The Physician's Guide to Investing

The Physician's Guide to Investing

A Practical Approach to Building Wealth

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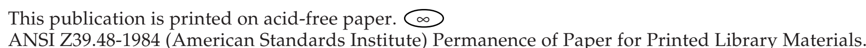

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Dedication

To my wife Susan, a spectacular lady.

Consulting Editor's Preface

I met Bob Doroghazi when he dropped the first draft of his manuscript of *The Physician's Guide to Investing: A Practical Approach to Building Wealth* at my office. I will have to admit I was a bit skeptical: a physician writing a book on investments? During that first meeting with Bob, it became evident that he had been a successful physician and a successful investor, so I agreed to take a look at the book. I was in for a pleasant surprise. Bob's manuscript was easy to read and had specific advice useful to physicians, interspersed with lots of practical tidbits for any investor.

Having written three college-level finance and investment texts, I was excited to be in on a project aimed at offering practical investment advice to a more general, yet specialized, audience. I had high expectations for the book and am pleased to say that I believe Bob has delivered a book that every physician interested in building wealth and protecting assets should read.

Bob is a straight shooter; he tells it like he sees it in his book. Some doctors might be indignant on reading his statements, such as "Physicians sometimes have no idea of their limitations. This type of arrogance and ego can result in investing disaster." However, if you do have these limitations (and most professionals, even college professors, do), then reading Bob's book will help you recognize situations in which they can lead to poor investment decisions. Bob's advice will help you deal with limitations and point you in the right direction for investing success.

Many of Bob's ideas are in good company and espoused by some of today's most successful investment professionals, such as Peter Lynch and Warren Buffett. Bob does not claim to have discovered these ideas, but he does contribute his own spin and anecdotes for each one. Some of my favorite topics in *The Physician's Guide to Investing: A Practical Approach to Building Wealth* are:

- Don't be the mark.
- Invest in what you know.
- Tips: real opportunities or useless information.
- How to identify real investment opportunities.

In "Investment Strategies of the Pros," Bob discusses some of the traits of three successful professional investors: Peter Lynch, Warren Buffett, and Burton Malkiel. Each have their own special methods. I read Malkiel's *A Random Walk Down Wall Street* when the first edition came out in 1973 as a beginning graduate student. I still have that old copy with its yellow dust cover sitting on my shelf. Next to it are a series of revisions, the latest being 2003. I suggested to Bob that he read and include ideas from Malkiel in his book. To

my delight, Bob liked what he read and dedicates a section to some of Malkiel's methods.

The Physician's Guide to Investing: A Practical Approach to Building Wealth is a goldmine of practical advice that anyone can use. Read through the book, pick out what you like, and incorporate those ideas into your own personalized investment strategy. I recognize many successful strategies that I use in my own investments. And yes, I do mow my own lawn.

Dan W. French, *PhD*

Introduction

Physicians are extremely intelligent, hard-working, highly motivated, dedicated, exquisitely trained, and honest, yet they are often poor investors. Even more alarming is the propensity of some physicians to fall prey to investment schemes that can result in a lifetime of debt or even bankruptcy. Why does this occur, and more importantly, what can be done to prevent it?

This book is a commonsense guide to investing, with special emphasis on areas where physicians (and other high-income professionals, such as athletes, artists, performers, and airline pilots) experience difficulty. Considerable time is spent in an effort to generate a sense of healthy skepticism. A good deal of the training of a physician involves trust. We are taught to implicitly trust what our patients and our colleagues tell us. This training is correct. Only by trusting can we create in our patients the trust that they must have in us to act as their advocate, to do what is best for them. In the business and legal world, such unquestioning blind trust is a formula for disaster.

U.S. medical schools produce the best physicians in the world. Yet no time is spent instructing these superbly trained physicians on how to invest the hard-earned fruits of their labor. This is a deficiency of the medical establishment in our country.

I begin by defining goals. What is a reasonable rate of return to anticipate on an investment? What promised rate of return on investment should immediately cause alarm? How do you recognize the real opportunities that do arise from time to time?

Another reason physicians are often poor investors is that the knowledge and confidence in one's abilities that makes an excellent physician can make a terrible investor. Why? Because physicians often feel this tremendous knowledge of medicine (usually a very narrow area of medicine) applies to everything. This feeling of invincibility leads to arrogance, which results in mistakes. Physicians often do not recognize or admit their limitations.

The remainder of *The Physician's Guide to Investing: A Practical Approach to Building Wealth* covers most of the general aspects of investing and financial planning, with the ultimate long-term goal of attaining financial security. There are suggestions regarding your home and the importance of paying the mortgage off early, the magnificence of compound interest, the power of thrift, when to buy an asset and when to sell, and whether you should invest in stocks, bonds, real estate, collectibles, or art. Invest in what you know.

The importance of financial planning is reviewed. Setting financial goals and drawing up appropriate documents, saving for the children's education

and your retirement, what type and how much insurance should be purchased, and the importance of minimizing fees are also addressed.

This book is not an exhaustive tome or discourse on investing. Although I have certainly experienced my share of investment failures, I have been successful enough in my personal financial management and investing to have paid my own way through college and medical school, to own my home and vacation condominium free of debt, to have my children's education funded, and to have accumulated sufficient assets so that I will be able to retire at age 54.

This book is not an academic work. It is adequately, but not heavily, referenced. To the contrary, it is meant to be practical and can be easily read in a weekend or on a long trip or plane flight. I would also suggest that spouses read this book.

With few exceptions, this book does not discuss the financial or economic aspects of a physician's practice. This book has nothing to do with the physician as an entrepreneur. Rather, this work is devoted to all aspects of a physician's personal finances and investments.

Physicians make a considerable amount of money. Taking care of sick patients on days, nights, weekends, and holidays is stressful, very hard work. This book provides simple practical advice on how a physician can invest their hard-earned money for a lifetime of financial security.

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I On Track With Your Financial Goals

Chapter One
Goals for Your Investment Return

I believe that any discussion should begin by defining goals. It is difficult to achieve what you want without having a well-defined goal. Expectations are important. Certainly with something as important as personal finances, one should define their goals and outline precisely how they plan to achieve them. I will thus start by defining what I believe are reasonable investment goals. Subsequent chapters will detail how to achieve these goals.

This chapter has three sections. The first outlines an appropriate minimum return that can be anticipated from investments. The second section details returns that are attainable, but only with hard work and effort. The last section describes returns on investments that are unrealistic, and when promised, should immediately cause concern and alarm. The latter is especially important because it will allow you to quickly recognize the army of promoters and sometimes just plain crooks whose only desire is to separate a physician from their hard-earned money.

YOUR MINIMUM INVESTMENT GOAL

Over the long term, physician investors should anticipate a 10% annual return on investments. Some years this will be greater, some years less, and some years there will even be losses. But over the course of your investing lifetime, actually, your investing lifetime is your entire lifetime, your goal should be a 10% annual return on non-cash investments.

Note I emphasize non-cash. There must always be sufficient cash to cover unexpected needs (more on the importance of cash and cash flow later), debt service, and to take advantage of opportunities. It is the person with cash in hand who can scoop up assets when they are cheap. But the price of cash is that its long-term return is inferior to other investments such as stocks or real estate. In general though, it is preferable to have a little more rather than not quite enough cash.

Ten percent is a round number but I did not choose it at random. Over the course of the twentieth century, stocks in the United States returned an average of just under 10% annually. Slightly more than half of the return, almost 5%, was due to capital appreciation, a number essentially identical to the general growth of corporate profits over this time period.

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Slightly less than half of this return, approximately 4.5%, was from the payout of dividends. However, when inflation is factored in, which decrease the contribution of capital appreciation, the average annual total return from stocks was approximately 7%. Thus dividends actually represented almost two-thirds of the wealth generated by corporations in the United States in the last century. I do not know how any other statistic can better emphasize the importance of dividends. During the stock market bubble of the later half of the last decade it was thought that capital appreciation was all-important and dividends were of no consequence and superfluous. There was a new game in town, we were operating under new rules, a "new paradigm," old rules no longer applied. In the end, old rules always apply, that is why they are old rules. The old rule is that dividends are very important and they count a great deal.

Why are dividends important? Dividends are cash in your pocket, to do with as you see fit. Cash from dividends can pay utility bills, the mortgage, your children's education bills and all the other expenses of daily living. Another reason that dividends matter is that investors believe that the payment of cash dividends is a reflection of a company's financial health. Investors treat a cut in the dividend as negative news about a company's future prospects, such that management will commit to increased dividends only when they are truly confident about their ability to maintain those dividends in the future. Financial analysts call this the "signaling theory of dividends." Simply stated, dividends are a signal about the future prospects for the company. Stable, and especially increasing dividends, are a general indicator of the financial health of a company.

Eventually a company must pay a dividend. If the price of a company's stock increases, but they do not pay a dividend, the only way to recognize this increase in value is to sell the stock. If the company continues not to pay a dividend, the only way the buyer can have cash to pay their daily bills is to sell the stock to someone else, and so on. Early in a company's history, their rapid growth phase, they may retain earnings for expansion, but at some time a dividend must be paid.

Stock prices may fluctuate markedly because of a change in the price-to-earnings (P/E) ratio. Investors are willing to pay more, or less, for what they anticipate will be a stock's price in the future. In the short term variations in P/E ratio are mostly expectations-driven and show a relatively poor correlation with an increase or decrease in corporate earnings. But over the long term, over the course of one's investing lifetime, this variation in price to earnings ratio essentially disappears. In the end, what is left is the true value of the company—as represented by improved earnings—and the dividends that have been paid.

Thus a reasonable long-term goal is an average of ten percent annual rate of return on investments. Considering the average physician's income all that is required to live comfortably and retire when you wish is a little fiscal discipline and the avoidance of stupid mistakes, which is one of the principle points of emphasis of this book. Financial security is important.

A REASONABLE INVESTMENT GOAL

With some work, a little common sense, and knowledge of where mistakes can arise, a 15% annual return on investments may be realized.

I chose 15% for two reasons. The first is that it is attainable. The second reason is that money will double in five years, due to the assistance of your greatest investment friend—compound interest (*see* Chapter Two).

Note this:

Year One $100 × 15% = $115
Year Two $115 × 15% = $132
Year Three $132 × 15% = $152
Year Four $152 × 15% = $174
Year Five $174 × 15% = $201

A little work, compound interest and patience can result in financial security.

A simple way to determine how quickly money doubles is the rule of 72. Divide the rate of return into 72. Money growing at 10% per year doubles in 7.2 years. In the example above, money growing at 15% per year doubles in just under 5 years.

Before concluding this section, I must emphasize that investing is a three-step process.

1. Earn money
2. Do not spend all of the money (for some people this is problematic)
3. Invest the money

For example, one physician saves $10,000 and hits an investment grand slam, realizing a 25% return resulting in $12,500 at the end of the year. Another physician is more thrifty, saves $15,000, and realizes the standard 10% return. At the end of the year this is $16,500. It is virtually impossible for great investing to overcome poor saving habits. The best way to accumulate wealth and attain financial security is consistently save money on a regular basis and invest it wisely. Peter Lynch's says that the number one principle of finance is that savings equals investment. **The best investors are the best savers.**

AN UNREASONABLE INVESTMENT GOAL

Warren Buffett, to my knowledge, has the greatest investment record of the post-World War II era. He has been able to realize almost a 30% annual compound return on his investments. He is a genius, the greatest investor of our time. George Soros (hedge fund director) and Peter Lynch (supervised Fidelity Magellan for many years) were able to generate annual returns nearly as great. They are in the Hall-of-Fame of investing. (*See* Chapter Thirty-Two for an in-depth analysis of the investment styles of Buffett and Lynch and Burton Malkiel).

I am sure there are other investors and groups that have generated similar returns of whom I am not aware, but they are literally one in a million. Of importance as it relates to this discussion is that such people will have bona-fide, verifiable results with reputations and references to match. If you should be lucky enough to find one of these truly gifted legitimate investment wizards, just hitch your star to theirs and hang on for the ride.

The point of this section is that if anyone comes to you saying they will make, almost guarantee, a 25 to 30% or more annual return on an investment, but they do not have a track record to prove it, just tell them to forget it. It is as pure and simple as that. They could conceivably be the next Warren Buffett or George Soros or Peter Lynch (possible,

but literally one in a million), but more likely they are bogus and just wish to relieve you of your money.

Here is the essence of what I feel are the difficulties that physicians experience with investing, and which I will detail in the remainder of this book. Physicians do not wish to be left out. They feel their great intellectual gifts, qualities that can result in being the greatest neurosurgeon, cardiologist, or oncologist in the world, automatically apply to areas outside of medicine. The ability to save a life does not necessarily imply the same ability to evaluate a real estate investment or read a financial statement or evaluate the potential of a natural gas property in Wyoming. It just does not.

No one was blessed with greater intellectual gifts than Sir Isaac Newton. In 1687, he published *Principia (Mathematical Principles of Natural Philosophy)* which outlined the basic laws of gravity. Newton developed the calculus (credit also goes to Gottfried Wilhelm von Leibniz for his simultaneous and independent work on the calculus) to provide the mathematical quantification of his theories. Yet Newton lost a great deal of money on the South Sea Company, one of history's most classic investment manias. Newton said "I can calculate the motions of heavenly bodies, but not the madness of people."

Do not worry about being left out. Chances are a million to one that anyone, especially someone you do not know, or have never heard of, who has no previous verifiable results, who tells you, who assures you, who guarantees you a 30% return on your investment, will not. Just forget them. Instruct them to leave and not to come back.

SUMMARY OF CHAPTER ONE

• Reasonable anticipated long-term return on investments	10%
• Return attainable with work and common sense	15%
• Promised, but unattainable, return that should cause alarm	30%

- Dividends are important
- Beware of the "new paradigm." Old rules are important
- The best investors are the best savers.
- Being a physician does not make you smart at everything.

