,000 buyers on their email list, and they start doing some Facebook ads and start syndicating it across different marketplaces. Potential buyers will start doing their due diligence on your business. You as the seller should be very hyper responsive during this period and answer any questions that come in. Empire Flippers sales team will take the most common questions that you’ve answered, and they’ll just start answering it for you and start prospecting their buyer database, doing criteria matching with them to bring them over to your business, and help you negotiate the deal for the highest offer.
Once you get an offer you accept from that same buyer-seller conference call, that is when the migration process begins, and it’s pretty similar to what it’s like when buying an online business, instead of them handing the business over to you though, they would help you hand the business over to the buyer.

**For a Buyer, What Additional Vetting Should You Do?**

The vetting that the broker does is just making sure that the business is a legitimate opportunity that is making money.

**Due diligence is different. It can be very personalized.**

Gregory said:

*My best tip when it comes to doing due diligence is write out a simple list of what kind of investment you want. Do you want something that’s hands off? Do you want something that you can really roll up your sleeves and get into, kind of like a rehab house, or fixer upper in real estate, if you will, or do you want something that has systems in place, has a team in place that you can scale, that just needs that little extra push because of some skill set that you bring to the table that the seller didn’t have?*

*Ask yourself those questions, what do you want first? And then when you have that list, when you’re looking at the potential businesses to buy, you should look for ways to disqualify those businesses as quickly as possible. So if something almost meets the criteria that you’re looking for, you should just X it out, because there’s tons of other opportunities out there, you should keep looking for the one that matches all your criteria. And as you filter them down, say you start with 100 business, do good due diligence, you probably end up looking at 10, maybe 12 of those businesses. And maybe make an offer on two or three at the end of the day, and take one.*
At Empire Flippers, they usually sell within 10% of the list price. And they are paid using a tiered system with commission. So anything less than a million dollars, they do 15% commission, and a million to two million is 12%. Then two to five million is 10%, and anything five million and above is 8%.

**What are the Biggest Mistakes Buyers and Sellers Make?**

The biggest mistakes he sees sellers making is trying to sell their business on potential:

So what I mean by that is you have a seller who’s excited to sell his business, and you get this buyer that’s interested in it. And the seller just keeps going on about how awesome his business is, like it’s perfect, this thing is going to be worth a million dollars, a billion dollars. And that actually turns the buyer off from buying your business when you sell it on potential. That buyer will look at you and say, “Well, if it’s so great, how about we do this, I’ll give you $5,000.00 and the rest we can do this big earn out that’s tied to the milestone of when that business hits this dreamy plateau you’re talking about.” So that I say is a big mistake that sellers make.

Instead focus on the mistakes you made in the business. They want to hear that, because a lot of times the mistakes, and what’s wrong with the business, is actually the investment opportunity for the buyer.

On the buyer side, one of the big mistakes is not asking for seller financing.

*I always recommend that the buyer should do seller financing. It doesn’t hurt to ask even on a $100,000.00 deal you can ask, “Hey, I’ll pay you this $100,000.00. I’ve give you $70,000.00 up front, and you seller finance me a $30,000.00...*
earn out over a period of so and so months.” The great thing about doing that is a lot of times sellers are very open to that, and very rare do they ever charge you interest, so it’s basically an interest free loan that you’re getting from the seller, so that is definitely something I recommend to buyers.

Not understanding how deal structuring works is also a big mistake that buyers end up leaving money on the table.

Deal structuring is where, when you put in an offer on a business, say it’s a million dollar offer, you put down $800,000.00 up front, and then $200,000.00 over a period of time, you want to attach milestones to those periods, and maybe those milestones are tied to revenue, or tied to net profit. If you’re a buyer, I’d always recommend tying it to net profit. Most sellers will likely not go for that, they prefer you to tie it to net revenue, but if you can tie it to net profit, that’s a really great way to mitigate your risk, even if you are paying full list price, you’re starting to mitigate your risk by how you structure the deal.

This might sound much more complex than it really is. It actually is not as complicated as it sounds, it just takes a few skill sets that you need to learn, similar to buying real estate. If you want to learn more from Empire Flippers, they have both a blog and a podcast.

What do you think? Is this an asset class that you are interested in?

**Full Transcription**

Intro: This is the White Coat Investor Podcast, where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high income professionals
stop doing dumb things with their money since 2011. Here’s your host, Dr. Jim Dahle.
WCI: Welcome to the White Coat Investor Podcast, this is episode number 77, Investing in Online Businesses. This episode is sponsored by our friends at Zoe Financial. Finding a reputable financial advisor can be difficult. And even more difficult is finding an advisor you personally connect with that also specializes in the areas where you need help. Like taxes, diversifying investments, or just budgeting. That’s where ZoeFin.com. They have developed an algorithm that matches you with an advisor based on your unique life stage and goals. All of the advisors in Zoe’s network are independent, accredited, fee only fiduciaries, and amazingly this means that Zoe rejects 95% of the advisors they interview, so you don’t have to waste time with sales people. Visit ZoeFin.com/whitecoat, take their quiz, and schedule your free call today. That’s Z-O-E, F-I-N dot com, slash white coat.

WCI: Our quote of the day today comes from Morgan Housel, who said, “A big enough bonus can convince even honest, law abiding finance workers selling garbage products that they’re doing good for their customers.”

WCI: Thanks for what you do, I know the work you do each day is not always appreciated by those you do it for. And a lot of people don’t appreciate the fact that you sacrificed a significant portion of your life and health to do it.

WCI: But it’s pretty interesting work, I’ve got to admit, I had an interesting heart rhythm, an arrhythmia in a young person in the ER just the other day, they had isorhythmic atrioventricular dissociation, which I’d never seen before in all the years I’ve been practicing. And it was kind of fun, I put it up on Twitter and got a lot of responses, you know, I had the cardiology types who correctly identified it, and I had the orthopedic types who said, “It goes up, it goes down, looks like it’ll move kephelex around the body.” And then of
course I had the finance people commenting on it, who said it looked like a stock chart for something they didn’t really want to buy. But either way, it was pretty fun to see what people thought of that EKG.

WCI: But there’s still lots of interesting stuff out there that you haven’t seen yet in your career, and that is still intellectually stimulating and so it’s awesome sometimes to have a job in clinical medicine.

WCI: We have a special treat today, we’re going to be talking about investing in online businesses, which is kind of a personal interest of mine. But also I think something that most of you would like to at least learn a little bit more about as well. Let’s get into it.

WCI: Today on the White Coat Investor Podcast we have a special guest, Gregory Elfrink, the director of marketing for Empire Flippers. And we’re going to talk about something I don’t think we’ve ever covered on the podcast at all. I discussed it once or twice over the years on the blog that we have at WhiteCoatInvestor.com, but not for years. It’s probably been two years since I even mentioned it, and I never got into as much depth as I think we’re going to do today.

WCI: So I’m excited to have you here, thanks for being on the show, Gregory.

Gregory Elfrink: Yeah, thanks Jim, thank you for having me, I’m really excited to be here.

WCI: Let’s start with you just telling a little bit about yourself, before we started recording we had a great conversation about our lives, and some of the things we have in common, so tell us a little bit about yourself.

Gregory Elfrink: Yeah, well, for your podcast listeners, Jim and I grew up basically in the same neighborhood, so we’re both from Alaska, pretty random. But yeah, outside of that, I
used to work in the oil fields in Alaska in the Arctic Circle, and then I got pretty heavily into internet marketing, I love marketing in general, like marketing and literature are two of my big passions. And I found this company called Empire Flippers and became their content marketer, and now I’m their director of marketing, and what we do is help people buy and sell online businesses.

WCI: That’s very cool. I always find it interesting to find people that are passionate about stuff that I have no passion for whatsoever. You know, I mean marketing’s super important, don’t get me wrong, I’ve got a business here, and I have to do lots of marketing, and we try to do it as best we can, but I’m not going to say I’m passionate about it. I’m not passionate about marketing, so I think it’s awesome that somebody is.

Gregory Elfrink: I totally relate. On another part of that, like you know, I’m so passionate about literature I’ll give someone a book, or whatever, and want to discuss the symbolism or whatever, and I’ll ask them, “What do you think?” They’re like, “Oh, I like it.” Well, what else? Like, “That’s it, man.”

WCI: Yeah, it’s so true. You know, even within the house of medicine though, you know, most of our listeners are doctors, and it’s funny because I’m just so happy that there is somebody that’s interested in pediatric pulmonology, you know. Or some sub specialized field of medicine that I’m just not all that interested in, but it’s awesome to call somebody up. I mean, just the other day I called up the pediatrician on call to talk to him about this terrible eczema this kid had that I was seeing in the ER, and he walked me through it. You know, like it’s something he did all day long, which he does, but it was something I hadn’t seen in the ER, you know, a terrible case of eczema like that, for years if ever. And so it’s just wonderful to have people that know stuff about things that I’m not particularly knowledgeable about.
Gregory Elfrink: Yeah. I totally agree with you, I mean, that’s why I listen to a bunch of random podcasts. I’ll sometimes just browse random ... like purely random podcasts and give it a spin, see what I can learn.

WCI: Yeah, it’s amazing how much information’s out there, you’re really only limited by your willingness to learn.

Gregory Elfrink: Yeah, absolutely.

WCI: Let’s talk a little bit about Empire Flippers before we get too far into this. Obviously you have a conflict of interest here, because you work for a company that buys and sells websites, you know.

Gregory Elfrink: Oh, we don’t buy and sell the websites, sorry, I probably should’ve been clear-

WCI: Oh, you broker for them.

Gregory Elfrink: Broker, yeah, yeah, yeah.

WCI: So tell us about Empire Flippers. I mean, how did it get started, what does it do, etc.

Gregory Elfrink: Yeah, so it’s a pretty interesting story. So we’ve been around since 2011, we actually were originally an outsourcing company in the Philippines, and what ended up happening was one of our clients, this is long before I came into the picture, one of our clients kind of pulled out, and we had this whole team in the Philippines, we’re like well, what are we going to do with them? And we started building our own AdSense sites, not making too much money, but we blogged about it, blogged about the journey in making these sites, and kind of like the system we had created. And eventually what we did is we started selling those sites on another platform, in what is, to me, kind of one of those accidental moments in entrepreneurship, our audience was like, “Hey, you guys have this reputation for selling your sites, I don’t, I want to
sell my site, would you sell my site and I’ll give you a piece of the commission.”

Gregory Elfrink: So we decided to try it out, and fast forward a few years … or less than a year later we realized wow, this is … we’re selling way more of other peoples’ online businesses than our own, why don’t we just stop building our own sites and go into just full time broker. And fast forward to 2018, we’ve been on the Inc 5000 list three years in a row now, and one of the biggest, if the not the biggest curated marketplace in the online business space. And that’s affiliate sites, e-commerce, SASS businesses, basically anything online, even some more esoteric ones like Kindle publishing businesses.

WCI: I looked at your website, which can be found, for those who are interested at EmpireFlippers.com, and you’ve got a rather large team there. A lot of people working there, and … but the site says you’ve only sold 50 million worth of websites. That just doesn’t seem like very many to me for the number one, or close to it, curated marketplace. Is this industry really that tiny, that 50 million gets you to number one?

Gregory Elfrink: Yeah. So that’s a super good question. And the answer is yes. The reasoning why, the long answer to why that is a yes, is because online businesses are really not that new. Or I’m sorry, not that old. And so a lot of them are just kind of becoming an asset class in the last few years. For example, there’s a type of e-commerce called Amazon FDA, which is fulfilled by Amazon. It’s kind of redundant naming, but basically these people will create these products, put it up on Amazon, Amazon will fulfill. Well that business model in and of itself only really started existing like maybe three or four years ago. And it only really got hot about two years ago, and really was only a year and a half ago that any of those online businesses for that entire business model became … had enough history of profit, of growth, trajectory, that
they started becoming interesting to investors to look into, and into buying.

Gregory Elfrink: So the oldest sites, or the oldest online models, an affiliate site, or an AdSense site, and those have only been around maybe for about 10 years, and really probably more like seven years when it comes to buying them as an asset. And so that kind of gives you like the backstory of why this is now just starting to happen, because now they’re that maturation point. But the other thing, why we are one of the biggest ones, while only have sold 50 million dollars, is because a lot of entrepreneurs out there just really don’t know they can do this. Which is pretty interesting. So we’re pretty big in what is called the digital nomad space, and we go to a lot of their events, we sponsor a lot of different stuff, put on things for the community. And even within that space where we’re relatively famous, there’s a lot of digital nomads out there building their own drop shipping store or their own affiliate site, that still never really has heard of us, or never even thought that they could sell their site, or buy a site for that matter.

WCI: So how many sites have been sold on Empire Flippers?

Gregory Elfrink: I don’t have the number directly in front of me, but I think … I’m pretty sure it’s over a thousand businesses. So for this quarter I think we will sell … or this year, I think we’re on track to selling like 500 or something like that, I think. I would have to look at the numbers. But over a thousand.

Gregory Elfrink: And the last two years we’ve seen big growth, versus the years before.

WCI: Now you’ve mentioned several types of sites that you’ve put into categories, an AdSense site, or an affiliate marketing site. Can you talk about each of those categories, and which ones tend to be most commonly sold on Empire
Flippers, and just tell our listeners what you mean when you say an AdSense site?

Gregory Elfrink: Yeah, sure. So for anyone interested, I actually wrote an e-book explaining the different popular online business models. I can shoot you the link if you want to put it in the show notes later. But basically, an affiliate site … there’s really three main kinds of online business models, and then they’re broken down into different segments. So like AdSense and affiliate sites, they would both fit into what I would call a content site. And that primary business model is basically you’re producing content around a certain subject. Let’s say you have a home and kitchen website, and you’re doing recipes about food, and maybe about juicers, and you have the reviews of juicers, like the best five juicers for losing weight, or whatever is the name of the article. Someone reads that article, and it lists those five juicers, you click the link to one, it goes, sends you to Amazon, and if you buy anything off of Amazon.com in the next 24 hours, there’s a cookie that Amazon has given that site owner that will give them a commission on anything that person buys, at no extra expense to the person buying off Amazon.

Gregory Elfrink: Amazon’s the most famous one as far as affiliate programs go. One of the first ones, really. But almost any business website out there has an affiliate program if they’re of any kind of large size. Usually local businesses don’t, but if you’re interested in like well what other people are selling an affiliate program, you can usually scroll down to like the footer of a business website, like WalMart.com, or any other big site, and they’ll usually have like some kind of link in the footer that says affiliate program. So basically you sell their products, you don’t have to keep any inventory yourself, so it’s a really great way to bootstrap.

Gregory Elfrink: With AdSense sites it’s a similar concept, it’s a content site, usually informational driven articles, so maybe how to stop snoring, or something like that is the
article. And someone clicks on that article, reads it, and there’s a little ad, whether it’s Google AdSense or another ad network, when someone clicks on that ad, you as the content publisher would get paid a little bit of money for that. So that’s that business model.

Gregory Elfrink: And then there’s another really big on, which is e-commerce, which I imagine more people are probably familiar with because it’s a little bit more mainstream nowadays. And that would be something like creating a Shopify store, so you source your own product, like iPhone case covers, or whatever it is. And you sell those through your Shopify store, you source the product, you have your own warehouse, just like a traditional retail store, except for there’s no offline component, it’s all online. And there’s several different schools of e-commerce, there’s drop shipping, where similar to affiliate you don’t hold the product yourself. Then there’s sourcing the product yourself, which is where you would have that sitting in your warehouse. And then there’s another type which is Amazon FBA, which is basically like a traditional e-commerce store, only all the sales are happening on your Amazon product listing. And Amazon takes care of a lot of the more tedious and oftentimes un-pleasurable parts of running an e-commerce business for you. So that’s one of the benefits there.

Gregory Elfrink: That and then the other, the third category is software stuff, so like software as a service, if you’re familiar with like Mail Chimp, or HubSpot, those are both software as a service, so it’s software that you pay monthly for, that’s a very, very hot business model because the recurring revenue is obviously very attractive. Then there’s also things like apps, which is … we all know what an app is, with a lot of in game purchases or in app purchases, or maybe they monetize through ads, bunch of different models within there.

Gregory Elfrink: And then the other two which are less common,
but they’re still pretty good businesses, is Merch by Amazon, which is basically like print on demand t-shirts that Amazon has created as a business model, which is interesting because that was originally created for game developers, but a lot of people have made that into a full blown business in and of itself. And then of course Kindle Publishing. Which you have a team of writers producing these books, whether fiction or nonfiction, and you sell them as kind of a publishing house.

Gregory Elfrink: In terms of what’s the most common, definitely e-commerce and affiliate sites. So content sites and e-commerce sites are by far and large the most common.

WCI: So make the case for investing in online businesses. Why should an investor do that?

Gregory Elfrink: Yeah, that’s a great question. And the reason why is you as an investor, let’s say you were really big into low index mutual funds, they’re low cost, you don’t have to do anything, that’s great, but let’s say you want to get into something like day trading, or something a little bit more risky. If you’re the average Joe, it’s unlikely that you would ever have the amount of money you would need to put into a certain stock to either make that price go up or that price go down. And if you do have that kind of money, you’re probably operating on someone else’s podcast, on some other level, you know? Like you might not be listening to me.

Gregory Elfrink: But the other investment thing is real estate, right? And real estate gives you a little bit more control, because it’s a physical house, you can repair it, fix it up, and then hopefully sell it for more later. And an online business is very similar to real estate, only I would argue that while it can be more volatile, because things change all the time in the online business space, I would argue it gives you far more control over any other investment out there. For example, let’s say you bought a content site for $40,000.00, which roughly will get you a site making 1500
to $2,000.00 cash flow on that profit every month. You would be hard pressed to do that same deal in real estate, and you’d be even more hard pressed to do a test, like a two week test that we call conversion rate optimization, that tests your affiliate links and different colors, different fonts, and different placements that could lift that income up by 20% within the first month, which isn’t that uncommon with CRO, with using conversion rate optimization. So that’s one of the huge advantages of investing in online businesses.

Gregory Elfrink: Of course one of the big disadvantages for someone who might be listening out there right now, is that you do need to have some kind of skillset, you do have to learn a little bit, what you’re buying and what it is, like what are the different levers you can pull. So there is a learning curve there. But I wouldn’t say it’s a bigger learning curve than say, investing in real estate, and the cash on cash return can be really awesome. WCI: Now what percentage of portfolio do you think would be appropriate for online businesses?

Gregory Elfrink: Well, I would always give the disclaimer out there, for anyone looking to invest in online businesses, it should never be like your emergency money, it should never be rainy day. It should be absolutely okay if you lost everything. So as a word of warning, like if you bought a content site with the main traffic source being Google, like Google organic traffic, and Google changes it’s algorithm, you might lose all that traffic overnight. Is that something that happens often, not really, but it can happen so you should always be okay with losing your money.

Gregory Elfrink: But outside of that, if you are young and you want aggressive growth, I would put a lot more in it, I’d probably like 40, 50% I would go towards online business, if you also have the willingness to learn some of the skill sets that can get you a leg up. If you’re looking more for hands off, something that can make you good money in say retirement
or whatever, maybe more like 10, 20%, or like 10% of your portfolio. It really depends on your individual, you know, what you want. Like if you want to just play around though, if you have a good nest egg in other asset classes, I would say $100,000.00 is a pretty good starting point to really get your … sink your teeth into this kind of investment vehicle.

WCI: Now you keep mentioning a skill set. Are you really just buying a job here? Or is this an investment? I mean, how do you get it to be more passive investment like rather than job like?

Gregory Elfrink: Yeah, that’s a great question. So one thing I tell entrepreneurs on the sale side, because right, we’re marketing to both buyers and sellers, I always tell the sellers that you need to make sure your business is not a job, because that’s not what an investor is looking for, right, they’re looking to buy something that has some kind of leverage.

Gregory Elfrink: So one of the cool things about online businesses in general is a lot of the work is pretty front loaded. So let’s go back to a content site, I’m a content writer myself, so I’m very familiar with this business model. So you start a site, let’s say it’s about those juicers, you put in all that work, you get 50, 80 articles on there, it’s starting to rank in Google, you’re starting to make some money. And let’s say you get it up to that $2,000.00 per month or $5,000.00 per month selling juicers and other related products around that niche, then you stop working on it. You decide, eh, I’m going to go to Bali or go on a vacation or whatever, and that money still keeps coming in. Just because you stop working on it doesn’t mean Google isn’t sending traffic to it over and over again. So you could theoretically have this huge website with thousands of articles that are pulling in this organic traffic on a daily basis, making sales for you, more or less hands off.
Gregory Elfrink: Now there is some maintenance. You want to update the articles, if you see something weird happen with your traffic you should probably investigate that. But overall, there’s not that much to go into maintaining a content business, or even in some cases an e-commerce business, if you get the logistic side down.

Gregory Elfrink: So there’s a few skill sets you should know about, but overall if you’re looking at buying a business that seller’s probably going to tell you what those skill sets are. They usually have standard operating procedure, kind of like an operator’s manual that the investor can look at, and that allows the investor to say like, “Okay, well, am I willing to do this, or is this too much risk?” And the cool thing is, with this kind of investment it’s more or less like you don’t have to do too much, especially in the content site, once you buy the site, unless you want to grow, if you want to scale the business then yeah, there’s probably going to be a lot more work involved.

WCI: So what kind of multiples should you expect?

Gregory Elfrink: Yeah, so in the industry you’ll often hear like two to four X, or you’ll hear 20 to 50 X. So why there’s that huge difference is two to four X, they’re talking about annual EBITA, so earnings before income and taxes … tax deductions I think that last one is. And when you hear 20 to 50, they’re talking about monthly. So online businesses, depending on who you’re talking to, can be valued on either. At Empire Flippers, we value it on a monthly multiple, because it’s a big more granular, it lets our investors see a little bit better, and also lets us evaluate the business better.

