Congratulations on your entry into the wonderful world of dentistry. It's time for your first BMW and mortgage, right? Not so fast. You may be able to cut a prep with a 400,000 rpm hand-piece in a couple minutes, yet the full restoration takes time and patience to build longevity.

The same is true of your financial strategy. Decisions made early in one's career have huge effects on stability years later.

In this article, I'll paint a landscape using the strokes dentists use to build real wealth.

But first, let's have some comments from a 2012 Dentaltown.com thread called “Financial Mistakes I Wish I Had Never Done.”

1. Wish I never bought the home before setting up the office.
2. Wish I bought a small home instead of buying the "dream home.”
3. Wish I bought life insurance and disability when I was younger and healthier.
4. Wish I didn't buy that swanky car and had my little fun for three years on it.
5. Wish I knew who had the Time Machine…

Nexxtdent 1/18/2012

• At the top of the list for financial mistakes (and general life mistakes) is marrying the wrong woman. Nothing else, other than losing your dental license, will be more expensive.
• I totally agree with getting your practice established before buying your house.
• Never spend more than 16 percent of your income on your mortgage.
• Pay cash for your toys. If you can’t pay cash, save until you can.
• If you are over 35 pay cash for everything that isn’t a home. Everything. Boat, CEREC, kitchen remodel… everything.

bkoenitzer 2/07/2012

continued on page 58
The number-one mistake I made: Arguing with my wife way too many times about changes that should have been made. If I had listened and made the changes she thought right, we’d have gotten out of that deep hole I dug much sooner.

Chip Payet 2/6/2012

The Psychology of Debt

Psychotherapist Phil Tyson lists two factors pertaining to the psychology of debt:

First is a principle he labels future discounting. We often take on debt giving little thought to how we need to change our lives to accommodate it. Madison Avenue has used this approach effectively for years.

Dr. Tyson’s second principle is the relationship between consumption and personal identity. “Advertising has brainwashed us all to consume brands that provide us an identity. Our self-esteem becomes captive to products.”

Student Loans

Dentists attending public institutions often graduate with more than $200,000 in student loan debt, while those attending private schools often end up owing $400,000.

Should the loan be paid off before taking on other loans or should it be paid off over a long period of time? Low interest rates often entice doctors to pay as slowly as possible.

For insight, I provide my favorite comment from Dave Ramsey, author and TV personality.

An abridged version:

Dear Dave,

I'm 33 and a resident with $250,000 in student loan debt. Next year I’ll finish my residency and increase my income dramatically. The interest rate on my student loan is just 3.5 percent, so I’d like to postpone paying it off and make house payments and begin saving for retirement instead. I’d put off paying the student loans as long as possible. Is this a good idea?

-Derrick

Dear Derrick,

That loan hanging over your head is unbelievable. I’ve worked with many doctors over the years where 20 years later they are still playing math games with the student loans like they’re a stupid pet!..... if you’re not careful, you might catch a nasty disease called “doc-itis.”...Some of the symptoms include two or three leased BMWs and a fully furnished house with a pool on the golf course. That student loan can just wait a while to be paid. It’s a financially debilitating disease.

You’ve been used to living on nothing (less than $40,000) for a while now. Just keep on doing that for a little bit longer… you can have that student loan debt knocked out in a few years.

I’d postpone any retirement savings and buying a home until you’ve completely knocked out the loan and have an emergency fund ($50,000+) in place...

-Dave

The full interview can be accessed at:

One who stretches out that first loan as long as possible has two strikes against him.

First is the fact that debt structure will be more complex and saving more difficult in the future.

Second, the young dentist will set up an insidious mental framework of debt being a natural part of life. It isn’t. If you tie your identity to debt, you’ll end up needing to work 10 to 15 more years than the dentist that doesn’t. This is the most important message in the article: Debt is never your friend. Many will tell you to use debt for leverage, tax advantage and other ploys. Nonsense!