Chapter Two
The Magnificence of Compound Interest

Einstein referred to compound interest as the Eighth Wonder of the World (*see* Table 1 for a list and *see* the first reference at the end of the chapter for an interesting discussion of the Seven Wonders of the Ancient World). How did this scientist, from all of my reading, a somewhat absent-minded individual with no particular investment prowess, come to make this comment, which merits the second chapter in this book and a detailed discussion?

Just examine Einstein's most famous field equation: $E = mc^2$. A tiny amount of mass compounded, compounded, and compounded, again and again and again, results in an unbelievable amount of energy.

A person was once challenged to come up with a saying that applied to everything. The result was "this too shall pass." Why does this comment apply to all situations? Because it describes an absolutely inevitable event—the passage of time.

The economy changes, tax rates increase or decrease, the party in control of the White House or Congress changes, the stock market goes up or down, but the passage of time and compound interest are absolutely inevitable. Compound interest is the physician investor's greatest most powerful tool, their best friend. Compound interest has the same potential power to generate wealth as Einstein's equation does to generate energy. The only requirements are money to invest and patience. Consider this equation:

$$\$ \times \text{CI (compound interest)} = \$\$\$\$\$\$\$\$\$\$\$\$\$\$\$$$

Unfortunately, for one in debt, compound interest possesses the same power to the detriment of the borrower. A home mortgage is compound interest in reverse, and a homebuyer with a 30-year mortgage pays several times the price for the home over the life of the mortgage (*see* Chapter Thirteen).

Examine Table 2 from the book by A. Gary Shilling entitled *Deflation*. Shilling notes that the table is borrowed from Richard Russell of the Dow Theory Newsletter (much more on Richard Russell later).

Each investor puts aside $2,000 per year, compound at the standard anticipated rate of return of 10%. All interest and dividends are reinvested, and thus recompounded. Investor B puts aside $2,000 a year for 7 years, from age 19 through 25, and then stops. He never invests another penny (this is just an example, you should never stop investing). Investor A starts at age 26 and invests $2,000 per year for the next 40 years. Look who wins. Absolutely amazing. Einstein was right.

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Table 1
The Seven Wonders of the Ancient World

The Pyramids of Giza
The Pharos (Lighthouse) of Alexandria
The Temple of Artemis in Ephesus
The Mausoleum at Halicarnassus
The Colossus of Rhodes
The Hanging Gardens of Babylon
The Status of Zeus at Olympia

Table 2
The Power of Compound Interest

Age	Investor A Contribution	Year-end Value	Investor B Contribution	Year-end Value
1–18	$0	$0	$0	$0
19	$0	$0	$2,000	$2,000
20	$0	$0	$2,000	$4,620
21	$0	$0	$2,000	$7,282
22	$0	$0	$2,000	$10,210
23	$0	$0	$2,000	$13,431
24	$0	$0	$2,000	$16,974
25	$0	$0	$2,000	$20,872
26	$2,000	$2,200	$0	$22,959
27	$2,000	$4,620	$0	$25,255
28	$2,000	$7,282	$0	$27,780
29	$2,000	$10,210	$0	$30,558
30	$2,000	$13,431	$0	$33,614
31	$2,000	$16,974	$0	$36,976
32	$2,000	$20,872	$0	$40,673
33	$2,000	$25,159	$0	$44,741
34	$2,000	$29,875	$0	$49,215
35	$2,000	$35,062	$0	$54,136
36	$2,000	$40,769	$0	$59,550
37	$2,000	$47,045	$0	$65,505
38	$2,000	$53,950	$0	$72,055
39	$2,000	$61,545	$0	$79,261
40	$2,000	$69,899	$0	$87,187
41	$2,000	$79,089	$0	$95,905
42	$2,000	$89,198	$0	$105,496
43	$2,000	$100,318	$0	$116,045
44	$2,000	$112,550	$0	$127,650
45	$2,000	$126,005	$0	$140,415
46	$2,000	$140,805	$0	$154,456
47	$2,000	$157,086	$0	$169,902
48	$2,000	$174,995	$0	$186,892
49	$2,000	$157,086 *(sic)*	$0	$169,902 *(sic)*

(continued)

Table 2 *(Continued)*

Age	Investor A Contribution	Year-end Value	Investor B Contribution	Year-end Value
50	$2,000	$216,364	$0	$226,140
51	$2,000	$240,200	$0	$248,754
52	$2,000	$266,420	$0	$273,629
53	$2,000	$295,262	$0	$300,992
54	$2,000	$326,988	$0	$331,091
55	$2,000	$361,887	$0	$364,200
56	$2,000	$400,276	$0	$400,620
57	$2,000	$442,503	$0	$440,682
58	$2,000	$488,953	$0	$484,750
59	$2,000	$540,049	$0	$533,225
60	$2,000	$596,254	$0	$586,548
61	$2,000	$658,079	$0	$645,203
62	$2,000	$726,087	$0	$709,723
63	$2,000	$800,896	$0	$780,695
64	$2,000	$883,185	$0	$858,765
65	$2,000	$973,704	$0	$944,641
Less Total Invested		**($80,000)**		**($14,000)**
Equals Net Earnings		**$893,704**		**$930,641**
Money Grew		**11-fold**		**66-fold**

Reprinted with permission of Richard Russell.

I will give another example of the power of compound interest. Queen Isabella spent $30,000 to finance Columbus. His voyage opened up another world, an amazing investment for humanity. But Warren Buffett suggested that it was a poor investment for Her Majesty. In a letter Buffett wrote at age 32 on "The Joys of Compounding," he suggested that if Queen Isabella had taken the $30,000, invested at 4% compounded annual interest (this is the intrinsic value of money, lent out in a zero inflation environment to a customer who can repay the loan), by the 1960s the Queen's investment would have grown to $2 trillion. Buffett's point is that even (apparently) small amounts of money should be invested with great care because of the amazing potential afforded by compound interest.

The more frequent the compounding of your money the greater the return. For example, on a Certificate of Deposit, the rate of interest may be 4.0%, but because of the quarterly (every 3 months) compounding, the Annual Percentage Rate (APR) is 4.06%. This is the real rate of return. When one is in debt, more frequent compounding has the opposite effect, to the obvious detriment of the borrower.

I have heard physicians make the statement—"you can make investment mistakes when you are young because you can make it up later." This is not correct! In fact, there are several significant problems with this statement.

- It suggests arrogance.
- It presumes that a physician will continue to make a significant amount of money in the future, a possibly faulty assumption.
- It suggests a lack of respect for money, another problem that afflicts some physicians.

- Finally, and most importantly, it ignores the benefits of compounding. It is more financially punishing to make mistakes early as compared to later in life. Profits made and compounded on early successes will more than make up for a bad late-career investment while missed opportunities and bad investment decisions made early in life will NEVER be recovered.

The money will not be made up later. It will never be recouped. Just examine Table 1. You must be more careful, not looser, with money when they are younger. You have less investing experience, and can and will make more mistakes. But as it pertains to this chapter, the younger the investor, the more valuable your money because of the power of compound interest. You must make more than $60 at age 65 for every dollar lost at age 23. Considered from another prospective, the money generated from an hour's work at a minimum wage job at age 23 is more valuable than that generated by a physician working for more than an hour at age 65.

Getting rich quickly sounds neat and glamorous and does occur occasionally. If it happens, consider yourself fortunate. But the desire to get rich quickly is much more likely to result in grief than in the big pay off. The easiest way to accumulate real wealth, your best chance of attaining financial security, is to work hard, save your money, and with the help of compound interest, do it the easy way. Get rich slowly.

SUMMARY OF CHAPTER TWO

- Compound interest is your most valuable investment tool. It is inevitable.
- Even seemingly small amounts of money have amazing potential.
- The younger you are, the more valuable your money.
- Lost money will never be recouped.
- Get rich the easy way. Get rich slowly.

SUGGESTED READING

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II Avoid Being Diverted From Your Financial Goals

Chapter Three
Arrogance, Ego, and Greed

It is impossible to be a successful investor, in fact, to be successful at much of anything in life, without controlling greed. Everyone, whether they are willing to admit it or not, has had quite thorough first-hand experience with greed. Should these comments seem misplaced, try to impartially analyze the greatest failures of your life. There is a good chance that greed was one of the principal culprits.

I make no pretensions that I can adequately discuss greed, nor, unfortunately, as it relates to this discussion, that I have any solutions that would otherwise seem obvious. One conclusion, though, is clear. Inability to control greed will result in financial ruin.

I am sure you feel these comments about greed apply to everyone but you. You are hard working, honest and diligent. You treat your patients with respect. You are a good and loving parent and spouse, an upright member of the community. You have everything that anyone would want, including a great income and the respect of your patients and colleagues. You have rightfully earned all of the success that you now enjoy. Well, Martha Stewart probably felt the same way. Now she has been convicted of multiple felonies and is spending time in jail. And let's be honest. It was due to greed.

Unfortunately, greed can be as subtle as it is powerful. You do not need to commit a crime to experience the financially devastating destructive capacity of greed.

The vast majority of the movie-going public probably feels that George C. Scott's greatest role was "Patton." But as it relates to this discussion, I feel he gave an outstanding performance in the movie "The Flim Flam Man." At the beginning of the movie, Scott, the flim-flam man, tells Michael Sarazin, "Greed's my line. Greed, and 14-karat ignorance. They never let you down...you can't jip an honest man." The flim-flam man is able to succeed because he plays on the greed of the sucker. In the end, the greedier the person, the greater the flim-flam man's chance of success.

I will spend more time discussing arrogance and ego. I admit at the outset that to discuss things such as this, in the manner I do, may appear overly blunt. Discussing the basic failings of humans is always difficult. But I truly believe that the poor investing judgment displayed by some physicians relates to their inability to appreciate the malevolent power of arrogance, ego, and greed.

This book discusses many points that I hope to be of value to most investors, although it is certainly tailored to the physician investor. This chapter, and several others, are directed specifically to physicians, and other professionals such as artists and athletes, who make their living by having a skill or talent that results in a high level of remuneration but that does not necessarily require a high degree of business skill.

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Physicians are extremely bright, in fact, often brilliant. Physicians often graduate at the head of the class. Things just seem to come so easily. They train for many years and eventually acquire a talent to save lives. They can cure cancer, treat heart attacks and save dying infants. They can diagnose an illness they have never seen before and may have read about only once 20 years ago. Doctors can be miracle workers. This ability both requires and creates tremendous self-confidence.

This also can be the problem. Physicians think they are invincible. They think they are faster than a speeding bullet, more powerful than a locomotive and that they can leap tall buildings in a single bound. The reader may recognize this as the introduction to the *Superman* TV series of the 1950s starring George Reeves and Phyllis Coates and later Noel Neill. Physicians often have the (mistaken) assumption that their amazing ability to impact life and death automatically results in the same capacities and abilities outside medicine. It does not!!

There is a fine line between self-confidence and arrogance. Physicians all too often think that just because they are a physician, possibly even the best physician in the world, that this tremendous talent, mental capacity and ability automatically applies to everything else in their life, including investing. Physicians sometimes have no idea of their limitations. This type of arrogance and ego can result in investing disaster.

Let me give an example. An intelligent, prominent physician must have investments and a net worth commensurate with their position and image. In simple terms, a "big shot" doctor should be rich. Ego can and often does trump financial sanity.

A physician will never be the richest person in town. This goal in and of itself suggests arrogance, ego, and greed. In a practical sense, a physician can make only so much money because there are only so many hours in the day. A physician can bill only for services directly performed. I once read that the secret to becoming truly wealthy is to be able to make money while asleep (investments can do this but a physician cannot) and to be able to make money from the labor of others. A businessman with employees can make money from the labors of others, but a physician cannot.

A physician must immediately give up the idea of being the wealthiest person in town, or even rich. How much money is enough? How do you define rich? Being rich should never be your goal. Rather, physicians make enough money that they just need to be wise—and control arrogance, ego, and greed—to be able to live a life of financial security. This should be a physician's goal—financial security.

I believe that more money is lost in the hospital doctor's lounge, or other similar settings where physicians tend to congregate and talk, such as at a party or the country club, than anywhere else. It is in such situations that the emotions of arrogance, ego, and greed overwhelm sanity.

Let me digress for a moment. Please note that I will routinely throughout this book say "he." I admit that I have not spoken with many female physicians regarding their investments. But the ones I have spoken with seem much more levelheaded than their male counterparts. More significantly, I do not believe that I have ever heard a story of a female physician who has done the things that some male physicians have done to lose millions of dollars or declare personal bankruptcy.

There would be no better place for male physicians to begin than by listening to their wives. I would at the same time encourage, actually challenge, wives to become more involved in investing decisions since by co-signing for investments they are equally liable. In essence, a spouse has veto power. Do not be afraid to use it!! A wife must not be intimidated by her brilliant, forceful, but possibly financially inept, physician husband. I would go even further to say there are situations where the man should stick to the practice of medicine and allow his wife to control the purse strings and manage the investments. To my knowledge, no one has ever shown that the gene for financial success resides on the Y chromosome.

To return to the previous thought. A physician who is the epitome of the trained professional believes he must have investments that match his medical prowess. A prominent, brilliant physician must have equally grand investments. How can one brag about a passbook savings account, a money market fund or a Certificate of Deposit? Good Lord what an embarrassment that would be! Or an investment in a Standard and Poor's (S&P) 500 Index mutual fund. Such investments are clearly not adequate for an important, prominent physician.

Only an investment that sounds really cool, exciting, or chic, available only to a few, which returns 25 or 30% a year, or even more, and of course is in some way tax advantaged or even tax-free, is an investment worthy of a prominent physician. It seems that to some people a glamorous investment that does not make money is more desirable than a dull, mundane investment that is profitable.

