What Should I Do Now If I Bailed Out in 2008?

I got an email a few months back that seemed like it would make for an excellent blog post as I think this situation is actually pretty common out there. Here it is, with any possible identifying information redacted or changed.

Q. Should I Get Back Into the Stock Market?

I am 11 years out of residency and have made many of the mistakes you have listed on the site. The primary one was getting OUT of stocks entirely with the 2008 crash. Oi. Now I have all this cash and some bonds and I want to reinvest, slowly, and think the market is overvalued. I hate the thought of getting back into the market, then losing 20+% in the next correction. But also the market is going up up up!

I’ve maxed all retirement accounts, including my SEP, most years—all the past 10 or so I think but I’ve lost a lot of it. I’m in solo practice. But most of my cash is currently not in retirement accounts.
I HATE financial advisors and want to do this asset allocation myself. So far I’ve invested in Vanguard bond funds, REITs, and the rest is in cash right now—way too much to be just sitting around.

On my non-tax protected cash I really want to earn 3-5% on it. Not anything crazy, but definitely safe and steady growth. I was thinking of just using Vanguard tax-exempt bond funds.

Do you have suggestions for those of us out of the market right now? I don’t see that on your blog lately. I know you have some simple investment recipes, but none I see addressing scared people who want to eventually get back into stocks—I am thinking of just doing the 500 Index Fund, just something simple with low fees when I do reinvest into stocks.

Don’t worry, I also have some real estate, but that is mostly an accident, I actually hate managing real estate but keep the properties so we can use them ourselves once a year or so.

A.

I think getting the response to this post just right is really important. Helping people like this is what I really want to do with this site, rather than just helping someone tweak a nearly perfect portfolio so they can retire 3 days earlier. Sites like this are magnets for people who live and breathe personal finance and don’t need all that much help anyway. But this sort of a situation…this is where I can really make a difference. So if you know someone in this situation, please feel free to forward this post on to them.

I’m going to hit the easy stuff first and then deal with the major issue at the end.
There Is No 3-5% Cash Option

First, we would all like to earn 3-5% on our cash. The problem is that you only get to choose from what is available in the market. Back in 2007, I think my Vanguard Prime Money Market Fund was paying 5.25%. That was great. But it hasn’t been available since. As I write this in September, it’s paying 1.12%. The tax-exempt money market fund is paying 0.75%. Ally Bank, a good example of a high-yield savings account, is paying 1.20%. Maybe you can find a 5 year CD paying 2%. But there’s basically nothing cash-like out there paying better than that without a catch like a high-yield checking account with a $25K limit requiring a dozen transactions a month or a whole life insurance policy with negative returns for the first decade.

The market doesn’t care what you want. You get to select your risk level. You don’t get to select your return. You get the return that comes with a given risk level. With the cash risk level, you get 1%. Not 3-5%. Sorry.

Bonds Aren’t Cash

Bonds are a lot less risky than stocks, but they certainly aren’t cash. They do go down in value. For example, the Vanguard Intermediate Tax-Exempt Bond Fund lost 1.56% in 2013. It lost 3.28% in the final quarter of 2016. Both bonds and
cash can reasonably be used in a retirement portfolio, but they aren’t interchangeable.

**REITs Are Stocks**

You indicate that you got out of stocks in 2008. Then you indicate that you actually own some REITs. **REITs** are stocks and publicly traded REITs are part of the overall stock market. So you didn’t actually get out of and stay out of the stock market in 2008. You just changed your stock asset allocation from a diversified one to a very undiversified one. Now, there may be some good reasons to overweight REITs in your portfolio, but I know of no reputable investment authority who recommends your stock allocation be 100% REITs. I’m actually surprised to see this, since REITS tanked MUCH harder in 2008 than the overall market. I think my REIT fund lost 78% from peak to trough.

**SEP-IRAs Are Less Than Ideal**

I comment on this every time I see it, but it is a rare doctor for whom a **SEP-IRA** is a better retirement account than an **individual 401(k)**. You can max out a 401(k) on less income, it allows you to do a **Backdoor Roth IRA** on the side, and it may get a little better **asset protection** in some states. The only downside is really a very small amount of additional paperwork and sometimes some very minor additional costs. Nonetheless, I’m glad to hear you’re maxing out your retirement accounts (well, excepting a Backdoor Roth IRA.) It turns out at your stage of the game (early to mid-career) that how much you save matters far more than what you invest it in.

