Fix the Car or Buy a New One – Podcast #116

Podcast #116 Show Notes: Fix the Car or Buy a New One

I received a couple of questions about cars in the Facebook group and thought it would be interesting to compare and contrast them. The first one was from a soon to be resident who wanted to know if he should ship his car across the country because he wasn't sure it would survive the cross country drive. It is worth $2000 but needs some repairs to survive residency. There comes a time when you have to admit that a car is "totaled". If it costs more to repair than the car is worth, it is time to get rid of it, getting whatever you can out of it.

The second question came from someone who is expecting a baby and wants a car with a third row. But he has a lease on another car until February and wanted to know if he should buy the new car anyway and just pay out the lease. Stop leasing cars first off. If you don't have the cash to buy the car, buy a less expensive car. If you don't have the cash to buy a less expensive car, and you have to borrow for it, it ought to be a $5,000 car or less. We get more into the details of these car questions in this episode and hopefully help you make that decision on when to fix the old car or buy a new one. We also answer many listener questions about ETFs, knowing how much home you should buy, getting denied for disability insurance, and more.

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Fix the Car or Buy a New One?

I received a couple of questions in the Facebook group and thought it would be interesting to compare and contrast them. Here's the first one.

> *"I left my current car, worth 2,000 dollars, on the east coast, with plans to ship it to the west coast that'll cost me about 1,500 dollars, where I'm doing residency. I had it inspected and our mechanic friend quoted repairs as being greater than 2,000 dollars for everything, but my dad can do some minor things himself to get it to better running conditions for just a few hundred dollars for parts. Do I look into buying a used car on the west coast, or doing the minimal repairs and bring it over here for residency? I'm not sure how the car will sell if I don't do the minimal repairs, though. I think I'm leaning towards buying a car over here, but wanted more knowledgeable opinions. The car would probably be worth 1K before repairs and 2K-ish after repairs."*

At a certain point, you have to admit the car is "totaled." If it costs more than $2,000 to repair, and it's only going to be worth $2,000 when you repair it, it's totaled. It's time to get rid of it. Get whatever you can out of it. If you can sell it for $1,000, that's wonderful. If you can take it down and get $300 from the junkyard, that's great, too. If it is still driveable and you're not going all the way across the United States, maybe you can drive it around for a couple months until it formally dies.

But at a certain point you've have to go, "Okay, that's it. This one died." When you're at a very low cost car, that happens a lot. If you're driving a $1,500 car, the clutch goes out, the engine goes out, the transmission goes out, the car is totaled. You're done with it, so it's time to get a new car. Now, in this situation, there is actually another factor here. It's going to cost $1,500 to ship it. No way would I pay $1,500 dollars to ship a $2,000 car. I for sure would sell it, get your $1,000 out of it, go across the country and buy a new $2,000 car, or buy a $5,000 car. Get yourself some transportation so you can get around at residency. Don't go buy a $25,000 car on credit, but it's okay to get a little bit more car than a $2,000 car when you're over there so you can make it when you're on call. But this car is dead. If you're not comfortable driving it across the country without making these repairs, and you are talking about paying to ship it, it is time to get rid of it.

Now, compare that to the next question I read on the [Facebook group](#).

> *"Advice needed. I'm expecting a baby in July. I want to buy a new car with a third row. I'm planning to buy a Nissan Armada, but the current lease is not up until February, 2020. Would you buy a 2018 Nissan now that is exactly what you want for $20,000 cheaper than brand new? I would still have to pay for my current leased luxury car until February, about $7,000. Or would you wait until the old lease is up in February, 2020, and buy a brand new 2019 that qualifies for $10,000 in rebates, or would you wait until the old lease is up in February, 2020, and buy a brand new 2020 at full price?"*

You're expecting one baby, and now you need a third row?!

That’s interesting. I’m assuming there are some other kids here, but maybe not. Holy smokes, you’re a year into a lease, and you’re talking about buying another car with three rows?! It is pretty interesting to compare these two. One person is talking about swapping a luxury car that was leased a year ago for another brand new car, and the other one’s trying to figure out how to drive around a $2,000 car even longer.

There is a huge range between these two things that are entirely reasonable. Leasing a car is not a great move. When you lease a car, you are renting the car, usually for three years. You have to look at the numbers because when you are leasing a car you are renting a car, and the person renting it to you wants to make a profit. They have their own business expenses above and beyond the cost of that car. They have to charge you enough to cover the cost of the car, cover their expenses, and make a profit. Now, obviously, that’s going to cost more than just the cost of the car, so even if you want to swap your cars every three years, which has to be the most expensive way to drive a car, buying it is probably still the best move.

It is not that expensive to sell a car, and so leasing very rarely is going to make sense. Now, if for some reason your crazy employment contract says,”we’ll cover a lease,” or something, you may be stuck in some sort of weird situation like that. But in general, even if you’re writing the car off for a business, you can do that owning it just as easily as you can leasing it. So leasing is not a great move, and you can see why. You get into situations like this where you’re stuck holding onto a car you don’t want for another nine months instead of buying what you want now. It is just kind of crazy to be doing that with cars.

Now, doctors can afford to make lots of mistakes because of their high income. Habits like this kill the average household in America. They just cannot do this on an income of $60 or $70 or $ 80,000, churning these cars like this, and the truth is even some doctors that do this, it really retards their financial progress. So what should you do in this situation?

I would quit leasing. No matter which one you do, by nine months from now, just be done with the leasing game. Stop leasing cars. If you don't have the cash to buy the car, buy a less expensive car. If you don't have the cash to buy a less expensive car, and you have to borrow for it, it ought to be a $5,000 car or less. Cindy and I talked before recording this podcast and she's like, "Dude, I drove a Honda Civic until I had my fourth kid." We both drive Sequoias now and that is fine, we can afford to do it, but the truth of the matter is people are buying cars because they have one kid. They're like, "I'm having a kid, I've got to get a minivan." What are you going to carry around for that kid? One kid, you can do just fine in a sedan. In fact, two kids works just fine in the sedan. Now, if you have three kids in car seats, they might not fit across the back row of a sedan. You may have to get a third row at that point, or at least something that's a little bit wider so you can put in three car seats, but for the first and second kid, you don't need to buy a special car for that.

Reader and Listener Q&A

ETFs in an Individual 401(k)

> *"I decided to open up an individual 401k at E-trade after I earned some income from 1099 work. I decided to place it in an ETF inside of the individual 401k, and I was just curious what your thoughts were on this approach. I've not really done much investing with ETFs, and this is my first time with an individual 401k, so I thought I would give it a try. Any feedback would be great."*

This listener's question is one that a lot of people wonder about until they really understand how investing works. He has an E-trade individual 401k, which is fine. I think that's a great place to have it. They have all kinds of features. I think you can take loans at E-trade. They have a Roth 401k option. They actually take IRA roll overs, unlike Vanguard, and of course you can buy any Vanguard ETF you want with a low commission. If you want to invest in Vanguard index funds and your individual 401k is at E-trade, you want to do it using the ETFs.

An ETF is an exchange traded fund, so it's a little bit different from a traditional mutual fund. With a traditional mutual fund you basically trade at 4:00 PM Eastern everyday. You can't buy it and sell it throughout the day as it goes up and down. An exchange traded fund, you can buy and sell throughout the day, so it's really useful for people that are trying to time the market or trying to speculate, that sort of a thing. For those of us who are long term investors, that's really not a particularly useful feature. But it is a feature of an exchange traded fund.

The really nice feature at a place like E-trade is they usually charge a commission like $50 to trade a traditional mutual fund, but an ETF, they usually charge about $5, so it's dramatically cheaper to trade, in that respect. In a taxable account, ETFs can be more tax efficient, because of the way the ETF shares are made and the way they dissolve, you can actually flush some of the capital gains out of the ETF, so in a taxable account they're significantly more tax efficient.

As far as Vanguard's funds go, that is not so much the case. Vanguard's funds are a little bit unique. Maybe their ETFs are slightly more tax efficient than Vanguard's traditional mutual funds, but there's not much of a difference there if you're using Vanguard index funds. So, should you use an ETF? In this case, almost surely, because E-trade doesn't offer low cost index funds commission free. So use the ETF versions in order to keep your costs down. I have a similar situation at Charles Schwab and at Fidelity with my accounts. I use the Vanguard

ETFs because the commissions are cheaper at both.

How Much House to Buy

A listener asked about how much to spend on a home, after sharing his income level, and wanted my opinion on whether the prices of homes he is looking at will make him house poor. Is he buying too much house?

It sounds like they're going to an expensive place in the northeast expecting an income of about $450,000 and no student loans. I'm a big fan of owning your home. I think once you are in a stable professional and a stable personal situation, you ought to buy a home. I think it's an important aspect of building wealth. That doesn't mean you can't build wealth if you're a lifelong renter, and in fact, there are a few areas in this country where that's not a crazy thing to do, especially since buying costs so much more than renting. But in general, I think it's good for doctors to be able to buy their homes. That said, that doesn't mean that everybody ought to buy a home all the time. There are times in your life when it's smarter to rent.

For example, if you're only going to be someplace for a year or two, if you're in the military and you're moving every three years, I think buying a home is dumb. Even if you hold it longer than the two or three or four years you'll be there, you're going to be a long distance landlord, which I assure you is no fun. I think in those situations where you're not going to be in a house for longer than five years or so, it's usually a mistake to buy.