The above statements may seem ill-advised and intemperant. But they are absolutely true and I feel perfectly characterize the mindset of the physician who most needs to read this book, but almost certainly will not. This chapter is not about logic. It is about the antithesis of logic, about the base emotions of arrogance, ego, and greed, that seem to be at the root of so many of the problems that plague physicians with their investments.

It almost seems that some physicians are attracted to the chic, glamorous investments so that they may boast of them. A year or two later the doctors who were boasting about the glamorous, can't-miss investments are not saying that their entire investment has been lost. Alarmingly, yet distressingly predictable, they are boasting of yet another investment opportunity that is also certain to make 30% or even 50% or more a year. Some people unfortunately never learn. And because of the previous loss, they must "make it up" on the next investment. This tends to initiate a cascade of more and often never-ending poor investments.

This is in contrast to the successful physician investors who are content with their unexciting ho-hum mundane investments that are earning 10 to 15% a year. These physicians will be the ones who can retire when they wish rather than continue to work because they must. In fact, I would recommend that the young physician seek out the opinion and advice of the older successful physician investors. In my experience, such physicians are delighted to help their junior colleagues in any way they can. Just ask.

The people who promote such grandiose, can't-miss investments know very well how to play to the physician's soft emotional underbelly. One angle is exclusivity. Any steelworker or secretary can purchase a CD at the local savings and loan or credit union or invest in a mutual fund. But an investment available to only a select few people is

clearly superior. The exclusivity plays to ego. It is a basic human emotion. One reason to belong to a Country Club, whether you are willing to admit this to yourself or not, is because of exclusivity. The more expensive, and thus exclusive, the Country Club, the better. The same with investments. Investments available only to a select few, such as those requiring a substantial minimum amount, say $10,000 or more, are worthy of a prominent physician.

The first chapter detailed a reasonable anticipated return on investment, a return that may be realized with hard work, and most importantly, a return that when promised should immediately cause alarm. This alone should help to quickly separate the solid opportunities from the bogus schemes.

When it is assured, guaranteed (you should know well from your training as a physician that no one can guarantee anything) that an investment can return 30% or more a year—just say no thank you and leave. But this angle works again and again. Remember—"fool me once, shame on you; fool me twice, shame on me." Everyone makes mistakes, but one should learn from their mistakes. It is terrible when physicians continue to be enticed into bogus schemes but it is invariably due to arrogance, ego, and greed.

It is essential to be able to cut your losses. This is difficult psychologically but must be done. Start by going to the nearest financial institution and purchase a Certificate of Deposit. You may not be able to brag about a CD to your colleagues but there will be money in the bank.

Do not be concerned about being "left out." Another physician tells you of a deal he has been offered that is so sweet, so sure to make millions, that he will be able to retire in 5 years. And if you miss this opportunity you will still be slaving away, taking call on nights, weekends, and holidays 10 years later. In fact, it was hearing the following true story that stimulated me to write this book. I have done my good deed for the day if I can prevent just one person from suffering a similar fate. (I must point out that none of those who invested live in Columbia, or to my knowledge, the state of Missouri.)

A group of physicians (one absolute sign of a loser is when all of the potential investors are physicians; *see* Chapter Twenty-One) were approached by a non-US citizen (you must be very wary of investing with foreigners; *see also* Chapter Twenty-One) regarding a fantastic investment opportunity in South America. The physicians were to put up some cash and sign some notes. After barely an hour of discussion and questions (actually very few "soft" questions, as the physicians did not wish to offend the man who was about to lead them to a life of financial and personal misery and despair) the majority of the physicians signed up. One of the physicians who did not invest in this "fantastic opportunity" is the one who related this story to me.

The deal went south (a terrible pun, but very true). Each physician lost between $3 and $10 million. Three and ten million dollars! A lifetime of hard work, an entire lifetime. These physicians will be working until they are seventy just to get out of debt. And it was their fault, and their wives'! Think of the pain. These physicians attended college for 4 years, medical school for 4 years, 3 to 7 more years of training and then will work 60 or more hours a week for another 25 or 30 years. The nights, the weekends, the holidays, the time away from their spouse, their children, and their grandchildren.

They have made millions of dollars in wages and are still in debt! Their lives, their family's lives, and possibly their mental and physical health, are destroyed.

One physician was later asked why he participated. He said that if his partners had been able to retire in 5 years in luxury he would kick himself. To lose $10 million just not feel left out. Pathetic.

But do not feel sorry for them. Their motives were simple—arrogance, ego, and especially greed. The "Big G" as a local businessman friend of mine calls it. They wished to be rich, to retire early, to be big shots, to have more money than everyone else and to be able to boast about how well they had done. They were skinned, and it was because of arrogance, ego, and greed. This happens too often. Please, please, do not let it happen to you.

SUMMARY OF CHAPTER THREE

- Greed is the most powerful and malevolent of your investment enemies.
- Greed can be as subtle as it is powerful.
- Just being a physician does not make you an expert at everything.
- Your goal is not to be rich, but to have financial security.
- A forceful spouse can help prevent investment mistakes.
- Forget glamor. The goal of an investment is to make money, not impress others.
- Do not be concerned about being left out.
- The best investment you can make is not making a stupid investment that was motivated by arrogance, ego, or greed.
- Do not underestimate the power of greed.

Chapter Four
The Mark

My favorite *Far Side* cartoon shows two deer in the woods. The one on the right has a huge red symbol on his chest that looks terribly like a bulls eye and the other deer says "Bummer of a birthmark, Hal."

Many salesmen, business people, and in fact a good number of people in general feel that physicians have this big target on their chest that says, "I'm The Mark." Unfortunately, it is both true and often well deserved. In fact, the basic reason for writing this book is to help prevent the reader from being "The Mark."

How can you avoid being "The Mark?" The nuts and bolts of accomplishing this represent much of this book, but I provide some basic practical tips:

- Accept the fact
- Seek help from a pro.

ACCEPT THE FACT

The first step is to accept the fact. As you know, the first reaction of a patient when told they have a major illness is denial. Do not deny it! You may be a hard-working superbly trained absolutely brilliant physician, but many people consider you "The Mark."

I can give no better example of a physician being considered "The Mark" than a story I heard recently in the doctor's lounge. One physician was teasing another physician (actually, one of his partners).

Bob said to Bill, "Remember when you bought your first SUV. It had snowed the day before, you were in your scrubs and you walked into the auto dealer's showroom with your wife and small children. You said you needed to buy a four-wheel drive vehicle and you needed to buy it today. It was dreary and the salesman probably thought he was going to have a bad day. Then he saw you walk in, the sun suddenly began to shine and he thought this might not be such a bad day after all." Bill was clearly up to the task when he replied, "I probably made his month."

These physicians are both my age and can joke about this sort of thing because their experience has allowed them to gain insight into this problem that so often afflicts physicians.

Do not proudly announce to people, especially salesmen, that they are dealing with a physician. Do not introduce yourself as Dr. so and so. An MD may carry weight at a scientific meeting, but in many business situations the other person just sees $$ signs

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and that big target on your chest. In fact there is a good chance that they may raise the asking price (I absolutely guarantee this happens). Physicians are "The Mark."

If you feel you are being patronized or taken for a chump because you are a physician, just leave. If dealing with this person cannot be avoided, make it clear to them that you are offended. Now they are on the defensive.

One comment that should immediately place you on guard is being referred to as a "rich doctor." This person *thinks* they see that bulls eye on your chest and is zeroing in for the kill. To use this term is clearly a sign of disrespect. You should never lower your guard with people who use the term "rich doctor."

Last summer I was cutting the lawn. A local businessman acquaintance drove by. I stopped and walked to the street to say hi. As I approached the car, he rolled down the window and said, "I didn't know that rich doctors cut their own grass!" Without hesitation I replied, "That's why I am a rich doctor."

Similar comments include: "this is not much for a doctor" or "you should be able to afford this." How the heck does anyone know what I can afford? Comments such as this show about as much insight as a physician telling a patient "this won't hurt" just before inserting a chest tube without the benefit of any anesthetic.

SEEK HELP FROM A PRO

Physicians are notorious for being poor negotiators. There are many reasons for this. Physicians are often dealing in an area outside of their expertise, a problem well detailed in many other areas of this book. Physicians do not understand patience as businessmen do. A physician's time frame for decision making is typically less than a day, and is often measured in hours, minutes, or even seconds, such as ventricular fibrillation or biopsying a mass that is actually the aorta, resulting in blood hitting the ceiling or the wall. A businessman's time frame of decision making is usually measured in weeks, months, or more commonly, years. The patient businessman can out-wait the brilliant and decisive, but impatient, physician.

The easiest remedy is to hire someone to negotiate for you. Admit that negotiation is not within your area of expertise and seek appropriate assistance.

There is a man in town who has a full-time job completely unrelated to the automobile. But his passion is cars. He buys them, sells them, fixes them up, reads car magazines, and knows the blue book by heart. It is not an exaggeration to say that he knows as much about cars as a physician knows about medicine. A friend told me of him. Whenever I want to buy or sell a car, I call him, tell him exactly what I want, including color and options, and it's done. He goes to multiple dealers, shops around my trade-in, and negotiates the deal. I just show up at the time of purchase to pay and sign papers. It is not an exaggeration to say that car dealers hate to see him walk in the door. I pay him a fee and he takes care of everything. Not only does he save me hours of time, but I am terribly impatient, and I am not a particularly good negotiator. He easily saves me hundreds or even thousands of dollars on each and every purchase.

I was talking to this gentleman recently. He assures me he has seen situations where the price was increased when a salesman discovered that they were dealing with a physician. He also expands this point further by saying that women routinely face a similar

problem with negotiations in general and especially when buying automobiles. This has also long been my wife Susan's impression. Even if a woman is knowledgeable, a good businesswoman, and a good negotiator, it is often difficult to command a salesperson, especially an auto salesman's, respect. A female physician would appear to be at a double disadvantage. I would suggest that, in appropriate circumstances, a female physician be accompanied by a male, if for no more than "muscle or backup."

Another person who can help with negotiating is a family member, or very close friend, who is an astute businessperson. Otherwise my recommendation for negotiating any significant investment or contract is to consult a lawyer. Their fee will be dependent on the time they spend, but in general it is worthwhile. If a six-figure purchase or investment is being considered, the savings could easily be thousands of dollars.

There are other reasons besides price where a lawyer's input is helpful, such as the terms. Once a deal is done, it is done. Everything must be negotiated up front and obtained in writing. It is possible to receive a reasonable price but terms that are terrible (*see* Chapter Twenty-Two). This could result in significant losses down the line. Details count and they count a great deal. Lawyers should also be able to identify anything that is not on the up and up. When they express concerns, heed their advice. To disregard such advice in this circumstance would be similar to a man obtaining annual blood tests for PSA then not following up when an abnormality is found.

A local businessman relates one circumstance where it can be to a physician's advantage to be considered "The Mark." Because physicians often have more cash available for investment they may be presented with more opportunities. A local physician has been able to purchase several pieces of real estate at distressed prices because the sellers needed to move quickly and the physician had cash, or borrowing capacity. But this requires tremendous patience and good judgment to invest only in the few situations that do represent real genuine opportunities.

SUMMARY OF CHAPTER FOUR

- Physicians are often considered "The Mark." Accept the fact.
- Do not hesitate to hire someone to negotiate for you. It is not a sign of weakness.
- Salesmen often do not have the same respect for a female as they do a male.
- To be referred to as a "rich doctor" is a sign of disrespect.

Chapter Five

It's Not Much, I Can Afford to Lose It

In medicine we are continually admonished not to make guarantees, but I will make one here. If you take the attitude of the title of this chapter, you will lose more money than you originally thought possible, and possibly even everything.

How much should you be willing to risk? The answer is both practical and psychological. One dollar, $1000, $100,000—where is the line drawn? The only correct answer is zero. There is no reason to "risk" anything unless you believe that the expected profit more than compensates the risk. To provide a medical analogy: How much can an alcoholic safely drink? The only correct answer is nothing.

I am not saying that you can completely avoid the possibility of losing money on an investment. This happens to even the greatest investors. I am referring to risking money, in essence, gambling with money. The vast majority of physicians would abhor the thought of being seen buying a lottery ticket or playing the quarter slots in a casino, yet they do the exact same thing when they "gamble" with investments. Do not make any investment unless you are as sure as possible that the projected return more than compensates for the risk, that is, generates an acceptable profit.

John D. Rockefeller used to give away dimes, when they were still silver, real money. He would say "this is the interest you would get on a dollar in one year." His lesson was that what seems like a tiny amount of money is actually the fruits of labor of a dollar for a whole year.

Be aware of the difference between uncertainty and risk. With uncertainty, you do not know what will happen in the future. With risk, you still do not know what will happen in the future, but you do have some idea of the different possibilities and the likelihood that they might occur and how they can be managed.

Let me relate the following story. An investment in an oil well was structured as a limited partnership with a minimum investment of $10,000. Drilling began immediately after the investment was made, and within 2 months you would know if it is a dry hole or a gusher. If it is a dry hole, the $10,000 is gone. If they strike oil, the payoff could be four or six to one or even greater. After dreams of being $50,000 richer in only 2 months on a $10,000 investment, some people decided to "risk" it. Two months later, the well was dry and the investors each lost $10,000.

Now, consider this situation in a different light. Suppose one of the investors hired a geologist who said he believed the probability of striking oil on the property to be 10%. This is still a risky investment, but the investor now has the right kind of information to make a rational decision. A 10% probability of achieving an investment worth $50,000

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gives that investment an expected value of $5,000 (0.10 × $50,000 = $5,000). So the risk of a $10,000 investment is not worth the expected profits.

To make wise investment decisions under conditions of risk, you should have a good idea of the possible future outcomes of the investment and the likelihood that each outcome might occur. If you do not know, consider retaining an advisor who can help (the advisor's fee must also be considered). If you still do not know the probabilities of making or losing money on an investment, then do not invest. Invest in only those opportunities that offer an appropriate chance of obtaining your targeted return or better.