**Real Estate Can Be A Great Investment**
You mention your real estate investments. Real estate can be a very profitable investment and is the usual refuge for smart investors who have an inordinate fear of the volatility of the stock market with its daily repricing. However, it is usually only a good option for those who love it and are interested in working in it. If you simply see the value of an investment with a solid return and low correlation with the overall market, you may wish to explore some other ways of investing in real estate that don’t involve landlording. These include REITs, crowdfunding sites, syndicated shares, or even buying real estate directly and hiring a management team. But I see little reason for you to be investing directly into real estate and managing it yourself when you hate doing it. Sure, the vacation perk once a year is nice, but you can just rent a place for that week with far less hassle than you are having managing a rental property. Chances are good that you aren’t even charging market rental rates for that property if you hate it and your renters gladly accommodate your annual vacation. You probably need a change there, whether it is hiring a good property manager or simply selling it and reallocating that money elsewhere in the portfolio.
The Value of an Advisor

It is unlikely that anyone will ever accuse me of being the most pro-financial advisor blogger on the planet. I do have a few financial advisor sponsors, but to be honest, the sum total of everything I get from financial advisors represents a tiny percentage of the WCI Empire’s revenue. The main reason I sell ads to financial advisors and maintain a list of recommended advisors is because for some doctors, maybe even the majority of doctors, they provide a service with a value that outweighs their substantial cost. One of the areas where an advisor can help the most is to help us to stay the course with a good plan. In fact, even if you pay 1% a year to an advisor for your entire 30 year career, that total cost adds up to less than what you could lose with just one instance of doing what you did—buying high and selling low. Take a look at the math:

Consider an investor who invests $50K a year for 30 years and the investment makes 8%. She pays an advisor 1%, so it’s really like the investments compound at 7%. After 30 years, she has $4.7M.

If she had not used an advisor, and so got to keep the entire 8%, she would have ended up with $5.6M, or 20% more. But if she sold low in a bad bear market after 20 years and lost 40% of the nest egg, and then left the money in cash earning 1% for that last 10 years, she would end up with $2 Million, just 43% of what she would have had if she had used an advisor in the first place.

I’m not saying you need to use an advisor, and I certainly don’t use one myself, but if an advisor could have kept you from making your previous two mistakes (selling low and staying out) they would have been well worth their fees.
Fear and Greed

Now, let’s address the elephant in the room. The Big Kahuna. The reason you’re writing me in the first place.

Why did people sell out of stocks in 2008 at the market bottom? One reason. Fear.

Why did people stay out of stocks for years afterward despite excellent (i.e. low) valuations and excellent recent returns? One reason. Fear.

Why did those same people feel a need to get back into stocks 8+ years into a bull market with high valuations and many worries about returns in the near future? One reason. Greed.

Your problem is not that investing money in the market right now is a good thing to do or a bad thing to do. It’s not how you invest that money into the market. The problem is that if you haven’t fixed the problem that led to the original mistakes, you’re highly likely to do the same thing again in the next bear market. And the one after that. And the one after that. In fact, if I were you, I’d expect your portfolio to pass through 5+ more bear market during the remainder of your investing career. You need to fix your behavior first or you’re going to be unsuccessful as an investor no matter what you do this year. I cannot emphasize this enough.

Fixing Behavior

There are a few strategies that others have used to fix their bad investing behavior. Hopefully they will work for you.

# 1 Education

I think the first place to start is with education. Lots of investors are surprised when the financial world goes to hell in a handbasket. So they react to it. But even an elementary
knowledge of financial history would tell you that the world goes to hell in a handbasket on average about once every 3-4 years. From 1900-2013, there were 123 market corrections (drop of 10%+) and 32 bear markets (drop of 20%+). On average, a bear market lasts 15 months and involves a drop in value of 32%. When you know this happens every few years, you know you need a plan that dictates what you are going to do in a bear market. Your investing career is probably going to involve passing though not just one or two, but more than a dozen bear markets.