Gregory Elfrink: But in terms of average multiples right now, what we’re seeing across the board is between 25 and 35 … or 25 to 32 X of monthly net income. Those multiples have gone up significantly, so like just two years ago content sites … or two and a half years ago, content sites were doing about 20 X
multiple, and Amazon FBA was doing right around 20 X, it was still just coming onto the scene. So those multiples have risen, so it’s still somewhat of a seller’s market, but I think the multiples will actually go higher. So, in some ways, it’s more of a buyer’s market, depending on which business you’re looking at. But if you’re looking to get into the online business game, I think now is a really good time, because there’s not that much financing in our industry, and as financing becomes more and more of a thing, my prediction is the multiples will actually go up as well.

WCI: Yeah, I find it fascinating, regular readers of my blog know that I considered very seriously selling a couple of years ago, selling the website. And I was surprised just how low multiples were. I mean, we’re talking about selling for basically what you’ll make in profit in the next two years.

Gregory Elfrink: Yeah.

WCI: And I kind of came to the thought that well, shoot, if I’m selling it for that small amount of money, I can just hold onto it, make that money over the next two years and still own the thing. I mean, these are incredibly low multiples compared to a brick and mortar business, or compared to a real estate property, income property for instance.

WCI: And so I guess my question is, why does anybody sell with that kind of a multiple?

Gregory Elfrink: Yeah, so that’s a great question. Selling is really more of an art than a science. So it really depends on what someone is doing. So online entrepreneurs tend to have several different projects running at any given time, because again, so much of the work is front loaded on these businesses. So a great story is we have this one seller, he built up this kind of like factory system of building these Amazon affiliate sites, where you can just crank them out, he had a … not huge team, he had like a few VAs, and he knew his
craft really well. And over a year and a half, he sold $700,000.00 worth of the sites on our platform, and then he used that $700,000.00 to buy a SaaS business. Also for a similar multiple, but he was able to use that money to leverage himself into a more lucrative market, right, so that’s the reason why he was selling.

Gregory Elfrink: And also because sense all of his sites had Google traffic going to it, organic traffic, he decided to take the two to three years of net monthly profit up front and mitigate his risk of a future Google update that might ruin his sites, whereas an investor came in, bought those, and decided I’m willing to take that risk because I see the cash on cash return, maybe they know a little bit about SEOs, or maybe they even know how to fix SEO penalties so it’s not really a big concern for them.

Gregory Elfrink: So there’s a bunch of different reasons why people sell, that’s just one business reason. But we’ve had people sell for other reasons too. One really cool story, oh actually I’ll give you two cool stories. This one guy, he sold a business with us to adopt a kid, which is pretty cool. Then other seller, who was not an American, he was actually a Cambodian who spoke very little English, we actually sold this business when I first came aboard, it was … it sold for around $250,000.00, I believe, and that’s a lot of money for anyone, but that’s generational wealth income for this guy in Phnom Penh in Cambodia, right? So now he started teaching all these other Cambodians like how to create these affiliate sites and all this stuff, because he was selling it in the American market, so he had a very interesting angle that was really cool.

Gregory Elfrink: But yeah, so there’s a bunch of reasons why people will sell, and while the multiples are lower compared to like a traditional business, I would say the cash flows tend to be much, much stronger than a traditional brick and mortar business.
WCI: Do you think they’re that low just because there’s so much risk involved, or just because it’s new and people haven’t discovered it yet, or can’t really scale it up, or … ?

Gregory Elfrink: I think it’s a mix of both. Both that it’s pretty new, there’s not that many players out there helping people buy and sell online businesses. We’re kind of at the forefront when it comes to like educating the market, and we just started now reaching out to professionals like you in the investment space to start talking to investors about this idea. So it’s still a really new thing, which of course people, they want to see how it turns out before they invest in something that’s new, right?

Gregory Elfrink: And the other thing goes back to what I said earlier is just a lot of these businesses are just now getting to this point where enough of them have been created, there’s enough history, there’s enough track record, that they’re starting to become interesting to investors.

Gregory Elfrink: And one other reason why the multiples might be relatively low right now too, is I hinted at earlier, is there’s very little financing in this industry. So say you wanted to buy an Amazon FBA business for 500 or $600,000.00, it’d be very difficult for you to go to your local Wells Fargo and get a finance, get like a business loan. No SBA loans are starting to come into play, but even those are pretty rare still in our industry. So a lot of times financing is a real difficult thing, and that leads to people doing earn outs when they do buy a business, if they don’t buy it outright, just because a lot of people don’t have the liquid amount to buy it all up front. So that’s kind of an interesting thing right there, that I think is causing the multiples to be a little bit lower.

WCI: Are the multiples the same for all the different size businesses? I mean, if you’ve got a site bringing in $1,000.00 a month, or $10,000.00 a month, or $100,000.00 a month, are
the multiples all still two to three X?

Gregory Elfrink: No, so every business is pretty different, that’s why I said across the board we’re seeing about 25 to 32, but we’ve sold as high as 58. So when a business comes into our marketplace, in particular, we actually vet the business, so I don’t want to put down like our industry, but there’s a lot of people out there who will sell things that aren’t ... then they’re selling you something that isn’t necessarily true. So when a business comes to our marketplace, we make them pay a fee that vets them as saying like, “Yeah, yes, I’m willing to pay to sell my business.” And then we actually have a team that pours through their P&L, their profit and loss statement. We have people who log into their traffic and analytics, any affiliate programs they have, collect the screenshots and verify, or review as much as we humanely, possibly can, saying that this is a legitimate opportunity.

Gregory Elfrink: And while we’re doing that, making sure it is a legitimate opportunity, we’re also seeing, okay, well how has past businesses that we’ve sold, what multiples did they sell at? And we also have a internal tool that uses various calculations that we’ve used along with that real sales data to input to come up with the valuation range, and then we decide with one of our vetting specialists what that business will sell for on the market.

Gregory Elfrink: Of course, we’re always working with the seller on this, so we don’t put anything on our marketplace until the seller’s agrees that that is an appropriate price for his business. But most of the time, we reject about two thirds of the businesses that do come our way.

WCI: So let’s talk about the process. I mean, the process of buying an online business. So let’s decide I want to invest $10,000.00 into an online business. What’s the process of doing so?
Gregory Elfrink: Yeah, so I would say, and this sounds self serving, but I would say you should probably invest more than $10,000.00, and the reason why I say that is because most of the scams and illegitimate opportunities when it comes to buying an online business happen at the sub $40,000.00 range. And the reason why is just because it’s much easier to fake traffic and sales at that level, because you’re getting very … you’re just getting handfuls of sales. So someone could theoretically go and get all of their cousins, and friends, and everyone on their Facebook go and inflate the numbers on the traffic analytics and on the sales dashboard, depending on what their business is.

Gregory Elfrink: So I’d recommend starting at 40k, you can obviously start much lower than that. There’s nothing wrong with buying a sub $40,000.00 business, just if you’re in that range, just be extra careful with your due diligence.

Gregory Elfrink: So but other than that, the process depends on if you decide to go with a broker, or if you decide to go with a private sale. So real quick on a private sale, that’s where you like … you find the site yourself, and you reached out to that site owner, you asked them if they were interested in selling, and they say yes or no, and that process starts. Versus a broker, you come to a place like as at Empire Flippers, you can click on our marketplace, and we have all these online businesses that are for sale that we have vetted. And with us, we use a deposit system. So you put down a 5% refundable deposit, and for us that’s just a way to weed out tire kickers, so that way we’re only bringing potential buyers to our sellers who are actually interested in the business and actually have some skin in the game, even though we always refund the deposit, but it does weed out a lot of that.

Gregory Elfrink: And what happens from there is we give the more substantial private information about the business, such as the URL, we’ll show the URL, the P&L, any other sensitive information that we kind of keep from the public eye, that
depositor can get that so they can start their due diligence. They can start asking our salesmen questions, and our business analysts will respond with answers, they’ll talk about what the seller might be willing to take. And eventually what happens is a potential buyer will get on what is called a buyers seller conference call, where one of our business analysts helps that buyer negotiate the deal with the seller, and answer any other outstanding questions, like what was this dip in traffic in August, or why did you stop this paid traffic campaign, and so on. So that’s what those are.

Gregory Elfrink: Once you come to a price that you agreed on, you sign what’s called a APA, asset purchase agreement, and that has like any other kind of contractual stuff you want in the deal, such as support or certain privileges, if they have a special deal with a manufacturer or things like that. And once that’s all signed, the money is sent in to Empire Flippers if you’re using a broker. We hold on the money acting as escrow while we help you actually migrate that business over to you as the buyer. So if you bought an affiliate site, we would help migrate that site over to your hosting, we would help you change all the affiliate links.

Gregory Elfrink: And then you’re given … of course you don’t get to have that if you go with private, and you also don’t get what we call revenue verification, so that’s a brief window or period, usually about two weeks, so it can be extended based off negotiations between the seller and the buyer. And that’s where we hold onto the money that the buyer has sent to us, and we hold onto the domain of the seller, if there is a domain involved, so that way we have like a bit of leverage to make sure everyone’s doing what they said they were going to do. And it gives the buyer time to look at their traffic analytics, or their P&L, and their income dashboard with whatever monetization they have to make sure that yes, everything the seller has told me is true, I’m seeing the traffic coming in, everything is correct.
Gregory Elfrink: And after that verification period, the buyer will tell us, “Go ahead, release the funds, everything is correct.” And we will release the funds to the seller, minus our commission, and that’s the whole process in a nutshell.

WCI: Now let’s talk a little bit on the selling side. Let’s say I’ve got a physician financial blog, where I just blog about financial topics for physicians and have display ads on it, and I make about $2,000.00 a month, and I decide I want to sell it. So I come to you, can you tell me about the process, what we’d go through to try to sell it through Empire Flippers?

Gregory Elfrink: Sure, yeah, no problem. So what you would do, you’d come to our website obviously, you submit your basic information, so that would be like date created, when was it first profitable, things like that, pretty basic information, and then your contact information, of course. And you’d pay a $297.00 listing fee, as I mentioned. Unless you are a repeat seller, then you only pay $97.00, and that covers our cost for our team to do the actual vetting part, which is what I was talking about earlier, about making sure it’s legitimate. And what we’ll do from there is we’ll collect information, such as get access to your analytics, ask you any kind of questions like did you use a PDN, if you’re doing a bunch of SEO, a bunch of other questions. We’d also verify that you are, in fact, you. So you’d send in your ID, like your license, driver’s license usually works just fine, but we have to verify that it is really you that is reaching out to us to make sure you’re not trying to scam one of our buyers or something like that.

Gregory Elfrink: And after we get all of that kind of … all of that information with your P&L and all that stuff, usually … well, with a content site, it’s not usually a big deal, but say you were e-commerce, we will usually help you with your profit and loss statement, just because a lot of e-commerce entrepreneurs, while they’re fantastic entrepreneurs, they’re
not exactly the best bookkeepers. We often help them create like a better P&L that’s more attractive, and help them figure out how to like transfer everything into a accrual account and all that kind of stuff.

Gregory Elfrink: But for content sites, that’s usually not a big deal, because you can see in their AdSense account dashboard or their affiliate dashboard what they’re making and all that kind of stuff.

Gregory Elfrink: So once that is done, that’s usually like a two week period. It can be a little bit longer depending on the complexity of the business. But content sites tend to be a little bit faster when it comes to vetting. We will tell you what we think it is worth, we’ll give you a price point that we think that it will sell on our marketplace, and then you will talk to your vetting specialist and say either, “Yes, I think this is the right price,” or, “No, I think this is wrong and here is why.” Now a lot of sellers, they obviously want to have more value for their business, so usually they’ll say, “This is wrong,” and not to be … to put them down, but often they are wrong when it comes to that.

Gregory Elfrink: And so we’ll talk to them, and tell them, “Well, this is what we see,” but every now and then they are correct, and so we might bump it up a little bit more from what we initially gave. And once that is all agreed on, again, that’s about a two week period, it goes live on our marketplace, we promote it out to our database of 80,000 buyers on our email list, and we start doing some Facebook ads, we start syndicating it across different marketplaces. And overall, just starting to promote the listing. Depositors will start depositing onto your business so they can start doing the due diligence. You as the seller should be very hyper responsive during this period. I’m always amazed at how many deals are killed by a seller just going dark. They suddenly take off for a week vacation, or something like that, and don’t answer any of the emails, when they have possibly a
two, three million dollar business that they’re selling with us, which is insane, really crazy to me.

Gregory Elfrink: But that kills a lot of deals, as you might imagine, so I always recommend being hyper responsive during this phase, and answer any questions that come in. Our sales team will take the most common questions that you’ve answered, and they’ll just start answering it for you so that we start doing the heavy lifting on that end. Our sales team will also start prospecting our buyer database, doing criteria matching with them to bring them over to your business, and help you negotiate the deal for the highest offer.

Gregory Elfrink: Once you get an offer you accept from that same thing as the buyer, seller conference call, that is when the migration process begins, and it’s pretty similar to what it’s like when buying an online business, instead of us handing the business over to you though, we would help you hand the business over to the buyer.

WCI: So for a buyer, what additional vetting do you think they should do above and beyond what your company has done?

Gregory Elfrink: Yeah, that’s a great question actually. So a lot of people confuse these two terms when it comes to investing in online businesses, and it is extremely important that a potential investor listening to this does not confuse these two. So, vetting is just us making sure that the business is legitimate. So that doesn’t meant that the business is good, that doesn’t mean the business is bad, it just means this is a legitimate opportunity that is making money.

Gregory Elfrink: So due diligence is different in due diligence scout all sorts of crazy criteria based off what you’re looking for as an investor. So if you’re looking, let’s go back to the SEO expert who knows how to remove Google penalties. That person’s due diligence might be including,
looking for a business that actually is hurt in Google. So Google has penalized this site, but that is what they want, so that’s part of their due diligence.

Gregory Elfrink: For most buyers, that’s probably not what they want. So due diligence can be very personalized. My best tip when it comes to doing due diligence is write out a simple list of what kind of investment do you want, do you want something that’s hands off, do you want something that you can really roll up your sleeves and get into, kind of like a rehab house, or fixer upper in real estate, if you will, or do you want something that is … has systems in place, has a team in place that you can scale that just needs that little extra push because of some skill set that you bring to the table that the seller didn’t have.

Gregory Elfrink: So I would ask yourself those questions, what do you want first? And then when you have that list, when you’re looking at the potential businesses to buy, you should look for ways to disqualify those businesses as quickly as possible. So if something almost doesn’t meet … or almost meets the criteria that you’re looking for, you should just X it out, because there’s tons of other opportunities out there, you should keep looking for the one that matches all your criteria. And as you filter them down, say you start with 100 business, you do good due diligence systems, you probably end up looking at 10, maybe 12 of those businesses. And maybe make an offer on two or three at the end of the day, and take one.

WCI: And are offers typically dramatically less than what they’re posted for on the site, about what they’re posted for, I mean, are there bidding wars? How does that usually stack up?

Gregory Elfrink: Yeah, so I can’t really say for other brokerages, because they often don’t post their sales numbers, but for us at Empire Flippers, we usually sell within 10% of the list price. So if it was a $100,000.00 business, we
usually sell it for like 90 to $100,000.00. And usually if it’s underneath the $300,000.00 range, it’s pretty rare for us not to give full list price for it.

Gregory Elfrink: Now as you get bigger, so as you get into say like a four million dollar business that we had on our marketplace, that is where the ability to negotiate the price becomes a much more realistic thing, where you can negotiate down possibly significantly, several hundreds of thousands of dollars on that business, because there’s room to work in, versus lower end businesses, or lower priced businesses tend to have less wiggle room on that.

Gregory Elfrink: But even on the lower end, you can still do deal structuring. So for a buyer looking to invest, since there is very little financing in this industry, I always recommend, which isn’t great for us at Empire Flippers, but I always recommend that the buyer should do seller financing. So it doesn’t hurt to ask even on a $100,000.00 deal you can ask, like, “Hey, I’ll pay you this $100,000.00, I’ve give you $70,000.00 up front, and you seller finance me a $30,000.00 earn out over a period of so and so months.” And the great thing about doing that is a lot of times sellers are very open to that, and very rare do they ever charge you interest, so it’s basically an interest free loan that you’re getting from the seller, so that is definitely something I recommend to buyers.

WCI: Wow, that’s … I’m surprised that so many sellers are willing to do that. So-

Gregory Elfrink: Yeah, yeah, definitely is a very good tip.

WCI: What are the commissions?

Gregory Elfrink: Yes-

WCI: You sell $100,000.00 website, what do we pay?
Gregory Elfrink: Yeah, so Empire Flippers, we have a tiered system with commission. So anything less than a million dollars, we do 15% commission, and a million to two million is 12%. Then two to five million is 10%, and anything five million and above is 8%.

WCI: Okay, so technically when you buy a home, the seller’s paying all the commissions.
Gregory Elfrink: Yeah, that is correct. So the seller is the person who ultimately is paying us. So our fiduciary responsibility is to the seller, but with that said, we… like while we do represent the seller from a fiduciary perspective, we like to think we represent both sides pretty well because we have a lot of repeat customers, so at the end of the day, we want the buyer and the seller to get the best possible deal for everyone, so, win, win, win. Ideally, it doesn’t always happen, but that is what we shoot for.

WCI: So what are the other options for buying and selling websites, and online businesses, besides Empire Flippers? Presumably you’ve got some brokers out there that are competing with you, and you mentioned a few things about private sales. What are the other options?

Gregory Elfrink: Yeah, so private sales is the first one that comes to mind. And again, that’s just you going out there and finding the deal yourself, without any kind of broker to help you out. Which is definitely a very cool option to do, you can often get much better deals, because sellers don’t quite understand what they have, so they don’t know how to value it. So if you’re a savvy buyer, and you understand how to do good outreach, and what to look for, that’s often a really good path to go and find deals that no one else is looking. So that’s a nice route.

Gregory Elfrink: There are others syndication channels too, so there’s… syndication is what most of the brokers use to put up their new business listing. So a really big one is
BizzBuySell.com, you can go check that out, and you can see a bunch of different online businesses, and offline businesses that are being sold by various brokers.

Gregory Elfrink: The majority of actual brokers in our industry in particular tend to be one man shows. So there’s one guy that might only need to sell one or two businesses a year to have a pretty good year, for the most part, maybe they’re doing the digital nomad thing and all that kind of stuff. So, and they can’t really handle the volume, so they restrict themselves to just a few deals a year.

Gregory Elfrink: And then there are some bigger players, probably the most famous is probably Flippa, which was very early on in the business. They are more of a do it yourself marketplace, they don’t really curate their listings like how we do, though they’ve started working with brokers a little bit more, so they’re becoming sort of a syndication channel in their own right. So they’re not necessarily a broker, but they’re a cool marketplace.

Gregory Elfrink: And there is another one, Quiet Light Brokerage, which they sell … they tend to sell pretty big e-commerce businesses, and they’re really reputable people, really nice guys. They have a great podcast, and we have a great podcast, and I love those guys, they’re really cool people.

Gregory Elfrink: But yeah, so Quite Light and Empire Flippers are like the two really big brokers in the space.

WCI: So what are the biggest mistakes you see buyers and sellers making?

Gregory Elfrink: Yeah, so the biggest mistakes I see sellers making is trying to sell their business on potential. So what I mean by that is you have a seller who’s excited to sell his business, and you get this buyer that’s interested in it. And the seller just keeps going on about how awesome his business
is, like it’s perfect, this thing is going to be worth a million dollars, a billion dollars. And what that does, is it actually turns the buyer off from buying your business when you sell it on potential. That buyer will look at you and say, “Well, if it’s so great, how about we do this, I’ll give you $5,000.00 and the rest we can do this big earn out that’s tied to the milestone of when that business hits this dreamy plateau you’re talking about.” So that I say is a big mistake that sellers make.

Gregory Elfrink: If you want to counter react that as the seller, I really suggest, and this sounds counterintuitive, but focus on the mistakes you made in the business. If you realize that like, hey, my content isn’t the greatest, or maybe my SEO is not the greatest, or I really messed up on this paid traffic campaign, and you tell that to the buyer, that might be the opportunity the buyer is looking for. They want to hear that, because a lot of times the mistakes, and what’s wrong with the business is actually the opportunity, the investment opportunity for the buyer.

Gregory Elfrink: On the buyer side, one of the big mistakes, I already kind of mentioned it, is not asking for seller financing. I think that’s a great way to leverage OPM in this industry, so I definitely ... a lot of buyers don’t even ask for that, which is crazy to me. I think not understanding how deal structuring works is also a big mistake that buyers end up leaving money on the table. So deal structuring is where, when you put in an offer on a business, say it’s a million dollar offer, you put down $800,000.00 up front, and then $200,000.00 over a period of time, you want to attach milestones to those periods, and maybe those milestones are tied to revenue, or tied to net profit. If you’re a buyer, I’d always recommend tying it to net profit. Most sellers will likely not go for that, they prefer you to tie it to net revenue, but if you can tie it to net profit, that’s a really great way to mitigate your risk, even if you are paying full list price, you’re
starting to mitigate your risk by how you structure the deal.

Gregory Elfrink: So not doing a deep dive into how deal structuring works I think is a huge mistake on a buyer’s part, because that’s really one of their big tool sets.

WCI: Anything else our readers should know that we haven’t covered so far?

Gregory Elfrink: Yeah, this might sound much more complex than it really is, so if your readers or listeners out there are like, “Wow, this sounds insane,” I just want them to know it’s actually not as complicated as it sounds, it just takes a few ... takes a few skill sets that you need to learn, similar to buying real estate, which I know when I got started in real estate, that was super complicated to me and now it’s fairly straightforward for me. So that’s definitely something that I would like to leave with your audience.

WCI: Very cool, well thank you so much for being on the White Coat Investor Podcast, Gregory, we really appreciate you being on here. And interesting fact that we haven’t talked about, at least since we started recording, is that you’re doing this call from Vietnam. You’ve actually been living over there for a couple of years, and I think that’s pretty fascinating to a lot of people. My audience is mostly high income professionals, physicians, dentists, attorneys, etc. And the idea of being location independent is pretty foreign to most of them, but it’s pretty awesome that you’re able to live basically anywhere you want in the world, and continue to work your job because it’s all basically online.