Even with appropriate efforts to identify, handicap and manage risk, playing a "long shot" is rarely worthwhile. Consider the racetrack. A horse goes off at 50:1. A $2 bet to win pays $100. After finishing your third beer you realize that a $100 bet on the nag would pay $5,000. You realize that you are unlikely to win, but are seduced by the huge potential payout. After all, one win at 50:1 odds will make the night. In addition, winning under such adverse conditions and with such a large payout allows you to brag to your friends. Winning $2.10 on a $2 show bet on "Dr. Bob" is nothing compared to winning $200 on a $2 bet at 100:1 odds on "Tony the Bull!"

The problem is that your chance of winning against such odds is actually less, usually much less, than even the quoted odds of 50:1. In reality, even the one huge payout is rarely sufficient to make up for all of the other losses. Avoid long shots at the racetrack and in investing. They rarely pay off.

If you have an investment portfolio of $100,000, a full year's return has just been lost. Remember sums that may seem small or inconsequential have amazing potential because of the power of compound interest. If your child is 1 year old, more than half of the money for his or her college education has just been squandered.

When I was growing up, my family would often get together to play Hungarian poker (we still do occasionally). The big winner for the evening could be anyone, but my grandfather was the consistent winner. He would only bet when he knew he had a strong hand. My father and uncles would tease him and say, "Denes, you only bet on the lead pipe cinches." He would just smile and say "igen" ("yes" in Hungarian) as he scooped up the pot.

I will conclude this chapter with a story and a quote from Warren Buffett. From time to time Buffett would get together for a weekend with several friends and business associates to play golf and bridge and exchange ideas. At one session, Jack Byrne, Chairman of GEICO (a large holding of Berkshire Hathaway) proposed that for a "premium" of $11, he would pay $10,000, almost 1000:1 odds, for anyone who could make a hole-in-one over the weekend. Only one person did not take the bet—Warren Buffett. The man, almost a billionaire at this time (the early 1980s), would not risk $11 for a chance to win $10,000. Buffett realized that the odds of him making a hole-in-one were so remote that even a 1000:1 payoff was not worth the risk. Buffett noted that he treated an $11 wager exactly as he would an $11 million investment.

Buffett said recently "Charlie [Munger, his principal associate at Berkshire Hathaway] and I detest taking even small risks unless we feel we are being adequately compensated for doing so." Buffett is now worth $40 billion and he detests even small risk. I suggest that you take his advice seriously.

SUMMARY OF CHAPTER FIVE

- There is no reason to "risk" any amount of money.
- Seemingly small amounts of money have amazing potential.
- Every dollar counts.
- A good investor must be able to identify, assess and manage risk.
- Avoid long shots. They rarely pay.
- Only play the "lead pipe cinches."
- Warren Buffett "detests" risks. You should too.

SUGGESTED READING

Lowenstein R. *Buffett: The Making of an American Capitalist*. Broadway Books, New York, 1995.

III Principles for Achieving Your Financial Goals

Chapter Six
Define Specific Goals

Few things that are really significant, that are truly important, that are a major part of your life, just happen. Financial security does not just happen. It requires years of detailed planning and discipline to put the plans into effect. Even if you receive a major financial windfall, such as an inheritance or winning the lottery, it will be gone in short order unless there is a plan on how to husband such a largesse.

As a note, I hope no physician plays the lottery. The French philosopher Voltaire (François Marie Arouet) called the lottery "a tax on stupidity."

There is one and only one time to start planning both your near-term and long-term financial goals, and that is right now. Today. Every day that goes by robs you of your most powerful investment tool, that magnificent friend of compound interest.

Spend time on the subject, as much time as you and your spouse can spare. Physicians will sometimes spend hours researching the purchase of a depreciating asset, an article of consumption, such as an automobile or a boat, and then not spend ten minutes researching a five or six figure investment. Money that took months or years to accumulate is squandered because a physician will rely on what someone else tells them rather than spend the appropriate amount of time and effort to research the investment for themselves.

Goals must be identified and should include, at a minimum, the topics in the next section, including paying your bills, buying and paying off your home, your children's education, insurance needs, and funding your retirement.

You may have other wishes and desires. You may love to fish, hunt, or just hike through the woods, so at some time you would like to purchase a suitable piece of recreational property. Family members besides your children may require significant financial assistance. Your parents may have spent all of their time and resources helping you obtain your medical degree. If you should ask them, I am sure they will tell you that they were happy to do it they would do it again any day, and they are proud of you for being a doctor. Your parents could be in their 50s or 60s with minimal savings and you feel it is your responsibility to help them financially. I think it is. Or you could have a sibling with special needs. Who is going to provide your sibling's financial support when your parents die? Considering that you are a well-educated, successful person who earns a great wage, you take it on yourself to provide financial support for your special-needs brother or sister when your parents pass away. If you do this, you are to be congratulated.

Or you may have some personal desires. You have always dreamed of an around-the-world trip. Your passion is collecting coins or stamps or antique furniture. Or you would

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like to leave a legacy, maybe a scholarship fund or even an endowed professorial chair. Something, that in either a small way or possibly even large way, that makes humanity a little better. My wife Susan and I have endowed teaching awards at our alma maters, Texas Woman's University and the University of Chicago, respectively. Believe me, it is a good and satisfying feeling and something one can be proud of.

Realizing such goals and desires requires significant planning. Since life rarely goes according to plan, you must re-evaluate your situation, the progress of your general plan, and at regular intervals make whatever changes are necessary.

SUMMARY OF CHAPTER SIX

- Start to plan your financial future today.
- It is essential to identify your financial needs and goals, only then can you make appropriate plans to achieve them.

Chapter Seven
Thrift

I strongly encourage you to read the book *The Millionaire Next Door: The Surprising Secrets of America's Wealthy* by Stanley and Danko. It is not a book on investing, but rather one of the best, if not the best, books ever written on thrift. I am convinced this book can save the average physician $10,000 a year or more. I also suggest that family members, including your spouse and children, read it.

After reading the *Millionaire Next Door*, I would suggest that you and your spouse and children read Peter Lynch's book *Learn to Earn*. It is an excellent book that explains the basics of investing, saving and thrift for all ages.

I mention several times in this book that investing is a three-step process:

1. Earn money.
2. Do not spend it (i.e., thrift).
3. Invest the money.

I SUBMIT TO YOU THAT THRIFT IS THE MOST CRUCIAL PROCESS IN THE ACCUMULATION OF WEALTH.

The reason is that this is the variable over which you have the most control. For example, it may be difficult or even impossible to increase your income significantly. If you are just some regular Joe or Jane working in the vast majority of jobs in our society, the only way to increase your income is by changing jobs (this may be difficult or even impossible) or, more likely, getting a second job.

For a physician, it may be just as difficult, or even impossible over the short term, to increase your income. If you work in an academic setting, or large clinic or similar organization, you are on a salary. Even if you are in a fee-for-service private practice and are willing to see more patients, the ability to increase your income may be limited by your competition and will be limited by the number of hours in the day. Even if you wish to see more patients, it may take months or years to ramp up your production significantly. You could take more call, but you would need to be pretty desperate to consider this drastic step. In essence, if you truly wish to increase your income, you must be willing to pursue and accept a different job or an amazingly different lifestyle.

How about increasing the return on your investment? That is one of the principal objectives of this book, but is a very long-term process. Over the course of 5 or 10 years it is very possible to increase your return on investment, but over the short term it is impossible. In fact, trying to force an issue such as this is much more likely to result in

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Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

a loss rather than a profit. You do not just wake up on Monday morning and say, "I want my investments to return 20% instead of 5%." That is not how investing works.

But how much you spend can be changed both drastically and instantaneously. You can spend less—10, 30, or 50% less—and you can do it today. Thrift is the most important variable in the accumulation of wealth because it is the one over which you have the most control.

Arrogance, ego and greed are in constant conflict with thrift. A successful physician, making a quarter of a million dollars a year or more, does not wish to appear "cheap or stingy or tight or chincy," or whatever other similar term may be applied. The people who apply these terms to one who is thrifty are often the spendthrifts, who are wasteful with their money. The preceding terms only apply to those who will not spend money when it should be spent. I suggest you read about Hetty Green, the "Witch of Wall Street," who accumulated more than $100 million around the turn of the last century but caused her teenage son to have a leg amputated because she would not pay his medical bills. This is how I would define cheap or stingy.

I hope the reader is able to garner many points, both general and specific, from this book. In the end, if there is only one point that you can remember from this book, I suggest the following. If you have the ability to say:

THIS IS TOO EXPENSIVE, I CANNOT AFFORD THIS.

You may never be rich or wealthy, but you will never be poor. If you can say, "I cannot afford this" you have taken the first step toward a lifetime of financial security.

To be careful with money, which is the term I much prefer, is not to be cheap, but is wise. No matter what the level of your income and no matter how much money is in the bank, if one does not have respect for money they will not have it for long. It is those who do not have an adequate respect for money that are most likely to succumb to the army of charlatans that prey on physicians.

You must always be cognizant of thrift, but an especially vulnerable time in a physician's financial life for excessive or unnecessary spending is when they complete training and start practice. Income may triple or quadruple in an instant. All those years of hard work, sacrifice and delayed gratification have finally paid off. It is appropriate to spend more at this time because you have finally reached your goal. The problem is that it is too easy to loosen up too much. Your income may have tripled but unless you are careful spending can easily outstrip income. What was previously just a dream now becomes an absolute necessity. Your previous vehicle was a $12,000 3-year-old used car. Your next car should be a $25,000 new car but you say "what the heck, I can afford it" and purchase a $45,000 new car. It is very easy at this time for your appetite to easily outstrip even the significant increase in your income.

I will give several examples of how I would define being careful with one's assets. I have a patient who just turned 80. I have gone over to her home every Monday evening for a year and a half for French lessons. She gave me the following example of thrift. She relates that her father had a stable job during the Depression and although they were not by any means rich all of their basic needs were covered. They were the only family on the block with a telephone and one of the few families on the block to receive a daily newspaper. They were instructed to read the paper carefully,

fold it nicely with no wrinkles, as four or five other families would be reading the paper when they were finished. This was especially so of the classified section, as there may be a help wanted advertisement for a job so sorely needed by one of their neighbors. The Great Depression was a terrible, painful time but it did teach those who lived through it a respect for the basic necessities of life that is often absent in our society today.

I loved to sleep at my grandmother's on Friday night. Saturday morning she would give me 25¢ for baseball cards. Each pack of five cards was 5¢. If I purchased all five 5¢ packs at once—i.e., 25¢—there was a penny tax. My grandmother would not give me the extra penny for tax. (This is an example of both generosity and thrift. These two virtues are not mutually exclusive) Instead, my instructions were "Bobby, buy three packs (i.e., 15¢ and no tax), open them, say something like "Wow, these cards are great, I don't have any of these guys" and then buy the other two packs. After I did this on several occasions, the owner of the confectionary, who knew my grandmother very well, said, "Bobby, your grandmother won't give you the extra penny for tax, will she?" I said, "No Mrs. Lambert, she won't!" After that, I was able to just plunk down my quarter, buy all five packs of cards at once, and Mrs. Lambert would ring them up as separate purchases.

Thrift is similar to being on a diet. It requires eternal vigilance. You can watch your snacks and serving sizes all week, exercise daily and then go out on Saturday night and chow down with a 5,000-calorie meal, negating the hard work of the previous week. You can do a nice job watching the pennies, nickels, and dimes and then make one purchase (often impulsive) and blow the budget for an entire month or more. Be careful.

What amount of money is too little to be concerned with? I suggest EDC—every dollar counts. If you do not respect a dollar, then there will be no respect for $100. If you do not respect $100, then there will be no respect for $1,000, and so on.

Several years ago a colleague made the following comment. It is simple but elegant and sums up the power of thrift:

I MARRIED A GOLD MINE. MY SPOUSE IS THRIFTY.

Let me provide a personal example of the meaning and significance of this statement. Last week my wife Susan came home from the grocery store and said, "Bob, with coupons I saved $15.67." One need not be concerned that they may waste a $1 million when such effort is expended to save $15.67. It will not happen.

Earlier I noted investing is a three-step process. The first step is to make money. Physicians are very adept at this. Sometimes it seems that the money will flow forever, almost as easily as opening a faucet. The second step is to save it, i.e.,—not spend the money. Only then is there money to invest.

How much should you save? John D. Rockefeller suggested 50% of your income. This is not outlandish but in fact quite attainable for a high-income wage earner such as a physician. Our average physician makes $250,000 a year. (*see* Figure 1). Forty percent goes to taxes leaving $150,000. Half of the remainder after taxes, $6,250 per month, is invested ($75,000 a year). This amount includes saving for the children's education (*see* Chapter Fourteen), personal non-retirement savings and pension contributions. The remainder, the other half of income left after taxes, $6,250 a month,

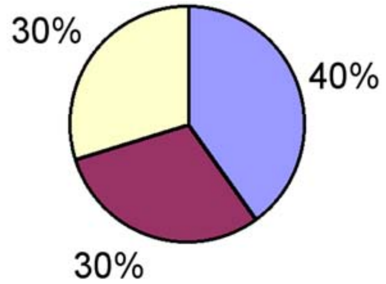

Fig. 1. Approximate distribution of total income.

Table 1
Rewards of Saving 50% of After-Tax Income

1 year	$75,000 × 10% = $82,500
2 years	($82,500 + 75,000) × 10% = $173,250
3 years	($173,250 + 75,000) × 10% = $273,075
4 years	($273,075 + 75,000) × 10% = $382,882
5 years	($382,882 + 75,000) × 10% = $503,670
6 years	($503,670 + 75,000) × 10% = $636,537
7 years	($636,577 + 75,000) × 10% = $782,691
8 years	($782,691 + 75,000) × 10% = $943,360
9 years	($943,460 + 75,000) × 10% = $1,120,306
10 years	($1,120,306 + 75,000) × 10% = $1,314,837

is for living expenses. After a mortgage payment of $2,902 a month (*see* Chapter Thirteen) there is still more than $3,300 a month of after-tax, after-mortgage money available for living expenses. Couples raise families of two to four children, with all children acquiring a college education, on a total pre-tax, pre-retirement, pre-mortgage, pre-savings salary of $3,300 per month.