# 2 A Written Plan

Now that you know what you’re up against, you can write down a plan of what you are going to do. My Investing Policy Statement actually says we won’t sell stocks in a bear market. I suggest you put that in yours too. In the depths of the next one, go back and review your written plan and it will help you remember why you set things up like you did, and hopefully, help you avoid bad investing behavior.

# 3 A Less Aggressive Asset Allocation

The best indicator of your risk tolerance (i.e. your ability to lose money in a bear market without selling low) is your past behavior in bear markets. In this respect, you’ve shown at least one thing- you couldn’t tolerate going through a bear
market with your previous asset allocation and level of education. We already mentioned the education bit, but it would probably be a good idea to hit the asset allocation side too. If you gave up with a 90% stock allocation, maybe you should trim it back to 50/50 or 60/40. If you bailed out with a 60/40 allocation, maybe a 25/75 portfolio is right for you. Likewise, if you are a new investor and have never been through a bad bear market like many new attendings, I would recommend you err on the conservative side until you go through your first bear. Don’t worry, it won’t be that long before it happens and at this stage savings rate matters more anyway. If you find it easy to stay the course, then you can ramp up your risk level in the depths of the bear market and really make a killing.

# 4 An Advisor

As mentioned above, an advisor might be able to help you avoid bad investment behavior. Of course, there’s always the risk that you’ll have to control the advisor’s behavior too, but in general it is much easier to tolerate investment losses with a philosophical and theoretical mindset when it isn’t your money. And the good advisors you should be hiring generally have high levels of financial education and risk tolerance.

# 5 Elimination of Financial Pornography

Financial pornography is basically anything that you can watch on TV, listen to on the radio, read in the newspaper, read in a magazine, or hear at the water cooler. Avoid it, particularly in a bad bear market. Those poor folks have to publish something every day, so they do. But 99% of it doesn’t matter. Even worse, it is likely to lead you to have a short-term perspective that can be very dangerous in a bear market. Turn it off. In fact, you don’t even have to open your investment statements in a bear market if you don’t want to. That might make it hard to rebalance, but avoiding selling low matters even more than properly rebalancing.
# 6 Controls

As a last ditch effort, you might try placing some controls in your way to prevent you from selling low. Maybe it is only letting your spouse know the logins for your investment accounts. Maybe it is deleting those links from your toolbar. Maybe it is just setting your 401(k) up on autopilot. Just like freezing a credit card in a block of ice (or freezing your credit) keeps you from going into debt, making it harder to see what your investments are doing on a daily or monthly basis and harder to do anything about it can promote good investor behavior.

What Now?

Okay, so what should you do now? Don’t do anything quickly. Start educating yourself with some good books. Come up with a written investing plan. If you need help, hire an hourly or flat rate financial advisor to help you make one. Make sure your asset allocation is significantly less aggressive than it was in 2008. Most importantly, stop allowing fear and greed to dictate how you invest.

Some advocate for a dollar cost averaging approach. If that mental crutch helps you, then feel free to do that. But sooner or later, you’ll be 100% invested anyway, and every day after that is exactly like you lump summed into your portfolio that day. So I would just lump sum your money into the market now, but do so in a less aggressive asset allocation. If you are nervous to lump sum into your asset allocation, it is too aggressive.

Remember that although a less aggressive approach is comforting, it might not reach your financial goals. You NEED to take at least some market risk. If you cannot do that with frequently revalued assets like publicly traded stocks, you should cultivate an interest in real estate, where the value
of investments at least seems less volatile.

Remember the words of Phil Demuth in this respect:

Even if risk tolerance existed and could be measured accurately, why would it be an important factor to consult when considering how to invest? You should invest in the way that has the greatest prospect to fulfill your investment goals. That might mean taking more or less risk than you would prefer. If you are a sensitive soul who can brook no paper losses, the solution is to get a grip, not to invest “safely” if that locks in running out of money when you are old.

Moderation in all things.

If you’re one of those who sold out in 2008 and never got back in, I hope this post has been helpful to you.

What do you think? Did you sell in 2008? Know someone who did? What advice would you give them? Comment below!