Gregory Elfrink: Yeah. I love it out here, I love traveling the world, and that is a big reason why people buy these online businesses from us. We get people all the time, high income professionals, maybe a mid level executive will come in and buy a few e-commerce businesses from us, quit that nine to five, go travel the world with their family, or just stay at
home and hang out with their family. So that’s one of the really cool things that this industry can give you.

WCI: Well thank you so much for being on. Those who are interested in learning more, they can learn more from Empire Flippers, they have both a blog and a podcast. Both are accessible at EmpireFlippers.com. And thank you so much for being on the show.

Gregory Elfrink: Yeah, thank you for having me, Jim, it was a pleasure.

WCI: Well that was fun, wasn’t it? Obviously I have a lot of interest in this subject, given that I own part of a couple other websites in the WCI network, as well as a profitable website myself. And so I find that subject endlessly interesting, although I haven’t just bought a few random sites from people I didn’t know first. I’ve considered it in the past, and I think it may become an up and coming asset class out there.

WCI: Obviously when I asked him about the percentage of your portfolio you should put into online businesses, I think 50% is ridiculous, so please don’t do that. And I say that as someone who has 50% of his net worth tied up in an online business. Luckily, that one I have obviously complete control over, and it’s in a little bit different situation when it’s a business you’re working in every day.

WCI: But, I think it’s something that those who are interested in getting into this stuff ought to consider.

WCI: Be sure to check out the forums we’ve got out there for those who are interested in talking about personal finance and investing with other high income professionals. You can find the main one, the White Coat Investor forum at WhiteCoatInvestor.com. However, we also have a sub Reddit, White Coat Investor sub Reddit, for those who are into Reddit. And the private Facebook group, White Coat Investors, that one
is for high income professionals that aren’t financial professionals only. But a lot of great discussions going on there as well.

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WCI: Head up, shoulders back, you’ve got this, we can help.

Disclaimer: My dad, your host, Dr. Dahle is a practicing emergency physician, blogger, author, and podcaster. He is not a licensed accountant, attorney, or financial advisor. So this podcast is for your entertainment and information only, and should not be considered official personalized financial advice.

A Dentist’s First Class
[Editor’s Note: The following email was sent to me by a retired dentist who wishes to remain anonymous but who desires to show younger docs what the “other end of the spectrum” can be like when you follow good principles of investing. Success like his is what the mission of WCI is all about. I couldn’t be more happy for this doc and echo his desire to want to spread the good word of financial literacy to the rest of the community.]

Dear Dr. Dahle,

I attended your seminar on personal finance at the recent AAE meeting in Denver. You might possibly remember me because I was by far the oldest person in the room. I was there with my son, a budding endodontist. I have been advising him about investing for years, but I was hoping that he would hear sound financial advice from somebody other than his father, which would help it sink in. I was definitely not disappointed. You gave an excellent overview of a very important, but usually overlooked aspect of a professional’s career.

I am the end result of faithfully following the financial concepts you are promoting. About 40 years ago, when my dental career was just beginning, I finally had a few extra bucks to invest so I foolishly “gave” it to some young advisor at a major investment firm. After a year or so of watching him frequently buy and sell stocks with my money – always with a commission, of course – I determined that I could do just as well on my own. Like you, I studied the process and then forged ahead.
Some items I learned early on and they have helped me stay the course:

**Pay Yourself First**

Develop a mindset that you will stash this money and pretend like it never was part of your pay. Set up automatic withdrawals from wherever your paycheck goes — checking account, savings. Start with as much as you can tolerate — 10% to start — and increase that percentage as your income increases. In my last several years of work *I was putting in 20% or more* of my gross income every month.

**Set up several “baskets” to put this money in:**

1) **A basket for emergencies**

Should be one of the first you fill. Get it to at least 6 months of living expenses and hold it there.

2) **A basket for retirement**

The more you can put in this account early on, the better off you’ll be when you get to my stage. One of my favorite quotes is from Albert Einstein:

> “Compound interest is the eighth wonder of the world. He who understands it, earns it. He who doesn’t pays it.” (Good old Al knew more than just quantum physics.)

3) **A “car basket”**

I fill this one until I can pay cash for my next vehicle. *I have never financed a car*. Think of how much I’ve saved on just that over the last 40+ years.


4) A vacation basket

...same concept.

You can set up as many baskets as you want – the more, the better.

**Track Your Finances**

Early in your career try to track your finances a while. My wife and I kept track of every penny we spent for about the first five years of our marriage. That’s probably a little anal – but I think most health care professionals are a little anal anyway! Even just a rough tally gives you a great idea of where all that money is going and highlights waste and areas in which you can cut back.

**Be Proactive About Your Office Retirement Plan**

One of the many things I learned was to continuously keep up with financial concepts related to office retirement plans. I practiced with a partner and an associate – we were an S-Corp with ten staff members. Several years ago I read about age-weighted defined benefit plans and realized that since I was at least ten years older than everyone else in the practice this would be very beneficial to me, so I convinced my partner that we should set one up. It’s not easy, and they are expensive to set up and maintain, but in the latter years of my career, I was able to stash away over $100,000 per year in this tax-deferred account.

I suspect you emphasize those concepts more, and go into more detail about them, in your book and website, but just thought I’d reinforce how important they were for me to get to where I am now.
Flying First Class

I have been a fairly aggressive investor over the years, and still am relative to my age – 73 years old and about 60/40 stocks over bonds & cash. In the late 90’s I could see the “dot-com” bubble approaching the bursting point, so I cashed out a chunk of my holdings and purchased my dream waterfront property and built my “Doc House”. About a decade later I held on through the housing/banking crash and almost cried when one of my good dentist friends related how he was “fed up” with the process and directed his advisor to sell all his holdings. I retired from private practice in 2012 and my wife and I have been thoroughly enjoying our life of leisure and travel.

Managing your finances well allows you to visit places like this both before and after retirement. Name the city for bonus points.

An interesting sidelight – shortly before I retired, a branch office of Fidelity, with whom I have about 30% of my holdings, opened in our city and an adviser contacted me and invited me to come in for a free evaluation of my portfolio. I brought my package in and he perused it. He noted my low 8 figure net worth and asked me what we were planning to do during retirement. I said that my wife and I love to travel and would be doing a lot of it in the future. He looked me in the eye and said: “You should fly First Class.”

We are now living on a retirement “budget” of about $400K per year. That breaks down to about $100K for taxes, $100K for travel all over the world – and “First Class” all the way, $100K we give away to our kids (we call that “inheritance on
the installment plan”) as well as to charity, and the rest is for “everything else”. I have been retired for six years now and even at that spending level, our retirement fund is more than $500K higher now than it was when I first retired.

Hope this isn’t too verbose, but I wanted to let you hear from someone on the other end of the spectrum who, by following the same concepts you are putting across, has made it to the final stage in fine shape. Thanks again, I hope the AAE has you back every year and I’m going to promote your book to all the young docs I can get to listen to me!

*Have you been living WCI principles throughout your career? How has it paid off for you? Were the sacrifices of living like a resident, paying cash for cars and holding off on the big doctor house worth it? Comment below!*

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**Investing Versus Debt Pay-off**

Perhaps the most common question I get by email, in the blog comments, and on the forum basically boils down to “Should I pay off my debt or should I invest?” I’ve addressed it before on the blog, and hit it hard in *The White Coat Investor: A Doctor’s Guide to Personal Finance and Investing,* but hopefully I’ve learned something in the last 4 years that I can contribute to the discussion. I hope to give very concrete guidelines where possible and outline the issues to consider when that isn’t possible. Let’s start with the very obvious.

**# 1 Don’t Leave Part of Your Salary**
On The Table

If your employer gives you a match in a retirement account like a 401(k) or 403(b), then be sure to get it. Not getting it is like rejecting part of your salary. So even if you have terrible, nasty debts, I would still contribute enough to get your full match. Think about it. If you get a 100% match on the first 3% of salary (let’s say that’s $6K) you contribute to the 401(k) then you get an extra $6K. Assuming immediate vesting, even if you turned around and pulled all that money out of the 401(k) and sent it to your lender, you would only pay $1200 in penalties in addition to the taxes you would pay either way. So you’re $4,800 ahead.

# 2 Don’t Pay Off Loans Someone Else Will Pay Off

If you are doing “The PSLF Thing” (meaning you made lots of tiny IBR/PAYE/REPAYE payments during residency or fellowship and are now employed full-time by a 501(c)3 anticipating tax-free forgiveness after 120 monthly payments), then don’t send in extra money to your student loan lender. If you’re worried Public Service Loan Forgiveness will go away, then let that worry motivate you to spend less money so you can divert a large percentage of your income toward building wealth. I’ve traditionally advised people to keep a “side fund” in a taxable account that can then be directed toward the student loans if PSLF gets changed and you’re not grandfathered in. However, it doesn’t make much sense to invest in taxable if you still have tax-protected space like a 401(k) or Backdoor Roth IRA available to you. So I’d probably put it there. Sure, it’s not going to allow you to instantly pay off those student loans in the event of PSLF catastrophe, but you’ll end up wealthier for preferentially using the tax-protected account.
# 3 Stop Digging

Here’s another somewhat obvious point. When you realize you’re in a deep hole (debt), stop digging! I can’t believe how many people are wondering how to get their student loans paid off while still borrowing money to buy other stuff. If it isn’t a modest house or a practice you probably shouldn’t be buying it on borrowed money. That includes cars, vacations, living expenses, boats, pets, or anything else. Professional school will make you debt-numb. Wake up to its wealth-destroying effects on your life! Do you have $400K in student loans? Then you’re likely one of the poorest people in the world. The guy living under the bridge is richer than you. His net worth is $0. You should be driving a beater and living somewhere that feels very middle-class.

# 4 High-Interest Rate Debt Is A Great Investment

If you have high-interest debt, chances are good that you’re not going to be able to find an investment that will make that much money. You don’t borrow money at 20% in order to invest because the risks you would have to take to attempt to beat that return are substantial. Thus, if you have debt at 20%, you should be paying it off as a major priority. And by major priority, I mean instead of eating. It probably wouldn’t hurt you to lose 10 or 20 lbs anyway, would it? In fact, you can probably lower that figure quite a bit. If you’ve got 8%+ debt, you’re probably better off paying that down instead of doing anything else with your money. That’s a guaranteed 8% investment. I wish I could find more of those.

Now that we’ve got those hard and fast rules out of the way, we can move on to some of the more subtle aspects of this
question. Let’s look at some of the aspects to consider as you decide how to allocate your disposable income between investments and extra debt payments.

# 5 How Long Do You Want To Be In Debt?

Personally, I think you ought to have your education paid for within 2-5 years of completing your training. You’re really not done with med school until you’ve paid for it. If you go much beyond 5 years, it will feel like a noose around your neck. I mean, you could have had the military pay for it and you would have been done in 4 years. In order to be out of debt that quickly, you’re going to have to direct a substantial portion of your income to it. Calculate out how much that is, and allocate that much toward the debt. Invest the rest.

But what if that doesn’t allow you to max out all the accounts you want to max out? Tough cookies. Take more money from your lifestyle spending (i.e. Live Like A Resident), not from your debt pay down money. That’s not negotiable. You’re getting out of debt in 2-5 years, come hell or high water. Now, if you want to keep your student loans for 5 years in order to max out some retirement accounts when you could get out of debt in 2 without maxing them out, that’s okay with me. But dragging your loans out for 15 years? You’re going to regret that. Those who lived like a resident when you should have will be financially independent by the time you pay for your school. How are you going to save for your kids’ schooling when you haven’t paid for yours yet?

Once your student loans are gone, you can ask yourself the same question about your mortgage. Do you really want to be paying for that stack of bricks for 15-30 years? Figure out when you want to be done paying and make payments large enough to be done by then. Don’t assume you’ll be able to make big
huge payments later (although there’s a good chance you will, thanks to inflation, but certainly no guarantee.)

# 6 It Isn’t Just About Comparing Rates of Return

Some people make this topic way too simple. They say, “If your investment is going to earn more than the interest rate of your student loans, then you should carry the loans and invest.” That ignores way too much. It ignores risk. It ignores the effects of taxes. And it ignores other important financial issues like asset protection, estate planning, and insurance costs.

Risk

If you can get 8% investing and have 7% loans, you should invest, right? No. Because that 7% is risk-free. And if you want a risk-free investment, you’re looking at only getting 1-2%. If you adjust for risk, paying off those loans is going to be the right choice. Now if you’re comparing an expected 8% return to a guaranteed 2% return, well, that’s a little easier argument to make.

Another important consideration with risk is your need to take it. If you’re a 55-year-old doctor with a net worth of $100K, you have substantial need to take risk (including leverage
risk) if you expect to retire with anything close to your accustomed standard of living. If you’re a 45-year-old doctor with a net worth of $4 Million, you can afford the luxury of being debt-free. This consideration had a substantial effect on our decision to pay off our very low-interest rate mortgage in less than 7 years.

**Taxes**

Some types of debt are tax-deductible. And some types of investments are taxable at various rates. In order to compare apples to apples, you have to tax-adjust both sides of the comparison. You have to know your marginal tax rates (and there is likely more than one). If your marginal rate on ordinary income is 35% (you can figure this out with tax software), and your debt interest is fully deductible (you can figure this out with tax software too), then a 4% debt is is really a (1-35%)*4% = 2.6% debt. If your investment return is taxed at your marginal tax rate and earns 6%, then after-tax it is really 3.9%. If your investment return is taxed at a 15% long-term capital gains rate, then that 6% return is really 5.1%. Your marginal tax rate on the investment could be even lower if you are able to defer some of those gains (such as with a tax-efficient stock mutual fund) or if you have offsetting depreciation (such as with a real estate investment.) And it would be zero if you’re investing in a tax-protected account. Now make your comparison.

In addition to those simple calculations, we also have to consider the other tax benefits of retirement accounts. For the typical attending physician in his peak earnings years, that mostly means a tax-deferred account like a 401(k). A typical physician should expect a tax arbitrage between his marginal rate at contribution and his effective withdrawal tax rate. 35% and 15% would not be unusual. That has the effect of boosting your investment return significantly as you basically started with a free 20% return in the account. In addition,
that money isn’t taxed as it grows. That tax-protected growth may boost your return by another 0.5-2% per year. And if you leave it to a young heir, it can be stretched for more than a century. That tax benefit is awfully hard to pass up in order to get out of debt a few months earlier. Similar principles hold for a tax-free account like a Roth IRA, minus the tax arbitrage.

For the new attending physician, keep in mind you may be able to delay retirement account contributions. Instead of contributing to the 401(k) or HSA in August, you could pay down debt in August and contribute in December. You have until April of next year to get your IRA, SEP-IRA, and employer individual 401(k) contributions in. Yes, you lose the benefit of having that money start compounding in a tax-protected way right away, but at least you don’t lose that tax-protected “space” forever.

Clearly, it makes a lot more sense to carry debt in order to invest in a tax-protected account than to invest in a taxable account. When you’re maxing out all your tax-protected accounts, that’s a good time to take a look at the debts you have left and see if throwing some money at them would be wise. A 401(k) is a lot more valuable than most people think it is, and it is most valuable for high-income professionals.

Asset Protection

You should be familiar with the asset protection laws in your state, as it can have a serious effect on this decision. For example, in Texas and Florida, you have strong homestead laws. So it can make a lot of sense to pay down a mortgage as that money is protected from creditors. In my state of Utah, not so smart as only $40K of home equity is protected. But our retirement accounts get 100% protection. So where a doc in
Texas might choose to pay down his mortgage, a doc in Utah could, just as logically, choose to invest in his cash balance plan instead, even if expected returns were similar.

You can be assured that your creditors aren’t going to take your student loans away from you, but money you use to pay them down also can’t be taken away from you, and since they’re not going away in bankruptcy, paying them off instead of investing in taxable is a smart asset protection move. Bear in mind that asset protection isn’t nearly as important as most docs think it is. The risk of having a significant above policy limits judgment that isn’t reduced on appeal is incredibly small.

**Estate Planning**

Retirement accounts are very useful for estate planning. By properly designating beneficiaries, that money doesn’t have to go through probate. Of course, if you expect to die any time soon, you probably don’t want to pay your student loans off, as they are generally forgiven at death (if you’ve refinanced, be sure to read the fine print to see if they’re assessed against the value of your estate.) Similar issues exist with disability as most student loans are forgiven in the event of permanent disability.

**Cash Flow and Insurance**

One of the best benefits of paying off debt is that your cash flow needs are lower. That allows you to carry less life and disability insurance to protect that cash flow. That could be worth hundreds or thousands per month. Now that we’ve paid off our mortgage, if I died, Katie wouldn’t have to come up with that $2,800 a month mortgage payment to stay in the house. She would only have to come up with $300 for property taxes and
$100 for property insurance. Big difference.

# 7 If Unsure, Split the Difference

As you can see, sometimes an invest vs pay off debt dilemma is very straightforward to resolve. And other times it is complex, murky, and dependent even on your emotional feelings about debt. In those times when you’re truly unsure what to do, and discussion with those closest to you doesn’t help, just split the difference. Send some of the money into your mortgage or student loan lender and invest the rest and realize that you’re choosing between two very good things to do. Which you do matters far less than the percentage of your income going toward building wealth instead of being spent.

What do you think? What else should be taken into consideration when choosing whether to pay off debt or invest? How do you make these decisions? Comment below!

Should I Invest at All-Time Highs?

Q.

Do you have any comments regarding holding any money for investing since the stock market is at all-time highs? For example, Mark Cuban stated recently that he liquified multiple assets and that Berkshire Hathaway is holding more than $100 Billion in surplus cash as if waiting for the right moment to invest?
Q.
I am an airline pilot who recently moved to Europe for work. We sold everything (house, cars, furniture, etc.) during the move and are sitting on a pile of cash….with having zero debt I’d love to put the cash in an index fund but at 25,000+ the market feels overvalued and on a precipice so I have a hard time deciding what to do. We will need to return to the U.S. in a few years so will need some cash to buy the house, cars, and furniture etc. Any insight would be appreciated.

A.

I get some variant of this question pretty regularly. The only time I can recall NOT seeing it was from about September 2008 to June 2009. I answer it the same way every time:

“I have no idea if we are at a market top and neither do you. Nor does Mark Cuban, Warren Buffett, CNBC, or anybody else.”

The realization of that fact, like coming to understand that index funds will outperform the vast majority of actively managed mutual funds over the long run, is immensely freeing. It allows you to concentrate on what really matters rather than spending all your time, worry, effort, and mental energy on something that doesn’t. Now, it isn’t that what happens in the near future won’t have an effect on your portfolio and financial position, it is simply that you really can’t do anything about it, so why worry about it? Actually, that’s not entirely true. You CAN do something about it. You can buy and sell and try to time the market. The problem is that you SHOULDN’T do anything about it, because you are far more likely to hurt yourself by trying to time the market.

The smart ones learn this lesson from watching the mistakes of others. But some of us have to make it ourselves, often
Guru-based Investing

Guru-based investing doesn’t work. I recall a study that looked at thousands of guru predictions about where the market was heading – they were correct 47% of the time, i.e. less accurate than a coin flip. “But it’s Warren Buffett!,” you say. Okay, let’s go to the tape. Apparently, Berkshire Hathaway has underperformed the market over the last decade. Look, if you think Warren Buffett can predict the future well enough to take advantage of it, just buy Berkshire Hathaway stock and quit worrying about anything else. But even a cursory examination of the record would cast doubt on that premise. I mean, take a look:

9.76% for the market and 9.39% for Warren Buffett over 15 years, and it’s even worse when you look at shorter time periods. That doesn’t seem to be the work of someone who can successfully predict the future. Why is the performance lower than the market? Well, it may very well be the cash drag. The difference between getting an 8% market return and a 1% cash return on $100 Billion is about $7 Billion dollars, or about half the state budget of Utah.

The other issue for Warren Buffett is that $100 Billion is a large number. What kind of a deal do you need to deploy $100 Billion? There are only about 50 companies in the S&P 500 that have a market capitalization larger than $100 Billion. So outside of those 50, you could buy the entire company with $100 Billion.

Emotion-based Investing

As bad as guru based investing is, it is almost certainly
better than emotion based investing. This is where you invest based on your own fear and greed and where you “feel” the market is at. This is an almost certain recipe for buying high and selling low. If your feelings could lead to outperforming the market, why would you be sitting in a clinic seeing patients instead of running a $100 Billion mutual fund? Besides, the market “felt” high to people in 2009-2010 (remember the fear of the double dip?, I do), and has felt high every year since. But what has the right move been so far? To hold your nose and invest.

My premise is that you are far better off acknowledging the near-certainty that you cannot predict the future and coming up with an investment plan designed to be successful in a broad range of future economic scenarios. Perhaps the best is a simple, fixed asset allocation you will hold through good times and bad. That’s what I have done since I started investing in 2004 and it worked very well for me, so I recommend it to others.

**Stocks for the Long Run**

Of course, this all assumes this is money you are investing for the long run. Money that you need in 2 years for a house, a car, or furniture shouldn’t be invested in the market at all. In the short run, the market return is dominated by its speculative component. In the long run, the market return is dominated by its investment component. But even on the eve of retirement, the vast majority of the portfolio is not going to be spent any time soon. Even on the eve of college enrollment, you don’t have to have all your 529 money in cash since some of it might not be spent for 3-4 years, more if the child goes to grad school.
Your Asset Allocation Might Be Too Aggressive

In truth, the fear of putting a lump sum into the market may be due to being too aggressive in your investments. The asset allocation that is right for you is the one where your fear of missing out on gains is precisely balanced by your fear of loss from market fluctuation. Unfortunately, those fears are not static, so you’ll have to assess where those fears are for you over the long-term. In 2008, I was 75% stocks and 25% bonds and that felt about right for me. I didn’t feel a need to sell stocks, but in early March of 2009 at the market bottom, I wasn’t super excited to buy more either. So if you’re uncomfortable buying into the market with a 90/10 portfolio, dial that risk level back until your fear of missing out kicks in. Maybe that’s 70/30 or 60/40, I have no idea. But at a certain point, holding cash won’t be so attractive to you. Of course, if that point is a 10/90 portfolio, you probably ought to consider the words of Phil Demuth:

Your psychological predisposition to take or shun risk is irrelevant to the ultimate means to reach your investment objectives...If you are a sensitive soul who can brook no paper losses, the solution is to get a grip, not to invest “safely” if that locks in running out of money when you are old.