Note the amazing rewards in just 10 years of this simple approach to saving and investing compounded at the standard 10% per year (*see* Table 1).

If you enter practice at age 35, the above approach has generated more than $1 million in savings by age 45 for you, your retirement, and your children's education. A fortune, and your home is paid off. Financial security is attainable, but discipline is required.

If one desires the biggest, fastest car, the most expensive clothes, an airplane, the biggest vacation home and all other sorts of flashy things this is their decision. This is not a criticism of those who choose this lifestyle. People who spend their money in this way are the ones who bring much of the color and excitement to the world. I admit that if everyone's personality were like me the world would probably not be quite as lively. In the end, people get what they want. If you desire financial security, considering a physician's income, it is a slam-dunk. If it is your desire to appear rich and important, with all of the luxuries, do not expect financial security. In *The Millionaire Next Door*, Stanley and Danko refer to the big spenders with sublime comment of "big hat, no

cattle." If you do wish to "splurge" a little, to loosen up, do it after there is $1 million in the bank and after the mortgage has been paid.

All of this talk of thrift is not to completely discourage you from spending money to obtain some of the finer things of life. To the contrary, these are the sorts of things that add color, zest, enjoyment and satisfaction to one's existence. And just about everyone agrees on what the finer things are. It is usually just a matter of price. Purchase all of the finer things of life that you wish, just make sure that it is within your budget. In fact, it is thrift and financial security that will allow you these luxuries.

This may or may not come as a surprise, but patients are acutely aware of how physicians spend their money. This is especially true if one lives in a smaller community. Patients realize how hard a physician works and most (but not all) expect them to have a higher standard of living. It is almost expected that a celebrity should flaunt their money, and it is almost expected that a physician should not. An occasional patient is drawn to the appearance of wealth (they often have the same personality), but generally patients do not like it. As the old saying goes, "Patients prefer that their doctors drive Buicks rather than Cadillacs."

The majority of patients make a mere fraction of a physician's income. Ten percent of $250,000 is $25,000; an amount probably greater than your nursing tech or secretary makes. Even just 20% is $50,000, which is probably more than your nurse makes. And as you know, some patients must decide between food and utility bills or buying their medications. Your bill to a patient for $1,500 could represent 2 years of their savings, or even their entire life savings. They may even be forced to borrow to pay the bill. Or they may be walking into your office to make the $20 monthly payment on their bill as they see you park your new $80,000 Mercedes.

Sometimes when making a purchase, I consider how long it took me to earn the amount to be spent, not as a cardiologist in private practice, but at my wage at previous jobs. When I was 8, I began to help my father cut lawns. When I was about 11 or 12, I started to cut them myself. The usual pay per lawn was $3, and that included raking, sweeping, and trimming, which was done with hand shears (I believe that the inventors of the weed whacker, power edger, and leaf blower have done such a service for humanity that they should be awarded a special Nobel Prize). When I turned 16 I began working at Graham's Book Store. My starting salary in 1967 was $1.59 1/2 per hour. In the summers between years at college and between college and medical school I worked at Granite City Steel. The base wage in 1970 was $2.66 per hour. Labor was a "two point" job. Each point was worth an additional 7¢ an hour. The addition of "bonus" actually brought the total wage to approximately $3.00 an hour. Now, when considering a purchase, rather than thinking of how many patients I must see, I consider how long I had to work for Mr. Graham or how long I had to shovel slag or chip fire brick off the walls of the soaking pits at Granite City Steel to make the money. It does provide a little perspective.

Or compare your income to that of your parents or grandparents, especially if they were working class people. It is very possible you would be embarrassed to tell your parents you make more in two or three weeks than your father made in his best years as a foreman at General Steel, or after the Commonwealth (as the plant was also called) closed, that he made as a janitor at the local high school.

CLEAN YOUR PLATE

I am a second generation American. All five of my grandparents (my mother's father died of the consumption when she was 4 years old, my grandmother then remarried) were immigrants from Hungary, coming to the United States between 1900 and 1921. I also considered myself "first generation Depression." Although I was born in 1951, the residual of that painful time was ever present in our home. "Don't go into debt. Don't buy stocks. Keep your money in a passbook. Don't go in and out too much because it lets in the cold or warm air. Turn off the lights when you leave a room, and clean your plate."

I mention this now to make both a general and a specific point. The essence of thrift is not to waste any resource. Do not buy things you do not make adequate use of and use to the fullest things you purchase. Although this example involves only pennies, it will illustrate the point. You go to the store to purchase a six-pack of imported beer for $8.50. Thus each beer costs $1.42. However, you recently joined a warehouse club with an annual fee of $25. Because they purchase in quantity and can pass the savings on directly to you, you can purchase a case of 24 beers for $25.00, or only $1.04 per beer. What a bargain, a savings of almost 27%. But you do not drink beer, you just keep it available for guests. One year later there are still eleven beers remaining and they are stale and flat and are discarded. Remember to include the annual fee when calculating how much was "saved" on the case of beer. Be sure that a bargain really is a bargain. A purchase at any price is not a bargain if you do not make use of the product.

A straightforward example of using what you have to the fullest would be if you belong to a club or organization that requires a minimal expenditure over some period of time to maintain your membership in good standing. Many country clubs require so much be spent on food every month or every quarter. You will be billed the minimum whether you go to the club or not. If you do not use the minimum you may as well flush the money down the toilet because you are receiving absolutely nothing in return. If you consistently do not meet the minimums, then consider dropping the membership.

Would you like to save one quarter to one third on your restaurant bills? When was the last time that you ate out and finished everything—the bread, the appetizer, the salad, the main dish, and the desert? Unless you have a BMI above thirty, I suspect you rarely finish everything you pay for. Try ordering less, often much less. Split the appetizer, and/or the salad, and/or the entrée, and/or the desert. In many restaurants, the servings are too large anyway. If you take children out to eat, I am sure that food, and what you paid for it, is being wasted.

Giving advice is easy. Taking it is more difficult. We just returned from Chicago. Even with the above paragraph crystal clear in my mind, I did a terrible job over-ordering, and thus wasting food and over-paying, at dinner. The restaurant proudly stated the servings were huge. Actually, they were humongous. Even before we ordered, there was the equivalent of a loaf of bread and a mound of pure butter on our table. Even with only one appetizer between us, and no salad, we did not quite finish the meal. We ate less than half of the bread. The desert was Susan's absolute favorite, key lime pie. It was at least a quarter of a pie and the meringue was four to five inches thick. Refrigerator Perry probably could not have finished this desert. In the end, we just picked at the

desert and overall ate barely half of the food served. I could easily have saved $30 to $40 had we ordered more wisely.

You may say you always bring home a doggie bag. In general, this is not an option when traveling. I would also point out you are eating some pretty expensive leftovers that are never as good reheated as they were when originally served, especially fish.

My recommendation to save a significant amount of money on your restaurant bills and/or be able to eat out more often is to only order enough food so that you "clean your plate."

I remind you that thrift is the ninth point of the Boy Scout Law.

SUMMARY OF CHAPTER SEVEN

- Thrift is the most important variable in the accumulation of wealth.
- You must not spend money in order to have money to invest.
- Remember the following phrases:

THIS IS TOO EXPENSIVE, I CANNOT AFFORD THIS.
I MARRIED A GOLD MINE, MY SPOUSE IS THRIFTY.

- Do not allow your spending to increase more rapidly than your income.
- A physician should be able to save 25–50% of their after-tax income.
- Do not allow ego to turn you into a spendthrift.
- Clean your plate.
- Thrift is a virtue.

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Stanley TJ and Danko WD. *The Millionaire Next Door: The Surprising Secrets of America's Wealthy.* Marietta, GA, Longstreet Press, 1998.

Lynch P and Rothchild J. *Learn to Earn: A Beginner's Guide to the Basics of Investing and Business.* New York, Fireside (Simon & Schuster), 1995.

Ketchum RM. *Faces From the Past.* New York, American Heritage Press, 1970.

Chapter Eight

Invest in What You Know

The best discussion regarding investing in what you know are in Peter Lynch's books *One Up on Wall Street* and *Beating the Street*. For many years Lynch was the extremely successful manager of the Fidelity Magellan Fund (for more on Peter Lynch, *see* Chapter Thirty-Two).

How many of the following questions can you answer correctly?

1. In a patient with hypertrophic cardiomyopathy with dynamic subaortic obstruction, is the preferred therapy a right ventricular electronic pacemaker or mitral valve replacement?
2. What is the preferred radiation therapy protocol for Stage IIB Hodgkin's disease?
3. Who pioneered the use of percussion in physical diagnosis?
4. How is a patient with both gonorrhea and chlamydia who is penicillin allergic best treated?
5. What are first, second, and third factor? (For extra credit: third factor is the same as what medication?)
6. What specialist would be consulted in a patient with a phlyctenule?
7. What is the preferred surgical procedure in a patient with diastasis recti?
8. In statistics, what is the multiple look phenomenon?
9. What is the preferred drug for the treatment of trichotilomania?
10. What is the normal range for biparietal diameter in a fetus of 26 weeks?

I chose topics from most major areas of medicine so that hopefully everyone answered at least one question correctly. You may even have answered two or three questions correctly, either because of reading extensively or perhaps a fact was remembered from medical school days. A bright, successful, well-trained physician just scored 20 or 30 out of a possible 100 on a medical quiz.

Presume you are a neurosurgeon and the computer-generated report of the EKG on your patient is abnormal. In fact, you are the premier neurosurgeon in the world in the treatment of saccular aneurysms. Rich and powerful people will travel any distance and pay any fee to seek your expert care. But what about the abnormal EKG? You recognize this is not within your area of expertise so a cardiology consultation is wisely obtained. By seeking a consultation you admit that your knowledge and skill is not all-encompassing, in fact, that it does not even extend to other areas of medicine. One of the world's premier neurosurgeons has been stopped by a simple EKG with the interpretation of "possible left atrial enlargement and non-specific ST-T wave changes. No previous EKG for comparison."

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A physician's amazing knowledge and expertise in one area of medicine does not make them an expert in everything. It certainly does not automatically imply they are an investment wizard.

Answer the following questions:

1. How are book value and return on equity calculated?
2. What is the current vacancy rate of commercial rental property in the Boston Area? In the West End of Boston as compared to Jamaica Plain or Natick ?
3. When can one use accelerated as compared to straight-line depreciation?
4. What was the best performing stock in the Standard and Poors 500 Index last year and how has it performed this year?
5. Which is more valuable: a 1954 Wilson Franks PSA-9 Mint Ted Williams, a 1954 Bowman PSA-9 Mint Ted Williams, or a 1957 Topps PSA-10 Gem Mint Ted Williams?
6. What does LIBOR stand for?
7. Which George Caleb Bingham painting would be most desirable to own? (Bingham lived here in central Missouri) "Portrait of Mrs. Robert Beverly Price" (an ancestor of our next-door neighbor), "Lighter Relieving a Steamboat Aground" (hangs in the White House), or "The Squatters" (in the Boston Museum of Fine Arts)?
8. In a business, what expenditures must be capitalized and what can be taken as direct expenses?
9. What is Tobin's Q ratio?
10. What is the difference between the bond rating systems of Moody's and Standard and Poors?
11. For extra credit. Who invented the ticker tape?
12. For double extra credit. The streets on the Monopoly board have their origin in what eastern city?

It is quite possible you did not know the answer to any of these questions. But I assure you that someone does. When investing there is someone who knows as much about any particular area as a physician knows about their area of medicine. They are just as bright as a physician. They graduated at the head of their college or business or law school class. They study just as hard as any physician. They read books and journals and go to seminars just as physicians do. They discuss investments with others just as physicians discuss cases with their colleagues. If you invest in their area of expertise, you will be competing directly against them. If you do not know as much about this area as they do, you will lose!! Remember this equation: Knowledge = Money.

A physician's great intellect, their tremendous knowledge in an area of medicine may make them the greatest physician in the world. But it does not make them expert at everything. I believe this feeling of intellectual invincibility is one of the physician's worst investment enemies.

Invest in what you know. If you do not understand stocks, bonds, real estate, collectibles, art or whatever, then do not buy it. It really is that simple. If all you understand is a Certificate of Deposit then invest in a Certificate of Deposit.

Many of the greatest, most successful companies in the world succeed because the principals of the business realize what skills they possess, but more importantly, they

realize their weaknesses, what skills they lack. One person often has the technical/engineering skills and the other the business/financial/management skills. Examples include Sloan and Kettering at General Motors (I am sure that every physician has heard of Memorial Sloan Kettering in New York), Hewlett and Packard, and Gates and Ballmer at Microsoft. These men succeeded just as much by realizing what they did not know, when to defer to the expertise of others, as by their own tremendous abilities and desire for success. It is just as important for a physician to realize the limits of his expertise.

Beware of peer pressure. This is especially critical for a young physician just beginning practice. I am sure that at sometime the following scenario will occur. An older physician will describe an investment that is so glamourous, so exclusive and so prestigious that only a few truly sophisticated and savvy investors (presumably such as him) can participate. Of course, it is essentially guaranteed to return 25 or 30% a year and requires no cash up front. A young and impressionable physician, who at this state of their investing career understands only a passbook savings account and a Certificate of Deposit, can easily be awed, or even intimidated, by a (seemingly) more knowledgeable senior physician discussing such an investment. And then this physician will say, "Bob, you should really consider this investment. Several other heavy-hitters in practice have already signed up (intimating that you will also be a heavy-hitter should you participate). It is at this moment that the young physician's judgment and self-confidence will be put to the test. Do not be pressured, do not be seduced. You may feel stupid and embarrassed but just say no thank you. A year or two later what appeared initially to be a paltry return on the Certificate of Deposit will look like a gold mine in comparison to the complete loss on their glamourous investment.