Obviously, sometimes, the market goes up quickly. You can't know that in advance, but maybe a third of the time if you hold onto a house for three years you still make money, but that means two thirds of the time you're not making money. Buy the house if you both like your jobs, and your jobs like you, and your family's stable. My general rule is to keep your mortgage under two times your gross income. If you're making $450,000 a year, that would suggest a mortgage no larger than $900,000. If you want to buy a million dollar house, you put $100,000 down, your mortgage is $900,000, you stay within that rule.

Now, in some really expensive areas, you might have to stretch this 2X gross income mortgage rule. But when I'm talking about stretching, I'm talking about 3X, maybe 4X, not 10X. That is just crazy. You're going to be totally house poor doing that. Even going to 3 to 4X, you have to realize that there are some significant financial sacrifices you are going to make buying a house that expensive.

You're not going to accumulate wealth as quickly. You may have trouble maxing out your retirement accounts. You may not be able to travel as much. You might need to drive a dumpier car. There are consequences to doing that, and often that means a longer career but if you're fine with that it is not crazy, if you're in San Francisco, to get a 3X mortgage.

Patented Share Class Structure at Vanguard

> *"If you get a chance on the podcast or elsewhere, I would very much appreciate it if you could explain to me and the audience the advantages to the individual investor of the unique and patented share class structure of Vanguard, and how having traditional open ended mutual funds paired with ETF share classes keeps fees and taxes lower. And, as a corollary to that, what if any impact will the expiration of Vanguard's patents have on the industry as a whole?"*

Vanguard set up a traditional index mutual fund and paired it with an exchange traded fund. They patented this structure, so they're the only mutual fund company with this. They are two share classes of the same fund. What that allows them to do is to take some of the capital gains out of the people who own the traditional mutual fund shares, and move those into the exchange traded fund shares, and eliminate them when the ETFs are dissolved. Now, you have to look at how an exchange traded fund is created. They have these units that they create. They bring all the stocks that are in there together and create this unit, and then from time to time they dissolve these units, and when they do that they can pass the shares with the low basis, these high capital gains to these groups, forming ETF shares. Because of that unique structure it allows the Vanguard traditional index mutual funds to be more tax efficient than they otherwise would be. In fact, they are nearly as tax efficient as the Vanguard exchange traded fund share class.

None of that matters, of course, in a Roth IRA, or 401k, or other tax protected account, but in a taxable account it does matter. Now, if you go to someplace like Fidelity, and you look at their traditional index mutual funds, and you compare them to iShares ETFs, what you will discover is for the similar stocks in the funds the ETF is significantly more tax efficient, and so the benefit at Vanguard of this unique structure they have is they basically make the traditional mutual funds just as tax efficient as an exchange traded fund.

That patent is going to expire eventually. When that expires what I would hope to see is all the other mutual fund companies doing the same thing. All these other companies that have these low cost index funds, hopefully they will make them even more tax efficient by adding an ETF share class to them. That is good for everyone. I don’t see a downside. Yes, it’s not going to help Vanguard to raise money as quickly as it has, but Vanguard is already the largest mutual fund company. They don’t need to get any bigger. It is okay if they have a little more competition. All that does is drive down prices and make things more competitive, which is good for all of us.

AARP Membership

> *"I know there are very few people in this group who are 50-plus. I am turning 51 this year and would like to know if you can do a post or a podcast on AARP membership and its pros and cons. I read mixed reviews online."*

AARP is the American Association of Retired Persons. When you turn 50, you start getting these fliers in your mailbox, and they're trying to advertise their services. This is an organization which is basically a discount organization. You pay them an annual fee and they take their big membership and try to negotiate discounts for you. It is really a pretty simple mathematical calculation. You basically look at the discounts and see how much money you're going to save from the discounts, then you look at the price of membership and see how much that costs you, and if the discounts are larger than the price of membership, sure, why not join?

You're going to come out ahead financially. But the truth is you don't need very many discounts for this to work out well. It costs $16 a year to be a member of the AARP. You basically need a discount on one hotel night and you're going to come out ahead so I think it's fine to join the AARP. The likelihood, if you actually try to use some of these discounts, of you not coming out ahead, seems pretty low to me.

Here is an interesting secret about the AARP. You don't actually have to be 50. You can join the AARP anytime you like. There is not an age restriction. You don't have to be retired. You don't have to have gray hair. You want to be a member of the AARP? Knock yourself out, go join the AARP, and get your 10 percent or 15 percent discounts or whatever off at these hotels and restaurants. Nothing wrong with the AARP. Well, I mean, there might be something wrong with the AARP, but $16 dollars? Come on. You can come up with something that'll save you 16 dollars during the year.

Changing Your Financial Ways

> *"After having spent the past couple of months reading through some articles, listening to your podcast, learning a lot of basics, I've been determined to get on track with a better plan. We both have moderate amounts of student loans. I have 100,000 dollars left. My wife has 120,000 dollars, all at 6.5 to 6.7 percent. I graduated seven years ago. I've been treading along with IBR and REPAYE. I joined my father, who is also a dentist, with goals of taking over his practice. I thought it would be only a few years, but it's dragged out a lot longer than expected. I'm still working for him, and thus my income hasn't increased much. I currently work part time with him and part time at a community clinic that I started a couple of years ago, and earn somewhere around $120-130,000. We bought a condo about five years ago for $185,000, and fortunately it's increased in value to about $420,000. It's on a 30 year, fixed, 4% mortgage. My wife just graduated a couple of years ago and this past year started a group private practice. We have a household income of about $230,000. In terms of retirement, we don't have much started. I would love to increase our income, but between my wife's new business, and how my income has stagnated in the past several years, we aren't sure when it's going to go up. I have several questions for you. Should we refinance our loans or keep REPAYE to keep the payments low if we want to move to a bigger home in five years? Any general advice for someone in my position? Moderate loan, average income, married, and trying to move forward in life?"*

He talks in his email a lot about being a low income doc. I've written lots of things aimed directly at low income docs that he will find helpful like being a low income doctor in a high cost of living area and financial advice specifically for low income doctors.

When reading about this listener’s situation the first thought that came into my head is, “Man, if you keep doing what you’re doing, you’re going to keep getting what you’re getting.” Here you are, seven years out of training. You’re living in a condo, you still have a mortgage, you still have student loans, your income’s still low, and you have essentially nothing in your retirement savings. If you stay on the path you’re on, your financial life is not going to look much different seven years from now, so something has to change.

I’m not meaning to be critical there. That’s just math. You don’t get a pass on math because you’re a doctor. I wonder if the reason his dad is still working is because he hasn’t yet discovered what this doctor now appears to be discovering; that this plan does not lead to financial freedom. So, what is going to change? The income here is not terrible. They are making $220-230,000 dollars a year. Katie and I became millionaires in seven years with an average annual income lower than that. It is not a terrible income. It is certainly possible to build wealth on that type of income. But that said, more income does make things easier. Let’s not kid ourselves. So, that’s probably the logical place to start this process.

I think the main thing here is to address his career. Honestly, it’s time to have a frank talk with his father. Something like, “Dad, I love working with you, it’s been fun to follow in your footsteps, but financial reality has hit me in the face. I’m seven years out of school, I still owe student loans, I’m still stuck in a rinky-dink condo, and I still have a below-average income. When I joined the practice, I kind of had the idea that you were on your way out, but it looks like you really aren’t. At least not for a while. I need to get my income up to take care of business for my family. That means I either need to find a job that pays more, open my own practice, or really get on some kind of set plan in the next few years to inherit yours. I might even need to move to a lower cost of living area, so I thought I'd start by talking to you about your career plans before I start making changes with mine."

I think that's kind of how my conversation would go. You need to solve that issue first and then move onto the other issues. The next issue is likely to get your spending down. That's tough to do in a high cost of living area. If you move somewhere else, that will likely have a major effect on your living expenses, and probably not affect your earning, or maybe even affect it positively.

He is putting so little into retirement I suspect he is not living on a budget. He needs to get on a budget. [Doctors need to budget too](). Until you figure out how to save 20 percent of your gross income for retirement, you will benefit from being on a budget. Once you've figured that out, it's time to really look at those student loans. You have to have a plan there. You have $220,000 in student loans on an income of $220,000. That's only a 1X ratio. That should be easily paid off in five years by living like a resident. You know, living like the average household income, you should be able to pay off 1X ratio in five years pretty easily.

It will help if you [refinance them](), but what's the alternative? Are you planning on dragging these out for another 18 years and then paying taxes on the forgiven amount for an IDR program? That's really not a winning strategy. I mean, you don't want to have student loans when you're in your mid 50s. I might even move those loans up ahead of retirement savings in priority.

After that, of course, you can focus on your investments, but at this point it's all about reducing your payments and your lifestyle spending so you can put more money toward building wealth, whether that goes to paying down debt, or whether that goes toward investing, it really doesn't matter all that much, but the point is more of your income needs to be going toward building wealth, or you’re not going to build wealth.

