49 Retirement Planning

Kamilah Halmon

Introduction

As a brand new attending, I suspect retirement and financial planning are the last thing on your mind, but ensuring a healthy financial position both during your career and during retirement should be at the forefront of the professional and personal decisions you make, starting with your first post-residency job. The bad news is that by the time most physicians can start saving for retirement, they are already behind. Your friends that immediately started working after college not only were able to vacation, eat out, and generally have a blast while you were stuck in the hospital, but they were also able to get an almost 10-year head start on saving for retirement. The good news is that by starting early and developing a comprehensive plan, you can spend the next 30 years working in a field you love while strategically planning for a worry-free retirement. A survey of over 8000 pediatricians showed that 27% of them would retire if it was affordable. My goal is that you will have the tools you need so that your retirement will not be dictated by your finances.

K. Halmon (✉)
Inova Children's Hospital, Falls Church, VA, USA
e-mail: kamilah.halmon@inova.org

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Pay Yourself First

Now that you are making significantly more money than you made as a resident, it can be easy to fall into the slippery slope of lifestyle creep where your discretionary spending increases exponentially as your income grows. The easiest way to avoid lifestyle creep is to automate paying yourself first so that income is first saved or invested before discretionary spending can occur. When starting your new position, meet with HR or the office manager and automate your direct deposits so that savings are directly sent from your paycheck to a savings account or an investment account. It is impossible to spend what is not there, so by not having the money deposited into your primary banking account, you minimize the temptation to spend that money. Automating paying yourself first also reduces the likelihood that you will skip a month or two of savings which can add up to a significant amount over the course of a career.

Build an Emergency Fund

We have established that you are going to pay yourself first, but where should that money go? One of the first places that money should go for a brand-new attending is into an emergency fund. An emergency fund is a stash of money which can be used to cover unexpected expenses such as job loss, medical expenses, and car or home expenses. Traditionally, physicians' careers are stable, and unexpected job loss is rare, but 2020 has shown us that even our jobs and compensation can be impacted by unforeseen events. Therefore, funding an emergency fund with 3–12 months of living expenses should be one of the top priorities for a new attending. The amount one keeps in an emergency fund is entirely dependent on your financial circumstances. If you do not have children or a home and would not mind doing locum tenens work if an unexpected job loss occurs, a shorter emergency fund is entirely appropriate. However, if you have significant financial responsibilities, a longer emergency fund is protection against accruing surprise debt.

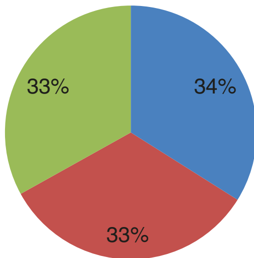
A good place to keep the money in an emergency fund is in a high-yield savings account (HYSA). HYSAs are primarily online banking accounts that are FDIC insured up to $250,000. They are able to offer a higher annual percentage yield (APY) than traditional brick and mortar banks because they do not have to pay for the overhead of a physical location. In 2020, the average APY for traditional savings accounts was 0.09% vs 1% for HYSAs. The APY will vary depending on many factors, primarily the Federal Reserve, so it is important to explore your options and pick the HYSA with the highest APY at the time of account opening. Bank rate offers a monthly update of the highest APYs of commercially available HYSA.

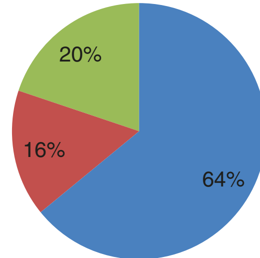
A Few Things I Did Not Learn in Medical School

We learn a lot of information over the course of our medical education, but retirement planning is not a frequently covered topic. Thousands of books have been written on investing, so this is by no means meant to be a comprehensive review. Instead, we will touch on basic concepts to help you get started on your investment journey.

1. Diversification: Diversification is a risk management strategy that involves limiting your portfolio risk by investing in a wide variety of asset classes across both domestic and foreign markets. The easiest way to diversify your portfolio at this early stage of your career is to invest in index funds. Index funds are a type of mutual fund or exchange traded fund (ETF) which track the components of a financial market such as the Standard and Poor's 500 Index. Index funds have lower costs than actively managed funds and less risks than if you were to cherry pick stocks, bonds, and other assets to buy. I recommend Vanguard's index funds which have the lowest expense ratios and consistently meet or outperform the market.
2. Asset Allocation: Thanks for agreeing not to channel your inner Warren Buffet and pick and choose individual stocks to buy. So let's chat about how to divvy up the different index

funds which should comprise your portfolio. I am a fan of the "Three Fund Portfolio" method which keeps investing simple especially when you are just getting started. The Three Fund Portfolio consists of a domestic total market index fund, an international total market index fund, and a bond total market index fund. Sticking with Vanguard index funds, below are two examples of ways one can construct a Three Fund Portfolio. I recommend starting off aggressively with the 80/20 portfolio.