Remember this equation: Knowledge = Money. An investor can and will make money if they know more about an investment than the person they are dealing with. They will lose money if the other person is more knowledgeable. It really is that simple.

How can you determine where to invest? It is quite simple. What do you like? It is essential not to "force" yourself to like something or pursue something just for the hope that it may be profitable. It will not work but more importantly it will not be profitable. Instead, just keep looking until finding an area that does captivate your interest and that is fun. This will be the investor's greatest chance for profits.

Do you already possess detailed knowledge in an area? How does one gain expertise in any area? The same way one acquires expertise in medicine—study and hard work.

What do you like? Do you have any hobbies or interests? Did you collect anything growing up? I collected baseball cards and could name the National and American league batting champions and home run champions from 1920 through 1970. Growing up in the St. Louis area, I was a Cardinal fan. Stan Musial, Ken Boyer, Bob "Super" Gibson, and Lou Brock were my heroes. I could not believe that one city was lucky enough to have both Harry Carey and Jack Buck as announcers. I can still name all 25 members of the 1964 (World Champions), 1967 (World Champions), and 1968 Cardinal teams. (They should have been World Champions. I still think Bob Gibson's performance in Game One is second only to Don Larsen's perfect game as the best World Series game ever pitched.) So I collect baseball cards and sports memorabilia.

Your family has had a farm for four generations. Certainly you and your family know the value of farmland. Buy farmland as an investment.

The best area to look for profitable investments is the area in which you are already an acknowledged expert—i.e., medicine. I am a cardiologist. Who has the best pacemaker? Who makes the best stent? (It is essential to note that just because a company has the best product does not necessarily make their stock a good buy. Price is always important.) If you are a surgeon, who manufactures the best surgical instruments? A nephrologist friend recognized the potential of erythropoetin and made millions of dollars investing in Amgen.

What about medicine in general? Does the pharmaceutical representative describe a new product that could be a blockbuster or do they proudly announce their company has just released the fourteenth angiotensin-converting enzyme inhibitor (ACE inhibitor) on the market? What about health maintenance organizations (HMOs), for-profit hospital chains, drug distributors, temporary staffing agencies, subspecialty management groups, and so on?

This is already your area of expertise. It is not an exaggeration to say that a practicing physician knows more about these companies than Wall Street analysts. There must be one stock in the general field of health care which you know enough about to buy (or buy more if you already own, or sell if already own, or sell short). There is no better place to learn about investing and to make money than in medicine, the area in which you are already an acknowledged expert.

Another area to find ideas for investments is in your daily life. Peter Lynch repeatedly mentions this as an important source of his investment ideas (*see* Chapter Thirty-Two). You and your family walk into a restaurant chain that is packed. The food is quite good and reasonably priced and the service is good, or even great. Consider investing in their stock, but only after more research, of course. You pay $110 for a pair of shoes that fall apart in 3 months. Do not buy the stock of that shoe manufacturer. If you are a wine connoisseur and a vineyard that produces a superior wine at a reasonable price and is well managed is coming public, consider purchasing their stock. In fact, you should visit the vineyard and speak with the owner. Even if you do not purchase the stock I am sure you would have a good time.

In August 2003, Susan and I went to Las Vegas to attend the National Flute Convention. Neither of us had been to Las Vegas before and we were both very impressed. When we were walking down the Strip, passing literally dozens of spectacular hotels, I mentioned to Susan that the annual meetings of American Heart Association and American College of Cardiology had become so large that there were only four or five cities with enough hotel rooms and facilities to service such a large group. When we returned to the hotel I picked up an issue of *Barron's*. There was an interview with the director of the Invesco Leisure Fund. Guess what city he said was now the number one convention destination in the United States? Yes, Las Vegas. He pointed out that there are more then 150,000 hotel rooms in a relatively small area, the weather is usually good and there is obviously plenty to do. He focused specifically on Mandalay Resort Group (MBG). They had just completed the largest single convention center in the country and I already knew that they had initiated a 2.5% dividend earlier in the year. The dividend has been raised twice. I did more research on Mandalay Bay.

They were a well-run, very profitable company and their focus on luring convention business fit nicely with my observation and impression. I purchased the stock that week (August 2003). In late June 2004, MGM Grand announced an offer to buy Mandalay Bay. I sold the stock that day for a gain of 95% (plus the dividends paid in the interim). It is possible to get investment ideas, and make money, by events in your daily life.

Are you really knowledgeable about computers? Who makes the best computer? A physician friend who is very knowledgeable in this area purchased Dell more than 10 years ago and has made a significant amount of money. Who is the best software manufacturer? What company manufactures junk?

To become a successful investor, do exactly what you did to become an expert in medicine. Find an area that you truly like, that captivates your interest, and specialize. Become as knowledgeable in that area as possible, and then stick to that area. I cannot emphasize this enough. You do not need to be knowledgeable in everything or even knowledgeable in many areas. Just be very knowledgeable in one area.

SUMMARY OF CHAPTER EIGHT

- A physician's great knowledge and intellect does not make them expert at everything.
- Knowledge = Money.
- Being a successful investor requires hard work. It does not just happen.
- Invest in what you know and like.
- Investing is like medicine, the greatest chance for success is to specialize.
- Beware of peer pressure.
- Invest where you are already an expert—i.e., medicine.
- You can get great investment ideas from your daily life.

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Bloch EM. *The Paintings of George Caleb Bingham.* Columbia, MO, University of Missouri Press, 1986.

Chapter Nine

Make Your Own Investment Decisions

Allowing someone else to make your investment decisions has the potential for complete financial devastation and ruin. I believe this ranks with arrogance, ego, and greed and the seductiveness of debt in its capacity to cause catastrophic harm.

Rasputin, as you may know, was a Russian monk who held a pathological influence over some members of the last Russian royal family, the Romanovs, who were ultimately deposed and shot by the communists. Beware of the "investment advisor" who wants to control everything, who wants to make all of the investment decisions. Physicians have lost their entire life savings with such people because they stopped making their own decisions and blindly did whatever these "Rasputins" suggested.

This chapter will help differentiate these Rasputin-like promoters, often mere flim-flam men, from legitimate investment advisors and money managers. Allowing a professional to manage a portion of your investment portfolio can be extremely profitable. Using their knowledge and expertise, they make the specific investment decision. However, you have made the strategic decision to allow them to manage your money, but only after very considerable evaluation of them and their firm. It is mandatory that they have good references, that their results are verifiable, and that there is no record of improprieties.

The easiest way to separate legitimate investment managers from the Rasputin-like characters is to use the same decision making process that a physician makes when evaluating a patient. Take a history, examine the patient, order tests, and if required, obtain a consultation. Sometimes additional reading is required on the subject and sometimes one or several colleagues are asked their opinion. You gather facts and make a decision. It is when this decision-making process is completely abrogated that catastrophes can occur.

Presuming such professional investment managers are legitimate does not guarantee their success. Because losses can and do occur, especially over a short period of time, it is essential not to place too great a percentage of your net worth with any one manager.

Before moving on, let me make one important point concerning investment managers. They may boast that they have beaten some particular average, such as the DJIA or the S&P 500, by some percentage each year, or that they outperformed 90% of their peers over some period of time. This is quite desirable when the market has been up, but it is of little use when the market is down. From 1929 to 1932, the DJIA lost almost 90% of its value. An investment advisor could have beaten the averages by 20% but still have lost 70%. I would not consider this to be successful investing. The goal of investing is to make money.

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Now let me describe the Rasputin-like characters who must be avoided at all costs. They want to manage everything. Rather than suggesting a CD or cost averaging into a mutual fund or paying down debt they suggest placing all of your money into a limited partnership. Can you guess the name of the general partner? Of course, Rasputin! The partnership will be structured with a $50,000 initial payment and the investor will sign two $50,000 notes, one due in one year and the other in two years.

The deal will not involve stocks, bonds or a traditional real estate investment such as a duplex down the street. Rather it will be a highly leveraged real estate development, an oil well, or a start-up company where he is the board of directors, or a deal in a foreign country such as a gold mine in China or a tax shelter in Bermuda. The payoff will be sometime in the future, or more likely, never. And as soon as you have more money to invest another deal will be available.

There are several reasons why such disasters occur. Allowing someone to make all of the investment decisions essentially gives them control of your money. Giving someone control of your money allows them to literally rob you. And they will.

The reason that such people can assume a position of control is because they know how to manipulate arrogance, ego, and especially greed. These Rasputins promise big returns, 25 or 30% a year or more. Such investments make spectacular conversation for the doctor's lounge and cocktail parties and only a very few select people can invest with this man. Do not underestimate the persuasive capacity of these Rasputins. Their ability to gain peoples complete confidence and trust can be astounding, absolutely mind-boggling. If someone tells you they have an investment advisor who is more spectacular than Superman, you should run in the other direction. There is no Superman.

Jó Isten ("Good God" in Hungarian). Please do not allow this to happen to you. Accountants, and especially lawyers, are often very good at recognizing these kinds of scams. Ask their advice, and if they say no, it is mandatory not to proceed.

I have so far refrained from using, and I promise that I will not again mention, the adage "beware of things that sound too good to be true." Everyone has heard this many times yet few seem to pay attention. Rather than continually repeating this clearly ineffectual phrase, I spend a good portion of this book specifically defining with numbers, examples and circumstances, what is "too good to be true."

Never invest in anything just because someone else does. Remember when you were small. One of the principle arguments that you voiced to your parents to obtain permission to do something was "but Johnnie's parents let him do it so why can't I." Of course, even before you had finished your request, the traditional reply was "if Johnnie's parents let him jump off a roof, would you jump too?"

Even if Warren Buffett has purchased a stock, you must evaluate the investment for yourself. As a practical matter, it is also very unlikely that you will be able to obtain the same price that Buffett paid. Even if someone you know personally and whose opinion you respect has invested, you must still evaluate the investment opportunity for yourself. This person could be wrong or the investment just may not be suited for you.

Most importantly, do not allow just plain name-dropping to induce you into any investment. You are told by the promoter that both Jay Leno and David Letterman have put large sums into this investment. (I use these two names only because they are well know personalities. I have no idea of their investing capabilities.) Such name-dropping

must immediately raise the red flag of caution. In fact, I would almost go so far to say that when this type of "hype" is used you should probably just walk away. Is this all the more that the salesman/broker/general partner can say about the investment? What counts are the fundamentals of the business, the model, the competition, the degree of debt, etc. I am not impressed one bit by who else has chosen to invest. You must make your own decisions.

Likewise, do not allow your name to be used to induce others to invest. In fact, no one else should ever know that you are even interested in any investment. At a minimum, this is very indiscreet. What I invest in is my business and absolutely no one else's. If I choose to tell someone else, that is my decision. If someone name-drops your name, you must be forceful and make it clear that this cannot be tolerated and is unacceptable. In my opinion, financial information is as private at medical information.

One time I actually allowed my name to be used when an investment was being sold to others, essentially an endorsement. In the end, I was terribly embarrassed. And it was my fault. I will not make that mistake again.

In the end it is just like anything else in life—you must make your own decisions. You can seek other people's council, placing more or less weight on their advice depending on their credibility, but in the end you must make your own decisions.

Obviously, you must gain confidence in your ability to evaluate investments. The only way to do this is by making an investment. You can watch or monitor something forever, but until a commitment is made, until you put cash on the barrelhead, you will never really learn.

Likewise, it is mandatory to start small. The importance of starting with small investments not only makes common sense, but also has a basis in statistical probability know as *The Theory of Gambler's Ruin*. Even the world's greatest gamblers have losing streaks, and these streaks could conceivably be long enough and severe enough to wipe them out, thus Gambler's Ruin. The equation to determine the potential for ruin includes variables for hourly win rate, standard deviation and size of bankroll. Thus, for an inexperienced investor (lower win rate owing to greater probability of a losing investment) greater standard deviation (larger amount placed on each investment) and smaller bankroll (smaller net worth) there is a finite probability of ruin that is actually much greater than you might imagine. For repeatedly poor investments that represent too great a percentage of total net worth, gamblers ruin is inevitable!

But as you gain experience and become more confident in your ability to objectively evaluate an investment, the amount of each investment can and should be increased. Note I did not say "risk" more on each investment. You should never "risk" anything (*see* Chapter Five). And when your increasing knowledge and experience indicate that a real opportunity has been identified, go for it!

There is another very practical reason to make your own investment decisions. With only occasional exceptions, every investment will sometime be sold. If you did not know the reasons that the investment was made initially, it is impossible to judge if these factors have changed sufficiently such that a sale of the asset is indicated. There is no mechanism for risk control.

The last reason to make your own decision would seem purely psychological, but it is also quite practical. If an investment results in a loss, it is essential to analyze the

situation to determine the cause(s) of failure. If someone else made the investment decision, you will never learn from your failure. But hopefully you will learn to be the one to make the decisions in the future.

SUMMARY OF CHAPTER NINE

- You may seek the advice of others, but in the end, you must make your own investment decisions.
- The goal of investing is to make money. Beating an average is immaterial.
- Do not place too much money with one investment manager.
- Do not invest just because someone else has.
- It is mandatory to start somewhere, but you must start small.
- As you gain confidence you can increase the size of your investments.
- The risk of Gambler's Ruin is much greater than you appreciate.
- Risk control mandates intimate knowledge of an investment.

Chapter Ten

Documents Required for Financial Security

BUDGET

This is not a personal legal document but is a prerequisite for any successful financial plan. Businesses and corporations keep detailed and exact records of receipts and expenses (At least they are supposed to. Unfortunately, it appears that many corporations, with the collusion of their accountants, have not been keeping accurate books.) They also make projected budgets to anticipate income and expenses in the future.