Ranking Debts to Pay Off

> *“We have a $657,000 mortgage at 3.875. I have a dental loan, a 10 year loan, of $625,000 at 5 percent. I’d like to pay both of these off quicker by making extra payments, and right now I rent my dental building, and would like to purchase a building to practice out of in 5-10 years. I believe you recommend paying down the highest interest rate loan first. However, a five percent loan is a lesser total dollar amount that has to be paid off in a much shorter amount of time, 10 years. Also, while the interest paid on my practice loan can be written off as a business expense, versus the mortgage interest and property taxes of $9,000 each year on our home. I’m curious if any of these factors matter, or should we still focus on paying off the dental practice first due to a higher interest rate?”*

There is no right answer here about what should be paid off first. Either is fine. Remember that your property taxes don’t go away when you pay off your mortgage, so that’s a total non factor. Also, be sure you’re comparing rates after tax. The mortgage interest may not be deductible for you, or may only be partially deductible. But the real problem with this doctor is there is a ton of debt despite not having student loans, and you’re looking at taking on more, so I’m much more concerned about the total amount of debt than I am the interest rates or what order you pay them off.

Buying a 3X income mortgage when you have a huge practice loan and looking into buying a practice building, was maybe not the best move, but at least you got rid of the student loans first. If you really want to build wealth quickly, consider downsizing the house, but otherwise, it’s really just a matter of buckling down, working hard, and pounding on the debt.

Obviously, if you pay off the practice loan first, you might feel like you're making more progress. It's a higher interest rate and will be paid off sooner, so I think that's probably where I would start with this one.

Denied for Disability Insurance

> *"There's an agent contacting me regarding disability insurance. In his email, he says if you reject the disability insurance or are denied, you may not qualify in the future. I don't know anything about this type of insurance."*

You can reject disability insurance anytime you want. That's not going to affect your ability to get disability insurance down the road. But if you're denied, that can affect your ability to get disability insurance down the road. What a good agent will do is shop you around informally to the companies and say, "Hey, I got somebody here with diabetes," or, "I got somebody here with hypertension," or, "I got somebody with a long history of low back pain. What's his option going to be? You know, is he going to be able to get insurance from you?" They do this informally, so you're not technically denied coverage, because when you apply for coverage again one of the questions they ask you is, "Have you ever been denied coverage?"

If they only shop you around informally, you can say no. If you actually applied formally and got rejected, then you have to say yes, and that's going to make it more difficult to get coverage.

Lowering Investment Fees

> *"I'm finally getting wise to the fact that our retirement accounts, around $250,000, at UBS for the past five years are making minimal progress and have big fees. I'm looking into moving everything elsewhere and simplifying. I can roll over*

> *some into my employer-based 401k, but my husband is currently not employed and doesn’t have that option. We are looking at Fidelity and Betterment. Any other ideas or recommendations? Any timing or tax concerns? What about 529 plans?”*

Fees matter. If you can get lower fees, that’s a good thing to do. My general default answer for where to invest is Vanguard. As a general rule, you’ll find lower fees and expenses there. Now, in some ways, you get what you pay for, and the customer service at Vanguard often is not as good as you might find at Fidelity or Charles Schwab, and so you have to weigh those two factors. It helps at Fidelity, Charles Schwab, and places like Betterment that they use Vanguard funds. They also have low cost index funds available of their own, and it’s perfectly fine to use the low cost Fidelity index funds.

Remember, they have two types at Fidelity, so you have to be careful to use their low cost ones. Same at Schwab. The important thing is you keep your costs low and get the market return. You can do that at all those places. Having Vanguard in the name doesn’t necessarily mean you’re going to perform better, although that’s not a bad screen when you’re picking mutual funds out of your 401k. If it starts with Vanguard, chances are it’s a pretty good fund.

What should you do in this situation? Roll yours into your 401k. If your husband has retirement plans and he’s not employed, his only option is to put it into a traditional IRA. If you do that, you can’t do backdoor Roth IRAs for him going forward. Weigh that opportunity versus the higher cost you have at UBS. It’s hard to say what the right answer is. If it was a small amount of money, maybe I’d look at just paying the taxes and converting the whole thing into your Roth IRA so you could keep doing backdoor Roth IRAs.

As far as 529 plans go you can roll stuff you’ve already contributed to a low cost plan, like the Utah, Nevada, California, or New York 529 plans. Those are all very low cost plans. I'm kind of partial to Utah, but those other ones are fine too. Of course, going forward you want to look at your own state and see if you get a tax break for your state, and if you do, use that plan for your contributions. If you don't, again, go to the low cost plans that offer good funds. I would not leave it someplace where you're paying high fees because that does slow down how quickly things grow. It really does make a difference in the longterm.

USAA for Investing

> *"We recently received a notice that the USAA SNP500 index fund is going to change around July 1st. It will no longer track the SNP500, but the Victory US large cap 500 index, a custom index. Have any of you received this? Do you plan to accept the changes and leave the money as it is, or switch to a different account that'll allow you to continue to track the SNP500? I would love to hear any thoughts on this."*

You have to understand how these index funds are made and put together. A typical index fund follows an index. If it's that company's own index, it's very cheap. Otherwise, if you're using somebody else's index, you have to pay them some licensing fees, and that can be kind of expensive, and you'll notice, because of this, every few years Vanguard changes what indexes they're following.

It doesn't make a huge difference because the correlation between all these indexes is usually .999, so it really doesn't matter all that much, but getting low costs does matter, and so the cheaper the index, the lower it costs, so this is a good thing for USAA. Instead of paying Standard and Poor's all this money to license the SNP500, they're basically using their own index and it's going to be much cheaper for them, so that's a good thing for the investors. I wouldn't worry much about that.

However, I wouldn’t invest at USAA in the first place, and I say that as a loyal USAA customer for decades. I have my insurance and I still have a checking account at USAA. We use them for all kinds of things, but I do not use them for investing. If you ask people that have been in the investing world for long about USAA, they will tell you in general that, yes, use them for insurance and go to Vanguard for your investments.

The USAA expense ratios are not terribly high, but they’re still .3, .4, and if you go to Vanguard you can often get .03, or .04 for those same types of mutual funds. So in general, as loyal as you may be to USAA, thank you for your service for our country, now go invest at Vanguard. That’s my tip for military folks.

Transferring 401(k)s

> *“I want to transfer my 401k to a company with lower fees and a better selection of funds. My problem is that if I transfer my 401k, I will have to liquidate it and buy new funds at market highs. All of my dollar cost averaging, my regular buying funds, and my 401k over the past 10 years will be for nothing. Is there a way around this without market timing?”*

I think we’re not understanding exactly what is going on here. If you are transferring your 401k from one company to another, you often cannot transfer in kind. Often, you have to liquidate it in one account, and move it over, and re-buy mutual funds in the other account. That’s not that big a deal. Because let’s say the market is at 20,000 today. You sell your funds, you move it over to the other company, and you buy the same funds or similar funds. Again, the market is at 20,000 and you’re not somehow, all of a sudden, screwing up all the dollar cost averaging you did over the last 10 or 20 years. Those effects still take place just like they would have otherwise.

Now, you can get burned in that situation if the market rises dramatically in the week or two while your money's being transferred from one company to the other. You could miss out on those gains. If the market went up two or three percent, you basically missed out or you had an opportunity cost of two or three percent. But the market could also go down, and you can get a windfall there too. If you pull your money out of the market, it falls three percent, and then you reinvest in the new 401k, you just saved a three percent loss.

I wouldn't worry about it too much. If you have a good reason to be changing from one provider to another, just make the change. Try not to calculate how much money you lost or gained by doing so; it'll drive you nuts.

Contributing to a Solo 401(k) as an S Corp

> *"Do you have to become an S-corp to contribute the employer portion, 19,000, to a solo 401k, or can it be done as a sole proprietorship?"*

First of all, the 19,000 portion is not the employer portion. It's the employee portion, and the way 401k rules are set up is that an employee can make a $19,000 a year contribution to a 401k. If you're over 50, you get an extra $6,000 catch up contribution there.

The additional portion, the match, or the profit sharing, that is the employer portion of the 401k. The total of employee and employer contributions can be $56,000 per year. You don't have to be an S-corp to use an individual 401k. A sole proprietorship can do it just fine. A partnership can do it. An LLC taxed as a sole proprietorship, partnership, or S-corp can do it. You don't need an S-corp just for that. What you use an S-corp for is to divide your income into salary and distribution. The benefit of calling some of your income distribution is that you don't have to pay payroll taxes on it, primarily Medicare taxes for doctors. The benefit of calling it salary is you can use it to contribute to retirement accounts. Obviously, you have to pay the payroll taxes, and so there's a balance there in how much you call salary and how much you call distribution. You also have to stay within the IRS guidelines for how much you have to pay as a salary. Basically, that is a reasonable salary for the work being done.

Saving Money in a Cash Value Life Insurance Policy

> *"I'm hearing some financial advisors offer a cash value life insurance, AKA whole life insurance, to build up enough dollars for the eventual income driven repayment tax bombs. I smell BS from a mile away given that I can make much higher returns from Vanguard with much less fees. My friends think the cash value returns are guaranteed at five percent. What do you guys think?"*

Someone is doing a lot of selling here. First of all, you do not get five percent guaranteed returns on cash value life insurance. If you look at the guarantees, what you will find is you will have negative returns for the first five to 15 years, and then typically low returns up to about year 20 or 30, and then moderate returns. The guaranteed returns, if you hold onto a whole life policy bought today from age 30 to age 80 or 85 or so, you will see are about two percent a year.

