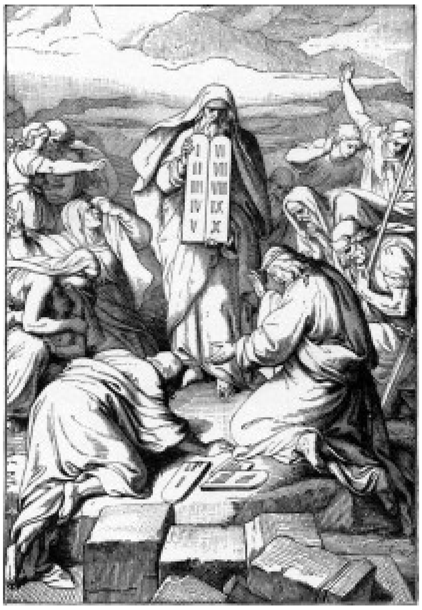
The 10 Commandments of the White Coat Investor

And The White Coat Investor went up into the Mount and out of the burning bush came a finger which engraved on the stone tablets the following:



10 Commandments for Financial Independence

1) Thou Shalt Realize Thou Hast A Second Job

Most doctors won't have any kind of a pension, so if you want to retire on more than Social Security will provide then you'll need to learn how to implement and maintain a retirement plan and fund it appropriately. Putting this off leads to failure. Trusting it all to your "money guy" will likely lead to disappointment. Just like rotating through gynecology or psychiatry, this has to be done no matter how painful you find it. Pretending you don't have to do this is simply denial. Not realizing you have to do this is simply ignorance.

2) Thou Shalt Do Continuing Financial Education

Everybody, no matter whether they choose to rely heavily on a financial advisor or not, needs to do some initial financial education such as reading 3 or 4 good books on personal finance and investing. I then recommend you read at least one good financial book a year. Just like CME, you need a few hours of CFE for your second job each year. Following this blog is another great way to get your CFE. *[Update July 2018: A few other ways to get your CFE is to get involved in the WCI Forum, the new White Coat Investors Facebook group or the r/whitecoatinvestor subreddit. – Ed]*

3) Thou Shalt Save 20% Of Your Income For Retirement Beginning the Day You Leave Residency

Many companies and municipalities have underfunded their pension plans. The reason why is that they have an unrealistic expectation of ridiculously high future investment returns (and they like to spend their money on other stuff). Individuals are no different. The "personal pension plans" of most Americans are almost all underfunded with a median 401K balance of just $23,000. *[Update: In 2017 the median was $26,331. Not much has changed.]* Now, granted, many people have an IRA or a taxable investing account on the side, but even if it were half as big as the 401K…you're still a long way from what I would view as a comfortable retirement.

Doctors, by virtue of their late start, high loan burden, and future changes in medicine, need to save 20% of their income each year just for retirement. If you assume a 30 year career, 5% after-inflation returns, and a 4% safe withdrawal rate in retirement, this savings rate will provide a portfolio that will replace approximately 56% of your pre-retirement income. When combined with Social Security this should provide a nice, comfortable retirement with the ability to travel, leave money to your children, and donate to charity. You may even be able to retire a little bit early. But if you wait 10 years to start, and only save 10% of your income, your retirement nest egg will only replace 14% of your income. Alpo here you come.

4) Thou Shalt Insure Against Catastrophe

There are lots of bad financial things that can happen to you in life. Most of these are minor, like your washing machine breaking. You don't need to insure against these, you simply need an emergency fund of 3-6 months worth of expenses so you don't have to go into debt when bad things happen. Some bad financial things are major, but you can't insure against them. These include losing your income due to sexual harassment claims, multiple malpractice suits, or the loss of an important contract. However, there are five major financial risks that you can and should insure against- death, disability, illness, liability, and property loss.

5) Thou Shalt Not Mix Insurance And Investing

Life insurance protects your family against the financial consequences of your death. A large 20-30 year level premium term insurance policy will likely do the trick until your portfolio becomes large enough that you can self-insure against this risk. Disability insurance protects you and your family from the financial consequences of your disability. A good individual disability policy is expensive but worth it. As a physician, it doesn’t take long to understand the value of comprehensive life insurance. You should also carry high limits on your auto and homeowner’s insurance policies. In addition, you need to have an “umbrella” policy above and beyond these policies. These policies not only protect you against natural and man-made disasters, but against something that can cost you far more than a car wreck or a fire- a lawsuit. Just as a malpractice policy protects you from work-related liability, so an umbrella policy protects you from liability in everything else in life.

Insurance is an important aspect of your financial life, but it should not be an important part of your investments. There are many insurance-related investment products such as cash-value life insurance and annuities which allow you to transfer investing risks to the insurance company in return for some guarantees. Unfortunately, when you transfer the risk, you also transfer the lion’s share of the returns. These products tend to be complex and that complexity favors the insurance company and its agents. The company doesn’t invest in any magic investments you can’t invest in yourself, but once the agent gets his commissions, the company pays its expenses and profits, and you pay for the costs of the insurance part of the policy, is there any surprise that the “investment” can’t keep up with more traditional investments? Even considering the tax advantages of these products, these are investments designed to be sold, not bought.