You must know how your money is being spent. To keep a daily expense record to the penny is impractical, ponderous and not required, unless you are having problems paying your daily bills. However, to keep a detailed record of expenses over a short period of time, such as one month, can be quite illuminating. I have not kept a detailed budget in years, but have in the past and I would encourage you to do it if you wish. Both Susan and I do, though, watch the checkbook and all of our bills closely.

When you look at your exact expenditures it is much easier to identify areas where money can be saved. You subscribe to four magazines. You really read only one, the other three are thrown away unread. Cancel those three subscriptions. Once or twice a month you use an ATM that is out of your bank's network. Charge = $1.25. If this is done 20 times a year, the charge is $25.00. You receive one or several premium cable channels. Is it really worth the extra $15 or $20 or more per month on top of the already expensive basic cable charge? This is $180 to $240 of after-tax money a year.

Or the expenses may be much larger. You have something for enjoyment and relaxation, such as a horse or a boat or a motorcycle. Are you using them enough to justify the expense? You have season tickets to a sporting event but because of call, working late and the children's activities, attend only one-third of the games. It will be difficult, especially if you have had the tickets for many years and have taken every opportunity to improve the seat location, but consider letting them go. It is often possible to use friend's tickets for one or two games a year, especially if they are physicians, since they have the same time constraints as you. As a practical matter, a physician is typically delighted to do such a favor for a potential referral source. If you want to go to a game, purchase tickets for the games that you can attend, otherwise, just watch them on TV.

Budgets are also required so that you will have cash available to pay bills when they come due, the concept of cash flow. You may have a million dollars in CDs at the bank, but if a bill for $5,000 is due on the 29th of the month and you do not get paid until the 5th business day of the next month, and there is only $1,000 in the checkbook, you

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do not have the cash to pay your bills on time. I will discuss more on the nuances of cash flow in Chapter Twelve, "Paying Your Daily Bills."

RECORD KEEPING

I examined almost a dozen books on the general topic of financial planning to prepare for this book. The one I found most useful was *The Road to Wealth: A Comprehensive Guide to Your Money* by Suzy Orman. The book is quite detailed, and also makes many points that are both disarmingly simple and amazingly practical. I suggest the reader purchase this book as reference material. Many of the points made throughout this work on the general topic of financial planning are taken from this work.

There certainly may be other books that are better, but one cannot read everything. In fact, this brings me to a point I have found very useful in my daily life: when you have found what you are looking for, stop looking. I could have read every book ever written on financial planning, but I found the one that answered my questions and I stopped there.

As the above work points out, it is mandatory to keep adequate records. The first category is legal documents that concern major events in your life. These should be kept in a safe deposit box (the fee for the safe deposit box should be deductible as an investment expense, consult your accountant) and include things such as birth certificates, passports, etc.

Tax returns should be kept for at least 6 years. Records of your investments should be kept at least 6 years. Major financial documents should be kept for as long as applicable.

Good record keeping protects you. If you are audited by the IRS and your records are sloppy or non-existent you are in "for a world of hurt." There will be interest and there could be fines and penalties.

Honest disagreements can and do arise on things as simple as a monthly newspaper bill or credit card statement or things as major as a significant business dealing or investment. If you have everything in writing you have the best chance of protecting your interests. Keeping good records also enhances your credibility so that when there are gray or ambiguous situations you are more likely to receive the benefit of the doubt.

In the end, what records should be saved? I suggest everything.

WILL

I am not a legal, tax, or accounting expert so I have taken significant pains throughout this book to avoid giving anything but the most superficial of advice in these areas.

If you die intestate (without a will), your estate is distributed according to a statute, not your wishes. All adults should have a will. Consult your lawyer.

PERSONAL FINANCIAL STATEMENT

There are two general reasons to have a personal financial statement.

The first is to accurately tabulate your assets and liabilities. There can be surprises. Sometimes people are worth more than they think, sometimes less. I recommend that the statement be updated every year. In this way you can accurately monitor your financial progress, or possibly, lack of progress.

The second reason is banks require this when applying for a loan. A bank will not loan money without a detailing of your income, assets, and liabilities. By having a prepared financial statement, you will save the time and drudgery of having to fill out a different statement for each bank. It will make your financial life easier.

I have included here an outline of my personal financial statement. I have found this statement not only meets my needs but it includes almost all of the information that banks, or other lenders, routinely request (*see* Figure 1).

I start with basic employment and demographic data on Susan, me, and the children including birthdays, social security numbers, employers and duration of employment.

Banks always require a detailing of all income. This includes direct income from your practice and your spouse's income, and indirect income such as interest, dividends, rental payments from real estate, etc. They also require knowledge of your taxes. The banks also want a listing of your monthly expenses. This includes amounts for debt service such as mortgage, car loan, investment loans, student loans, etc. and is detailed at the end of the statement. They also like a detailing of all other expenses including food, transportation, utility bills, vacations, and essentially everything. I find this onerous and would not take the time to list such things individually unless specifically requested.

I have found the simplest way to supply the income and tax data is to provide the first two pages of last year's tax returns. If the bank asks for more data and details, just supply the entire return. Everything is there, it is accurate and is much easier than filling in all sorts of blanks on the form supplied by the bank. Remember, your time is worth $100 to $200 an hour. Do not waste it filling out forms.

Next, I list assets in retirement accounts.

I then divide non-retirement assets into cash (or cash equivalents) and non-cash. The former includes liquid assets, things that can be converted into cash very quickly such as a checking account, passbook savings, money market account, bonds, stock brokerage accounts and certificates of deposit.

I then list non-retirement, non-cash assets, assets that are fairly illiquid. This would include limited partnerships, stocks of personal or closely held corporations, collectibles, art and anything else that has a significant value. When listing things such as collectibles, I have found it much easier to place an aggregate value on the collection rather than list each individually. Let me emphasize you must be very honest when placing a value on such assets. For example, you know to the penny what your checking account is worth or the value of your CDs, whereas many of the assets in this category are impossible to value precisely. Please be conservative. If the bank finds you placing wildly inflated, essentially bogus values on such assets they will be rightfully quite perturbed and you will lose credibility. Remember also that although a collectible (and, in fact many assets) may be worth some particular amount, after price negotiation and fees and commissions associated with a sale or auction, you will probably only realize 75 to 85% (at the absolute most) of this value.

I always list automobiles with an appropriate value, they are worth real money, but I never include the value of the autos in the final calculation of net worth. They only represent money in your pocket if sold, but then what will you drive?

Name

Address

Phone Number

Fax Number

E-mail address

Occupation	You	Spouse
	Medical Doctor	
	Work Address	
	Work Phone	
	Work Fax #	
	Work E-mail	

Duration of Employment

Social Security #

Marital Status

Children	#1	#2	etc.
Birthday			
Social Security #			

ANNUAL INCOME AND TAXES

See tax returns from specific years

RETIREMENT ACCOUNTS

IRA	________
KEOUGH	________
PENSION/PROFIT SHARING	________
401 K	________
TOTAL — RETIREMENT ACCOUNTS	________

Fig. 1. Personal financial statement.

NON-RETIREMENT, CASH OR EQUIVALENTS

Checking Accounts	________
PassBook Savings	________
Stocks/Mutual Funds	________
Bonds/Bond Funds	________
U.S. Savings Bonds	________
Certificate of Deposit	________
Other	________
TOTAL, NON-RETIERMENT CASH	________

COLLECTIBLES

Art, Antiques	________
Any Thing With	________
Significant Value	________
TOTAL COLLECTIBLES	________

PERSONAL PROPERTY

Automobiles	________
Boat	________

(Value of Personal Property not included in calculation of Net Worth)

Non-Retirement, Non-Cash

Partnerships	
A) Limited	________
B) LLC	________
C) Other	________
Closely Held Companies	________
Your Practice	
Practice Associated Real Estate	

TOTAL, Non-Retirement, Non-Cash

Fig. 1. *(continued)*

REAL ESTATE

Home	________
Vacation/Second Home	________
Any Other Real Estate	________
A) Farm	________
B) Rental Property	________
TOTAL	________

INSURANCE

Life

Disability

Indebtedness

	Monthly Payment	Loan Balance	(if Rental Property Income)
Property	________	________	
Lender			
Student Loan(s)	________	________	
Car Loan	________	________	
Investment Loan	________	________	
Any other secured or Unsecured note	________	________	

TOTAL INDEBTEDNESS ________

*(Note — all credit card and similar accounts are routinely paid in full each month)

* - If you can say this.

TOTAL NET WORTH

Retirement Accounts		________
Non-Retirement, Cash or Equivalents		________
Collectibles		________
Real Estate		________
Subtotal		________
Debt	Subtract	(________)
FINAL TOTAL	________	

Fig. 1. *(continued)*

I then list real estate, both my home and investment real estate, and life and disability insurance policies with policy numbers and amounts. The bank needs to know their investment is protected should something happen to you.

I then list in detail any indebtedness or other obligations or required payments with the amount of the monthly payment and the total loan amount.

At the end of the section on indebtedness, I then put the following line:

(**Note**—all credit cards and similar accounts are routinely paid in full every month.)

If you can say this, your personal stock has just gone up ten points with anyone who reads your personal financial statement.

At the end I add up assets, subtract liabilities, and you have your net worth. The first time that you do this it will take a good deal of time but the yearly updates rarely take much more than an hour.

SUMMARY OF CHAPTER TEN

- Keep a budget. It will save you money.
- Are you using something sufficiently to justify the expense?
- Be a good record-keeper, it will protect you.
- All adults should have a will.
- Keep a personal financial statement and update it yearly.
- Be conservative when estimating the value of assets.

SUGGESTED READING

Orman S. *The Road to Wealth: A Comprehensive Guide to Your Money.* New York, Riverhead Books, 2003.

Chapter Eleven

The Importance of Relationships, Goodwill, Friendship, and Reciprocity

If you know people and have credibility with them, if you treat them nicely and with respect, they will not only give you the benefit of the doubt, but they will bend over backwards to help you. I am not referring here to real personal friendships, rather I am talking about productive, long-term business acquaintances and relationships based on credibility.

The following examples are anecdotal but illustrate my point.

I have been in practice and lived in the same community for 22 years. In spite of being quite attentive to my personal financial affairs, I have bounced checks several times. Twice it was my fault. One time was the bank's error. These experiences bring up a personal observation. It has been my experience that front-line bank employees, such as tellers and the like, make more mistakes and provide more misinformation than you may think. If what you are told does not sound correct, question it.

The first time I bounced a check was 12 or 13 years ago. I had done the vast majority of my banking and had my home loan, safe deposit box, and checking account at this bank since coming to town. One afternoon the executive vice-president of the bank called and said "Bob, your account is overdrawn. However, because we know you so well, we have paid the check [it was more than $1,000] but would appreciate if you could come down this afternoon or tomorrow and take care of things." I did. This is service! I fully appreciated it and realized what they did for me and told them so.

However, this bank was subsequently taken over by another bank, which was taken over by another bank that is now one of the larger banks in the country. Four or five years ago, after all of the take overs, I bounced another check. The treatment this time was much different. I only found out that I was overdrawn when I began to receive notices that a total of six checks were bounced—with a $20 fee for each = $120 in fees. I did not receive a personal phone call but was provided an 800 number to call to obtain more information.

To digress for a moment—I later read an article that this particular bank, and several others, made a tremendous amount of money on fees in this circumstance. Say there was $1,000 in your checking account and you had written five checks: one for $1,100 and the other four for $20 each. They would post the $1,100 check first, thus making your account overdrawn, and then post the smaller checks so that they could generate overdrawn fees on each check.

Back to the subject. Was I wrong in my account being overdrawn? Absolutely. Did they have every legal right to do as they did? Of course. But as a practical matter, in hopes of generating some fees they lost the business of a good, and big, customer. Over the years I

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had taken out and paid back multiple loans which generated more than $100,000 in interest income for the bank. I ran thousands of dollars through my checking account monthly and I used other services of the bank. I went to the bank and had all of the fees removed from my account. Then after a reasonable period of time I have taken almost all of my business out of that bank. If they had cut me just a little slack, as in the earlier episode, they would still have my business. In hopes of generating $120 of fees, they lost a big customer.

I have used the same insurance agent for 22 years—home, cars, watercraft, rental property, umbrella policy, everything. I just call him up, tell him what I need, and it's done. Two years ago, the statement on a policy for a rental property was not even mailed until the due date. As soon as I received the statement I called the agent. I mailed the check that day but he went to bat for me with the underwriters and told them it was their fault, not mine, that the payment was late. This is service, and it is due to the credibility generated by long-term relationships.

One of the very basic messages of this book is to make every effort to minimize fees (*see* Chapter Nineteen). I will now partially contradict this by saying there are situations where the extra personal service is worth ten times the extra cost. As all good physicians know, use your judgment.

I hate to do business on-line. I admit that a large part of this problem is that I am essentially bereft of even basic computer skills. But the other, and more significant reason, is lack of and difficulty with service. It is not uncommon for things obtained on-line to be cheaper than things obtained in person at a bricks and mortar store. But if there are problems, and there are occasionally, then the small savings from ten transactions could be more than negated by the big problems with one transaction that is not adequately serviced.

I prefer to deal with people. And if they know you, and you are a good customer who pays their bills on time, you will come out very far ahead in the long run.

Reciprocity is a basic rule in business. If a local hardware store has all of their accounts at one bank, the officers of that bank use that hardware store. In fact, whenever they go to the store they make sure the owner notices. The owner of an auto dealership has made generous financial contributions to a charity for many years. The charity will go to him or her first when they need to purchase a vehicle.