They are projected at about five percent a year, and until you've held onto that thing for 30 years or so, you're not even going to be close to that five percent, and so there certainly is not a guaranteed five percent return. You'll be doing well if you get five percent. I'd expect three or four percent on a policy held for 50 years starting today. This is not a great place to put money that you're going to need for an IDR tax bomb in five, or 10, or 15, or 20 years.

You can almost definitely make higher returns in more traditional investments. So, no, I don’t think a cash value life insurance plan is a great place to save up money for an IDR tax bomb. Bear in mind, I don’t think IDR forgiveness is a very great option for most doctors. I mean, this is like a desperation option for people who have student loans that are 3X, 4X their income. You know you’re in a terrible debt to income ratio when you’re starting to consider getting the IDR forgiveness, and the reason why is that it takes 20 to 25 years of payments to get IBR forgiveness. And that forgiveness, unlike public service loan forgiveness, is fully taxable, so what would typically happen is you make payments for 25 years, and then you end up owing a tax bill that’s about the same amount as the debt was originally so this just isn’t a great way to go unless you’re in a pretty desperate situation.

Ending

Be sure to check out our recommendation pages if you are in need of a financial professional for financial advice, insurance, a mortgage, student loan advice, contract reviews, or tax help.

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.
Jim Dahle: This is White Coat Investor Podcast number 116, “When to Get a New Car”. Our sponsor this podcast is SoFi, a long term White Coat Investor partner. Hundreds of white coat investors have refinanced with SoFi over the years. If you

apply via the links in the show notes, not only do I get paid if you close a loan, but you'll get paid, too. 300 dollars. If you're smart, you'll just have them apply that to your loan balance, but I suppose you could use it to buy a Frosty at Wendy's every day for 10 months, too, if you want.

Jim Dahle: SoFi also lends to medical and dental residents with 100 dollar monthly payments, so it's a great option if you're not getting any sort of a Repaye subsidy to go through SoFi. They have a number of other products as well. They have a personal loan product. They have a mortgage product. It's not technically a doctor mortgage, but you can avoid PMI with less than 20 percent down, with it, and they have some investing products as well, and SoFi Money, which is basically a high yield checking account which I've tried out.

Jim Dahle: The only downside I've found with it, I'm trying to get them to make an exception for me, is you can't seem to move electronically. You can't pull money in there more than 100,000 dollars a month, but if that's not an issue for you, it is a great account, and I'd already be using it as my main checking account, so check out those SoFi products today, including SoFi for student loan refinancing, which is what most of you white coat investors have used them for.

Jim Dahle: Knocking a couple of percentage points off your interest rate can save you thousands and help you get out of debt months sooner. All right. For those of you who have been waiting, the White Coat Investors Financial Bootcamp Book is now available on audible. Go check it out. If you like listening to podcasts, you'll like audible books, and so that's a great opportunity to listen to that and really get yourself up to speed with the rest of the white coat investors.

Jim Dahle: If you haven't had a chance to look through the website, you'll notice that we have a recommendations tab at the top, and under that, we have all kinds of financial professionals that can help you. You can get advice on your student loans, for instance. You're not sure what to do, which IDR program to be in, whether you should go for public service loan forgiveness, whether you should refinance; there are a number of firms there who are experts just in student loans, and they'll help you decide which program to be in, how to file your taxes to maximize those benefits, which retirement account to use to maximize those benefits, et cetera, so check that out.

Jim Dahle: Also, if you've got a new contract coming up, either a partnership contract or an employment contract, and want to find somebody to review that with you, to go over it and explain to you what it means, to even negotiate on your behalf, you can find people there, as well, under our contract advice and negotiation page. Of course, we have recommendations for doctor mortgages there. Hundreds of you have used those, and also, refinancing your student loans with companies like our sponsor today, SoFi.

Jim Dahle: You can go on there and see all the different companies that will give you cash back if you go through the White Coat Investor links and refinance. It doesn't cost you any more, it just literally puts cash in your pocket. Thanks for what you do. Doctoring is not easy. Lawyering is not easy. Whatever you do, you're a high income professional, and you're paid a high income because your job is difficult, and because usually there’s high liability, and often a 24/7, 365 component to it, so if you take call, thank you very much. Your sacrifices are appreciated.

Jim Dahle: Today we’re going to go over lots of questions from listeners, and we’re going to take them from the Speak Pipe. If you haven’t left a question on the Speak Pipe before, it’s super easy to do. You can record a question up to a minute and a half long. Try to keep them shorter, though. And you do that at www.SpeakPipe.com/WhiteCoatInvestor, and you leave them there, we’ll put them on the podcast.

Jim Dahle: So far, we haven’t had a Speak Pipe question yet that we didn’t put on the podcast, but a lot of the other ones that come in via social media or via email I leave out, because I want to have your voice on the podcast whenever possible. Today, we’re taking them from all kinds of places, though. Our first question on the Speak Pipe is Donny.

Donny: Hi, Jim. I’m in an ER position in North Carolina, and I had a question about my individual 401k. I decided to open up an individual 401k at E-trade after I earned some income from 1099 work. I decided to place it in an ETF inside of the individual 401k, and I was just curious what your thoughts were on this approach.

Donny: I’ve not really done much investing with ETFs, and this is my first time with an individual 401k, so I thought I would give it a try. Any feedback would be great. Thanks for all the work that you do.

Jim Dahle: Okay. Donny’s question is one that a lot of people wonder about until they really understand how investing works. He’s got an E-trade, individual 401k, which is fine. I think that’s a great place to have it. They have all kinds of features. I think you can take loans at E-trade. They have Roth 401k option. They actually take IRA roll overs, unlike Vanguard, and of course you can buy any ETF you want for a low commission, so if you want to invest in Vanguard index funds and your individual 401k is at E-trade, you want to do it using the ETFs.

Jim Dahle: Now, an ETF is an exchange traded fund, so it’s a little bit different from a traditional mutual fund. A traditional mutual fund, you basically trade at 4:00 PM Eastern everyday. You can’t buy it and sell it throughout the day as it goes up and down. An exchange traded fund, you can buy and sell throughout the day, and so it’s really useful for people that are trying to time the market, or trying to speculate, that sort of a thing, for those of us who are long term investors, that’s really not a particularly useful feature.

Jim Dahle: But it is a feature of an exchange traded fund. The really nice feature at a place like E-trade is they usually charge a commission like 50 bucks to trade a traditional mutual fund, but an ETF, they usually charge about five bucks, so it’s dramatically cheaper to trade, in that respect. In a taxable account, ETFs can be more tax efficient, because of their structure, because of the way the ETF shares are made and the way they dissolve, you can actually flush some of the capital gains out of the ETF, and so on a taxable account they’re significantly more tax efficient.

Jim Dahle: As far as Vanguard’s funds go, that’s not so much the case. Vanguard’s funds are a little bit unique. We’ll get into that a little bit later in this podcast. Maybe they’re slightly more tax efficient than Vanguard’s traditional mutual funds, but there’s not much of a difference there if you’re using Vanguard index funds. So, should you use an ETF? In your case, almost surely, because E-trade doesn’t offer low cost index funds commission free. You’re going to need to pay a five dollar commission every time you buy or sell those, and so use the ETF versions in order to keep your costs down.

Jim Dahle: I have a similar situation at Charles Schwab, and at Fidelity with my accounts there, my individual 401ks at Fidelity, and so I use the Vanguard ETFs because the commissions are cheaper at Schwab, and my 401k for my partnership, it’s the same deal. I use the ETFs because the commissions are lower. All right, our next question comes from an anonymous listener.

Anonymous: Dear Dr. Dahle. I’m looking for your opinion regarding purchasing a home. First, a little background about myself. I’m finishing a competitive internal medicine subspecialty fellowship this year. I will be moving to an expensive suburb of a metropolitan city in the northeast part of the US. I have worked for one year as a hospitalist between residency and fellowship. My wife is currently a part time employee, due to us having two very young children at home, and she will be going back to being a full time employee within the calendar year.

Anonymous: She will be making about 100,000 dollars per year when she goes back to being full-time. I will be making in the mid-300,000 dollar range. We have, currently, our investments, which are about 350,000 dollars. I have zero student debt, and we have two 529 plans with 4,000 dollars in each. The homes we are looking at range around 800,000 to 900,000 dollars range.

Anonymous: I wanted to get your opinion regarding if those pricing of the homes will make me house poor if I buy too much house. Thank you for all you do. Thank you.

Jim Dahle: Okay. Basically, the question is should I buy a home? How much home should I buy? It sounds like they’re going to an expensive place in the northeast expecting an income of about 450,000 dollars and no student loans. Well, I’m a big fan of owning your home. I think once you are in a stable professional and a stable personal situation, you ought to buy a home. I think it’s an important aspect of building wealth. That doesn’t mean you can’t build wealth if you’re a lifelong renter, and in fact there’s a few areas in this country where that’s not a crazy thing to do, especially since buying costs so much more than renting.

Jim Dahle: You know, in some places like the Bay Area. But in general, I think it’s good for doctors to be able to buy their homes. If doctors can’t buy a home, who can buy a home, right? That said, that doesn’t mean that everybody ought to buy a home all the time. There are times in your life when it’s smarter to rent.

Jim Dahle: For example, if you’re only going to be someplace for a year or two. You know, if you’re in the military and you’re moving every three years, I think buying a home’s dumb. Even if you hold it longer than the two or three or four years you’ll be there, you’re going to be a long distance landlord, which I assure you is no fun, and so I think in those situations where you’re not going to be in a house for longer than five years or so, it’s usually a mistake to buy.

