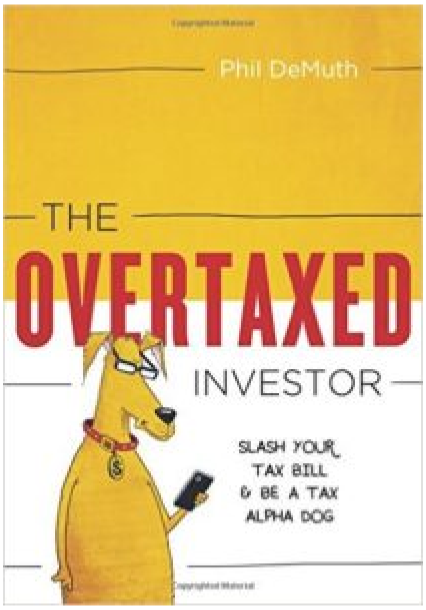
Reviews of The Overtaxed Investor and How To Think About Money

Welcome back for day two of Continuing Financial Education week here at The White Coat Investor. On tap today are two excellent, although not necessarily physician-specific, books written by popular and talented personal finance writers Phil Demuth and Jonathan Clements.

The Overtaxed Investor

Up first is The Overtaxed Investor by Phil Demuth. I've referred to this one in the free monthly newsletter and in a post earlier this year and it has been discussed on the forum a bit as well. It's a bit longer than most of the books I review, clocking in at 279 pages, not including the notes at the end. The thing I like about Demuth's writing is that it is very readable. He's actually funny, at least if you think jokes about taxes are funny. He explains the origin of the book in the preface, after his client told him that the client paid no taxes on a recent six figure capital gains distribution:

Great Caesar's Ghost! I had no idea a wormhole existed inside the tax code so that someone could pay nothing on a six-figure capital gains distribution. I naively assumed that tax rates were continuous and connected to reality. I needed to educate myself on this topic, but I could find no readable, up-to-date book on taxes for investors. This left me with no choice but to write the damn thing myself. Believe me, I didn't want to. If you had bothered to write one, it would have saved me a lot of trouble.



The book is all about reducing investment related taxes, so don't expect anything about how to claim more of your expenses as business expenses and that sort of stuff. But with regards to investment related taxes this book is the best (perhaps only) book on the market. In the first chapter, he teaches you how to be a Tax Alpha Dog. He spends the first four pages detailing all the taxes you pay. By the time you get to the end of that list, you'll be so hopping mad that you'll read the rest of the book. He also explains why it's tough to just hire a CPA to deal with this:

Sadly, my clients rarely have a good word to say about their accountants. As one succinctly put it, "I point out his mistakes, and then he charges me $350 an hour to fix them." To be fair, I think we may be expecting too much from these beleaguered chaps. We dump shoeboxes of receipts in their laps on April 14 and expect them to work miracles. This is not a recipe for success.

He then suggests you go meet with your accountant in November, or even do your taxes yourself once:

Here is another novel thought: try doing your own taxes, at *least once. I don't mean fire your accountant—are you crazy? No, you need him. I mean get Turbotax or H&R Block tax software and actually enter the information yourself and see how the whole thing works. You will lose your tax virginity. This will let you collaborate more intelligently with your tax planner going forward.*

The rest of the first chapter is dedicated to the idea that you need to pay far more attention to the tax "tail" than the investment "dog" than most investors do "because investment returns are speculative, but investment expenses are certain."

Chapter two goes over tax-free accounts, tax-deferred accounts, and taxable accounts. My only beef with this chapter is he falls into the two common asset location trap where high return assets go into a tax-free account and lower returning assets go into tax-deferred. He tried to address it in the "objections" section at the end of the chapter, but I felt it was done inadequately ("Investing is not an exact science!" was basically the answer to the important objection.) A relatively minor beef in a lengthy book.

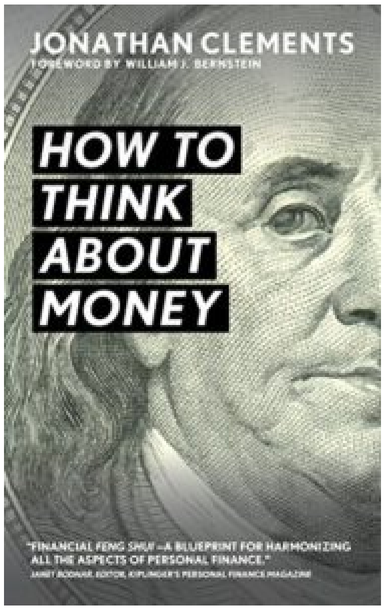
Chapter three is all about the various legal means investors use to reduce their taxes. Excellent stuff. He even gets into Oil and Gas, MLPs, and real estate. Chapter four discusses the stages in life and how your tax outlook changes as an investor. While I’m glossing over these chapters in this review, either of these alone is worth the time and money you’ll spend on this book. Of course, like any tax book, much of it may soon be out of date, especially with the changing of the guard at the White House.