We’re Usually at Market Highs

Finally, while it would be fun to go back and invest in March 2009 knowing what was about to happen, the truth is that we are USUALLY investing at market highs. Take a look at the chart:
As you can see, buying at any point from 2005-2007 or from 2013-2018 was buying at a market high. If you go back further in time, you can see this is NORMAL. Check it out:

Why does this kid have a larger Roth IRA than you? Because she isn’t afraid to invest at market highs. If you’re 3 years old, that’s all you’ve known.

This is a logarithmic scale, which seems a bit more accurate. As you can see, the market spends about 3/4 of its time at a market high. If you wait to invest until the market ISN’T at a market high, there is a very good chance you will be waiting for years AND buying in at a higher level than you would have. Consider the worst case scenario – an investor with such terrible market timing that she ALWAYS buys at the market peak. What do her outcomes look like? Luckily for us, Ben Carlson, CFA, has answered this question. Basically, over the long run, she ends up with half the money as if she had just invested every month like a blind monkey. But she still ends up with enough to reach her financial goals.

My recommendation to you if you’re having trouble convincing yourself to buy at a market high? Invest like they vote in Chicago – early and often.

What do you think? How do you invest at market highs? Comment below!
PSLF Side Fund

Q.

I’m a new attending with a wife who is a fellow. We both have a lot of debt and both have put about 4 years toward PSLF. I’m set up for PSLF but my wife may do private practice. I want to create a fund where we save what we would have otherwise spent to pay loans off early. Is the best place just a taxable account or is there some better place to put it and I’m just not thinking through all the implications?

A.

The Public Service Loan Forgiveness program provides tax-free forgiveness for federal direct loans once 120 monthly payments have been made toward it while employed full-time by a government employer or a non-profit (501(c)3). These payments can be made through any of the Income Based Repayment (IBR), Pay As You Earn (PAYE), Revised Pay As You Earn (RePAYE), or the standard 10 year repayment programs. Since most residencies and fellowships are non-profits, and since most residents and fellows enrolled in the various Income-Driven Repayment (IDR) programs qualify for payments that are a fraction of what they would owe in the 10 year standard repayment program, a doctor who made many relatively small payments during training stands to have a great deal of their student loan burden forgiven upon completing 120 payments. For someone who was enrolled in an IDR program during most or all
of their training and is subsequently working for the military, VA, or a non-profit, going for PSLF is a no-brainer.

However, many PSLF enrollees fear the legislative risk inherent in any program that exists at the whims of Congress. Despite the fact that people are now starting to obtain PSLF, they fear the program will be changed and that they will not be grandfathered into the terms of the old program. This lack of faith in Congress leads some doctors to a drastic and potentially foolhardy course – they simply ignore the program despite the fact that it could be worth tens or even hundreds of thousands of dollars to them.

While this does allow them to refinance the loans to a slightly lower rate (potentially saving a few thousand in interest) and with proper financial management and discipline may even allow them to be debt-free sooner, it is probably a mistake when looking at their overall lifetime financial picture. The solution to a lack of faith in PSLF is not to leave the program, it is simply to hedge your bet by using a “PSLF side fund.”

Update Prior to Publication

I did a podcast a week or so ago and talked about PSLF for a few minutes in it. I had a bunch of people email me to tell me they’re REALLY worried PSLF isn’t going to work out because the bureaucrats managing the program can’t seem to keep track of what loans they have and how many valid payments they’ve made. They even suggest that the reason that 98% of those who have applied for PSLF so far didn’t get it was NOT because they didn’t understand the rules or because they couldn’t fill the paperwork out right, but because the bureaucrats couldn’t keep track of their payments. They may be entirely correct, although I wouldn’t bet on it because I think the PSLF bureaucrats will get this paperwork thing figured out before the lawsuits start coming, or at least after the first few.
But again, the solution is NOT to refinance and start paying off your loans. The solution is a “PSLF side fund” (and keeping a copy of every promissory note you’ve ever had, every communication you ever have with the bureaucrats, every annual certification form you’ve had signed, and every payment you’ve ever made.) But hey, if you want to pay off your loan because you’re 99% sure you’ll never receive PSLF, it’s a free country.

**PSLF Side Fund**

The idea behind a PSLF Side Fund is that if, for some crazy reason, Congress changes the law AND doesn’t grandfather you in (or the bureaucrats can’t find record of all those payments you made), you now have a pot of money you can instantly use to pay off your student loans. If PSLF does materialize, then you can use that money for a house down payment, some really awesome vacations, a new Tesla, or add it to your retirement stash.

My goal in suggesting docs use this side fund is two-fold. First, it keeps them in a program that I believe is highly likely to give them a ton of money, eventually. Second, it keeps them from using “I’m going for PSLF” as an excuse to not live like a resident for the first 2-5 years out of residency.

Once you understand this concept, it usually seems like a no-brainer. “Of course that’s what I should do,” the newly enlightened doc realizes. The next question, of course, is the one asked at the beginning of this post – what kind of account and investment should this money go into?

**Where To Invest Your PSLF Side Fund**

Ideally, a new residency graduate is living like a resident. This should provide enough money to max out all available retirement accounts (403b, 457b, a personal and spousal
Backdoor Roth IRA, your spouse’s available accounts, and maybe even an HSA), start working toward a down payment on the dream home, AND still put enough money into the PSLF side fund that it would equal the remaining student loan burden in less than 5 years. In that case, the “where” question is easily answered – in a taxable account.

However, the new graduate who has foolishly decided not to live like a resident may find that she is forced into the unsavory choice of EITHER maxing out retirement accounts OR saving up the PSLF side fund in a taxable account. In that situation, I would generally lean toward maxing out the retirement accounts for the tax benefits both short and long-term and additional asset protection. If PSLF materializes, the money is already in that tax-protected space you can never get back if you don’t use.

If it does not materialize, of course, she’ll be faced with the choice of whether or not to actually take money out of the retirement accounts, pay any taxes and penalties due, and pay off the loans. But at least she’ll back to a net worth of “broke” whichever choice she makes. (Honestly, I’d probably leave it in the retirement accounts and continue the student loan payments, but then again I wouldn’t be in that position because I lived like a resident.)

Of course, if she really thinks that PSLF is going away for her and she would actually withdraw from the accounts if it did, then she may pass on those retirement account benefits and just invest the money in taxable to decrease the withdrawal penalties.

How To Invest Your PSLF Side Fund

Once you’ve decided WHERE (i.e. which account) to invest your
PSLF side fund, you now need to decide HOW (i.e. which investment) to put the money into. While it is generally a bad idea to invest money you may need in the next 5 years into risky investments like stocks and real estate, one must also consider the likelihood of actually needing that money in the next 5 years. If you judge that chance as highly unlikely, it’s fine to invest the money as you would the rest of your retirement funds – i.e. for the long run in an aggressive mix of stocks, bonds, and real estate, although I would stay away from illiquid investments like a syndicated property.

If you think there’s a pretty decent chance you’re going to get hosed, then stick with safer investments such as a high-yield savings account, a bond fund, or a balanced fund. The less faith you have in PSLF, the more conservative your investment should be.

Personally, if it were me, I’d be maxing out all of my retirement accounts and saving up my PSLF side fund in stock index funds in a taxable account. But I’ve got a lot of faith that PSLF will still exist in some form 5-7 years from now and that even if it doesn’t, those already enrolled in the program will be grandfathered into its current terms.

What do you think? Where and how do you think a PSLF side fund should be invested and why? Comment below!

16 Different Ways to Invest in Real Estate

[Editor’s Note: The following is a republished post from Passive Income, MD. I love real estate, but not as much as PIMD does! In this post, he discusses...]
a bunch of ways to invest in it. If you prefer a podcast format, he also covered this recently on a podcast with Financial Residency."

"Invest in Real Estate."

I’m sure many of you have heard this tried-and-true advice. Maybe you even know someone who does just that and is doing quite well for themselves. I’ve heard it uttered countless times, but when I first started in my journey as a real estate investor, I barely knew where to start. I just knew that it could be a good source of passive income.

Well, it’s taken time to learn about the many ways that one can profit off of real estate—and it’s not just being a landlord. But you can’t just pick one at random. The way I see it, choosing how to invest in real estate is very similar to the method by which you chose your medical specialty.

At some point in your life, you decided to be a doctor. But you probably didn’t know what kind—at least, not at first. In fact, there were many, many medical specialties you didn’t even know existed. It was only after you learned what they were, did some rotations, researched a bit, and talked to people that you eventually decided which specialty to pursue.

The same goes for real estate. The best thing you can do after realizing your interest is to educate yourself and immerse yourself in the different niches to see which one fits you best.

Different Ways to Invest in Real Estate

So what are the different “specialties”? Well, that’s the main point of this post. If you’ve considered real estate investing
for yourself, hopefully, some of the following ideas can get you on the right track.

Here are 16 ways to invest in real estate, along with a plus and a minus about each. I recognize there are many more pluses and minuses, but that’s for their own separate posts.

DIRECT OWNERSHIP

Direct ownership of a property can be as a sole owner or as part of a group. This group can be a couple friends and be structured as a partnership or it can mean as a limited partner in a syndication. A syndication is a structure where there is a main sponsor or operator that puts together a deal to purchase a property and you invest as a limited partner and essentially buy a share of the deal.

1) Single-Family Homes

This one is probably the easiest for people to understand. Own a single home (or condo) and rent it out to a tenant.

Plus: Tenants in Single Family Residences (SFRs) tend to take care of the property better.

Minus: If it’s vacant, you have no income coming in.

2) Duplex / Triplex / Quad

Simply more units under one roof, but again, the process is simple: find a tenant and collect rent.

Plus: Tend to have better cash flow, especially because if one unit goes vacant, you still have others bringing in rent.

Minus: Tougher to self-manage than SFRs because you have to deal with more tenants.
3) **Apartment (Multifamily) Building**

This usually applies to buildings with five or more units. Lenders and banks treat these buildings differently – the loan is considered a commercial loan and has a completely different set of lending standards, qualifications, rates, and terms. This is a favorite of syndications where investors pool their funds with professional operators who put together deals. Investors receive a monthly/quarterly dividend. The operators then add value to the building through good management and ultimately sell the building in 3-7 years and everyone hopefully gains a nice profit by the end.

**Plus:** Economies of scale and value of the property is based on income and that means there’s an opportunity to dramatically increase the value of the building with good management.

**Minus:** More management intensive, and so makes sense to hire a professional.

4) **Retail**

Obviously what this looks like varies quite a bit, but it could be a strip mall with multiple businesses housed in it. It could also be a *triple net lease* situation where you own the building and land where a business like CVS operates.

**Plus:** Long-term leases, often minimum 3 years. If it’s a triple net, could be a 20-25 year lease.

**Minus:** Not always easy to swap tenants. Can remain vacant for a while especially if it’s not in a great area.

5) **Mixed Use**

This can also mean a lot of things, but it’s typically a combination of residential, retail, office space, industrial, etc.
Plus: Can benefit from having varied income and length of leases.

Minus: Have to understand more than one niche to be successful.

6) Industrial

This is definitely not exciting by any standards but typically, these are warehouses that businesses rent for storage or manufacturing.

Plus: Known to be steady performing niche with little day to day management needed.

Minus: Usually a single tenant so not always easy to rent on a turnover and therefore may sit unoccupied for a while

7) Self-Storage Facilities

These days it seems that people have more and more stuff and need places to house it. As a result, self-storage facilities have popped up all over the place.

Plus: Don’t have to deal with typical tenant-type problems (loud neighbors, overflowing toilet)

Minus: Very reliant on management who can make or break your investment. It’s very much a customer service business.

8) Mobile Home Parks

This seems to be quite a popular investment these days as well especially because they’re known to do quite well in times of economic stress. Why? Because it’s affordable housing and that’s obviously a bigger deal when the economy isn’t doing quite well (and people are predicting this to be the case soon). Directly owning it means you essentially own the land that the mobile homes sit on and are paid rent to have the homes housed there. However, I rarely see it owned solely, more as pooled investors like the mobile home park funds I’ve
seen on crowdfunding sites like RealtyMogul.

**Plus:** Little tenant turnover  
**Minus:** I’ve heard getting a loan for this is quite difficult and can be quite capital intensive (expensive), which is why people prefer to invest in these as part of a fund.

### 9) Land

Raw land. This land can be improved, subdivided or split up. If you think it’s in the path of progress, some people like to buy up land they foresee being developed and wait for the area to improve. Then they’ll sell it off for a profit.

**Plus:** No real tenants to deal with.  
**Minus:** If it’s not desirable in any way, don’t expect any appreciation and unfortunately it doesn’t provide any cash flow unless you put a billboard on it or figure something else out.

### 10) Short-Term Rental / Airbnb

You can rent out an entire property you own or just a room similar to a hotel. There are many people who do this quite well and have figured out how to squeeze profit out of an unused room(s).

**Plus:** Often times you can make more per night than you would if you rented it out to a long-term tenant.  
**Minus:** Constantly have to worry about who will be renting and for how long, although that can be mitigated some by having management.

**REITs**
11) Public REITs

Real Estate Investment Trusts (REITs) are very similar to a mutual fund for stocks. Could be good for someone who wants exposure to the real estate market, but wants the investment to be totally passive. They typically pay higher dividends than stocks.

Plus: Allows you to invest in high-end real estate (large commercial properties) with professional management.
Minus: As mentioned in this post, public REITs may tend to correlate highly with the overall stock market and so may not provide the diversification that people are looking for.

12) Private REITs

These are REITs that are not publicly traded. Same concept as public REITs where you are able to buy shares and benefit in the form of dividends.

Plus: Offer higher potential returns
Minus: Typically only available to accredited investors however that seems to be changing with real estate crowdfunding.

OTHER WAYS

13) Tax Liens

We all have to pay taxes as a homeowner. Well, if you don’t pay them, the government can place a lien on the property, which is a legal claim for the taxes owed on the property. If those taxes go unpaid, then whoever owns the lien can essentially take ownership of the property. These tax liens often get auctioned off and savvy investors take ownership of these liens. It’s then possible to ultimately acquire the
property at a tremendous discount.

**Plus:** The potential for huge gains.
**Minus:** Understanding the due diligence on how to invest wisely in tax liens takes a good amount of knowledge and experience.

### 14) Notes

Investing in notes is like being the bank and having the borrower pay you monthly interest and principal. I was surprised to find that all home loans aren’t always with the banks but sometimes owned in the form of private notes. There’s a humongous market out there and there are people who specialize in buying non-performing notes, meaning that the borrower is late on payments. The owner of the note may be willing to dump it at a huge discount and this gives the opportunity for the buyer of the note to try to get the borrower paying again or take ownership of the property.

**Plus:** For a performing note, it can be an easy check every month.
**Minus:** Again, this form of real estate investing can get quite complicated, particularly with non-performing notes, and I believe it isn’t for the faint of heart.

### 15) Hard Money Lending

This is very similar to holding a note where you act as the bank or lender and the borrower pays you back a certain amount of interest every month. The distinction here is usually the term of the loan and the interest rate. It tends to be for a shorter term like 6 to 18 months and at a significantly higher interest rate, often 8-15%. Who is borrowing in this case? A good deal of the time it’s fix and flippers who can’t get conventional lending but need the short-term cash to buy and try to turn a property around for a sale. This is typically
what you see mentioned as “Debt” investing on [real estate crowdfunding](https://www.itchincredible.com) platforms.

**Plus:** Potential for significant, steady, passive returns.

**Minus:** May have to deal with foreclosures if borrower defaults.

16) **Fix & Flip**

This is what you see on HGTV all the time. You’ve seen those shows where a good looking couple finds and buys a fixer-upper, renovates it, and sells it for a nice profit. They make it look so easy! While it can be a lucrative business, realize it’s not nearly as easy as they make it out to be. You’re definitely at the mercy of supply and demand and the state of the housing market by the time you’re finished with your project. I’ve never personally house flipped but I do enjoy playing [House Flip by Chip and Joanna Gaines](https://www.itchincredible.com).

**Plus:** Can be an enjoyable project to fix up a place and make money at the same time.

**Minus:** Not as easy as HGTV makes it out to be, and a lot of people lost a lot of money in 2008-2010.

**Summary**

As we’ve seen, real estate investing isn’t always just about buying a home and renting it out. The field is much more varied and diverse than that. That’s why I always have a hard time with anyone simply trying to compare whether the stock market or real estate is a better investment. It’s not so easy to do that.

Now, of course, this list isn’t even close to being exhaustive. There are many more ways to invest, ranging from relatively passive to extremely active, and they run the gamut of risk profiles.
As for me, I’ve chosen to invest in several different niches including direct ownership of SFRs and apartment buildings. I own some of these solely, in partnerships, and as an investor in syndications. I do some hard money lending as well through real estate crowdfunding. These are the “specialties” that make the most sense for me, and as a result, I’ve found some success with them. Personally, I don’t know of anyone who invests in all of these ways. That may be too much for one person to handle. Most often, it seems that successful real estate investors choose a couple and get to know those niches extremely well. The hard part is deciding which ones suit you and your interests the best.

How about you? How many of these ways have you invested in real estate? Are there any real estate investment opportunities I may have left out?

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**Bitcoin From a Trader’s Perspective**

[Editor’s Note: The following guest post was written by Donald Wieczorek, President and Founder of Purple Valley Capital, Inc. Don is married to an emergency physician and has guest posted for WCI in the past about managed futures. He clearly has thick skin given the reception his last post here received. We have no financial relationship. Purple Valley Capital is NOT on the list of WCI recommended advisors. See my note at the end of the post for further information or perhaps just to satisfy your curiosity as to why this post was run on this site at all.]
Bitcoin Isn’t Suitable for Everyone

In the ten years since Bitcoin was invented, its price appreciated from less than one cent to over $19,000 per coin. In 2017 alone, the popular cryptocurrency doubled in value more than four times. But after reaching a peak in December 2017, the same month that Bitcoin futures were introduced, Bitcoin and Bitcoin futures tumbled over 70%. They are both currently worth about $6,000 per coin. While violent, the most recent fall in price is not new nor unprecedented—Bitcoin spot prices have actually experienced four drops of over 70% in its short lifespan, including a 93% drop in 2011. To say Bitcoin and Bitcoin futures are volatile is an understatement; they are some of the craziest markets that I have ever seen. Bitcoin markets are not suitable for everyone, and while I assume very few readers of Dr. Dahle’s blog have exposure to them (which is totally fine!), I do think that you may find the concept, and their price action, fascinating. Bitcoin, and its derivatives, have the potential to go down in history as some of the biggest financial asset bubbles ever. My goal is to offer some information about what Bitcoin and Bitcoin futures are, the risks of getting involved in such volatile markets, and how my firm approaches trading the futures market from a risk management perspective.

Virtual Currencies

For some background, Bitcoin is a virtual currency (a.k.a. cryptocurrency) that was created in 2009 and is designed to work worldwide as a medium of exchange and store of value without a central repository or single administrator. The system is incredibly unique in that it is peer-to-peer, and transactions take place between anonymous users directly without an intermediary. All transactions are recorded in a blockchain, which is an open, distributed ledger that can record transactions between two parties efficiently and in a
verifiable and permanent way. This underlying technology in and of itself, is an extraordinary achievement, and it is the core component of Bitcoin where it serves as the public ledger for all transactions. While over 1,000 cryptocurrencies have been created, Bitcoin was the first, and remains the most popular and widely used. Over 100,000 merchants and vendors accept Bitcoin as payment, and world central banks are currently evaluating cryptocurrencies as potential reserve currencies. Because of its increased popularity and fixed supply, Bitcoin’s price skyrocketed over the past decade (with extreme volatility), as investors and speculators rushed to get involved.

How to Buy Bitcoin

Don Wieczorek

There are two main ways to gain direct access to the Bitcoin market. The first is through buying or selling Bitcoin for dollars or other fiat currency through one of the various specialized (but unregulated) exchanges. As an example, the largest such exchange in the U.S. is Coinbase. After buying Bitcoin, the coins are then stored in your “cold” (offline) or “hot” (online) cryptocurrency wallet to be sold or used at a later point in time. The prices of these Bitcoin are known as spot, or cash, prices. I must emphasize that, because Bitcoin is completely unregulated, the spot market has attracted bad actors who commit fraud, theft, and hacks, with very little recourse for the victims. The second method to gain access to the Bitcoin market is via the Bitcoin futures market, which is a product that was launched in December 2017 by the Chicago Board Options Exchange (CBOE) and the Chicago Mercantile Exchange (CME), both of which are regulated exchanges under the U.S. Commodity Futures Trading Commission (CFTC). Bitcoin futures derive their price from the underlying spot price of
Bitcoin. The futures offer a way to gain exposure to the gains and losses of the market without owning the underlying virtual coin. While more regulated than the unregulated spot market, Bitcoin futures do have added risks that are associated with being a futures market—leverage, volatility, and complexity (see disclosures at the bottom of my article, per my regulators).