Jim Dahle: Obviously, sometimes, the market goes up quickly. You can’t know that in advance, but maybe a third of the time if you hold onto a house for three years you still make money, but that means two thirds of the time you’re not making money, so in this case buy the house if you guys both like your jobs, and your jobs like you, and your family’s stable.

Jim Dahle: You know, the marriage is good, you’re not expecting twins next week and you’re not going to have enough bedrooms for them, that sort of a thing, then go ahead and buy the house. My general rule is to keep your mortgage under two times your gross income, and so if you’re making 450,000 dollars a year, that would suggest a mortgage no larger than 900,000 dollars, so if you want to buy a million dollar house, you put 100,000 dollars down, your mortgage is 900,000, you stay within that rule.

Jim Dahle: Now, in some really expensive areas, maybe your DC and your Boston and your Manhattan and your Bay Area, sometimes you might have to stretch that rule a little bit. You might have to stretch this 2X gross income mortgage rule. But when I'm talking about stretching, I'm talking about 3X, maybe 4X, not 10X. That's just crazy. You're going to be totally house poor doing that. Even going to 3 to 4X, you got to realize that there are some significant financial sacrifices you are going to make buying a house that expensive.

Jim Dahle: You're not going to accumulate wealth as quickly. You may have trouble maxing out your retirement accounts. You may not be able to travel as much. You might need to drive a dumpier car, et cetera. There are consequences to doing that, and often that means a longer career, and working longer, but if you're fine with that it's not crazy, if you're in San Francisco, to get a 3X mortgage. Right? And in fact, you're probably going to have to be given the cost of housing related to the salaries of doctors there.

Jim Dahle: Okay. Our next question comes from Bill Yount. He's one of our Facebook group moderators, and he tells me he's planning on coming to the White Coat Investor conference, so you may get a chance to meet him there if you're coming, but he asked, "If you get a chance on the podcast or elsewhere, I would very much appreciate it if you could explain to me and the audience the advantages to the individual investor of the unique and patented share class structure of Vanguard, and how having traditional open ended mutual funds paired with ETF share classes keeps fees and taxes lower. And, as a corollary to that, what if any impact will the expiration of Vanguard's patents have on the industry as a whole?

Jim Dahle: Well, here's the deal. Vanguard patented this structure, so they're the only mutual fund company with this structure, but the way they've set this up is they've set up a traditional index mutual fund, and paired it with an exchange traded fund. They're two share classes of the same fund. What that allows them to do is to take some of the capital gains out of the people who own the traditional mutual fund shares, and move those into the exchange traded fund shares, and eliminate them when the ETFs are dissolved. Now, you have to look at how an exchange traded fund is created. They have these units that they create.

Jim Dahle: They bring all the stocks that are in there together and create this unit, and then from time to time they dissolve these units, and when they do that they can pass the shares with the low basis, you know, these high capital gains in there, to these groups that basically, that’s what they do, is form these ETF shares, and so because of that unique structure it allows the Vanguard traditional index mutual funds to be more tax efficient than they otherwise would be. In fact, they are nearly as tax efficient as the Vanguard exchange traded fund share class.

Jim Dahle: None of that matters, of course, in a Roth IRA, or 401k, or other tax protected account, but in a taxable account it does matter. Now, if you go to someplace like Fidelity, and you look at their traditional index mutual funds, and you compare them to iShares ETFs, what you will discover is for the similar stocks in the funds the ETF is significantly more tax efficient, and so the benefit at Vanguard of this unique structure they have is they basically make the traditional mutual funds just as tax efficient as an exchange traded fund.

Jim Dahle: Now, that patent is going to expire eventually. I don’t know exactly when it is. Probably coming up soon, I would imagine, and so when that expires what I would hope to see is all the other mutual fund companies doing the same thing. You know, your Fidelity, and your Schwab, and your iShares, and all these other companies that have these low cost index funds, hopefully, they will make them even more tax efficient by adding an ETF share class to them.

Jim Dahle: That’s good for everybody. I don’t see any downside there. Yes, it’s not going to help Vanguard to raise money as quickly as it has, but jeez, Vanguard's already the largest mutual fund company in the country, in the world. They don't need to get any bigger. It's okay if they have a little more competition there. All that does is drive down prices and make things more competitive, which is good for all of us.

Jim Dahle: Okay, our next question. This one is also via email, and it's kind of an interesting one, when I started researching. "I know there are very few people in this group who are 50-plus. I am turning 51 this year and would like to know if you can do a post or a podcast on AARP membership and its pros and cons. I read mixed reviews online." Okay, AARP is the American Association of Retired Persons. Right? When you turn 50, you start getting these fliers in your mailbox, and they're trying to advertise their services.

Jim Dahle: But here's the deal with it, right? This is an organization which is basically a discount organization. You pay them an annual fee and they take their big membership out there and they try to negotiate discounts for you, and so it's really a pretty simple mathematical calculation. Right? You basically look at the discounts and see how much money you're going to save from the discounts, then you look at the price of membership and see how much that costs you, and if the discounts are larger than the price of membership, sure. Why not? Right?

Jim Dahle: You're going to come out ahead financially. But the truth is you don't need very many discounts for this to work out well. It costs 16 dollars a year to be a member of the AARP. I mean, you basically need a discount on one hotel night and you're going to come out ahead, and so I think it's fine to join the AARP. The likelihood, if you actually try to use some of these discounts, of you not coming out ahead, seems pretty low to me. I mean, it's 16 dollars a year.

Jim Dahle: And I think if you renew automatically, the price is even lower. But look at all the companies you can get discounts with, right? There’s some longterm carer options, a dental insurance plan, a vision plan, a Medicare supplemental plan, some Medicare RX plans. You can get insurance for your vehicle, and life, and property, and business. You can get golf cart insurance, snowmobile insurance. They got all these health and wellness things. You know, hearing aids, and LensCrafters offers discounts.

Jim Dahle: There are travel discounts. Avis Budget, Pay Less, Zipcar, all offer an AARP discount. Several cruise companies offer an AARP discount. There are flights and vacation packages that will give you a discount, like British Airways, for instance. Hotels and resorts, right? I mean, these are people you know of, you hear of, right? Best Western. Econolodge. Comfort Suites. Days Inn. Park Inn. La Quinta. Howard Johnson. Hilton. The Roadway Inn. Travel Lodge. Right? These are not companies you’ve never heard of. Windom. Right?

Jim Dahle: If you travel at all, you can probably get an AARP discount at some point during the year that is going to make up for your 16 dollar membership. Restaurants, right? Bubba Gump Shrimp Company, Joe’s Crab Shack, Denny’s, Outback. You know, a lot of these chains have AARP discounts, and even if they don’t, you can ask for one. You’d be surprised how often you get a discount when you ask for one. I know a lot of you know this because you keep asking me to discount the stuff I sell, and so I know it must work or you guys wouldn’t keep asking.

Jim Dahle: Ticketmaster offers discounts. You know, there’s all these things you can do. 1800Flowers.com. It’s a big organization, and so they’ve got all these organizations that you can use for discounts, and so yeah, I think it’s probably worth joining as long as you’ll use it. You know, if you get to the end of the year and you’re like, “Wow, I didn’t use this once,” so what? You’re out 16 bucks. I mean, that’s just a movie, these days.

Jim Dahle: If you're going out to a premium complex, it's just not that expensive, but here's an interesting secret about the AARP. You don't actually have to be 50. You can join the AARP anytime you like. There's not actually an age restriction. At 50, you get a regular membership, but prior to 50, the way it used to be, you would get an associate membership. Those were actually cheaper. They were 12.50. I think the way they've done this now is they've just standardized it, so it's 16 dollars for everybody.

Jim Dahle: You don't have to be 50. You don't have to be retired. You don't have to have gray hair. You want to be a member of the AARP? Knock yourself out, go join the AARP, and get your 10 percent or 15 percent discounts or whatever off these hotels and restaurants, so yeah, go for it. Nothing wrong with the AARP. Well, I mean, there might be something wrong with the AARP, but 16 dollars, come on. You can come up with something that'll save you 16 dollars during the year.

Jim Dahle: Okay. Our next email comes from a dentist. This is lengthy, but I think it's worth going over, because I think there's important lessons learned in here. "After having spent the past couple of months reading through some articles, listening to your podcast, learning a lot of basics, I've been determined to get on track with a better plan. I get that you focus on your MD brethren. A lot of them are what seems like extreme situations, but what about people that are in more lower to middle situations? Not every high income professional's making 300 to 700,000 dollars." Isn't that the truth? I mean, the average physician only makes 275.

Jim Dahle: "A lot of us are making 100 to 200,000. That's why the averages are where they are. I'm throwing my post into your hat to see what you recommend regular Joes can do with limited resources." I love that we get so skewed sometimes that we think 100 to 200,000 dollars is a regular Joe. A regular Joe these days, guys, is about a household income of 60,000 dollars. That's the average, so even if you're a dentist making 150,000 dollars, or a pediatrician making 170,000 dollars, you're still doing much better than a regular Joe.