The only reasonable use for debt is a home mortgage and a practice loan.

What can a young dentist do with onerous student debt? Unfortunately, suck it up and live like a student for a few years after becoming a doctor. One who pays off student debt quickly will have real savings by age 50.

**How Much Debt is Appropriate?**

**Auto**

An example involves two dentists, Dr. I.B. Smart and Dr. Wanda Beemer, who became financially prudent at slightly different ages. The first dentist, Dr. Smart, from age 30 until age 65, always paid cash for a two-year-old moderately priced, yet nice vehicle, such as a Toyota Highlander, and replaced every four years. The second dentist, Dr. Beemer, did the same, except for one slight difference. She splurged at age 30 and took out a four-year loan for a new BMW 7 series. Four years later, she became enlightened to the high depreciation inherent in a luxury auto and prudently bought two-year-old Highlander-type vehicles for the remaining 31 years of her career.

That one-time purchase created a difference in savings of $35,480 for those four years between our two dentists that compounded to $309,000 (in age 30 dollars) by age 65, or the equivalent of $14,000/year for life! After all fees and taxes, the average sale amount of a dental practice is near $300,000. In other words, an expensive capital purchase early in one’s career can have an effect as powerful as the sale of a dental practice.

A dentist will spend vast amounts of potential retirement savings taking out loans or leasing new autos frequently. Start a good habit. Always pay cash.

*Consumer Reports* repeatedly states that the worst way to buy a car is via lease with its hidden fees. Second worst is dealer financing. The best way to buy is cash.

**Practice Loan**

Brian Hufford, CPA, CFP of Hufford Financial, provides guidance with his Financial Balance Guide. From a dentist’s net income, Hufford indicates that one should designate 25 percent to personal living expenses; 25 percent to all loans, personal and business; 20 percent to savings; 25 percent to taxes; and five percent to large personal or practice purchases.2

For a young dentist, age 35, with a $180,000 income, total annual loan payments should be no more than $45,000. Two auto loans at $1,250 per month eats up $15,000. A student loan of $2,500 per month ends the process. No practice or home loan is possible. Kill that student loan early, docs!

For a young dentist with no student loan or auto debt and an expected net income of $180,000, a 10-year $300,000 practice loan at a rate of seven percent would have $3,500 monthly payments with a total yearly loan burden of $42,000. That’s within Hufford’s guidelines. Yet, there isn’t enough left for a home loan yet.

Please be careful to take out a reasonable practice loan, with plenty of wiggle-room in your personal and practice budget in case your practice production falls short of projections.

**Mortgage**

Charles Farrell, JD, LLM, in *Your Money Ratios: 8 Simple Tools for Financial Security*, points out that the maximum amount of mortgage debt should never be more than twice your net family income. By age 50 it should be down to 1.5 times income to retire by age 65. By age 65 it should be completely paid off.3 Below are ratios for different ages.

Therefore, our 35-year-old dentist making $180,000 per year should not have a mortgage of more than $360,000. And that’s contingent on Hufford’s total loan amount, including any practice loan or auto loans, of 25 percent of $180,000, or $45,000. Not easy, is it?!

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Take out a 15-year mortgage. The monthly interest isn’t that much more than a 30-year loan and will provide additional savings in your 50s.

Farrell also makes it clear that your primary residence value increases only at the rate of inflation over many years. You will not be able to fund your retirement via your personal residence. And the more mortgage you have, the less you’ll have for retirement. Never buy more home than you need.

It’s great to look successful, yet real wealth is measured by your Vanguard account, not the size of your kitchen, master bath accessories, or the money you owe to Bank of America.

**Carlsen Debt Recommendations**

- Read *The Total Money Makeover* by Dave Ramsey.
- Pay off student loans as quickly as possible and before taking out any other loan. This means always paying cash for autos. That BMW X6 M is a wonder, yet pay cash.
- Set up an emergency fund.
- Take out a practice loan, if applicable.
- Take out a home mortgage. The home mortgage always comes last and should be for 15 years.

