Why Aren’t Doctors Rich?

Everyone thinks doctors are rich. Most people, of course, don’t realize that rich doesn’t mean having a high income, but rather a high net worth. They see the average physician salary and just make assumptions about their net worth. But I would argue that despite the many unique issues physicians have to deal with, there is no reason for them not to be rich, eventually. Consider this example: (we’ll do all the calculations in after-inflation dollars)

A physician finishes residency at age 30 and begins earning a salary of $200,000. Since she just went from a salary of $40,000 as a resident, she figures she can easily live on $160,000 and save 20% of her income. She invests this into retirement accounts each year and earns an annualized average after-inflation return of 5% per year, which is very reasonable even in today’s markets. At age 65, her net worth would be $3.6 Million. Given a reasonably safe 4% withdrawal rate from the portfolio, plus another $25,000 a year from social security, she would have an income of $170,000 a year, which would equate to an even better standard of living in retirement than while she was working! Without the extra expenses of a mortgage and child-rearing, she’ll have an extremely comfortable retirement. Other options available to her would be going to part-time work, retiring early, or giving substantial sums to charity.
None of that is hard. So why are so few of our colleagues in that enviable position as they approach the retirement years?

There are a number of reasons, none of which are good, but all of which I am sure have befallen our colleagues.

6 Reasons Why Doctor’s Aren’t Rich

1) A late start

Non-traditional students might not get out of residency/fellowship until 40 or 50 years old. Losing those first few years of compounding can really make a big impact on the bottom line. This loss can be made up by having a working (and saving) spouse, by working until later in life, by choosing a more highly-paid specialty, or by being more frugal.

2) High student loan debt

I was appalled to learn that tuition for my medical school has increased by 150% in the last decade. In 2009, the AMA said the average medical student had debt of $140,000. Since that includes those on scholarships and “parental grants”, there are plenty of medical students who come out of the pipeline at 30 with a negative net worth of $200,000 or even $300,000. Some, especially those with families, borrow more as residents from lenders or even credit cards. The money that goes to paying off those loans can’t be invested, so that can make a huge dent in your eventual net worth. Consider that $200,000 invested at that same 5% for 35 years is worth $1.1 Million, or nearly a third of the expected nest egg. Bottom line- You cannot take the money you need to pay off your student loans out of your retirement savings, it has to come out of your lifestyle.
3) Inadequate savings

Whether it is lack of financial sophistication, a sense of entitlement, or lack of self-discipline, you cannot invest if you cannot save. Choosing to skip on retirement plan contributions, especially early on when compound interest has plenty of time to work its magic, can devastate a retirement plan. Consider this: One physician saves $50,000 a year for his first 15 years of practice, then saves nothing until he retires 25 years later. ($750,000 total saved) A second physician saves nothing his first 15 years of practice, then saves $75,000 a year for the next 20 years. ($1.5 Million saved) Which one ends up with more money? The physician who saved early ends up with $2.86 million and the late-saving physician, despite saving twice as much of his income, ends up with $383,000 less. The longer you wait until you start saving, the more you need to save. Likewise, saving just 5 or 10% of your income isn’t enough. With savings rates like that, you’ll end up with a much lower standard of living in retirement than while in practice. Another benefit of a high savings rate is that you’re used to living on less money. A doctor earning $200K a year and saving $50K a year only needs 75% of his pre-retirement income to have the same standard of living. A doctor earning $200K a year and only saving $20K a year would need 90% of his pre-retirement income to maintain his standard of living. That will mean more years of work. You should aim to save 15-25% of your income each year you practice. More if you had a late start or want to retire early.
4) Failure to insure against financial catastrophe

There are really only a few things that can wipe a doctor (or his family) out financially. Death, disability, natural disaster, and liability. These are all very easy to insure against.

5) Inappropriate investment plan

With a high income and a high savings rate, any reasonable investment plan should get the physician investor to his goal. Unfortunately, far too many doctors have inappropriate investment plans. These range from day-trading tech stocks, to huge swings in asset allocation into the asset class with the most impressive recent performance (buying high/selling low), to being overly conservative and leaving money in assets without adequate long-term returns. Getting 5% after-inflation long-term returns is not that hard to do, but without a reasonable investment plan, even that may be asking too much. Compounding doesn’t do any good if it doesn’t happen at a rate significantly higher than inflation.

6) Excessive investment costs

Getting help from a financial adviser can help the physician
investor avoid the problems outlined in 5 above, but if done improperly, can introduce a new problem. In investing, you get what you don’t pay for. So if your investment costs are 1%, 2%, or even 3% a year, that comes straight off the top of your return. Costs of 3% a year reduce your after-inflation return of 5% to 2%. After 35 years of saving $50K a year, that’s a difference of $2 Million! That’s more than all the money you saved over those years! Taxes on your investments can have exactly the same effect, so it is important to minimize those as much as possible too.