Jim Dahle: All right, he says, "I'm a general dentist married to a psychologist. We both have moderate amounts of student loans. I have 100,000 dollars left. My wife has 120,000 dollars, all at 6.5 to 6.7 percent. I graduated seven years ago. I've been treading along with IBR and repay. I joined my father, who is also a dentist, with goals of taking over his practice. I thought it would be only a few years, but it's dragged out a lot longer than expected. I'm still working for him, and thus my income hasn't increased much. I currently work part time with him and part time at a community clinic that I started a couple of years ago, and earn somewhere around 120 to 130,000 dollars."

Jim Dahle: "Bought a condo about five years ago for 185,000 dollars, and fortunately it's increased in value to about 420,000 dollars." Congratulations on that. That was a great buy. "It's on a 30 year, fixed, four percent mortgage. My wife just graduated a couple of years ago and this past year started a group private practice with two other psychologists. She'll make just under 100,000 dollars in 2018." That's a household income, there, of it looks like about 230,000 dollars. "In terms of retirement, we don't have much started. I have a 403b that the community clinic started for me when I started with them that has about 8,000 dollars in it. I started a Roth IRA last year, managed to put 5,500 in there. My wife doesn't have anything. I'm 33, she's 32. We're hoping to start a family soon, and we're in a high cost of living area."

Jim Dahle: "I would love to increase our income, but between my wife's new business, and how my income has stagnated in the past several years, we aren't sure when it's going to go up. I will have several questions for you. Should we refinance our loans or keep repay to keep the payments slow if we want to move to a bigger home in five years?” I’m not sure why those issues have been put together, but I guess there are two questions in there. Should you say in repay, and should you move to a bigger home in five years?

Jim Dahle: “I heard about mortgage acceleration on one of your podcasts. Do you think I’m in a situation where that would work well for me?” Well, I’m not a big fan of mortgage acceleration. You guys who have heard all the podcasts, we had an entire podcast on mortgage acceleration, and it’s mostly a scam, although there’s a little bit of a free lunch there. It’s pretty small.

Jim Dahle: “I opened my Roth IRA with Schwab and have started with their index funds. I understand I could buy the Vanguard funds there, but would have to pay their expense ratio.” You mean commissions. “At what point do you start looking at opening other retirement accounts at other firms? This may be a funny question, but you’re only allowed one Roth IRA per person, right?” No, you can actually have as many Roth IRAs as you want, you just can only contribute a total of 6,000 dollars a year in 2019 to a Roth IRA.

Jim Dahle: “Any other general advice for someone in my position? Moderate loan, average income, married, and trying to move forward in life.” Okay. Well, there’s a few things that I think are worth diving into in this email. That’s why I read the whole, long thing. First of all, I’ve written lots of things aimed directly at low income docs. I’ve got three links to posts that we’ll put in the show notes that talk all about issues and how to deal with them when you’re making 100 to 200,000 dollars a year.

Jim Dahle: But about your situation specifically, the first thought that came into my head is, “Man, if you keep doing what you’re doing, you’re going to keep getting what you’re getting.” I mean, here you are, seven years out of training. You’re living in a condo, you still have a mortgage, you still have student loans, your income's still low, and you have essentially nothing in your retirement savings. If you stay on the path you're on, your financial life is not going to look much different seven years from now, so something has to change.

Jim Dahle: Now, I'm not meaning to be critical there. That's just math. Right? You don't get a pass on math because you're a doctor. I wonder if the reason your dad is still working is because he hasn't yet discovered what you now appear to be discovering; that this plan does not lead to financial freedom. So, what are you going to change, right? The income here is not terrible. You guys are making 220, 230,000 dollars a year. Katie and I became millionaires in seven years with an average annual income lower than that.

Jim Dahle: It's not a terrible income. It is certainly possible to build wealth on that type of income. But that said, more income does make things easier. Let's not kid ourselves. So, that's probably the logical place to start this process. If there's a way for your wife to get a job that pays more, to get a raise at her job, or work more hours, or start a side gig, that's a great thing to do.

Jim Dahle: But I think the main thing here is to address your career. Honestly, it's time to have a frank talk with your father. Right? Something like, "Dad, I love working with you, it's been fun to follow in your footsteps, but financial reality has hit me in the face. I'm seven years out of school, I still owe student loans, I'm still stuck in a rinky-dink condo, and I still have a below average income. When I joined the practice, I kind of had the idea that you were on your way out, but it looks like you really aren't. At least not for a while. I need to get my income up to take care of business for my family. That means I either need to find a job that pays more, open my own practice, or really get on some kind of set plan in the next few years to inherit yours."

Jim Dahle: “I might even need to move to a lower cost of living area, so I thought I’d start by talking to you about your career plans before I start making changes with mine.” I think that’s kind of how my conversation would go. You need to solve that issue first and then move onto the other issues. The next issue is likely to get your spending down. That’s tough to do in a high cost of living area, despite being in an area with low income taxes, due to the cost of living.

Jim Dahle: If you move somewhere else, that will likely have a major effect on your living expenses, and probably not affect your earning, or maybe even affect it positively. It may affect your spouse’s earning, of course, so you have to take that into account, but I suspect if you’re only putting 14,000 dollars away in seven years on a 200,000 dollar, plus, income, that you’re just not living on a budget.

Jim Dahle: You know, you got to learn how to live on a budget. You are pissing away all kinds of money that you don’t realize is going away because you are not watching where it’s going, and if you actually write down where your money’s going, I bet you’ll be surprised by how much you’re wasting on stuff that you don’t even care about, so doctors need to budget, too. I have a post that that’s the title. Doctors need to budget, too, and it’s true.

Jim Dahle: Until you’ve figured out how to save 20 percent of your gross income for retirement, you will benefit from being on a budget. Once you’ve figured that out, it’s time to really look at those student loans. You got to have a plan there. You got 220,000 dollars in student loans on an income of 220,000 dollars. That’s only a 1X ratio. That should be easily paid off in five years by living like a resident. You know, living like the average household income, you should be able to pay off 1X ratio in five years pretty easily.

Jim Dahle: I mean, it’ll help if you refinance them, but what’s the alternative? Are you planning on dragging these out for another 18 years and then paying taxes on the forgiven amount for an IDR program? That's really not a winning strategy. I mean, you don't want to have student loans when you're in your mid 50s. I might even move those loans up ahead of retirement savings in priority.

Jim Dahle: After that, of course, you can focus on your investments, but at this point it's all about reducing your payments and your lifestyle spending so you can put more money toward building wealth, whether that goes to paying down debt, or whether that goes toward investing, it really doesn't matter all that much, but the point is more of your income needs to be going toward building wealth, or you're not going to build wealth.

Jim Dahle: I hope that's helpful. I think there's probably a lot of docs in that situation that thought they were going to get their father's practice, and then are disappointed to find out that dad can't retire, or dad works longer than you think, or the practice isn't worth as much as you think, or it's not a very profitable practice and you don't want to be there anyway, or your spouse doesn't want to be anywhere near your dad, or whatever, and I suspect there's been a lot of disappointments among doctors over the years in that sort of a situation. Okay. Next question also comes from a dentist.

Jim Dahle: "Here's a little background info. I'm 31, a general dentist, graduated from dental school six years ago. Wife is a nurse. We paid off all our school loans." Good job. "We have a three-year-old child, six-month-old child. We live in California. I make 240,000 dollars. My wife makes 100,000 dollars. We're putting 17 percent of our paychecks in Vanguard index funds to max out our 401k and Roth IRA, our HSA, and 30,000 dollars toward my SEP IRA. We have a 657,000 dollar mortgage at 3.875. I have a dental loan, a 10 year loan, of 625,000 dollars at 5 percent. I'd like to pay both of these off quicker by making extra payments, and right now I rent my dental building, and would like to purchase a building to practice out of in five to 10 years."

Jim Dahle: "I believe you recommend paying down the highest interest rate loan first. However, a five percent loan is a lesser total dollar amount that has to be paid off in a much shorter amount of time, 10 years. Also, while the interest paid on my practice loan can be written off as a business expense, versus the mortgage interest and property taxes of 9,000 each year on our home. I'm curious if any of these factors matter, or should we still focus on paying off the dental practice first due to a higher interest rate?"

Jim Dahle: Well, there's no right answer there, necessarily, what should be paid off. Either is fine. Remember that your property taxes don't go away when you pay off your mortgage, so that's a total non-factor. Also, be sure you're comparing rates after tax. The mortgage interest may not be deductible for you, or may only be partially deductible, but the real problem with this doc is there's a ton of debt despite not having student loans, and you're looking at taking on more, so I'm much more concerned about the total amount of debt than I am the interest rates or what order you pay them off in.

Jim Dahle: Buying a 3X income mortgage when you have a huge practice loan, looking into buying a practice building, was maybe not the best move, but at least you got rid of the student loans first, right? Otherwise, it'd feel like you have four mortgages at once. I guess if you really want to build wealth quickly, consider downsizing the house, but otherwise, it's really just a matter of buckling down, working hard, and pounding on the debt.

Jim Dahle: Obviously if you pay off the practice loan first, you might feel like you're making more progress. It's a higher interest rate and will be paid off sooner, so I think that's probably where I would start with this one. All right, this next question comes from Twitter. "Hi, doctor. I have a question. There's an agent contacting me regarding disability insurance. In his email, he says if you reject the disability insurance or are denied, you may not qualify in the future. I don't know anything about this type of insurance." Well, that's a partial truth, right? You can reject disability insurance anytime you want.