Bitcoin futures can experience significant price volatility, and thus margins may be higher and trading halts can be imposed making it difficult to enter or exit markets. Bitcoin futures trading involves a high degree of risk, potentially even more so than other futures markets, because of the risks inherent in the underlying spot market. Again, Bitcoin spot is completely unregulated, not recognized as legal tender in the U.S., extremely volatile, subject to cybersecurity risks, and difficult to value. My firm is registered to trade commodity futures products, so I trade Bitcoin futures, but I do not trade Bitcoin spot. I’d like to emphasize that while I do trade Bitcoin futures, it makes up a very small portion of my trading program’s activity. I also trade over 40 other commodity and currency futures markets. But for the purpose of this post, I am focusing on Bitcoin markets. Below are charts of both Bitcoin spot, and Bitcoin futures, with the Bitcoin futures chart having a much shorter time frame since they were only introduced last winter.

Why I Trade

While some people understandably elect to watch the price of Bitcoin and its derivatives from the sidelines, I’m cut from a different cloth. My temperament and interests attract me to
hot volatile markets (commodity futures in particular), where I try to manage the risks and attempt to make trading gains from large moves. Managers who trade futures products, including Bitcoin futures, are known as Commodity Trading Advisors (CTAs) or Commodity Pool Operators (CPOs). My firm, Purple Valley Capital, Inc., has been registered as both since I founded it over ten years ago. I’ve traded my share of volatile futures markets over the years, but they pale in comparison to the Bitcoin futures market. I enjoy trading Bitcoin futures because I feel they are the perfect speculative market—demand is driven by human emotion (and faith, or lack thereof, in fiat currencies), supply is finite, and trying to find a fundamental value on the underlying asset is virtually impossible. Thus, the market is prone to having huge booms and busts, more so than most other markets.

**My Trading Plan**

While CTAs can trade a whole portfolio of various commodity and currency futures markets searching for large trends, Bitcoin futures are often the most volatile market in the commodity futures space. It is essential to allocate accordingly and have a bullet proof trading plan. Some essential aspects of a plan may include:

- Only allocate capital that you can afford to lose
- Properly size the position such that the volatility is normalized
- Have a clear plan for when (and at what price) you will exit with a win or loss
- Cut losses extremely quickly; ride winners
- Never turn a trade into an “investment” because it’s losing and you want to give it more time to “work”
- Don’t deviate from your plan
- Enjoy the ride

I feel that even the most volatile market in the world
shouldn’t keep you awake at night if you’re properly allocated, understand the risks, and have a plan for when to exit with a loss or a win. Still, some people may choose to stay away from Bitcoin spot and/or futures, and that’s totally ok! As Warren Buffet says, “You don’t have to swing at every pitch.” But then again there are others, like George Soros, Paul Tudor Jones, and other global macro trend traders who feel bubbles and crashes offer the greatest opportunities to make the most money (but obviously have correspondingly elevated risk of loss too). The best risk managers figure out ways to manage the downside risk while retaining the upside on both their long and short trades. Volatility does not scare traders. We know that we need volatility to help spring us higher; our job is simply to try and limit the downside volatility while preserving the upside. As any successful trader will tell you, there’s no better way to do this than by cutting losers quickly and riding winners. Because of this paradigm, the majority of futures traders with any length of tenure are trend following in nature.

While my firm’s risk management strategy is reactive, systematic, and does not predict price direction, I can’t help but be fascinated by the Bitcoin and Bitcoin futures markets and wonder what will happen to them moving forward. I have an avid interest in financial market history and bubbles. The word bubble gets thrown around frequently, and everyone has their own definition. I think my view will be different than most, because in my opinion, the Bitcoin markets are not a massive bubble, but could still be one. I do think they undoubtedly have some ingredients of a bubble including a breakthrough idea, incredible price appreciations and collapses, enthusiasm, as well as rampant speculation. Cab drivers, co-workers and neighbors are talking about Bitcoin markets, and articles about them continue to pop up everywhere. But it’s still only in the very beginning stages of leverage, liquidity and mass adoption.
Most of my neighbors and friends don’t own Bitcoin or its derivatives, and I doubt many of you do either. The biggest bubbles affect almost everyone. Wall Street is still in the beginning phases of expressing interest. The futures market (which was only introduced last year) and ETFs (not yet approved) may help with this next stage of mass adoption. I do think Bitcoin could be on the path to becoming a bubble, and in the end when it eventually bursts, unfortunately lots of people and entities will get hurt financially due to over extension and improper risk management and position sizing. This was the case with the Tulip, South Sea, Technology, and Housing bubbles too. But to be mentioned alongside these historic bubbles, I think Bitcoin will have to be much more widely owned and affect many more people and institutions, both on the way up, and way down. It may sound crazy, but the main bubble part of the move could still be ahead of us. The recent 70% drop in Bitcoin spot and futures markets could actually be interpreted as a “normal” correction in a wildly volatile market. When it’s all said and done, I think the Bitcoin markets have a chance to go down in history as the largest financial market bubble ever simply based on the fact that, unlike all other prior bubbles, this is truly a global phenomenon and the supply is inelastic.

I hope this discussion was interesting and helpful for you. If you do decide to get involved in Bitcoin spot and/or futures, please understand the risks, because there are many. I would strongly urge you to either have a plan and allocate properly yourself, or utilize the help of a professional. The Bitcoin markets are a speculative beast that moves with ferocious velocity, and no one knows where they will move next.

**From the Editor:**

*I don’t buy Bitcoin. I don’t view Bitcoin as a viable currency. I don’t buy futures. I don’t speculate. I don’t trade in the sense discussed in this article. I don’t use*
technical analysis. Like other humans, I am not particularly talented at predicting the future. Yet somehow, I am a multi-millionaire in my early 40s and am freed from the need to work for money ever again.

So, is trading Bitcoin smart or stupid? Wrong question. The question you should be asking is, “Is trading Bitcoin relevant to your life?” Almost surely not. This is one of many corners of the investing universe that you can safely ignore. There are no called strikes in investing. You can stand there at the plate all day waiting for a pitch you like to come by. Trading, speculating, and buying bitcoin are all pitches that I would let go right by.

Two points about Bitcoin that are worth understanding.

# 1 Bitcoin absolutely was in a classic bubble and that bubble has burst. Bubbles are sometimes difficult to identify while you’re in them, but they’re very obvious in hindsight, and Bitcoin had a bubble. It was the most impressive speculative frenzy of my investing career, and a pleasure to watch. Bernstein identified the following characteristics of a financial market bubble and warned that when you see at least 3 of the 4, steer clear:

1. The asset becomes the subject of conversation at social gatherings
2. People are quitting jobs to speculate in it
3. Skeptics are met with anger
4. Extreme price projections

By December of 2017, all four of those were in place as evidenced by the links. So it should be no surprise that the Bitcoin chart for the last year looked like the classic chart of a bubble.
Wow! You’d think that second chart was drawn AFTER the first one happened, but no, that second one has been around for years. At any rate, anyone who couldn’t see that there was a Bitcoin bubble, especially in retrospect, has no business managing their own money, much less anyone else’s. Now I have no idea where Bitcoin goes from here. Maybe it goes up. Maybe it goes down. Maybe it goes to zero. Maybe it goes to the cost to produce it. Maybe it never again equals its previous height. I truly don’t know. But it certainly was in a bubble and what happened is what always happens with bubbles. On December 17th, it peaked at $19,783. By June 28th, it was at $5,822, a loss of 71%. That’s a return that makes the first year of a whole life insurance policy look good.

# 2 Bitcoin is not, never has been, and given the current trade, is highly unlikely to ever function as a viable currency. Much of the hype driving this mania was that we were all going to start using Bitcoin as a currency. It was supposedly confidential, reliable, and out of the control of governments. Subsequent developments showed that none of that was the case. Besides, Bitcoin failed in the most elementary way – it simply didn’t function as a currency. Nobody was using it in any significant way to buy anything. Try it! Check your local area to see which businesses you can use Bitcoin at. I found about a dozen in the Salt Lake Valley, the largest of which repairs lawnmowers. Even those early adopters who tried to use it seem to be backing away from their decision. Try it yourself. Try to buy your next 30 purchases with Bitcoin and report back on how many of them you could use it for.

So if it isn’t the currency it pretends to be, what is it? It’s an instrument of speculation. Before costs, speculation is a zero-sum game. After costs, like roulette, it is a negative sum game. Don’t play negative-sum games.
As a high-income professional, you have an income in the top 1-3% of Americans. If you simply put 20% of your gross income away during your career and invest it in boring old stocks, bonds, and real estate, with a very high degree of reliability will have more money than you will ever need. You don’t need to speculate or buy stuff like Bitcoin in order to be financially successful, no matter how many seemingly smart people are doing so. Do yourself a favor and let this pitch go right by.

What do you think? Does trading or Bitcoin have a place in the portfolio of a serious investor? Why or why not? Comment below!

Mandatory Disclosure Material:

FUTURES TRADING IS SPECULATIVE & INVOLVES A HIGH DEGREE OF RISK. IT IS NOT SUITABLE FOR EVERYONE. THERE CAN BE NO ASSURANCE THAT THE STRATEGY WILL ACHIEVE ITS OBJECTIVES, RISK MANAGEMENT TECHNIQUES WILL BE SUCCESSFUL OR THAT LOSSES WILL BE AVOIDED. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

VIRTUAL CURRENCY DERIVATIVES DISCLOSURE: Purple Valley Capital, Inc. may trade Bitcoin futures. The underlying cash markets and exchanges for Bitcoin remain largely unregulated markets over which the CFTC has limited statutory authority. This could lead to increased volatility and increased risk of loss. The initial margin for virtual currency derivatives may be set as a percentage of the value of a particular contract, which means that margin requirements for long positions can increase if the price of the contract rises. Exchanges may set higher margins for virtual currency derivatives than other market derivatives. Additionally, FCMs may require a margin level beyond the exchange minimums. FCMs may pose restrictions on customer trading activity in virtual currency derivatives, such as requiring additional margin, imposing position limits, prohibiting naked shorting or prohibiting give-in transactions. The rules of certain designated contract markets impose trading halts that may restrict a market participant’s ability to exit a position during a period of high volatility.
Don’t Fear The Reaper (RMDs)

I’ve now run into a misunderstanding enough times that I think it’s worth writing a post about it. I call this misunderstanding “Inappropriate Fear of Required Minimum Distributions (RMDs).” It is when the fear that your RMDs will be large and cause you a large tax burden in retirement causes you to make a bad financial move. In this post, I’ll discuss RMDs, what an appropriate response is if you truly will have an “RMD Problem,” and why the inappropriate responses are wrong.

What Is A Required Minimum Distribution?

Starting at 70 1/2, you have to start taking money out of your tax-deferred accounts like 401(k)s and IRAs. Technically, RMDs also apply to inherited IRAs prior to age 70 1/2. They also apply to Roth 401(k)s, but since they do not apply to Roth IRAs, the easy solution there is to roll the Roth 401(k) over to a Roth IRA. Voila- no more RMDs. At age 70, the RMD is about 3.6% of the nest egg. That’s amazingly similar to what you actually WANT to pull out of your retirement accounts and spend based on a 4% withdrawal rate unless you plan to be the richest person in the graveyard. As time goes on, those RMDs go up as a percentage of your account. By the time you’re 90, the percentage is 8.8% of the current nest egg. However, that is quite likely very similar to 4% of the original nest egg adjusted for inflation. In fact, just taking out your RMD and spending it is a completely reasonable way to spend down your nest egg in a safe way.

Bear in mind, of course, that an RMD need not be spent. You
can simply pull the money out of your IRA, pay the tax on it, and invest the rest in a taxable account. Nobody is making you spend it. Also, bear in mind, if you are a high-income professional, that you likely saved 32-37% when you put that money in and you are likely pulling it out at rates of 0-24%. Saving at 37% and paying at an effective rate of 15% is a winning combination, even if the tax bill is larger on an absolute basis due to a few decades of compounding.

**First World Problem**

Now, let’s describe the RMD “problem.” A true RMD problem is someone who will actually pay taxes at a higher rate upon withdrawal than they paid during their peak earning years. If ever there were a first world problem, this would be it. If your RMD at age 70 is 3.6% of your nest egg, and your peak earnings years marginal federal tax rate is 37% (like mine is), how large would your tax-deferred account have to be in order for you to pay 37% on ANY of your RMD? Let’s give you the benefit of the doubt and say you have $100K of other taxable income from your taxable account and Social Security. The top tax bracket starts at a taxable income of $600,000 (married). Let’s say a gross income of $700K to make things easy and $100K worth of deductions. Subtract out another $100K worth of taxable account and Social Security income, leaving $500K coming as an RMD. $500K/3.6% = $13.9 Million. In today’s dollars. That’s right. You may need an IRA of nearly $14M in order to have this first world problem. (Remember that’s in today’s dollars since the brackets are adjusted for inflation.) And that’s just for the marginal tax rate to EQUAL your current marginal tax rate. The effective tax rate in the future would still be less than your current marginal tax rate as that entire $500K wouldn’t be taxed at 37%.

×

Just another first
world problem.

My point is that this is a problem that only super savers are going to have. You’re not going to have it with a $1M IRA and a $36K RMD. I mean, how much do you have to save a year at 5% real over 40 years to get $14M? About $110K. A year. For 40 years. And not spend any of it. Most of us don’t even have access to $110K in tax-deferred contributions.

This is all a first world problem, of course. Assuming no change in the tax code, the only way you’re going to be paying taxes at a higher rate than you paid during your peak earnings years is if you have more taxable income in retirement than you had during your peak earnings years. May we all be cursed with this problem. When you combine it with the usually dramatically lower expenses of retirement, it’s going to be a heck of a party. Even with significant tax rate increases, if you do the math most are still going to be better off deferring taxes during their peak earnings years.

What To Do With an RMD Problem

Now, for the benefit of those rare people who will have a true RMD problem (who admittedly are concentrated in places like this website), let me describe the solution. The solution is to do Roth conversions. A Roth conversion is basically taking tax-deferred money and taxable money and moving them together into a tax-free account. So you might take $50K of tax-deferred money and convert it to a Roth and pay $20K in taxes. In essence, you’re taking $50K of tax-deferred money (actually $30K in post-tax money) and $20K of taxable money and putting it into a Roth IRA. Now there are no more RMDs. If you recognize this is a problem you’ll have, you can even do Roth 401(k) contributions as you go along and then move that money into a Roth IRA before age 70 1/2.

This solution allows your money to continue to grow in a tax-protected manner, eliminates RMDs, provides even more asset...
protection than you had previously (because some of the money was in taxable), facilitates estate planning through the use of beneficiaries, and allows the use of a Stretch Roth IRA.

This solution also works in a similar way for those who are able to do Roth conversions at a relatively low rate in their 50s and 60s after early retirement, even if they don’t have a true RMD problem. Another possible solution for those who are charitably inclined is to give tax-deferred money to charities in lieu of cash (Qualified Charitable Distributions), a solution I wrote about last week. While you don’t get the usual tax deduction too, you don’t have to pay taxes on the charitable contribution and don’t have to take an RMD, so that’s really the same thing.

What NOT To Do With an RMD Problem

So now that we’ve pointed out what reasonable solutions are, let’s point out what the solution IS NOT.

# 1 Pull all your money out now.

The solution is NOT to pull all the money out of your 401(k) now, pay the taxes and penalties, and reinvest it in taxable. This solution is generally advocated by someone who wants to sell you something, like whole life insurance. It’s stupid. Not only do you pay the penalties, pay taxes at the highest possible rate, lose the asset protection benefits and lose the estate planning benefits, but you also lose the benefit of that tax-protected compounding for the rest of your life and that of your heirs. And you probably end up with a crummy investment. It’s idiotic. Really, really dumb. Don’t do that.

# 2 Avoid making tax-deferred contributions.

The second bad solution, although not as bad as the first, is
the one I hear about more often by people who are trying to do the right thing. This is to quit contributing to a tax-deferred account in the first place and invest in taxable instead. The only reason to EVER pass up a tax-deferred account during your peak earnings years is if you have some investment opportunity that promises much higher returns than something you could buy in the tax-deferred account and you don’t have the money to do both. Minimizing RMDs is NOT a good reason to avoid maxing out that account.

The reason why is that you can simply do a Roth conversion. You might not be able to do a Roth conversion of that money right then due to 401(k) rules. But you can probably do it later. Or you could do what is essentially the same thing in the same tax year by converting a DIFFERENT tax-deferred account. Money is fungible, you see.

Contribute $50K in the 401(k) + Convert $50K in the IRA to a Roth IRA = Contribute $50K to the Roth IRA

Why would anyone choose to invest in taxable when they could invest in a Roth account? It makes no sense whatsoever. But that is what you are doing when you choose to invest in taxable instead of a tax-deferred account due to inappropriate fear of RMDs.


Why Invest in Bonds? —
So you are in your 30s, just out of training, and you really want to catch your retirement savings up since the pipeline to get here was so long. And you think, why should I put any investment money in bonds? I understand they are lower risk and every book recommends a minimum of 10% of my portfolio be in bonds but since I won’t be touching this money for decades I can just add bonds to my portfolio in 10 years or so. I mean I could tolerate any changes in the total stock market over the next 10 years before I make my portfolio more conservative by adding bonds.

Well, truth of the matter is that you don’t need to have bonds to be successful.

Probably........

In this episode I caution you that when you decide not to invest in a major asset class like bonds you’re making a pretty big bet. And so I think it’s probably a good idea for you to at least include a little bit of bonds in your portfolio even when you are after those high returns.

PLUS

More importantly the reason to include bonds in your portfolio is that you don’t really know your risk tolerance when you’re just starting out as an investor. This period of time when you think you can get away with not owning bonds because you want those high returns. That is also the period of time when you are an unproven investor. You’re unproven to yourself. It
seems like you could to stay the course in a big bear market but you don’t actually know that you can because you’ve never done it. You’re essentially an investing virgin. And I think it’s a good idea to set your asset allocation up a little more conservatively than what you think you can handle until you go through your first bear market.

But before we get into what else is in this episode, here is our sponsor. Have you downloaded Adam’s free e-book yet?

Podcast # 72 Sponsor

[00:00:20] This episode was sponsored by Adam Grossman of Mayport Wealth Management. Adam is a Boston-based advisor and works with physicians across the country. Unlike most other advisors, Adam offers straightforward flat fees for both standalone financial planning and investment management. Whatever stage you’re at in your career, Adam can help you get organized with a personalized financial plan and can help you implement it with a low-cost index fund portfolio.

Adam is a CFA charterholder and received his MBA from MIT, but more importantly, you’ll benefit from Adam’s own personal experience with many of the same financial obstacles and opportunities that face physicians.

To learn more, visit Adam’s website mayport.com/whitecoat to download a free e-book especially for physicians.

Quote of the Day

And of course our Quote of the Day. So many good quotes to share from Morgan Housel.

[00:01:03] “There is a lot of money to be made in the finance
Introduction

Three things I cover in the introduction.

1) Read The White Coat Investor book

[00:01:23] Seriously though if you haven’t had a chance to read the White Coat Investor. It’s a great book. And I’m not just saying that because I wrote it. You should take a look at it. It has had hundreds of reviews, almost all of them are five star reviews, and it is changed a lot of lives. It’s a great way to catch up quickly to other listeners of the podcast or readers of the blog. And it contains information that isn’t found either on the podcast or on the blog. So if you haven’t had a chance to read that, I’d suggest picking up a copy and reading it. If you know somebody else that could benefit from it, get them a copy while you’re at it. It could change their financial life.

2) Subscribe to the White Coat Investor Youtube channel.

[00:02:04] Check out the WCI channel. We are putting a lot of effort into it, to reach more people with this financial information. There is both audio and video there covering important topics. Be sure to check it out and subscribe.

3) Speak Your Questions Directly on to the WCI Podcast

[00:02:27] And most excitedly, you can now speak your questions directly on to the WCI podcast. Listeners won’t have to listen to me read your question. They can hear it directly
from you. Go to speakpipe.com/whitecoatinvestor and press record. You have 90 seconds to ask your question. So if you have a question right now, go here and record it! Okay you can still email me questions but we thought it would be fun to get more voices on the podcast.

Main Topic

Why Invest in Bonds?

[00:02:48] You may do just fine not investing in bonds. Maybe. But since we don’t have a crystal ball I recommend you include bonds in your portfolio because:

- There may be a situation in which bonds outperformed stocks over your investment horizon. Is that situation unlikely? Yes that’s unlikely. You’re more than likely going to do better with stocks then bonds over 30 to 60 years. That said there are significant periods of time in history when bonds have outperformed stocks for periods of 10 and up to almost 20 years. And that could certainly happen again and it has happened in other countries.

- You don’t really know your risk tolerance when you’re just starting out as an investor. You are an unproven investor. Like I said earlier you’re essentially an investing virgin. So set your asset allocation up a little more conservatively than what you think you can handle until you go through your first bear market. It is a little bit like the Price is Right. You want to have as many stocks as you can tolerate but not any more than that. So you’re trying to get as close as you can to the right amount of stocks for you without going over.

- Specialized kinds of bonds can be important to your portfolio. Municipal bonds for instance kick out tax free income when you hold those in your taxable account. Treasury Inflation Protected Securities or TIPS can also
help protect you against inflation. So don’t ignore this asset class.

Q&A from Readers and Listeners

Enough about investing in bonds. Let’s get to some listener questions.

Q) [00:06:56] “I’d love to hear your thoughts on target date retirement funds.”

A) A target date retirement fund is a fund of funds. It’s a mutual fund that buys a bunch of other mutual funds. And at Vanguard they’re basically invested entirely in the Vanguard Total Stock Market Index, the Vanguard Total International Stock Market Index, the Vanguard Total Bond Market Index Fund, and the Vanguard International Bond Market Index Fund. I think as you get into the later stages, toward the less aggressive ones, they even throw their Treasury Inflation Protected Securities Fund in there. And so it’s a good mix of funds. It’s not like you’re going to go wrong picking a target retirement fund. There are no bad funds in there at Vanguard anyway. Now some of the other companies have some higher expense funds you may want to avoid. But the problem with target retirement funds is not only that you get the higher expense ratios, you can’t get the lower ones you would get with Admiral shares or the ETF share classes of Vanguard, but also it’s probably not available to you in all of your accounts. For instance my 401k at my partnership doesn’t offer target retirement funds so if this is supposed to be a one stop shopping solution, use one fund and forget about it. Well that doesn’t work if it’s not available in your 401k.