Chapter five is dedicated to one of Demuth’s pet topics, investing with zero dividends. He tries to make a case for buying individual stocks that don’t pay dividends. I felt this was unsuccessful. I don’t think the tax benefits outweigh the uncompensated risk you’re taking on, not to mention the massive hassle required to achieve any sort of diversification with individual stocks. I mean, you’ve got to be really anal about investment related taxes to complain that a 5 basis point total stock index fund is so tax-inefficient that you’re going to try to run your own mutual fund instead. If you want to make the book shorter, this is the chapter to skip. Or you can side with Demuth in this argument (What!? Reasonable people can disagree on the best way to invest?) I won’t think any less of you.

Chapter six is all about estate taxes. It is short, but well done. The perfect length for the topic.

Overall, this is a very important book, and Demuth is right that it wasn’t available before he wrote it. I highly encourage you to not only pick up a copy, but to read it! I’ll certainly be referring to it as I plod my way along toward completing my own book on tax reduction for physicians.

How To Think About Money



This is another excellent book that I sent a few tweets out about earlier this summer when I read it. Both of these books are so good I feel terrible about lumping them both into one blog post, but such is life. You know a book is good when Bill Bernstein writes the foreword, and the latest from WSJ columnist Jonathan Clements doesn't disappoint. In fact, How To Think About Money might be the best financial book I've read in the last 5 years, certainly for me now with where I am at in my financial life. I confess right now that Jonathan Clements can do no wrong in my eyes. Even if I found out he was a cattle rustler on the side I would still think the world of him. In this book, he gives us the "big picture." He helps you to get your mindset right about your money- to use it to make your life and those of others better and happier, but also keeping it in its appropriate place.

I was delighted to read the foreword where Bernstein mentioned me briefly, and in the middle of one of the most important paragraphs in the book:

> *Academics tout the idea of so-called consumption smoothing: borrowing heavily when you're young then paying off those debts when you're old, so as to maintain a constant standard of living throughout your life. This is a really, really dumb idea, since it ignores habituation: Get used to the Beemer and business class when you're young, and by the time you're middle-aged you'll need a Bentley and private jet. My medical colleague and fellow financial author Jim Dahle advises newly established doctors to continue "living like a resident" for several more years after starting practice. That's good advice for just about everyone else too.*

Who doesn't like a book they're mentioned in? Clements introduces (and sums up) the book in this way:

> *There are those who think the goal of investing is to beat the market and amass as much wealth as possible, that street smarts and hard work ensure investment success, and that the road to happiness is paved with more of everything. And then there are those who get it. I realize that sounds horribly arrogant. But in truth, those words are born of the humble realization that very few of us will beat the market, that saving diligently is the key to amassing wealth, that money buys limited happiness and that much of the time we are our own worst enemy.*

Chapter one is all about how to buy happiness. I cannot recommend it more highly. Well worth the price of admission. I just want to quote page after page here, but here are a few nuggets:

> *Money can buy happiness, but not nearly as much as we imagine.*
>
> *We place too high a value on possessions and not enough on experiences.*
>
> *Spending money on others can deliver greater happiness than spending it on ourselves.*
>
> *We're often happier when we have less choice, not more.*
>
> *Working hard toward our goals can bring great pleasure—but achieving our goals is often a letdown.*
>
> *Raising children isn't nearly as life-enhancing as many parents claim.*
>
> *Satisfaction through life appears to be U-shaped, with reported happiness falling through our 20s and 30s, hitting bottom in our 40s and bouncing back from there.*

> *Other insights are less surprising: Those who are married, or who are surrounded by friends an family, tend to be happier. Ditto for the self-employed and those who exercise regularly. We also get a lot of pleasure from helping others. Meanwhile, commuting, ill health, unemployment, and financial problems can bring unhappiness….*
>
> *We all have different happiness "set points" that are genetically determined….This set point might account for 50 percent of an individual's happiness level. Circumstances—our age, income, whether we're divorced—might determine another 10 percent. What about the remaining 40 percent? That's up to us. We can influence our level of happiness by how we choose to lead our life.*

I've got 5 times as much as is in those quotes that deserves to be cited in this review, just from chapter one. That's how good it is.