Jim Dahle: That's not going to affect your ability to get disability insurance down the road. You know, they make you an offer, and they say, "I don't want it," that doesn't mean you can't buy it the next day, or the next week, or the next year. But if you're denied, that can affect your ability to get disability insurance down the road. One of my WCI network partners, The Physician Philosopher, got denied on his disability insurance, and I think he still doesn't have disability insurance to this day.

Jim Dahle: What a good agent will do is they will shop you around informally to the companies and say, "Hey, I got somebody here with diabetes," or, "I got somebody here with hypertension," or, "I got somebody with a long history of low back pain. What's his option going to be? You know, is he going to be able to get insurance for you? And they do this informally, so you're not technically denied coverage, because when you apply for coverage again one of the questions they ask you is, "Have you ever been denied coverage?"
Jim Dahle: And if they only shop you around informally, you can say no. If you actually applied formally and got rejected, then you have to say yes, and that's going to make it more difficult to get coverage. Hope that's helpful. All right, another question from the Facebook group. "I'm finally getting wise to the fact that our retirement accounts, around 250,000 dollars, at UBS for the past five years are making minimal progress and have big fees." Yep. We all come to that realization someday, don't we?

Jim Dahle: "I'm looking into moving everything elsewhere and simplifying. I can roll over some into my employer based 401k, but my husband is currently not employed and doesn't have that option. We are looking at Fidelity and Betterment. Any other ideas or recommendations? Any timing or tax concerns? What about 529 plans?" Okay, well, here's the deal. Fees matter. If you can get lower fees, that's a good thing to do. My general, default answer for where to invest is Vanguard. They're the only mutual fund company, and they operate at cost, and so as a general rule you'll find lower fees and expenses there.

Jim Dahle: Now, in some ways, you get what you pay for, and the customer service at Vanguard often is not as good as you might find at Fidelity or Charles Schwab, and so you got to kind of weigh those two factors. It helps at Fidelity and Charles Schwab, and places like Betterment that use Vanguard funds, that they have low cost index funds available of their own, and it's perfectly fine to use the low cost Fidelity index funds.

Jim Dahle: Remember, they have two types at Fidelity, so you got to be careful. They use their low cost ones. That's fine. Same at Schwab. You know, the important thing is you keep your costs low and you get the market return, and you can do those at both those places. Having Vanguard in the name doesn't necessarily mean you're going to perform better, although that's not a bad screen when you're picking mutual funds out of your 401k. If it starts with Vanguard, chances are it's a pretty good fund.

Jim Dahle: What should you do in this situation? Well, you can roll yours into your 401k. That's fine. If your husband has retirement plans and he's not employed, well, his only option is to put it into a traditional IRA, so if you do that, you probably can't do backdoor Roth IRAs for him going forward, so you're really weighing that opportunity versus the higher cost you have at UBS. It's hard to say what the right answer is.

Jim Dahle: I guess if it's a lot of money I would maybe leave it at … maybe I'd just bring it over and get lower costs on all that money. If it was a small amount of money, maybe I'd look at just paying the taxes and Roth converting the whole thing into your Roth IRA so you could keep doing backdoor Roth IRAs. If it's somewhere in between, maybe you roll it over to a traditional IRA and you stop doing backdoor Roth IRAs for him. You can still do them for yourself, but those are the main issues.

Jim Dahle: As far as 529 plans go, you know, you can roll stuff you've already contributed to a low cost plan, like the Utah plan or the Nevada plan, the California plan, the New York plan. Those are all very low cost plans. I'm kind of partial to Utah, but those other ones are fine too, and then, of course, going forward you want to look at your own state and see if you get a tax break for your state, and if you do, use that plan for your contributions.

Jim Dahle: If you don't, again, go to the low cost plans that offer good funds. These are Utah, and Nevada, and California, and New York. Occasionally, you'll see some other ones in that list, but those are always in the top five or 10, so I'd go to one of those plans with your 529 money. I would not leave it someplace where you're paying high fees because that does slow down how quickly things grow. It really does make a difference in the longterm.

Jim Dahle: Okay. The next couple of questions both come from the Facebook group. Now, I read them within a few minutes of each other, and I thought it was really interesting to kind of compare and contrast them. They're all about cars, and I called this podcast when to get a new car based on these two questions. Here's the first one. "I left my current car, worth 2,000 dollars, on the east coast, with plans to ship it to the west coast that'll cost me about 1,500 dollars, where I'm doing residency. I had it inspected and our mechanic friend quoted repairs as being greater than 2,000 dollars for everything, but my dad can do some minor things himself like the control arms and engine mounts to get it to better running conditions for just a few hundred dollars for parts."

Jim Dahle: “Do I look into buying a used car in the west coast, or doing the minimal repairs and bring it over here for residency? I’m not sure how the car will sell if I don’t do the minimal repairs, though. I think I’m leaning towards buying a car over here, but wanted more knowledgeable opinions. The car would probably be worth 1K before repairs and 2K-ish after repairs.”

Jim Dahle: Okay, at a certain point, you got to go, “The car’s totaled.” All right? If it costs more than 2,000 dollars to repair, and it’s only going to be worth 2,000 dollars when you repair it, it’s totaled. It’s time to get rid of it. Get whatever you can out of it. If you can sell it for 1,000 dollars, that’s wonderful. If you can take it down and get 300 dollars from the junkyard, that’s great too. If it;’s still drivable and you’re not going all the way across the United States, maybe you can drive it around for a couple months until it formally dies.

Jim Dahle: But at a certain point you got to go, “Okay, that’s it. This one died.” When you’re at a very low cost car, that happens a lot. Right? If you’re driving a 1,500 dollar car, you know, the clutch goes out, the engine goes out, the transmission goes out, the car’s totaled. You’re done with it, so it’s time to get a new car. Now, in this, there’s actually another factor, here. It’s going to cost 1,500 dollars to ship it. No way would I pay 1,500 dollars to ship a 2,000 dollar car. I for sure would sell it, get your 1,000 dollars out of it, go across the country and buy a new 2,000 dollar car, or buy a 5,000 dollar car. Whatever, right?

Jim Dahle: Get yourself some transportation so you can get around at residency. Don’t go buy a 25,000 dollar car on credit, but it’s okay to get a little bit more car than 2,000 dollar car when you’re over there so you can make it when you’re on call. But come on, you know? This one’s dead. You’re done. You know, if you’re not comfortable driving it across without making these repairs, and you are talking about paying to ship it, I mean, it’s time to get rid of it.

Jim Dahle: Now, compare that to the next question I read on the Facebook group. “Advice needed. I’m expecting a baby in July. I want to buy a new car with a third row.” Okay. You’re expecting one baby, and now you need a third row. That’s interesting. I’m assuming there’s some other kids here, but maybe now. “I’m planning to buy a Nisan Armada, but the current lease is not up until February, 2020.” Holy smokes. So, you’re a year into a lease, and you’re talking about buying another car with three rows. “Would you buy a 2018 Nisan now that is exactly what you want with less than 10,000 dollars for 20,000 dollars cheaper than brand new? I would still have to pay for my current leased luxury car until February, about 7,000 dollars.”

Jim Dahle: “Or would you wait until the old lease is up in February, 2020, and buy a brand new 2019 that qualifies for 10,000 dollars in rebates, or would you wait until the old lease is up in February, 2020, and buy a brand new 2020 at full price?” Okay. Well, that is pretty interesting, right, to compare these two. One person’s talking about swapping a luxury car that was leased a year ago for another brand new car, and the other one’s trying to figure out how to drive around a 2,000 dollar car even longer.

Jim Dahle: I mean, there’s a huge range between these two things that is entirely reasonable. Leasing a car is not a great move. When you lease a car, you are renting the car. You are renting it for three years, usually. It’s usually a 36 or 42 month lease, and you’ve got to look at the numbers, here, because when you are leasing a car you are renting a car, and the person renting it to you wants to make a profit. They have their own business expenses above and beyond the cost of that car.

Jim Dahle: They have to charge you enough to cover the cost of the car, they have to charge you enough to cover their expenses, and they have to charge you enough to make a profit. Now, obviously, that's going to cost more than just the cost of the car, so even if you want to swap your cars every three years, which has got to be the most expensive way to drive a car, you know, buying it is probably still the best move.

Jim Dahle: Right? I mean, it's not that expensive to sell a car, and so leasing very rarely is going to make sense. Now, if for some reason your crazy employment contract says, you know, "We'll cover a lease," or something, well, you may be stuck in some sort of weird situation like that. But in general, even if you're writing the car off for a business, you can do that owning it just as easily as you can leasing it.

Jim Dahle: So, leasing is not a great move, and you can see why. You get into situations like this where you're stuck holding onto a car you don't want for another year and a half. You know, another, I guess less than a year and a half. For another nine months, anyway, instead of buying what you want now. It's just kind of crazy to be doing that with cars.

Jim Dahle: Now, doctors can afford to make lots of mistakes because of their high income. Habits like this kill the average household in America. They just cannot do this on an income of 60 or 70 or 80,000 dollars, of churning these cars like this, and the truth is even some doctors that do this, it really retards their financial progress, so what should you do in this situation?