Why have I spent over half the article beating you guys up on debt? Debt is the main block to savings and real wealth. If you have nothing to save, investing is not important. And there are many dentists, age 50, with little savings.

**Savings**

**Emergency Fund**

This is funded after paying off student loans and before taking out a mortgage. It may be funded along with a practice loan. Remember the mortgage always comes last.

Have the emergency fund in liquid form (money market account) of at least six months of your expenses. For the young doctor, this is normally $25,000-plus. Why? I personally know three doctors, who suffered a ski injury, a stroke and cancer, which caused three to six months of disability. Disability policies paid little and they lost a huge chunk of income to medical co-pays and loss of work.

This is not an “emergency-trip-to-the-Caribbean fund” or “I-really-need-a-new-golf-membership” fund. It’s strictly for medical and family emergencies.

**Retirement Savings**

How much is appropriate?

Those who I’ve worked with that have saved 20 percent consistently, have no trouble retiring between age 55 and 58. But 20 percent is very difficult for many of us!

For an article titled, “Only Four Percent of Dentists Able to Retire at 65? Nonsense,” I used Monte Carlo software to analyze savings scenarios for a hypothetical doctor. Savings would be held in index funds with a 50/50 mix of stocks to bonds at a discount brokerage such as Vanguard with passive, buy-and-hold investing.

A typical dental couple needs around $140,000 per year in retirement to keep his or her lifestyle intact. This is less than the working incomes listed, yet lack of mortgage, savings and decreased taxes lower the income needed substantially in the non-working years.

From the article:

Let’s next look at a young dentist, Dr. Anita Know, age 30, with an income that starts at $125,000, increasing to $170,000 at age 40, $230,000 at age 50, and $310,000 at age 60. These are fairly normal averages for dentists (four percent real increase per year).

If she saves 10 percent per year starting at age 30, she will be able to retire with $140,000 income at age 63 using a 50/50 stock-bond portfolio throughout her career.

Saving 15 percent per year will provide retirement at age 60.

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4. Ibid. page 85.
Saving 20 percent will provide retirement at age 57.

If Dr. Know waits to start saving until age 35 at 10 percent per year, she will be able to retire at age 65.

If Dr. Know doesn’t start saving until age 45 with 10 percent per year, she will be able to retire at age 69. If she wishes to retire at age 63, though, she will have to save 21 percent per year.

If using active management investment strategy, add one to two years to retirement ages above (see Swedroe comments); if using a traditional broker or insurance agent, add another two years due to high fees/commissions.

The bottom line is to make a commitment, as soon as student loans are paid off, to save at a rate of 15 percent per year and you’ll never look back.

As far as savings for children’s education, it takes second place to saving for retirement and there isn’t space for coverage of the topic in this article.

Where Does One Invest?

I need to be blunt. You need to read two books before funding retirement savings.

*The Elements of Investing* by Burton Malkiel and Charles Ellis

*The Only Guide to A Winning Investment Strategy You’ll Ever Need* by Larry Swedroe.

This is paramount before choosing where to invest.

Excerpts from Swedroe’s book on active management (timing the market by buying and selling individual stocks and/or mutual funds):

*Fortunately, there is a sure way to win the loser’s game of active management. Don’t play! Rather than attempt to time the market or pick individual stocks, it is more productive to invest and stay invested. Warren Buffet said: “We continue to make more money when snoring than when active.” Mr. Buffet also said: “Most investors, both institutional and individual, will find that the best way to own common stocks is through an index fund that charges minimal fees. Those following this path are sure to beat the net results delivered by the great majority of investment professionals”*.6

*We have seen that the average actively managed fund underperforms its benchmark by close to two percent per annum… With the availability of tax-managed funds, which improve on the tax efficiency of index and passive asset-class funds, we can now raise our underperformance estimate to perhaps as much a three percent per annum.*7

My comments: A three percent annual loss of capital over a working career of 30 years means a loss of about 60 percent of one’s total portfolio. $2.5 million in savings invested with a buy-and-hold strategy would be reduced to $1.4 million if managed actively.