Chapter two, Bet On A Long Life, talks about how we are likely to live a long time and the financial implications of that. He points out that the retirement age needs to climb and that this will be driven by lower investment returns, rising inflation, cuts in Social Security, or some combination of these and other factors that put financial pressure on older Americans and prods them to stay in the workforce longer. I love his advice to college students:

> *When I talk to college students, I don't tell them to follow their dreams. Instead, I tell them to focus on making and saving money. I even suggest that they might deliberately opt for a less interesting but higher paying job, so they can sock away serious sums of money. All this might sound deadly dull and horribly reactionary. Aren't those in their 20s meant to pursue their passions, before they become burdened by the demands of raising a family and making the monthly*

> *mortgage payment? Underpinning this is an implicit—but rarely examined—assumption: that pursuing our passions is somehow more important in our 20s than in our 50s. I think this is nonsense. In fact, I think just the opposite is true.*

Clements points out that

> *There is a reason the world's gardens are full of benches that nobody ever sits on. As distant relatives of our hunter-gatherer ancestors, we aren't built for leisure or built to relax. Rather we are built to strive. We are often happiest when we are engaged in activities that we think are important, we are passionate about, we find challenging, and we think we are good at.*

At this point in the book, I asked myself, "Self, why are you such a terrible writer? Why can't you write like Clements?" Darn that guy. I'm so jealous of his talent. If I had written a book as good as this one, I would consider my life's work complete.

Chapter three is all about behavioral finance and teaches you how to rewire your brain for financial success.

> *There are all kinds of rational reasons to be a good saver: By socking away money early and often, we can avoid a lifetime of financial anxiety, enjoy decades of investment compounding, buy ourselves the financial freedom to pursue our passions and ensure a comfortable retirement. Meanwhile, as we learned in chapter 1, spending less today isn't any great sacrifice, because much of our spending delivers little happiness.*
>
> *Appeals to rationality, however, are no match for our lack of self-control and our instinct to consume as much as possible today. What to do? Consider a two-part strategy. First, we*

> *should make it possible to save by keeping our fixed costs as low as possible. We're talking here about recurring expenses such as mortgage or rent, car payments, groceries, utilities and insurance premiums. In particular, we should focus on the sum we devote to housing and cars….Second, we should make saving as painless as possible [by automating investing.]*

He also mentions a truism that I have found (and preach often – "Grow into your income as slowly as you can") and that Bernstein mentions in the foreword:

> *By being frugal early in our adult life, we will enjoy the pleasure of a gradually rising standard of living. If we start out in economy, but eventually we can afford to fly first class, sitting at the front of the plane will seem like a treat. What if we start out in first class? It won't seem all that special—and, when our skimpy retirement nest egg forces us to the back of the plane, sitting in the cheap seats will seem especially grim.*

So true, and it reminds me of this awesome bit by Louis CK (profanity and crudeness warning) about flying on a plane.

Chapter four is about "thinking big" and what he means by this is to use your paycheck to bring financial order to your life.

> *Amassing enough for a comfortable retirement is our life's greatest financial task: During our working years, we need to take the income from our human capital and use it to amass a heaping pile of financial capital so that one day we can live without the income from our human capital. To achieve this goal, we might need to save 10 to 15 percent of our pretax income every year for 30 or 40 years. Yet retirement often gets short shrift, in large part because we are so focused on immediate goals and so bad at planning for the distant future.*

Clements says that he would like the distinction between working and retirement to get a whole lot murkier and that retirement should be redefined as an opportunity to take on new challenges without worrying about whether those challenges come with a paycheck. Now where have I read that before? He also talks about the appropriate use of debt– a reasonable mortgage is okay, a reasonable amount of student loans is okay if they increase our earning potential, but have all your debt paid off by the time you retire. I agree.

Chapter five is all about not losing your wealth, not only quickly (through financial catastrophe) but slowly through investment costs and taxes, and I would add, inflation. He talks about focusing less on the odds of success or failure, and more on the consequences. I agree.

> *Maybe we can get through life successfully with no health or disability insurance. Maybe we will be okay with a handful of hot stocks or a few heavily mortgaged rental properties. Maybe we will win again and again at Russian roulette. But all it takes is one loss, and our happy financial future will die a quick death.*

So true, and we all know someone who has fallen prey to that.

This post is far too long, now that I've tried to give you a taste of not just one, but two awesome books. Do yourself a favor. Buy them both and actually read them. You'll be healthier, wealthier, and wiser for doing so.

Buy The OverTaxed Investor Today!

Buy How To Think About Money Today!

What do you think? Have you read either book? What did you like and dislike about them? What do you do to limit your investment taxes? What have you done to improve the ways you think about money? Do you focus on happiness when spending?

Comment below!