The other problem with it is if you are investing in a taxable account you’re going to have some assets in there that you probably don’t want in your taxable account. For example most docs are in a high tax bracket and if you are going to hold
bonds in taxable you want to be holding muni bonds or tax exempt bonds. The bonds in the target retirement funds are not tax exempt bonds. And so in that respect you may not want to hold it in a taxable account if you’re looking for the most tax efficient solution possible.

Most people using target retirement funds are looking for a simple solution, a one stop shop, something they can set and forget. They’re not usually the people who are listening to financial podcasts and reading financial blogs and that worry about things like a 10 basis point difference in expense ratios. If you are the type of person who worries about those things you probably don’t belong in target retirement funds. You might as well set your own asset allocation. But are they perfectly fine? Sure they are. It just doesn’t work for most docs because they have all kinds of different investing accounts they’re trying to manage. But certainly when you’re starting out in residency, in a Roth IRA, and that’s your only investment account, throw it into a retirement fund, that’s a great choice.

Q) [00:10:38] “I have a loan for disadvantaged students where 5% interest is paid for during my training. Should I continue with this loan as is or consolidate all my loans and and go for REPAY or PAY and presumably eventually public service loan forgiveness?”

A) The reader has 150,000 dollars in student loans at 6% with Great Lakes and 80,000 at 5% with heartland. The smaller loan is a loan for disadvantaged students. He was not considering loan forgiveness at the time he deferred the loan for disadvantaged students since 5% interest would be paid for during his training (6 years). He could still make four years of qualified payments. after that. But is unsure whether he will be in a nonprofit after training though is not opposed to the idea. If he consolidates the loan for disadvantaged
The most difficult part of this is deciding whether you are going for public service loan forgiveness or not. If you’re going for a public service loan forgiveness you want to get as many of your loans as eligible for public service loan forgiveness as you can. And if consolidating helps you do that. You want to do that. You also want to make as many tiny payments during your training as you can. And so it’s hard to answer this question without knowing the future, whether you’re going to be working for a qualifying institution for Public Service Loan Forgiveness.

If you’re not, there’s no reason to consolidate that loan for disadvantaged students. This is a subsidized loan and they’re covering the interest for you during residency. That is a great deal. However you’re not making payments toward public service loan forgiveness. So which one’s a better deal? Well the Public Service Loan Forgiveness is probably the better deal. But if you end up working in private practice you will have paid a lot of interest that you didn’t have to pay by taking that loan out of that program and putting it into a typical loan program. So the first thing to decide is whether or not you’re going for public service loan forgiveness. If you are then go ahead and consolidate that LDS loan. If you are not, leave it where it is right now and let the government cover the interest on it.

Q) [00:13:19] “I’ve been saving money in a taxable account just in case something happens with the Public Service Loan Forgiveness program. If I plan to potentially use that money for loan payoff in five years what is the best allocation
strategy?”

A) So he’s asking what should you do with your public service loan forgiveness side fund. I’ve got a blog post coming up on this. It really gets into the details of it. But here are a few principles you should consider when looking at this.

1. The first is how likely are you to use this to actually pay off the loan? And in my view you’re pretty unlikely to use it. This money is almost surely going to be used for something else because I don’t think public service loan forgiveness is going away. And even if it does in the next five years I think this doc is going to be grandfathered in. So the most likely thing is that this money is just going to be added to the retirement portfolio in which case it ought to be invested aggressively like the rest of the retirement portfolio.

2. If you think for some reason that you’re very unlikely to stay in a job that’s going to qualify for public service loan forgiveness and you really are going to use this money to pay off your loans then I would invest it much less aggressively perhaps just in a money market fund or a short term bond fund or a high yield savings account.

Q) [00:15:13] “We have 401k retirement accounts through are current jobs that we max out each year, Roth IRAs and a separate investment account with T.D. Ameritrade. Should we invest in the same low cost index fund for all accounts, the Vanguard Index S&P 500, or is it better to diversify somewhat?”

A) This is one of those questions I get all the time and the answer to it is – you need a written investment plan! If you can draw one up yourself. That’s fine. I’ve got a post about how to do an investing plan. And so does Physician on Fire. If you’re not ready to do that but you want to learn how to do
it yourself you might consider taking my online course, *Fire your Financial Adviser*. It teaches you how to not only interact with a financial adviser but also to draw up your own financial plan if you should want to.

There are basically lots of *reasonable asset allocations* out there. You need to pick one that you can stick with through thick and thin and then when you go to choose investments you choose them according to that asset allocation, according to your written investing plan.

Q) [00:17:54] After we pay off our loans where should we direct funds? Emergency fund, pay off the mortgage, or invest in funds or property?

A) If you don’t have an emergency fund, you need to get an emergency fund. It is probably okay to have a small one while you’re trying to knock out your student loans but should get a bigger one, three to six months of what you spend, after you pay those loans off. So that’s priority number one. Should you invest or pay off the mortgage? Both are reasonable things to do. As long as you have additional tax protected space I think you should invest. But once you’re looking at your taxable money I think it’s reasonable to consider paying off your mortgage with all or part of that savings above and beyond your retirement accounts. This assumes you’re putting at least 20% of your gross toward retirement even if that’s being invested in a taxable account.

Q) “We have a long term goal to move to New Zealand. We realize this would lead to much lower salaries. Is there a better time to do this? Would you recommend working 10 years in the U.S. to save as much as possible in retirement before going? Any certain amount we should save up before going or other tips?”

A) [00:20:12] I don’t know if there is a right answer here as
far as when is the best time to go to New Zealand. Obviously the more you save first the better off you’re going to be financially. But life isn’t always about money. It might be tough to do that New Zealand thing once kids are in high school. So if you’re going to go temporarily I think I’d go before that. If you’re going to go permanently, I’d probably do it before then as well. So maybe they can work for five years and then go. There is not really a certain dollar amount you should save in the U.S. before going to New Zealand, it’s just too personal of a question for me to answer. But I suggested they send in a guest post about what they decide to do!

**Ending**

[0:0:21:46]
That is all for this week. Be sure to
check out the White Coat Investor book if you haven’t yet. Also check out our Yo
Full Transcription

[00:00:00] This is the White Coat Investor podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high income professionals stop doing dumb things with their money since 2011. Here’s your host Dr. Jim Dahle.
Welcomed to the White Coat Investor podcast number 72, Why Bonds. This episode is sponsored by Adam Grossman of Mayport Wealth Management. Adam is a Boston based adviser and works with physicians across the country. Unlike most other advisers Adam offers straightforward flat fees for both standalone financial planning and investment management. Whatever stage you’re at in your career Adam can help you get organized with a personalized financial plan. He can help you implement it with a low cost index fund portfolio. Adam is a CFA Charter holder and received his MBA from MIT but more importantly you’ll benefit from Adam’s own personal experience with many of the same financial obstacles and opportunities that face physicians. To learn more visit Adam’s website Mayport dot com slash white coat to download a free eBook especially for physicians.

Our quote of the day today comes from Morgan Housel. There’s a lot of money to be made in the finance industry which despite regulations has attracted armies of scammers, hucksters, and truth benders promising the moon. I guess that’s just what happens when you have a lot of money sloshing around in one industry. You’re going to get people who are just in it for the money going after it rather than people who really want to help you.

If you haven’t had a chance to read the White Coat Investor, the book. It’s a great book. You should take a look at it. It’s had hundreds of reviews almost all of them are five star reviews and it’s changed a lot of lives. It’s a great way to catch up quickly to other listeners of the podcast or readers of the blog. And it contains information that isn’t found either on the podcast or on the blog. And I’m surprised that I continue to not only sell lots of copies of it each month because it continues to help people but also the feedback I get on it and just how many lives is changed. So if you haven’t had a chance to read that I’d suggest picking that up and reading it. And if you know somebody else that could
benefit from them get them a copy while you’re at it.

[00:02:04] Be sure to also check out our youtube channel. This is something where you can not only get some audio and video, covering these important financial topics but also another way in which we can put some really great content together. It really only works in that format so we’re trying to use that more and more. Be sure to check it out and subscribe.

[00:02:27] The first topic we’re going to hit today was sent in by a reader who asked us to cover this important question of why Bonds? And by the way, you are able to leave your own questions, in your own voice soon, that we’ll be able to put on to this podcast. More info on that to come but we think that’s going to be a great addition to the podcast.

[00:02:48] But this doc wants to know why he should have bonds in his portfolio? “Specifically for a 30 something M.D like me. Only one year out of training. Why should I put any of my 401k and other investment money in bonds as opposed investing only in equities and a smaller amount in real estate. I understand that bonds are much lower risk and every book I’ve read recommends a minimum of 10 percent bonds for anyone. But since I don’t plan on touching any of these funds until retirement it could be reasonable to invest no money in bonds for now and then add that to my portfolio maybe 10 years in the future. Well this would be a relatively aggressive investment strategy. It seems that I could tolerate any changes in the total stock market over the next 10 years before I made my portfolio more conservative by adding bonds.”.

[00:03:29] Well you know this is an interesting question. Lots of people have this. There is no right answer to it which makes it worth a discussion really. The truth of the matter is that you don’t have to have bonds to be successful, probably. You know there may be a situation in which bonds outperformed stocks over your investment horizon. Is that situation
unlikely? Yes that’s unlikely. You’re more than likely going to do better with stocks then bonds over 30 to 60 years. That said there are significant periods of time in history when bonds have outperformed stocks for periods of 10 up to almost 20 years. And that could certainly happen again and it has certainly happened in other countries. And so bear in mind that when you decide not to invest in a major asset class like bonds you’re making a pretty big bet. And so I think it’s probably a good idea for you to at least include a little bit of bonds in your portfolio for that reason.

[00:04:28] But a more important reason to include bonds in your portfolio is that you don’t really know your risk tolerance when you’re just starting out as an investor. This period of time when you think you can get away with not owning bonds because you want those high returns. That’s also the period of time when you are an unproven investor. You’re unproven to yourself. It seems like you would be able to stay the course in a big bear market but you don’t actually know that you can because you’ve never done it. You’re essentially an investing virgin. And I think it’s a good idea to set your asset allocation up a little more conservatively than what you think you can handle until you go through your first bear market.

[00:05:08] My first bear market was the 2008 bear market and I’ll tell you what, By the end of that I was pretty darn glad that I had 25 percent of my portfolio in bonds because it felt like stocks were going to keep going down and down and down forever. But by having those bonds in my portfolio it made it easier for me to tolerate the losses I had had in stocks. And so you may find that you’re in the same situation but if you decided not to own any bonds you may have exceeded your risk tolerance and end up doing the worst possible thing you can do in a bear market which is cashing out and basically selling low. And so you’re far better off holding 10 20 30 40 percent bonds than you are selling low in a bear market. It’s a little
bit like the price right. You want to have as many stocks as you can tolerate but not any more than that.

So you’re trying to get as close as you can to the right amount of stocks for you without going over. So be very careful in that respect. There’s also some other benefits of bonds for example some specialized kinds of bonds. Municipal bonds for instance kick out tax free income. You know when you hold those in your taxable account. Treasury Inflation Protected Securities or TIPS can also help protect you against inflation. And so that’s also another great case for why you might want to own some bonds in your portfolio. But those are my main thoughts on whether you should own bonds in your portfolio or not. I certainly do and have throughout my entire career and I haven’t regretted it. But the truth of the matter is if I went back and had held 100 percent stocks instead of bonds I would have more money today assuming I was able to tolerate the ups and downs than I do now. And whether that continues in the future or not of course is anybody’s guess.

All right. Second question from the same listener. “I’d love to hear thoughts or even entire episode on target date retirement funds. For example I have Roth IRA funds and Vanguard target date fund with an expense ratio of zero point one five percent. I can instead put that money directly into the component individual index funds with an expense ratio of about point 04 percent if I use the ETF. I don’t have enough funds to purchase Admiral shares in all categories. So is this difference in fees large enough to justify the time needed to rebalance the account and adjust the asset allocation through retirement? I understand I could choose a different asset allocation and different glide path in retirement but I don’t have any evidence based reason to think that my choices would be better than Vanguard settings for its target date funds.”.

Well what a target date fund is, it is a fund of funds. It’s a mutual fund that buys a bunch of other mutual funds. And at vanguard they’re basically invested entirely in
the Vanguard Total Stock Market Index, the Vanguard Total International Stock Market Index, the Vanguard Total Bond Market Index Fund. I think they also now have the Vanguard international bond index fund in there as well. And I think even as you get into the later stages toward the less aggressive ones they even throw their Treasury Inflation Protected Securities Fund in there. And so it’s a good mix of funds. It’s not like you’re going to go wrong picking a target retirement fund. There are no bad funds in there at Vanguard anyway. Now some of the other companies have some higher expense funds you may want to avoid.

[00:08:32] But the problem with target retirement funds is not only that you get the higher expense ratios, that you can’t don’t get the lower ones you would get with Admiral shares or the ETF share classes of Vanguard but also it’s probably not available to you in all of your accounts. For instance my 401k and my partnership doesn’t offer target retirement funds so this is supposed to be a one stop shopping solution, buy one fund and forget about it. Well that doesn’t work if it’s not available in your 401k.

[00:09:03] The other problem with it is if you are investing in a taxable account you’re going to have some assets in there that you probably don’t want in your taxable account. For example most docs are in a high tax bracket and if they’re going to hold bonds in taxable they want to be holding muni bonds there or tax exempt bonds and the bonds and the target retirement funds are not tax exempt bonds their taxable bonds. And so in that respect you may not want to hold it in a taxable account if you’re looking for the most tax efficient solution possible.

[00:09:35] Now the truth is most people are using target retirement funds are looking for a simple solution, a one stop shop, something they can set and forget. They’re not usually the people who are listening to financial podcasts and reading financial blogs and that worry about things like a 10 basis
point difference in expense ratios. If you are the type of person who worries about those things you probably don’t belong in target retirement funds. You might as well roll your own asset allocation in that respect. But are they perfectly fine? Sure they are. Even some very sophisticated investors use those types of funds. For example Mike Piper who blogs at The Oblivious Investor his entire portfolio is in a vanguard life strategy fund which is basically a target retirement fund that doesn’t change its asset allocation as you move toward retirement and so it’s a very simple but elegant solution. It just doesn’t work for most docs because they have all kinds of different investing accounts they’re trying to manage. But certainly when you’re starting out in residency, in a Roth IRA, and that’s your only investment account sure throw it in a retirement fund, that’s a great choice.

[00:10:38] All right next question is about student loans, specifically a loan for disadvantaged students. This doc writes in, “I have about 150000 dollars in student loans at 6 percent with great lakes and 80 thousand dollars at five percent with heartland. The smaller loan is a loan for disadvantaged students. I was not considering loan forgiveness at the time I deferred the loan for disadvantaged students since 5 percent interest would be paid for during my training including fellowships and put the rest in forbearance. I have been making payments on the Great Lakes loans to get the tax deduction over the last two years. I plan on finishing two fellowships that will put me at six years of training. I could still make four years of qualified payments. I’m not sure whether I will be in a nonprofit after training but I’m not opposed to the idea. If I consolidate the loan for disadvantaged students I lose the 5 percent benefit. Should I continue with these loans as is, put the Great Lakes portion into repay or pay and leave the loan for disadvantaged students out? Or consolidate them all and go for repay and pay and presumably eventually public service loan forgiveness?”
Well here’s the deal. The most difficult part of this is deciding whether you’re going for public service loan forgiveness or not. If you’re going for a public service loan forgiveness you want to get as many of your loans as eligible for public service loan forgiveness as you can. And if consolidating helps you do that. You want to do that. You also want to make as many tiny payments during your training as you can because the amount that’s left to be forgiven after ten years of payments in the Public Service Loan Forgiveness program is the difference between a full payment that you’ll make as an attending and the tiny little payments you make as a resident and a fellow. And so it’s hard to answer this question without knowing the future, whether you’re going to be working for a qualifying institution for Public Service Loan Forgiveness.

If you’re not. Well certainly there’s no reason to consolidate that loan for disadvantaged students. This is a subsidized loan and they’re covering the interest for you during residency. That is a great deal. However you’re not making payments toward public service loan forgiveness. So which one’s a better deal? Well the Public Service Loan Forgiveness is probably the better deal. But if you end up working in private practice you will have paid a lot of interest that you didn’t have to pay by taking that loan out of that program and putting it into a typical loan program. And the first thing to decide is whether or not you’re going for public service loan forgiveness. If you are then go ahead and consolidate that LDS loan. If you are not then you know leave it where it is right now and let the government cover the interest on it.

Next question comes from an anesthesiologist. “I am finishing my first year in practice as a pain management anesthesiologist at a county hospital. I have about five years left to plan Public Service Loan Forgiveness based on my payments from residency and fellowship. I’ve been saving money...
in a taxable account just in case something happens with the Public Service Loan Forgiveness program.” Good. That’s what you should be doing. “That being said we’ve saved about 100,000 so far and planned to have 150,000 by the end of the year which is what I expect the remaining balance to be after five years should the public service loan forgiveness program be abolished. If I plan to potentially use that money for loan payoff in five years what is the best allocation strategy?”

[00:13:58] So he’s asking what should you do with your public service loan forgiveness side fund. And I’ve got a blog post coming up on this. It really gets into the nitty gritty in the details of it. But here’s a few principles you should consider when looking at this. The first is how likely are you to use this to actually pay off the loan. And in my view you’re pretty unlikely to use it. This money is almost surely going to be used for something else, probably retirement, because I don’t think public service loan forgiveness is going away. And even if it does in the next five years I think this doc is going to be grandfathered in. So the most likely thing is that this money is just going to be added to the retirement portfolio in which case it ought to be invested aggressively like the rest of the retirement portfolio. However if you think for some reason that you’re very unlikely to stay in a job that’s going to qualify for public service loan forgiveness and you really are going to use this money to pay off your loans. Then I would invest it much less aggressively perhaps even just in a money market fund or a short term bond fund something like that, a high yield savings account. But if it were my money I’d be investing it pretty aggressively. Just because I think it’s unlikely that you’ll actually use it for that purpose.

[00:15:13] All right. Next letter this comes from somebody who has three separate questions we’ll go through them one by one. “My husband and I found your podcast and website a year ago and have implemented several suggestions. We feel we have
improved our financial situation substantially.” That’s great. “When we finished medical training we had about eight hundred fifty thousand dollars in combined medical school debt.” Ouch. “We had high interest rates 7 to 9 percent.” Ouch. “So refinanced with Sofi and Laurel Road for interest rates in the 3 to 4 percent range.” That’s great. My husband is four years out of anesthesia residency. I’m two out of allergy fellowship and we’re on track to pay off all our debt by early next year.” That’s awesome. Eight hundred fifty thousand dollars in debt by early next year. “We have achieved this by paying about twenty thousand dollars per month toward the loan since I’ve been in fellowship.” That’s awesome. “I now make about 200000 a year supposed to increase substantially but my group sold the private equity and now pretty much stuck with that salary long term. My husband is in private practice anesthesia makes about 800000 thousand a year but with a pretty grueling schedule. We have four kids and live in the Midwest.” All right. So here are the questions, “we have 401k retirement accounts through are current jobs that we maxed out each year, Roth IRAs and a separate investment account with T.D. Ameritrade. Should we invest in the same low cost index fund for all accounts, the Vanguard Index S&P 500, or is it better to diversify somewhat?”

[00:16:39] Well. That’s one of those questions I get all the time and the answer to it is you need a written investment plan. If you can draw one up yourself. That’s fine. I’ve got a post about how to do an investing plan. If you’re not ready to do that but you want to learn how to do it yourself you might consider taking my online course. I call it fire your financial adviser which got all my advertisers that are financial adviser kind of riled up when I titled it that but it’s useful in that it teaches you how to not only interact with a financial adviser but also to draw up your own financial plan if you should want to.

[00:17:15] But there are basically lots of reasonable asset
allocations out there. You need to pick one that you can stick with through thick and thin and then when you go to choose investments you choose them according to that asset allocation. According to that written investing plan. And so you know if you can’t just call me up and ask me what funds should I invest in? My answer is what’s your plan say you should invest in? If you don’t have a plan, go get a plan. But I get lots of questions like that that people just want to know what I should invest in my 529 or what I should invest into my HSA? And the answer is you need a plan. So go get one.

[00:17:54] All right next question, “after we pay off the loans where should we direct funds? Option 1 is an emergency fund. Is that supposed to be six months of what we usually spend?” Yes, three to six months of what you spend is an emergency fund. “Option two, pay off the mortgage. We currently owe Four hundred Fifty thousand dollars at three point five percent. Option number three investments if so which ones? Option number four investment properties.”.

[00:18:19] OK. Well yes if you don’t have an emergency fund you got to get an emergency fund which is probably OK to have a small one while you’re trying to knock out your student loans but probably ought to get a little bit bigger one, a real one, three to six months of what you spend, after you pay those off. So that’s priority number one and the next question is should we invest or should we pay off the mortgage. Well I think both are reasonable things to do. As long as you have additional tax protected space I think you should invest. But once you’re looking at your taxable money I think it’s reasonable to consider paying off your mortgage with all or part of that savings above and beyond your retirement accounts. This also assumes you’re putting at least 20 percent of your gross toward retirement even if that’s being invested in a taxable account.

[00:19:06] But what investments should they go into? Again it comes down to what is your return investment plan? That might
be more index funds very similar to the ones in their retirement accounts. It might be investment properties. If your plan calls for you to invest in real estate in that manner. So of course there’s no right or wrong answer to that question, what should be done with your money. But they do want to make sure they’re putting 20 percent toward retirement.