Please don’t fall for the hype. Of all investment firms I talk to, 98 percent of them use only active management, as if it’s better. It’s worse docs; normally much worse.

- Owning individual stocks and sector funds is speculating, not investing.
- Never work with a commission-based advisor (stock broker or insurance agent) – there is a misalignment of interests.
- Before acting on seemingly valuable information, ask yourself why you believe that information is not already incorporated into prices.8

Where does one go for financial advice besides the above-mentioned books?

**Podcasts**

“Sound Investing” provides clear, concise advice on money and retirement, and includes interviews with the most influential people in the money business including Vanguard’s Jack Bogle, Kiplinger’s Knight Kiplinger, and Money Magazine’s Jason Zweig.

7. Ibid., page 242.
8. Ibid., page 256.
“Man vs. Debt” provides wonderful commentary on the perils of debt and how to escape its ugly clutches.

The Web

Fund Advice (www.fundadvice.com) provides free model portfolios for Vanguard, Schwab, T. Rowe Price and Fidelity investors.

Lazy Portfolios (www.marketwatch.com/lazyportfolio) provides even simpler portfolios that beat the street easily in the last decade.

Financial Adviser?

It often makes sense for one who doesn’t want to take the time to invest on one’s own to hire an adviser, yet be aware that the airwaves are full of sharks. Your best bet is to work with a Certified Financial Planner or a CPA with a Personal Financial Specialist certificate.

For dentists specifically, Thomas Wiring Doll at 877-939-2500 has a bevy of planners who offer ethical advice with reasonable fees.

Discount brokerages offer the lowest cost financial advice. Examples are Vanguard, Schwab and Fidelity.

Can one invest effectively on one’s own? It’s fairly simple. The easiest way is to use a target retirement fund from a discount broker. There is virtually no work, your portfolio is diversified, it’s automatically rebalanced periodically and the fees are low.

An even lower cost is to devise your own portfolio from Fund Advice or Lazy Portfolios listed above and rebalance on your own once a year.

Please, don’t fall for anyone who promises to beat the market. Academically, almost all trail their benchmark indices by a wide margin.

Dark Pits of Financial Depravity

Insurance Companies: Please steer clear of any insurance product touted as an investment. Annuity is normally a moniker for “sucker.” There are valid reasons for annuities, but only in retirement. The fees are hidden and atrocious.

HELOCs (Home Equity Line of Credit): These were really fun for many during the housing boom. It was like free money for new kitchens, cruises, Cerecs, and paying off credit cards. Yet many lost their homes because of HELOCs they couldn’t afford in later years.

Free Seminars with Meals Attached: Content, beef-fed dentists are favorite prey for annuity, commodity partnership and time-share salesmen. Be sure to get a second opinion from a neutral third party before “investing” in something presented with any freebee.

Day Trading: Jim Cramer and his gang may be fun to watch on CNBC, yet any type of market timing is anathema to your savings. And it looks so easy! Yet there are countless illustrations of PhD mathematicians and engineers diving headfirst into trading, followed quickly by an unremitting plunge due to the competition of institutions’ algorithmic computer programs. It’s a no-win game, docs.

Vacation Timeshares: The maintenance, special assessments and taxes are normally higher than the rental rate at the same resort. And dare I mention depreciation? It’s higher in the first year than purchase of a luxury auto. Yes, I know that you can trade for other resorts whenever you like. Yet, I’ll normally find a better price through AAA or Kayak for the Grand Hyatt next to your condo without the trading hassle.

You are entering a very honored profession. There is little taught in school of practice management or personal finance. Please keep this article in a special place to refer to in the years ahead. I’m always available at the listed e-mail in my bio.