1. Time in the Market: Time invested in the stock market is more important than trying to time the market. Do not wait for the stock market to hit a low point in its natural cycle to start investing for retirement.

Retirement Tools: 401ks, IRAs, Roth IRAs, and Backdoor Roth IRAs

A 401k is an employer-sponsored, tax-advantaged retirement account. As an employee, you can contribute a percentage of your salary up to the annual limit set forth by the IRS ($19,500 in 2020). This limit does not include your employer's contributions.

401k investments come directly from your paycheck, so you will not be taxed on it until it is withdrawn in retirement. Approximately 50% of employers offer matching contributions to the employees contributions. Most will match 50 cents for every dollar the employee contributes up to a predetermined limit. Fidelity Investments, The Vanguard Group, and Schwab are a few of the financial services advisory groups that service 401ks. When onboarding at your new job, take the following steps to set up your 401k:

1. Determine which financial services group will be servicing your 401k and set up online access so that you can directly manage your account.
2. Calculate what percentage of your paycheck should be distributed to your 401k so that by the end of the year, you max out the IRS limits for the year. Maxing out to the IRS limits will help you catch up on the years during residency you were not able to save for retirement and ensure you will receive the full employer match.
3. Review the investment options in your 401k paying close attention to the expense ratios for each option and pick funds with the lowest fees, ideally less than 1%. Picking a fund with an expense ratio of 0.1% vs one with an expense ratio of 1% can mean thousands of dollars in savings over time.
4. Determine if your employer has a vesting requirement. Some plans require employees to work a certain number of years before they are fully vested and can receive the full amount the employer has contributed to the retirement plan.

Many employers will choose default investment options for you oftentimes into a target date fund that automatically rebalances the closer you get to retirement age. This can be an easy and convenient option, but the fees associated with these funds can lead you to overpay for their convenience. Take the time to explore the options in your employer's plan and choose what works best for you. Most importantly, once the money is in your 401k, *leave it there!* Withdrawal from a 401k before the age of 59 ½ will trigger a 10% tax penalty and immediate payment of income taxes.

An individualized retirement account (IRA) is a tax-advantaged retirement account that investors can use to augment the retirement accounts provided by their employers. Hundreds of financial institutions offer IRAs so it is important to shop around and find the ones with the lowest costs. There are several types of IRAs, but we will focus on the two most common types here: the traditional IRA and the Roth IRA. Both IRAs have the same contribution amount, $6000 for 2020, set by the IRS on a yearly basis. The main difference between the two IRAs is how they are taxed.

Traditional IRAs are tax-deferred retirement accounts similar to 401ks in that individuals can invest pre-tax money to a retirement account where the money grows tax deferred until withdrawal during retirement. The withdrawals are then taxed at your current income rate during retirement. Traditional IRAs can be tax deductible, but if you also contribute to an employer-sponsored retirement plan, the amount you can deduct will be dependent on your modified adjusted gross income. Although pediatrics is not one of the highly compensated specialties, most pediatricians will still make too much money to take advantage of the tax deduction.

Roth IRAs differ from traditional IRAs in that the contributions are made from after tax dollars, so all investments grow without any taxes on the gains and when you retire, you can withdraw from a Roth IRA without incurring any income tax. Most physicians will be in a higher tax bracket at retirement than early in their career, so investing in Roth IRAs is a great way to minimize your tax bill in retirement. I know you are probably wondering, “why doesn’t everyone just contribute to a Roth IRA? They sound too good to be true.” Well, the answer is because the IRS has income limits above which you cannot contribute to a Roth IRA. Make sure in the first year post residency, you fully fund a Roth IRA. When your income exceeds the limits to contribute to a Roth IRA, you can still fund one via an entity known as the “Backdoor Roth” during which you fund a traditional IRA and then immediately convert it to a Roth IRA. Backdoor Roth IRAs are more complicated than the intended scope of this chapter so instead of going too far in the weeds, I recommend you read more on the topic and keep it in the back of your mind as an option.

This is, by no means, an exhaustive review of all of the financial tools at your fingertips when it comes to financial planning and retirement. There are health savings accounts, taxable accounts, and SEP IRAs to name a few which can serve as other ways to prepare for retirement. I will frequently give medical students and residents the feedback to continue to read to expand their knowledge base. I hope this chapter gave you a foundation upon which you can continue to read, grow, and have both a successful professional career and a successful, stress free retirement.

Suggested Reading

Dahle JM. The white coat investor: a doctor's guide to personal finance and investing. White Coat Investor LLC; 2014.

Doroghazi R. The physician's guide to investing: a practical approach to building wealth. Humana; 2007.