[00:19:33] In this case given that her husband is burning the candle at both ends making a eight hundred thousand dollars as an anesthesiologist. I think one of the things they ought to invest in is letting him cut back a little bit. His longevity is pretty critical to their long term financial plan it sounds like, given that he’s bringing in about 80 percent of their income right now. So I think cutting back on that would make it more sustainable long term and give him some career longevity. But all of that’s good to do. Paying down a mortgage. Boosting the emergency fund. Saving for college. And of course getting a written investing plan in place.

[00:20:12] Next question, “we have another long term goal to move to New Zealand perhaps permanently. We realize this would lead to much lower salaries and are considering this for various reasons such as a better work life balance, simpler lifestyle, less stress, safer environment for our children et cetera. Is there a better time to do this. Would you recommend working 10 years in the U.S. to save as much as possible in retirement before going? Any certain amount we should save up before going or other tips?”.

[00:20:36] You know this is interesting and these guys are doing awesome right. They’re making a million dollars a year. They’re paying off eight hundred fifty thousand dollars in student loans within just a few years and they’re asking me for advice. I mean really they ought to be giving the advice. So anyway I don’t know. I don’t know there is a right answer here as far as when the best time to go to New Zealand is. Obviously the more you save first the better off you’re going
to be financially. But life isn’t always about money. It might be tough to do that New Zealand thing once the seven year old is in high school. So if you’re going to go temporarily I think I’d go before the seven year old hits high school. If you’re going to go permanently, I’d probably do it before high school as well. So maybe they can work for five years and then go. I don’t know. So there’s not really a certain dollar amount you should save in the U.S. for before going to New Zealand, it’s just too personal of a question for me to answer. Than I suggested they send in a guest post about what they decide to do on that subject.

[00:21:33] So some great questions today. please send in your questions and we’ll cover those in the podcast. I love hearing what you guys are wondering about and what you’re interested in and getting that information here available for you.

[00:21:46] Be sure to check out the White Coat Investor book if you haven’t yet. Check out our youtube channel. And thank you for supporting our sponsors.

[00:21:52] This episode was sponsored by Adam Grossman of Mayport Wealth Management, a longtime sponsor of our podcast. Adams a Boston based adviser but works with physicians across the country by phone, teleconference, etc. And unlike most other advisers offers straightforward flat fees for both standalone financial planning and investment management. So whatever stage you’re out in your career Adam can help you get organized with a personal financial plan and can help you implement it with a low cost index fund portfolio. To learn more visit Adams website Mayport dot com slash Whitecoat to download a free eBook especially for physicians. Head up shoulders back. You’ve got this and we can help. See you next time on the white coat investor podcast.

[00:22:32] My dad, your host, Dr. Dahle, is a practicing emergency physician, blogger, author, and podcasters. He is not a licensed accountant, attorney, or financial advisor. So
Backdoor Roth IRA Ultimate Guide and Tutorial

[Editor’s Note 9/18/2018: We’ve updated and republished this popular post to include a new infographic and tutorial video to help make the steps to contributing to a Backdoor Roth IRA and filling out IRS Form 8606 even easier to understand and execute. This guide will show you how to get it done right and avoid/identify mistakes that can cost you time and money – even if the mistake was made by your financial advisor. We also cover how to handle late contributions to the backdoor Roth IRA (if you contribute in the following calendar year). If you’ve hesitated to make a Backdoor contribution on your own in the past, this post will give you the confidence to finally go ahead and get it done.]

I’m still getting frequent questions on how to do a Backdoor Roth IRA. So I thought I’d put together a basic, step by step, tutorial people can refer to when they do this. Most physicians should be using a personal and spousal Backdoor Roth IRA. Not only does this provide an additional $5,500 each ($6,500 each if you and your spouse are over 50) of tax-protected and (in most states) asset protected space, but it allows for more tax diversification in retirement. That allows you to determine your own tax rate as a retiree by deciding
how much to take from tax-deferred accounts and how much from Roth accounts.

5 Steps to Making the Backdoor Roth IRA Contribution

Step 1 Contribute to Your Traditional IRA

Make a $5500 ($6500 if over 50) non-deductible traditional IRA contribution for yourself, and one for your spouse. You can use the same traditional IRA accounts every year, they just spend most of the time with $0 in it. Most fund companies, including Vanguard, don’t close the account just because there is nothing in it. I do this every January 2nd. I just place it into the Prime Money Market Fund to keep the math simple. Since it yields something like 0.04% and doesn’t go down in value, the sum when you convert will be exactly the same as when you contribute. No gains, no losses.

Step 2 Convert the Traditional IRA to a Roth IRA

Convert the non-deductible traditional IRA to a Roth IRA by transferring the money from your traditional IRA into your Roth IRA at the same fund company. If you don’t already have a Roth IRA there, you’ll need to open one. This can be done in a minute or two online at Vanguard and is essentially the same process as opening the traditional IRA. I do this the very next day after I make the contribution. It is very straightforward. When you transfer the money, the website will throw up a scary banner saying something like “THIS IS A TAXABLE EVENT.” That’s true. It is taxable. It is just that the tax bill is zero for it since you’ve already paid taxes on the $5500 and couldn’t claim it as a deduction because you make too much money. You can now invest the money as per your investing plan.
Step 3 Beware of the Pro-Rata Rule

Get rid of any SEP-IRA, SIMPLE IRA, traditional IRA, or rollover IRA money. The total sum of these accounts on December 31st of the year in which you do Step 3 must be zero to avoid a “pro-rata” calculation (see line 6 on Form 8606) that can eliminate most of the benefit of a Backdoor Roth IRA.

You can get rid of these accounts in 3 ways:

1. Withdraw the money (not recommended, as the money would be subject to tax and/or penalties, not to mention DECREASING your tax-advantaged/asset-protected investment space.)

2. Convert the entire sum to a Roth IRA. Only recommended if it is a relatively small amount and you can afford to pay the taxes out of current earnings or taxable investments with relatively high basis.)

3. Roll the money over into a 401K, 403B, or Individual 401K. 401Ks don’t count in the aforementioned pro-rata calculation. Some physicians have even opened an Individual 401K at Fidelity or eTrade (the Vanguard Individual 401K doesn’t accept IRA rollovers) in order to facilitate a Backdoor Roth IRA.

Step 4 Fill Out IRS Form 8606 Correctly

The second part of The Backdoor Roth IRA is done 15 months later when you (or your accountant) fill out your IRS Form 8606 on your taxes. Remember that you need one form for each spouse. You need to double check this to make sure it is done right, even if you hire a pro. Advisors have told me that they have had to help clients fix dozens of these that tax preparers had done improperly. If you don’t do it right, you’ll pay taxes twice on your Backdoor Roth IRA contribution.

[Update 2018: To get this step right, I’ve put together a Form 8606 tutorial video AND a correctly filled out 2017 form. Both
show in detail how Form 8606 should be completed in a typical year. Yours will look different if you did your conversion in a different year from your contribution, or if you had an additional Roth conversion this year.

Page 1 (below) shows a “distribution” from your non-deductible IRA. Since the money was already taxed, the taxable amount on your distribution is zero. Line 1 is your non-deductible contribution. On Line 2, your basis is zero because you had no money in a traditional IRA on December 31 of last year (if you’ve been carrying a non-deductible IRA for years this may not be zero.) Line 6 is zero in a typical year. Note that Turbotax may fill this out a little differently (may leave lines 6-12 blank) but you end up with the same thing. Line 13 is the same as line 3, so tax due is zero.

On page 2 (below), you are showing the Roth conversion. I’m not really sure why you have to do this twice (since you’re just transferring the amounts from lines 8 and 11 and then subtracting them), but that’s what the form calls for. As you can see, a Roth conversion of a non-deductible traditional IRA contribution without any gains is a taxable event, it’s just that the tax bill is zero for it.

When double-checking your tax-preparer’s work, you want to concentrate on lines 2, 14, 15c, and 18, and make sure they’re a very small amount, like zero, and not a very large amount, like $5500.

Notice how there is no place on the form to put the date when you made the contribution or the date when you made the conversion. It isn’t on the form your IRA custodian sends to the IRS (1099-R) either.

Harry Sit’s blog, The Finance Buff, has a nice tutorial
showing how to fill out form 8606 using Turbotax, which, believe it or not, is trickier than doing it by hand.

**Step 5 Repeat Next Year**

**Contribute and Convert Each Year**

You do not have to wait any period of time between the contribution and conversion. Each year, I make my Traditional IRA contribution on January 2, then convert to a Roth IRA the next day. That gets my investment money working as soon as possible and simplifies the record keeping. Vanguard won’t let you do it the same day, so I have to wait one day anyway.

**The Step Transaction Doctrine**

There used to be concern that the IRS would have a problem with the backdoor Roth due to an IRS rule called The Step Transaction Doctrine. This rule basically says that if the sum of a bunch of legal steps is illegal, then you can’t do it. Some wondered if this backdoor conversion from traditional IRA to Roth was a legal transaction considering this doctrine. Those concerns, valid or not, are no longer an issue. The IRS clarified in early 2018 that no waiting period is required between the contribution and conversion steps of the Backdoor Roth IRA and essentially given its blessing on the whole process. Waiting just makes things more complicated on the 8606, as discussed in Pennies and the Backdoor Roth IRA.

**Late Contributions to the Backdoor Roth IRA**

While it is “cleaner” to make your contribution and your conversion all in the same calendar tax year, you can make your contribution up until your tax filing date of the next year. Late Contributions to the Backdoor Roth IRA has more details about doing this but hasn’t been updated in a while,
so let’s do it now. The key to filling out the 8606 correctly when you make a contribution after the calendar year is to recognize that the contribution step is reported for the tax year and the conversion step is reported for the calendar year. So imagine you did the following during the calendar year 2018:

- Made a 2017 IRA contribution (reported on 2017 8606)
- Did a Roth conversion of that contribution (reported on 2018 8606)
- Made a 2018 IRA contribution (reported on 2018 8606)
- Did a Roth conversion of that contribution (reported on 2018 8606)

Your forms would look like this:

2017 Form 8606 (only have to fill out part I)

Note that all this serves to do is report basis for the next year. No tax is due. Since no conversion step was done during calendar year 2017, you only have to fill out lines 1-3 and 14.

2018 Form 8606 (must fill out parts I and II)

Notice a couple things here. First, you’ve got to do all of Part I plus Part II for this year because you did the conversion step, unlike last year. Second, don’t get confused by the fact that this form says “2017” and line 4 asks about 2018. This is the 2017 form and you would actually be filling out the 2018 form. But since the 2018 form doesn’t exist yet, I had to use the 2017 form for this demonstration. So add one year to anything you see here. But let’s go through this line by line.
Part I

- Line 1 – That’s the money you contributed for 2018
- Line 2 – This is your basis. Since you made a contribution for 2017 but didn’t do a conversion during 2017, your basis is $5,500
- Line 3 – $5,500 + $5,500 = $11,000
- Line 4 – Remember this is asking about 2019, not 2018 and since you didn’t make the mistake of doing your contribution late again, this will be zero.
- Line 5 – $11,000 – $0 = $11,000
- Line 6 – This is the line that triggers the pro-rata issue. Even though you made a 2017 contribution, you did so AFTER December 31st, so this line would still be zero if had to fill it out for 2017, which you didn’t because you didn’t do a conversion in 2017 and got to skip lines 4-13. But this is the 2018 form and since you converted your entire traditional IRA, this will be $0.
- Line 7 – This doesn’t include conversions. Since you didn’t take any money out of your traditional IRA this year except the conversion, this is $0
- Line 8 – You converted a total of $11,000 this year to a Roth IRA, so $11,000.
- Line 9 – $0 + $0 + $11,000 = $11,000
- Line 10 – $11,000/$11,000 = 1
- Line 11 – $11,000 * 1 = $11,000
- Line 12 – $0 * 1 = $0
- Line 13 – $11,000 + $0 = $11,000
- Line 14 – $11,000 – $11,000 = $0 Note that when you do this form for 2019, line 2 will be $0. (Line 14 on 2018 form = Line 2 of 2019 form)

Your Roth IRA contributions will
need to go through the “backdoor” many times as you build your portfolio.

Line 15a – $0 – $0 = $0

- Line 15b – You didn’t take money out of an IRA to help you survive a disaster, so $0
- Line 15c – $0 – $0 = $0

Part II

- Line 16 – Line 8 is $11,000 so $11,000
- Line 17 – Line 11 is $11,000 so $11,000
- Line 18 – $11,000 – $11,000 = $0

As simple as this all seems, there are a few ways to screw up the process. Read 17 Ways to Screw Up A Backdoor Roth IRA to see them.


The Mindset of the Wealthy

[The following is a republished, updated post that first appeared as one of my regular columns at MDMag.com. It is about mindset – specifically the mindset of the wealthy. Those who are wealthy, or who are destined to become so, think differently from other people in several important ways. Luckily, there’s nothing keeping you from changing the way you think.]
There are a number of ways in which the wealthy differ from the poor or even the middle class. When I refer to the wealthy, I’m not talking about super-wealthy celebrities like Donald Trump, Beyoncé, or Peyton Manning. I’m referring to the simple multi-millionaire, a status anyone with a physician-like income can achieve eventually with a reasonable amount of hard work, discipline, and planning. Perhaps the most significant difference between a physician destined to remain poor and one who will become a multi-millionaire is mindset. The wealthy, and those destined to become that way, (often referred to as HENRYs- High Earner, Not Rich Yet), simply think differently from the majority of their peers in six distinct ways.

6 Ways the Wealthy Think Differently From You

1. The Wealthy Think Long Term

More than anything else, those who are poor and will stay that way aren’t thinking about their life in 20 years or even five years. They’re thinking about Friday night, or worse, what they’re going to have for lunch. The wealthy, as a rule, are planners and started planning their retirement in their 20s when they received their first paycheck. When the middle class gets around to thinking about retirement, typically in their mid-50s, the wealthy are doing estate planning to try to figure out how many generations they can make their wealth last. When an automobile needs to be replaced, Middle Class Mike buys a new one on credit, because he didn’t realize that...
car would need to be replaced someday. Wealthy Willy purchases the car with cash, with money he’s been setting aside for that purpose for years. When considering whether he can afford something, Poor Peter thinks, “What is the payment and how does that relate to my income?” or “How can I make the payment lower?” Rich Rick thinks, “What is the least expensive way I can acquire this item?” If it must be bought on credit, Wealthy Willy and Rich Rick figure out how to minimize the interest paid, or at least compare the interest rate to their expected investing returns.

2. When Spending, the Wealthy Focus on Quality and Happiness

When a wealthy person purchases an item, he focuses on its quality more than its price. It is not simply “If you have to ask, you can’t afford it.” He has learned that a quality item will often be less expensive in the long run because it will last longer due to its superior craftsmanship. More importantly, he has a priori determined how to spend in a way to maximally increase his happiness. Once he has decided that a nice car will make him happier than a new boat or a vacation or retiring earlier, he saves up for and purchases the nice car. He derives pleasure from the entire experience—saving up and anticipating the purchase, making the purchase, and using the purchase afterward without having to worry about making future payments for it. It isn’t that wealthy physicians don’t spend, it is that they spend deliberately.

3. The Wealthy Have an Ownership Mentality

As a general rule, the wealthy prefer to be owners, rather than employees. An employee’s income is always capped at his
salary, but a business owner has infinite income potential. A business owner never pays an employee more income than he can generate. If he did, there would be nothing left over for profit. When a business does particularly well, those who own it derive the benefit. When it does poorly, the owners do poorly. But so do the employees, since they lose their job. All the downside and none of the upside. Likewise, the wealthy prefer investments where they function as owners. This means investing in their own businesses and those of other people, whether privately owned or publicly owned (i.e. the stock market). They also invest in real estate, where they can collect (and increase) rent and benefit from appreciation. They invest, rather than speculate, holding their investments for decades rather than hours. Meanwhile, the poor invest in bank accounts, CDs, and similar investments, if they invest at all.

4. The Wealthy Focus on Providing Value to Others

It is almost a universal rule that a successful business owner is far more focused on his customers than on his bottom line. He knows that if he provides value to others, the money will eventually take care of itself. In addition, after reaching a certain level of success, the marginal utility of additional income to the owner declines markedly. If he continues to work, he does it because he enjoys helping others and building something of value. It truly isn’t about the paycheck every other Friday, and that focus on others breeds even more success.

5. The Wealthy Put Themselves in a Position to Take Risk

While it is true that the wealthy are often far more willing to take significant risk in their careers and with their
investments than the poor or middle class, they are also experts at getting themselves into a position where they can afford to take that risk. They avoid consumer debt, like credit cards and auto loans. They minimized their educational debt, and paid it off faster than their peers. They live on a fraction of their income, allowing them to have cash continually available for additional investments. They minimize their fixed ongoing expenses through debt reduction and deliberate spending. They keep enough money in safe investments that they can afford to lose a job, start a business, or take care of a family emergency without having to tap long-term investments or retirement accounts. They also know their worth in the marketplace and are continually improving their skills and knowledge so they will be worth more each year to their clients and/or employers. Confidence breeds success which breeds even more confidence. In many ways, those destined to become rich literally will themselves to become wealthy through the power of focus.

6. The Wealthy Become Financially Educated

The rich learn how to speak the language of finance and investing. That doesn’t necessarily mean that the wealthy don’t use financial, accounting, or legal advisors. However, they know it is impossible to have an intelligent conversation with a financial professional if you can’t even speak their language. Inflation, depreciation, deductions, Roth IRAs, long-term capital gains, and other terms are all just simple vocabulary to the wealthy, but they might as well be Chinese words to most Americans. The wealthy pass this language on to their children, giving them a competitive edge in their schooling and careers.

The wonderful thing about all of these habits and knowledge is that no one is excluded from developing them. While there is plenty of income inequality in our society and
undoubtedly factors beyond your control, a certain amount of your own financial success lies entirely within your control. Develop the mindset of the wealthy and achieve your financial goals.

Do you agree the wealthy think differently? Is that innate, or can it be taught? What have you done to change the way you think about money, saving, spending, and investing? Comment below!

Stuff I Don’t Invest In – Podcast #70

Podcast #70 Show Notes: Stuff I Don’t Invest In

In this episode, I talk for a few minutes about stuff that I don’t invest in and why that is. We discuss precious metals, individual stocks, actively managed mutual funds, currencies, bitcoin, starts-ups, commodities, options, and insurance. I share with you why I don’t invest in any of these alternatives. Some listener questions are also answered in this episode about what to do when your investments are boring, investing in taxable accounts, and what to do when you over fund your retirement account. You can listen to the podcast here or it is available via the traditional podcast outlets, iTunes, Overcast, Acast, Stitcher, Google Play. Or ask Alexa to play it for you. Or watch the video here or on YouTube. Enjoy!
Podcast # 70 Sponsor

[00:00:19] This episode is sponsored by Bob Bhayani at Doctor Disability Quotes.com. They are a truly independent provider of disability insurance planning solutions to the medical community nationwide. Bob specializes in working with residents and fellows early in their careers to set up sound financial and insurance strategies. Contact Bob today by email at info@drdisabilityquotes.com or by calling 973-771-9100.

Quote of the Day

[00:01:30] “A big enough bonus can convince even honest, law-abiding finance workers selling garbage products that they’re doing good for their customers.” — Morgan Housel

Main Topic

[00:02:12] Correction: Reservist retirement age is 60, not 65.

[00:02:39] Precious Metals

[00:04:36] Individual Stocks

[00:05:38] Actively managed mutual funds

[00:06:37] Currencies

[00:07:29] Bitcoin

[00:08:20] Start-ups/Angel investing

[00:08:59] Commodities
Q&A from Readers and Listeners

1. “I’d like to put one to five percent of my income into something fun. How do you learn about investing in new startups? Are their resources to get into such investing? What the heck is crowdfunding? Where do you find out how to do that? Is real estate a safer but more active and risky venture? I would really like to add a small chunk to my portfolio that has some higher risk in return. What do you think?”

2. “I just graduated from residency and I’m looking into where to invest at least 20 percent this year. I plan to max out my 403b and do a backdoor Roth IRA. I remember you had a post within the last six months about other places to invest after you’ve maxed these out but have been unable to find it when searching in the blog.”

3. “In December 2017 I contributed to an individual 401K which is my first time doing so. When my accountant was preparing my taxes he noted that I actually had overfunded the account based on my income and suggested that I contact the brokerage, which was Fidelity, and have them recharacterize the access to the 2018 tax year. I went to the brokerage to ask that they do that and got a basic response: we’re too busy to deal with you but will write a letter on your behalf. I got a call a month later that the information the letter contained was incorrect although written by an employee of the brokerage. I went in to solve this issue and was told I needed to fill out a form and pay a 10 percent penalty on the excess. The accountant says that because we reported the correct amount to the IRS the form is
not necessary and he’s planning on reporting it as excess, as a 2018 contribution on next year’s taxes. I’m frustrated with Fidelity because they tell me something different every time I speak with them and am contemplating switching to Vanguard, Ameritrade or E-Trade. I’ve also contemplated opening a totally new 401k for 2018 to keep everything separate. What do you recommend?”

4. [00:23:16] “I’m reading everything you’ve recommended for the past few weeks after it was recommended by my med school roommate. And it appears that I’ve made many mistakes that I need some guidance to rectify.” He is asking for tips and recommendations concerning retirement accounts, student loans, and his savings.

Ending

[00:27:57] Be sure you stop by White Coat Investor Facebook Group if you haven’t joined yet. All high income professionals, but not financial professionals, are welcome.

Full Transcription

[00:00:00] This is the white coat investor podcast where we help those who wear the white coat get a fair shake on Wall Street. We’ve been helping doctors and other high income professionals stop doing dumb things with their money since 2011. Here’s your host Dr. Jim Dahle.

[00:00:19] Welcome back to the White Coat Investor podcast. This is episode number 70, Stuff I Don’t Invest In. This episode was sponsored by Bob Bhayani at doctor disability quotes dot com. They are a truly independent provider of
disability insurance planning solutions to the medical community nationwide. Bob specializes in working with residents and fellows early in their careers to set up sound financial and insurance strategies. Contact Bob today by email at info at Dr Disability quotes dot com or by calling 9 7 3 7 7 1 9 1 0 0. I had Bob on the phone just the other day, he is a great guy, and knows his stuff about insurance. I’ve had a lot of very happy white coat investors after they have met with him to take care of their disability and term life insurance needs.