Jim Dahle: Well, I would probably quit leasing. No matter which one you do, by nine months from now, just be done with the leasing game. Stop leasing cars. If you don't have the cash to buy the car, buy a less expensive car. If you don't have the cash to buy a less expensive car, and you got to borrow for it, it ought to be a 5,000 dollar car or less.

Jim Dahle: Cindy and I were just looking at each other and talking before this podcast came on, and she's like, "Dude, I drove a Honda Civic until I had my fourth kid." You know, we both drive Sequoias now. That's fine, we can afford to do it, but the truth of the matter is people are buying cars because they have one kid. They're like, "I'm having a kid, I got to get a minivan." What are you going to carry around for that kid? One kid, you can do just fine in a Sedan.

Jim Dahle: In fact, two kids works just fine in the Sedan. Now, if you got three kids in car seats, they might not fit across the back row of a Sedan. You may have to get a third row at that point, or at least something that's a little bit wider so you can put in three car seats, but come on. For the first and second kid, you don't need to buy a special car for that. Okay, let's go onto our next question, this one also in the Facebook group.

Jim Dahle: "We recently received a notice that the USAA SNP500 index fund is going to change around July 1st. It will no longer track the SNP500, but the Victory US large cap 500 index, a custom index. Have any of you received this? Do you plan to accept the changes and leave the money as it is, or switch to a different account that'll allow you to continue to track the SNP500? I would love to hear any thoughts on this."

Jim Dahle: Well, understanding this, you've got to understand how these index funds are made and put together. Now, a typical index fund follows an index. If it's that company's own index, it's very cheap. Otherwise, if you're using somebody else's index, you've got to pay them some licensing fees, and that can be kind of expensive, and you'll notice, because of this, every few years Vanguard changes what indexes they're following.

Jim Dahle: It doesn't make a huge difference because the correlation between all these indexes is usually .999, so it really doesn't matter all that much, but getting low costs does matter, and so the cheaper the index, the lower it costs, so this is a good thing for USAA. Right? Instead of paying Standard and Poor’s all this money to license the SNP500, they’re basically using their own index and it’s going to be much cheaper for them, so that’s a good thing for the investors. I wouldn’t worry much about that.

Jim Dahle: However, I wouldn’t invest at USAA in the first place, and I say that as a loyal USAA customer for decades. I got my insurance. I’ve still got a checking account at USAA. We use them for all kinds of things, but I do not use them for investing, and so if you ask people that have been in the investing world for long about USAA, they will tell you in general that, yes, use them for insurance and go to Vanguard for your investments.

Jim Dahle: The USAA expense ratios are not terribly high, but they’re still .3, .4, and if you go to Vanguard you can often get .03, or .04 for those same types of mutual funds, and so in general, as loyal as you may be to USAA, thank you for your service for our country, now go invest at Vanguard. That’s my tip for military folks, today. Okay, next question. I have a question about 401k transfers.

Jim Dahle: “I want to transfer my 401k to a company with lower fees and a better selection of funds. My problem is that if I transfer my 401k, I will have to liquidate it and buy new funds at market highs. All of my dollar cost averaging, my regular buying funds, and my 401k over the past 10 years will be for nothing. Is there a way around this without market timing?” I think we’re not understanding exactly what is going on here. If you are transferring your 401k from one company to another, you often cannot transfer in kind.
Jim Dahle: Often, you have to liquidate it in one account, and move it over, and re-buy mutual funds in the other account. That’s not that big a deal, right? Because let’s say the market is at 20,000 today. You sell your funds, you move it over to the other company, and you buy the same funds or similar funds. Again, the market’s at 20,000 dollars, or

20,000 points, or whatever it is, but the point is you're not somehow, all of a sudden, screwing up all the dollar cost averaging you did over the last 10 or 20 years. Those effects still take place just like they would have otherwise.

Jim Dahle: Now, you can get burned in that situation if the market rises dramatically in the week or two while your money's being transferred from one company to the other. You could miss out on those gains. If the market went up two or three percent, you basically missed out or you had an opportunity cost of two or three percent. But the market could also go down, and you can get a windfall there, you know? If you pull your money out of the market, it falls three percent, and then you reinvest in the new 401k, you just saved a three percent loss.
Jim Dahle: That's just like a three percent gain, and so it can go both ways. I wouldn't worry about it too much. If you've got a good reason to be changing from one provider to another, just make the change. Try not to calculate how much money you lost or gained by doing so, it'll drive you nuts. But I think you got to also just understand what's going on here. You know, when you change from one provider to another, and you're buying the same percentage of stocks in your account, you are not buying high somehow.

Jim Dahle: You know, this is all the same stuff you've been putting money in over decades. Okay, next question. "Do you have to become an S-corp to contribute the employer portion, 19,000, to a solo 401k, or can it be done as a sole proprietorship?" Well, first of all, the 19,000 portion is not the employer portion. It's the employee portion, and the way 401k rules are set up is that an employee can make a 19,000 dollar a year contribution to a 401k. If you're over 50, you get an extra 6,000 dollar catch up contribution there.

Jim Dahle: The additional portion, the match, or the profit sharing, that is the employer portion of the 401k, and the total of employee and employer contributions can be 56,000 dollars per year. Now, you don't have to be an S-corp to use an individual 401k. A sole proprietorship can do it just fine. A partnership can do it. An LLC taxed as a sole proprietorship, partnership, or S-corp can do it. You don't need an S-corp just for that. What you use an S-corp for is to divide your income into salary and distribution, and the benefit of calling some of your income distribution is that you don't have to pay payroll taxes on it, primarily Medicare taxes for doctors.

Jim Dahle: The benefit of calling it salary is you can use it to contribute to retirement accounts. Obviously, you got to pay the payroll taxes, and so there's a balance there in how much you call salary and how much you call distribution. You also have to stay within the IRS guidelines for how much you got to pay as a salary, and basically that is a reasonable salary for the work being done.

Jim Dahle: Next question, also from the Facebook group. "I'm hearing some financial advisors offer a cash value life insurance, AKA whole life insurance, to build up enough dollars for the eventual income driven repayment tax bombs. I smell BS from a mile away given that I can make much higher returns from Vanguard with much less fees. My friends think the cash value returns are guaranteed at five percent. What do you guys think?"

Jim Dahle: Holy crap. Somebody is doing a lot of selling, here. First of all, you do not get five percent guaranteed returns on cash value life insurance. If you look at the guarantees, what you will find is you will have negative returns for the first five to 15 years, and then typically low returns up to about year 20 or 30, and then moderate returns. The guaranteed returns, if you hold onto a whole life policy bought today from age 30 to age 80 or 85 or so, you will see that they are guaranteed at about two percent a year.

Jim Dahle: They are projected at about five percent a year, and until you've held onto that thing for 30 years or so, you're not even going to be close to that five percent, and so there certainly is not a guaranteed five percent return. You'll be doing well if you get five percent. I'd expect three or four percent on a policy held for 50 years starting today, but you know, this is not a great place to put money that you're going to need for an IDR tax bomb in five, or 10, or 15, or 20 years.

Jim Dahle: You know, you can definitely make higher returns in more traditional investments. Well, I guess I can't say definitely, right? There's no guarantee. Maybe the market melts down and we have a 1930s kind of situation, but boy, I'll tell you which way I would bet on that one for money that I need in a relatively short period of time.

Jim Dahle: So, no, I don't think a cash value life insurance plan is a great place to save up money for an IDR tax bomb. Bear in mind, I don't think IDR forgiveness is a very great option for most doctors. I mean, this is like a desperation option for people who have student loans that are 3X, 4X their income. You know, you're in a terrible debt to income ratio when you're starting to consider getting the IDR forgiveness, and the reason why is that it takes 20 to 25 years of payments to get IBR pay, repay, forgiveness.

Jim Dahle: And that forgiveness, unlike public service loan forgiveness, is fully taxable, so what would typically happen is you make payments for 25 years, and then you end up owing a tax bill that's about the same amount as the debt that was originally so this just isn't a great way to go unless you're in a pretty desperate situation.

Jim Dahle: All right. We're getting toward the end here, so we better start wrapping this up. Remember to check out our recommendation pages at the White Coat Investor website. We've got recommendations for student loan advice. We've got recommendations for contract advice and negotiation, doctor mortgages, student loan refinancing, recommended books, for instance.

Jim Dahle: I see questions all the time, "Hey, what books should I be reading?" I put together a whole list for you of what I think are the best books for personal finance, investing, real estate investing, advanced investing, mortgages. You know, all these categories of books that I think are worth reading, so if you are looking for book recommendations, check that out as well.

Jim Dahle: All right, our sponsor for this podcast is SoFi. Hundreds of White Coast Investor readers have refinanced with SoFi over the years. If you apply via the White Coat Investor links, you will get 300 dollars cash back in addition to very low interest rates, and so that is a great thing to do if you are in the market for refinancing your student loans, be sure to include SoFi in your search.

Jim Dahle: You can get an estimate of the interest rate you will pay in a couple of minutes online. It really is super easy. When I ask people who've refinanced their loans what they wish they had done differently, they all say, "I wish I'd done it earlier." So, get off your duff, go refinance your loans today with SoFi.

Jim Dahle: They've even got a program for medical and dental residents. If you’ve got private loans during residency, you might as well refinance them. Right? Why pay eight percent when you could be paying four and a half or five percent? There’s really no reason. All right, head up, shoulders back. You’ve got this. We can help. We’ll see you next time on the White Coat Investor podcast.

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