[Update: This post was originally a two-part post, but since I added it to the list of "Classic Posts" I thought it might be better to combine it all into one post.]

6) Thou Shalt Favor A Passive Investing Approach

The academic literature is quite clear- active management is a loser's game. Stock pickers and market timers simply cannot outperform by more than it costs to do so. Proponents of active management like to point to Warren Buffett's record and say, "Look, it can be done." But Warren says, "A low-cost index fund is the most sensible equity investment for the great majority of investors. My mentor, Ben Graham, took this position many years ago, and everything I have seen since convinces me of its truth." Humble yourself and realize that yes, you are part of that "great majority of investors." I am too, and that's okay. I don't invest competitively, I invest to meet my financial goals while taking the lowest possible amount of risk.

7) Thou Shalt Hire Only Competent Advisors

It's okay to do your own financial planning, manage your own investments, and do your own taxes. With minimal input and assistance from appropriate attorneys you can even design and implement an adequate estate plan and asset protection plan. You do need to put in some effort up front to educate yourself, but these subjects are far easier to understand than a nephron or an action potential. Developing an interest in financial subjects is far easier when you realize just how much of a difference it can make in your finances.

A) High level credentials such as one or more of the following: CFP, CFA, ChFC, or a CPA/PFSIt is also okay to rely heavily on an advisor. This doesn't excuse you from your need to learn about finance and investing and to do your CFE each year, but many doctors simply don't have the interest, time, or disposition to manage their own money. However, there are legions of financial professionals out there whose business is transferring money from your pocket to theirs, not necessarily helping you to reach your financial goals. In many ways, by the time you know enough to select a good financial advisor you know enough to do it yourself. When choosing a financial advisor you should look for the following:

B) Reasonable fees- Avoid commissioned salesmen by sticking with a fee-only advisor. Annual fees should be less than $5000 per year. These might be payable as an hourly rate, as a percentage of assets under management, or as an annual retainer. There are advisors out there who will work for $100-200 per hour, for 0.15-0.5% of assets under management, or for an annual fee of as low as $1000 per year. If you're paying more than this, realize that every dollar you pay in fees is a dollar you don't have working for your retirement.

C) A Fiduciary- Many financial advisors select investments for you based on a lower "suitability standard." If the investment is suitable for you, he can sell it to you. You want someone who is willing to sign a pledge to act as a fiduciary, meaning he is obligated to do what's best for you, no matter what it costs him.

D) A Cloudy Crystal Ball- You want an advisor who knows that neither you nor he can predict the future, and who will design and maintain a plan that has a high likelihood of success no matter what happens in the financial markets over the next month, year, or decade.

E) A Bias Toward Low-Cost, Passive Investments- As mentioned above, active management is a loser's game. If your advisor isn't aware of this, it reflects a serious ignorance of the academic investment literature and you should look elsewhere.

8) Thou Shalt Minimize Expenses And Taxes

Every dollar you spend on investment expenses, fees and commissions, or that you send to Uncle Sam, is a dollar that isn't working toward your retirement. Studies show that the best predictor of future mutual fund returns is the cost of the mutual fund management. The lower, the better. Despite frequent claims to the contrary, a buy and hold strategy is still the best way to invest not only because it helps you avoid buying high and selling low, but also because it minimizes expenses AND taxes. A wise physician also maximizes tax-protected investing accounts such as 401Ks, cash balance plans, and backdoor Roth IRAs. When investing in taxable accounts, use only tax-efficient investments, and take advantages of opportunities to tax-loss harvest.

9) Thou Shalt Minimize Debt And Manage Necessary Debt Well

Credits cards are not for credit. Buy your automobiles, recreational vehicles, furniture, and vacations with cash. Don't ever have a mortgage more than twice as big as your salary. Minimize your mortgage interest by putting 20% down, refinancing when rates drop, and using a 15 year mortgage instead of a 30. Prioritize paying off high-interest student loans. If you have sizable student loans, become an expert on the IBR and PSLF programs. Refinance your loans as soon as you know you won't be going for forgiveness. Live like a resident until saving 20% of your income toward retirement is easy and your only remaining mortgage or student loans are at ridiculously low rates.

10) Thou Shalt Protect Thy Assets, Plan Thy Estate And Stay The Course

Most importantly, don't sell out at market bottoms. You will pass through 3-6 serious bear markets during your investing career. Don't invest so aggressively that you cannot sleep at night when things turn South, as we know they will. Buying high and selling low can add 5-10 years to your career that you might have preferred to spend doing something else. Your investment plan should be like an oil tanker, not a speedboat. Any changes in direction should occur over a long time period. Be aware of the simple strategies to protect your exposed assets from malpractice and personal lawsuits. Consider implementing some of the more complex strategies. Get a will and a trust. If your assets begin to approach the estate tax exemption limits, see an attorney to draw up a more complex estate plan.

This is the financial and investing philosophy of The White Coat Investor. You may not agree with all of it, but if you follow these commandments, financial success is guaranteed.

Do you agree that by following these 10 steps you can achieve financial independence? Why or why not? What would you add or take away from the list? Sound off below!