[00:01:04] If you haven’t had a chance yet, be sure to check out the white coat investors Facebook group. This is totally free to you. There are some minimal ads there that you’ll notice but there is a lot of great discussions going on there. So if you like getting your financial information through Facebook this is a great resource for you. There are already over 4000 members, maybe by the time you hear this there might be twice that many. But it’s really started off with a bang, with a lot of really great people in there.

[00:01:30] Our quote of the day today comes from Morgan Housel who said a big enough bonus can convince even honest, law abiding finance worker selling garbage products that they’re doing good for their customers. And I think that’s really true. Boy have I run into a lot of people who are really peddling the lousy stuff that honestly do we believe they’re helping you. So don’t assume that because someone’s selling you something crummy that they are trying to scam you. They actually do believe they’re doing you a favor even if they really aren’t.

[00:02:01] Thanks for what you do. I appreciate you. I know
your patients do. Maybe not all of them but enough of them that it makes your time worthwhile for what you’re doing. So thank you for the sacrifices you have made.

[00:02:12] I’ve got a correction to issue. Apparently, in a podcast I did a few weeks ago, I said the military reservist retirement age is age 65. That is not true. It is age 60. Your reserve retirement starts coming in at age 60. That’s obviously later than if your active duty in which case it starts kicking in as soon as you retire. You know typically after 20 years which could be as early as really 38 years old. But for reservists, it is age 60.

[00:02:39] Today I thought I’d talk for a few minutes about stuff that I don’t invest in and talk with you about why that is. The first thing on my list that I want to talk about is precious metals. I get e-mails all the time from people asking, hey should I invest in gold? How should I invest in gold? How much should I invest in gold? And I usually tell them you know if you want to invest in precious metals with five or 10 percent of your portfolio. That’s fine. Knock yourself out. Go ahead and do it. But I don’t invest in precious metals and I’ll tell you the reason why. The reason why is I don’t expect much of a return out of them. If you look at the long term returns of gold and other precious metals you will see that they basically keep up with inflation and that’s it. If you go back hundreds of years you’ll see that an ounce of gold bought a man’s suit and today an ounce of gold basically buys a nice man’s suit. Whereas if that had been something like stocks or real estate it would be worth tons more than it originally was. But because it just keeps up the inflation that’s what you get. To make matters worse it’s extremely volatile. I track a number of investments in my monthly newsletter. If you’ll look at that you’ll notice that
perhaps the most volatile of those investments is silver. It goes up and down by 10 or 15 percent every month. It’s just something that people use to speculate and I’m not really interested in speculating. I’m not interested in short term returns. I’m not interested in trying to trade in and out of a market to try to make a buck. I’m looking for long term investments that are going to make me money and precious metals do not qualify in that category. Now you want to limit it to a small portion of your portfolio. I think that’s fine. I think there are obviously times where the return is better than average. Just like there are times when you lose a lot of money in precious metals. So that is why I don’t invest in those.

Next thing I don’t invest in is individual stocks. In fact, I don’t think I’ve ever owned an individual stock. I have no interest in researching Facebook and watching it drop 20 percent based on the fact that some investor doesn’t like Mark Zuckerberg. I really don’t care. I have better things to do than research among the 5000 publicly traded stocks in the country. If I felt like I had to do that to have a successful retirement maybe I’d be more interested in it. But all the data shows that those who buy individual stocks are taking on an uncompensated risk. Sometimes they get lucky and come out ahead. But most of the time they do not, even if they’re professionals. And they end up underperforming the strategy of just buying all the stocks which is basically investing in low cost broadly diversified index funds. So that’s what I do. I buy all the stocks. I own them all. I own Facebook. I own Amazon. I own Netflix, you name it, I own it. I owned it before it got big. But that’s because I buy it through an index fund.
managed mutual funds. Now that’s not entirely true. Sometimes I own a very minimally actively managed mutual fund. For example, some of the Vanguard bond funds technically are not index funds, they are actively managed. But they basically just capture the market return for that particular market. And so they basically act as closet index funds. Again at very low cost. But I’m not going out there trying to find mutual fund managers that I think are going to outperform an index fund that invests in the same investments that they invest in. I just think it’s a loser’s game and I think over 20 or 30 years your chances of doing it are less than 10 to 20 percent. I would much rather take the guarantee of beating 80 percent of the mutual funds out there by investing in an index fund over my time horizon than take a gamble on trying to get you know the top fifth or top 10 of mutual funds that may luckily outperform an index fund.

[00:06:37] Here’s another thing I don’t invest in I don’t invest in currencies. I don’t buy yen, I don’t try to understand the foreign exchange markets. I don’t buy Euros. I don’t try to speculate on Greek drachmas or whatever they use in Greece. I just have no interest in it number one and number two I look at it as basically a zero sum game before expenses. In the long run I don’t expect one currency to outperform other currencies. I expect them to go back and forth at times one will outperform, other times another will outperform and it’ll go back and forth and over the long run I expect them to basically equal each other out. Of course if you’re trying to invest in them you’re going to incur costs. And so if it’s a zero sum game before cost, it’s a negative sum game after costs. And I’m not really interested in playing negative sum games.

[00:07:29] I extend this into the cryptocurrency space. You
know when we were talking about Bitcoin and its hundreds of competitors. This is not something that I am interested in investing in. Number one it has a lot of the signs of a bubble as you saw at the beginning of 2018 when the bitcoin bubble basically burst. I mean it was a classic bubble. It is like you read about in books, it was very impressive. But even now that that bubble has burst I still don’t know where it’s going. It could be going to zero for all I know. But the nice thing about investing is there are no called strikes. You don’t have to invest in everything. So if you don’t understand something, if you don’t really think something’s likely to do well. If you don’t want to speculate on stuff, if you don’t want something that’s particularly volatile, you don’t have to invest in it. There’s plenty of other great investments that you don’t have to use the ones that you’re not a believer in.

[00:08:20] Here’s something else I don’t invest in, I don’t invest in startups. I’m not an angel investor. You know some of these guys say well you know I invest in 20 or 30 of these and I get the one home run out of the bunch and that makes up for the losses in all the other ones. Well the data is not actually very good that you have a positive expected return as an angel investor. So if you’ve got a lot of money to throw away and that’s really your hobby, to go out and find startups and meet with startup starters, knock yourself out. You know just realize it’s probably a very expensive hobby because you’re probably losing money on it. Not to mention it takes an incredible amount of effort to do it well.

[00:08:59] Here’s something else I don’t invest and I don’t invest in commodities. All right I don’t go out and buy a bunch of oil futures. I don’t go out and buy a bunch of pork bellies and wheat futures or whatever else you can invest in as far as commodities. It’s not a market I understand
particularly well. I don’t see a very positive expected return in that market. And likewise, I just ask myself why? Why complicate my portfolio anymore? It’s complicated enough as it is and I haven’t been convinced that adding any sort of commodities including commodity futures fund is particularly wise for my style of buy and hold investing.

[00:09:37] Something else I don’t invest in: options. That’s not entirely true. My first investment was actually an option. My father came to me when I was, I don’t know 10 or 12 years old, and said Hey my buddy says we should buy these and we can make a lot of money in a short period of time. And so we put some money into some options and he convinced me to go along with 500 dollars of my money. That was money that I’d gotten from the Alaska Permanent Fund dividend or something, that’s the only way I could have come into that sum of money. Needless to say a few weeks later we both lost the entire investment. We lost it all. And you know that’s just the way options work, it shouldn’t have been a surprise to us. But that was literally our only investment at the time. We put everything into options on some stock or something. And it expired worthless. So it’s not that I was particularly burned on that, that I don’t invest in options. I just don’t see any point to it for me. Number one I think there’s a lot of very talented options traders out there that are likely going to take advantage of me knowing less than they do. And I think that’s probably not a good place for me to be where I’m in a market with a lot of people that know a lot more about it than I do.

[00:10:44] But secondly options are basically like buying insurance policies on the value of an investment. The expected return on it is zero. And after expenses the expected return is negative. I mean you’re basically using it to hedge
something to make a bet. And I’m not really interested in making bets. Gambling is not the reason I invest.

[00:11:07] Something else I don’t invest in, at least not anymore, is insurance. I find the investing proposition made by insurance companies, You know I’m talking about whole life insurance and variable universal life insurance and other types of universal life insurance, to not be very good bets. I mean if I got to tie my money up for the rest of my life and then I expect returns in the two to five percent range that’s not very attractive to me especially when they’re negative for the first decade. So basically, since I got rid of the whole life insurance policy I was sold as a medical student, have decided not to invest in insurance and maybe somewhere down the line I’ll have some estate planning reason to buy an insurance policy I don’t know. But for now that is not something that I invest in or plan to invest in anytime soon.

[00:11:55] I basically invest in boring old index funds and real estate. That’s what I invest in. You know a lot of people think investing is a lot like gambling. You know they referred even to the stock market as oh you’re just gambling your money in there. But I think investing is significantly different from gambling. For example in investing, you have a positive expected return. You actually expect to make money which is not the case for gambling. In gambling the house makes money. They’re the ones who have the guarantee over the long run of making money. The people in there rolling the dice, playing craps, or playing cards do not have an expected positive return at least on average. And so that’s one difference between gambling and investing. Also I meet a lot of people who are looking for fun. They find investing to be boring and they’re looking for a little excitement in their life. I’ll tell you what, go get your excitement somewhere else. I got an
e-mail today from a doc who does base jumping. You want excitement in your life? Go jump off a 400 foot cliffs with a parachute. That would be exciting for you. But I just have way more fun hobbies than investing. Investing is not that fun of a hobby. So if this is your hobby and you feel like well now I’ve learned a bunch of stuff about it, what am I going to do now? And you find yourself reaching for options and individual stocks and Bitcoin. Well you’ve probably carried it a little too far and you need to find a more fun hobby.

[00:13:18] When I’m buying shares of stock I am buying real businesses with real profits. It’s not a paper investment like the real estate investors like to call it. It is not some sort of throwaway thing. When you buy a share of Amazon your own a share of those profits that Amazon makes. And every time people go online and buy something from Amazon and Amazon makes money some of that money is yours. And that’s a real live business that’s making real life money not some gambling thing.

[00:13:50] All right let’s get into some questions the first one kind of deals with the subject I’ve been addressing in this blog or this podcast so far. I’m a somewhat new attending a couple of years into practice. I’m doing all the right things financially and I am bored. Yes I know that’s good. This is a first world problem. I know a little about investing. I basically read your site and Bogleheads. I go on the evidence based stuff, maxed out every tax protected account, contribute at least 20 percent index funds closer to 30 percent recently with increasing income. I’ve got my mortgage and student loans at a good low rate and set for a reasonable payoff, 14 years in the House and four on the loans. I’ve got Term life and disability insurance and can coast on this formula to retirement.
[00:14:34] I think it would be more fun to have a small percentage in a more active and or risky investment. I’m in my early 30s I have lots of time. I’ll never be contributing less than 20 percent to the good formula for retirement. I’d like to put one to five percent of my income into something fun. How do you learn about investing in new startups? Are their resources to get into such investing? What the heck is crowdfunding? Where do you find out how to do that? Is real estate a safer but more active and risky venture? I would really like to add a small chunk of my portfolio that has some higher risk in return. I’ve helped kickstart a couple of sweet video games but all I got out of it was the game for free when they launched and I’d like a little more skin in the game maybe the chance for a higher payoff. What do you think?

[00:15:15] Well I think being bored with your investments is a good thing. Then you can go focus on the other things in your life that matter more than investing. I mean investing just should not be the most important thing in your life, particularly after you win the game. You know once you’re financially independent how much time do you really want to spend on just maintaining financial independence? It’s not particularly fun. So let’s talk about this a little bit. This is a doc that’s saving enough for retirement into smart investments. So truly he can throw away that 1 the 5 percent that he’s talking about investing on other stuff. I mean if he wants to blow it on a wake boat. Fine. If he wants to blow it on angel investments? Fine. You know knock yourself out. As long as you’re saving enough. It’s up to you what you want to use your money for. But I think let’s answer a few of the questions.
First how do you learn about investing in new startups? One of the best places to go is to some meetings in your town among startup investors, among you know entrepreneurs, and just start doing some networking. And you’d be surprised how many people are out there looking for money for their startups. It might not be wise to invest in them but there’s plenty of startups to invest in all the time in most towns of any significant size.

Are there resources to get into such investing? I’m sure there are resources out there. I don’t really invest in them particularly so I’m not terribly familiar with the resources. So I cannot vouch to which ones are the best ones and whether they’ll lead you astray or not.

His next question was what the heck is crowdfunding and where do you find out how to do that? Well crowdfunding refers to a bunch of people putting the money together to buy one thing you know. I mean technically the stock market’s crowdfunding right. I mean a bunch of people that own Amazon or a bunch of people that own Facebook. I mean that’s crowdfunding at its best right. But I think what people are usually referring to these days is crowdfunded real estate. We’re talking about going through these Web sites, like some of my web site sponsors, like Realty Shares and Realty Mogul and Equity Multiple and these kinds of sites and going in there and buying real estate with dozens of other investors. You know it’s a form of syndicated real estate ownership were you just own a small piece of it. And you can spend as little as five thousand dollars on an investment and that can either be on the debt side where you’re lending money to a house flipper or it can be on an equity side where you get your share of the rents and the appreciation and depreciation and all those kinds of problems or all those kinds of benefits.
rather. But you know it’s pretty easy to go to these crowdfunding websites. You do have to be an accredited investor. But it sounds like this doc is an accredited investor and that’s a good way to get your toe wet in real estate investing and maybe some of these little bit more risky investments. I do have some crowdfunded investments and they’ve treated me well. I’ve gotten nice returns out of them and expect to continue to get some more.

[00:18:00] Is real estate a safer but more active and risky venture? Yes I think that’s a good description of it. It can be both safer and more risky. The thing about real estate is the market is not nearly as efficient as the stock market is. And so I think there’s room there for somebody who knows what they’re doing to add value to the investment. You know even if you’re just buying the house down the street, renting it out, if you’re particularly good at finding deals, at managing properties, and knowing when to sell them, at managing tenants, you can really add a lot of value to an investment. Conversely if you’re not good at it you can subtract a lot of value from an investment. So just realize that that street works both ways. But for someone who really wants to be more active maybe increase the returns a little bit. I think real estate is a great way to go. I’m not sure kickstarting new video games is a particularly profitable investment though I’ve never really done that and I don’t plan to.

[00:18:58] All right next question I just graduated from residency and I’m looking into where to invest at least 20 percent this year. I plan to max out my 403b and do a backdoor Roth. I remember you had a post within the last six months about other places to invest after you’ve maxed these out but have been unable to find it when searching the blog. Just wondering if you remember this post and could send me a link.
I mean the bottom line is once you’ve maxed out your retirement accounts and you want to save more for retirement you gotta invest in a taxable account. It’s ok, it’s not that bad. A non-qualified or taxable or brokerage account is a perfectly fine place to invest and in fact many people particularly those interested in early retirement do. It makes up the majority of their investments. There are a lot of nice things about it. One you can invest in anything you like. You can use leverage. The rules aren’t nearly as strict as in a retirement account and you can spend the money on anything you like which is great. There’s few other benefits. For example you can donate appreciated shares to charity. Not only do you get the deduction for the donation but you also don’t have to pay the capital gains taxes and neither does the charity. You can also do tax loss harvesting with assets in a taxable account that can lower your taxes as you go along. So there’s lots of things about a taxable account. Don’t be afraid to invest in it. I mean don’t invest in it before you’ve maxed out your retirement accounts. But don’t be afraid of it. But that’s the main thing you can do once you’ve maxed out other accounts including your Backdoor Roth IRA and your HSA.

[00:20:24] All right next question. In December 2017 I contributed to an individual 401K which is my first time doing so. My accountant was preparing taxes in the spring he noted that I actually had overfunded the account based on my income and suggested that I contact the brokerage which was fidelity and have them recharacterize the access to the 2018 tax year. I went to the brokerage to ask that they do that and got a basic response: we’re too busy to deal with you but will write a letter on your behalf. I got a call a month later that the information the letter contained was incorrect although written by an employee of the brokerage. I went in to solve this issue and was told I needed to fill out a form and pay a 10 percent penalty on the excess. The accountant says that
because we reported the correct amount to the IRS the form is not necessary and he’s planning on reporting it as excess as a 2018 contribution on next year’s taxes. I’m frustrated with Fidelity because they told me something different every time I speak with them and am contemplating switching to Vanguard, Ameritrade or E-Trade. I’ve also contemplated opening a totally new 401k for 2018 to keep everything separate. What do you recommend?

[00:21:28] Well this sort of thing can happen all the time. I’m always amazed by people that have an accountant they are paying to help them with their taxes and then they don’t call up the accountant when they have a tax related question. I mean if I had an accountant I’d call the accountant up and say hey how much can I put in my individual 401K? That’s what you’re paying him for. Right. To answer questions like that for you. Or people that have a financial adviser and then shoot me emails you know asking questions. Why would you hire some yahoo on the Internet if you’ve got a financial adviser that you’re paying 1 percent of your assets to every year. Ask the financial adviser. That’s what you’re paying them for.

[00:22:04] So in this case I think the accountant is right. And I would go with the accountant. But that’s not unusual for one of these mutual fund or brokerage companies to screw something up. That happens all the time and I don’t know that it is any more likely with Fidelity or Vanguard or Ameritrade or E-Trade. I don’t think I’d switch company based on one screw up. Maybe they keep screwing things up I’d change. But you know Fidelity enjoys a pretty good reputation for customer service and so I don’t know that this would have been any different anywhere else. Just get it corrected for this year. By following the directions of your accountant not some yahoo on the phone at fidelity and then move on and ask the
accountant next year to make sure you’re putting the right amount in there. Remember with the employee contribution you have until a little bit of time after the first of the year and with the employer contribution you have until you basically file your taxes the next year. So there’s plenty of time to talk to your accountant about how much to put in there if you’re not exactly sure. I know this year with my partnership 401k I wasn’t sure I was going to make enough at the Partnership to actually max it out. So I haven’t actually maxed it out yet this year I’ve left a little bit of space that I can wait to see how much money I make. To see if I’ll be able to max it out this year.

[00:23:16] Next question. I’m out of residency for a couple of years. I’m a child psychiatrist. I’m reading everything you’ve recommended for the past few weeks after it was recommended by my med school roommate. Thank you to that med school roommate by the way you’ve done somebody a huge favor. Honestly, I can’t thank you enough for everything because I had no clue about savings or how to go about it. I was just totally lost. And it appears that I’ve made many mistakes that I need some guidance to rectify. Well, that’s not unusual. Most people once they found the white coat investor realize that they have made quite a few mistakes. I am both an employee at the hospital and have my own LLC that is an S corp, files as an S corp, and this is what I’ve established in the last couple of months. With my 401k my employer pays up to 11 percent and sounds like also provides a match 50 cents on the dollar so that’s great. They also provide some stock options that I’m maximizing that is about 500 dollars a paycheck and I’ve set up a SEP IRA through my LLC that I’m putting some money into and also have an individual stock account. I plan to put as much as possible once I close on a house into those accounts. I’ve got 50 percent of my money in S&P 500, 20 percent in midcaps, 10 percent in small caps, 10 percent in
international, and 10 percent in bonds. Okay, that’s not a
crazy asset allocation. An aggressive one but not crazy.

[00:24:42] I don’t like the fact that you’re using a SEP IRA
instead of an individual 401k individual. Individual 401K
allows you to do Backdoor Roth IRAs as well where a SEP Ira
does not. So this doc is almost surely going to want to set up
a Solo 401k or an individual 401k, same thing, and roll that
SEP IRA money in there as part of getting all this mess
straight. He says I’m closing on a nine hundred thousand to a
million dollar house in the next two months with a 30 year
fixed mortgage. I’m now wishing I’d bought a house half this
price after learning what I’ve learned the past few weeks.
Well I guess it’s not too late to get out. Now you can always
give up your earnest money. I hope you haven’t put too much of
a down. I suspect the doc is going to go ahead and buy the
house though. I’ll be setting up 529s for my two children once
I close on the home. Yes assuming you have any money after
paying their mortgage.

[00:25:37] I do have loans of about a hundred fifty thousand
dollars still for myself and my partner that we are paying at
4 percent. We are reasonable spenders, save about a hundred
thousand dollars a year. Well that’s good.

[00:25:49] That’s actually a pretty good amount of savings
given their two professions. He is just asking for any tips,
recommendations from the above mentioned issues. We want
financial flexibility, we’re willing to save a lot more than
we have been but are now dedicating a lot of time to
understanding the stuff.
Well this is awesome because this doc is becoming financially literate. He feels like it’s too late but it’s not. It’s never too late. He’s very early on. I kind of wish he’d found it a few weeks before put an offer down in that house because a big house especially a million dollar house as a psychiatrist it’s a pretty big rock in your life. But you know better now than later. Can you recover from that? Probably. I mean it depends on how much money they make together and how much they save. But I suspect his goal to be saving a lot more money than he is now is going to be not as easy as he thinks it will be once he’s paying for the mortgage and insuring a million dollar house. That can really eat into your ability to save a lot of money.

I guess I’d also like to see him maybe refinancing his loans and paying them off quickly. I mean a hundred fifty thousand dollars certainly isn’t the hugest loan burden we’ve heard about on here but it is something that requires cashflow to meet each month. And I think getting rid of your student loans within the first two to five years out of residency is going to make you happier than dragging that out for a long time even at 4 percent. So I think this docs doing well there’s a few minor tweaks that can be done.

Maybe they want to back out of that home purchase that’ll be up to him. But you know it may not be compatible with their financial goals once they look at them carefully.

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