A physician is in business to see patients and make a living. If you are a reasonable physician and a reasonable person, you should expect that (other things being equal, such as you participating in their insurance plan or one of their family members are not already seeing another physician) the people you do business with reciprocate and see you when they need a physician. If you have purchased four Fords over the last 10 years and the owner of the dealership chooses another physician instead of you, purchase your cars elsewhere. And the next time you see him at a party, be sure to mention how much you love your new Honda.

SUMMARY OF CHAPTER ELEVEN

- If you are a long-term, solid customer who pays their bills on time, you have built up more credibility that you can imagine.
- Price is important, but service is important too.
- If you do business with someone, you should expect their business in return.

IV Attaining Specific Goals

Chapter Twelve
Paying Daily Bills

The bottom line here is that you must have the adequate funds available when bills are due. This is basic financial or money management, essentially the concept of cash flow.

One point before proceeding: if you are a physician making a six-figure income and are always having to scramble to come up with cash to pay daily bills, you are in big trouble. Contact a financial planner, credit analyst, banker or accountant immediately.

I have taken significant pains to keep the topic of this book focused on a physician's personal finances and investments, avoiding any discussion of the financial aspects of a physician's practice. However, I will make an exception here. Over the years, my associates have displayed a great deal of cooperation and foresight and because of this, once a year we set our monthly salary. Thus I know that on the first day of each month I will have a check for some specific amount. This makes paying bills so easy. More importantly, it makes you a better investor by knowing that you will have some particular amount of money available each month for income averaging into your favorite mutual fund(s), mortgage payment(s) for your rental property or other investments.

Contrast this to the situation where a physician receives a check on the fifth business day of each month dependent only on the amount collected (not billed, but collected) in the proceeding month minus expenses. If you had a great month, took no days off and were very busy, the check could be for $30,000 or $40,000, double or even more than your average check. But if you took a week off, and it was the beginning of the year, and patients had not yet met their deductibles, you might even be negative. You return from your Florida vacation with great memories and a wonderful tan but owe $3,000 on the credit cards and must write a check to your practice to cover overhead—OUCH! If this describes your practice I suggest you and your associates be creative and determine some formula to even out the highs and lows, ideally being able to depend on some minimum salary each month. It will make you a much more successful investor.

The first rule is to pay your bills in full and on time. If you have built up a nice record of being a prompt payer, people will "cut you some slack" if an occasional problem occurs. But if you are always slow in paying your bills, creditors have every right to never give you the benefit of the doubt.

Likewise, there is no reason to pay bills too early. The mortgage is due on the 1st and there is a penalty if paid after the 15th. Mail the check on the 10th. It is the 10th of the month and you receive the credit card bill due the 29th. Mail the check on the 22nd or 23rd. Initial renewal notices for magazines and journals often begin to arrive as much

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as 4 to 6 months before the subscription expires. Wait until the minimal time necessary to insure uninterrupted service to mail the check.

While money is in your possession it is working for you. When money is in someone else's possession, you do not receive interest. This is the essence of the phrase everyone has heard: "time is money." The goal is to keep the money in your pocket for as long as possible.

The total of all of your bills, including the mortgage payment, car payment, utility bills, credit card bills, etc. comes to $6,000 a month. By the timely payment of the bills, you are able to keep that $6,000 in your possession an extra ten days each month. This is a third of the month, taken over a year, this is a third of the year, or 4 months. Four months of standard investment return on $6,000 at 10% is $200.

You may be thinking: "All of this effort for $200. This guy needs to get a life." Writing a check on the 20th of the month as compared to the 10th of the month, what effort is this? It is such attention to detail magnified by all of your business transactions compounded over the course of many years that allows you to accumulate wealth and attain financial security. Details are important. The most successful people are the ones who pay the most attention to details. In finance, details represent money in your pocket.

Many banking transactions and bill paying can now be performed on-line. My wife prefers this. The records are as good or better and it saves stamps, envelopes, and time in general. There is also the option of automatic bill paying; that is, giving someone such as your home mortgage lender direct access to your checking account to automatically withdraw the appropriate amount of money at the appropriate time to pay the bill. If you are a spendthrift and the only way to impose financial discipline is to never allow the money to touch your hands, then you may consider this. Otherwise, I prefer to pay my own bills on time and not allow others direct access to my money.

If I lose money on an investment because of a poor decision that was my fault I say so be it, try to learn from the loss and do better the next time. If I do not earn more money because I am not willing to see that extra patient or work that extra 30 minutes at the end of the day, that is my decision. But I will not lose a penny to paperwork. This is like seeing a $10 bill on the street and just bending over and picking it up. It is yours for the seemingly most miniscule of efforts.

SUMMARY OF CHAPTER TWELVE

- Attention to detail is money in your pocket.
- Pay all bills on time, but not too early.
- Time is money.
- Do not lose a penny to paperwork.

Chapter Thirteen
Your Home

It is standard teaching, almost gospel, that your home is your best investment. A physician's home may be a good investment for their heirs, but I contend it could be one of the poorest investments of a physician's life if the home is too expensive.

There are many reasons for this. Chapter Three discussed the basic human failings of arrogance, ego, and greed. Chapter Eighteen details the seductiveness and destructive power of debt. Chapter Two details why compound interest is an investor's best friend. A home mortgage is compound interest in reverse, compound interest working against the borrower. Unless extreme caution is exercised, all of these factors have the potential of turning your place of residence into a life-long drain on your resources.

Inability to control arrogance, ego, and greed can easily result in the purchase of a home that is far beyond what an impartial assessment of your financial situation would dictate. You may be a wonderfully skilled physician, possibly a specialist or even a subspecialist. Prominent people, who can afford the best, demand to see only you. No one else will do. You are the best physician in town or your state or for that matter possibly anywhere. You must have a home that reflects this, that is commensurate with your status as a prominent physician. A humble nine- or ten-room 4,000-sq foot residence is not adequate. It is just not appropriate for such a prominent, important physician to live in a neighborhood next door to a bank vice president, or a two wage earner family such as an electrician married to a social worker or a nurse married to a college professor or a man whose family has owned a local clothing store for three generations.

Such a physician must live in an exclusive area where everyone is equally as prominent and as important, where the movers and shakers live. It is mandatory that such a physician own a million dollar, 10,000-sq foot home in the best neighborhood.

The first place a physician can work on controlling arrogance and ego, and thus achieving better control of their investments, is quite literally in the home.

Consider these financial practicalities. You own a million dollar home and for the sake of this discussion it is paid off. Your personal financial statement reads: "home value—$1,000,000." The number may appear impressive on paper, but it is not one spendable penny in your pocket. Your family must live somewhere. The equity in a home, whether the home is paid off or not, is just a number on paper.

It is, of course, possible to borrow against a home. Any bank would certainly be delighted to extend a physician a home equity loan. I believe home equity loans are in general to be avoided, are unwise, and are potentially dangerous. Your goal should be to pay your home off as quickly as possible rather than use it as a piggy bank.

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Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

You may also establish a home equity line of credit. This is exactly what it sounds like—a line of credit, i.e., the bank has agreed in advance to loan up to some particular amount of money at predefined terms, backed up by the equity in your home. These do allow considerable financial flexibility. I established a home equity line of credit some time ago but had never even considered using it until recently. We were involved in an automobile accident and our car was totaled. Thus we needed a new car quickly but had only about one-half of the cash for the vehicle we hoped to purchase. I called the bank and because I had previously arranged the line of credit, a check was drawn up in less than 30 minutes. This saved me the hassle of having to apply for a car loan or being forced to liquidate an investment to raise cash. Being forced to liquidate an investment can destroy otherwise well-laid plans.

Another example of when a home equity line of credit would be useful is when an opportunity arises with little or no notice and you do not have sufficient cash available to cover the purchase. You have been waiting for a particular collectible or antique. Auction catalogues for coins, stamps, baseball cards, autographs, etc., are often mailed only three to four weeks at most before the sale. Thus there is minimal notice. Or a dealer may call with a collectible you have been waiting for years to come on the market. You have 24 hours to make up your mind before it will be offered to someone else. Situations such as this do not arise often and a home equity line of credit can allow you to take advantage of them. But remember, the situation must be very compelling because you have just put your home on the line.

You could contend that it is possible to sell a home at anytime to realize the equity. But in the real world it is not that easy. The more expensive a home, the less marketable. If a buyer can truly afford a million-dollar home, they are going to be a very successful, very particular person with specific tastes, desires, requirements and needs. Buyers such as this know exactly what they want and if a home does not meet these exact, absolute, specific, requirements, they will not buy it (unless the price has been discounted so significantly that they will consider it, essentially a distressed sale). The less expensive the home, the more marketable. The more expensive the home, the less marketable, a problem greatly magnified in a smaller community. There are very few buyers indeed at the million-dollar level. Remember that you must also pay a real estate commission unless the home is sold by the owner, something that I would not suggest for the average physician. In the end, your dream home, the most amazing home on earth, worth a million dollars on paper, is really not worth a million dollars. In addition, if this is a forced sale, or the home is being sold at a time of general economic weakness, the amount received will be further compromised.

The currently strong real estate market (Professor Schiller of *Irrational Exuberance*, Alan Abelson of *Barron's*, and the author feel that we are currently experiencing a real estate "bubble") has probably diminished the strength and credibility of the above arguments. Apparently in some "hot" markets, when a home or property is listed the "list" price serves as the "base" price for a subsequent bidding war between the interested parties. Those who lack the perspective of time will recognize that this is not the normal or routine state of affairs of any market. Such things raise the concern of a "blow-off" or "speculative" top.

The following is a true story. A physician built a million-dollar dream home. An additional $200,000 was spent on furniture and another $100,000 to $200,000 on change orders because this or that just did not look quite right. After all, everything must be perfect in a dream home. In the end, he could not afford the home. The debt was just crushing. I later heard a perfect term to describe this situation—"golden handcuffs." It is both insightful and sublime.

Several years later the physician was forced to sell. Everyone wanted to look but there were no buyers. The home sat on the market for some time. It finally sold for between 60 and 70¢ on the dollar. The physician not only lost all of his equity, but he had to bring money to the table to complete the sale. He was forced to pay to sell his dream home! This is Pain with a capital P.

Let me take this opportunity to discuss liquidity. Liquidity is the ease with which something can be sold. Cash is liquidity. As Yogi Berra (Berra and Joe Garagiola are from "The Hill" in St. Louis. The Cardinals passed on Berra to sign Garagiola) says, it is just as good as money. Cash earns no interest, but it has amazing power. Cash can be taken anywhere to buy anything instantly. Cash is king. It would appear possible to purchase something instantly with a credit card or a check, but this can actually be quite difficult if the seller does not honor the credit card, or if you are over your credit limit, or the check is not from a local financial institution. I am sure everyone has seen the sign "out of town checks not accepted." A passbook savings account can be converted to cash on demand. A checking account, if not overdrawn, can be converted to cash. A Certificate of Deposit (CD) can be converted to cash, but there is an interest penalty if redeemed before the date of maturity. Also note that converting a check, passbook or CD to cash presumes the bank has sufficient liquidity. During times of financial panic when there are "runs" on banks, such as during the Great Depression in the United States or more recently in South America, banks may not have the cash to honor the request. Securities, such as the stocks or bonds of major corporations traded on the major stock exchanges, such as General Electric (GE) or General Motors (GM), can be converted into cash within several business days.

Real estate is at the other end of the spectrum. It is illiquid. A home may be "worth" a million dollars on paper, but it may take weeks, months, or even years to convert into cash. With some investments, such as limited partnerships or the stocks of closely held businesses, it may be impossible to convert to cash, even if you are willing to sell at absolutely distressed prices.

Before continuing on with my recommendations regarding the home you should purchase, let me give an example of what a real estate agent may say when you and your spouse are being shown a million dollar home. I emphasize that the following is not in any way critical of real estate agents. Just as a physician's job is to care for patients, a real estate agent's job is to sell homes. The real estate agent would say the same to potential buyers when selling your home. It is the buyer's responsibility not to allow a sales pitch that plays to ego to overcome good judgment. The real estate agent may say, "Doctor, this is a very elegant home in a prestigious neighborhood. You better buy it now because it will sell quickly. We have three other people interested in this home. We think at least two of them will place a contract before the weekend. Look at that four-car garage. Isn't it heavenly? Now you can buy another

Hummer. Creative financing [this is a term that should scare the pants off of you] is available for someone with your income. Your spouse will love the kitchen. This is in the best school district. The home is expensive, but it is worth it. This will be the best investment of your life. Everyone knows that you cannot lose money on real estate. It never goes down."

How much should you spend on a home? It is actually much more instructive to begin with what should be avoided.

In February, 2003, I saw the following on the CNNMoney website: "How much house can you afford?" It requested the following data and I filled in the blanks as follows:

Gross annual income	$250,000
Down payment amount	$50,000
Monthly debt	$1,000 (include auto and student loans, alimony, child support payments, and credit card payments)
Mortgage rate	7%
Annual property taxes	$3,500
Annual homeowners insurance	$481

The site makes the following comments and assumptions: "These are 'affordable' home price guidelines used by most lenders. There is a total debt to income ratio of no more than 36% and an assumed housing payment to income ratio of 28% for the conservative estimate and 33% for the aggressive estimate. Before buying, you should also factor in other savings needs including retirement and college."

The calculator assumed a 30-year term with the national average for property taxes and homeowners insurance. They did not include private mortgage insurance (known as PMI), which will be owed if down payment is less than 20% of purchase price (average cost, $50 to $80 per month, *see* several other discussions of PMI).

These are the recommendations:

	Conservative	Aggressive
House price	$876,929	$1,033,499
Loan amount	$826,929	$983,499
Monthly mortgage payment	$5,501	$6,543
Taxes/Insurance	$331	$331
Total monthly payment	$5,833	$6,875

In my opinion, recommending this much debt is irresponsible. Please note that I am not criticizing CNNMoney; they are just relaying information. Rather, I am commenting on our society in general, especially the financial community, where such guidelines allow, actually encourage, this amount of (potentially destructive) debt.

Even if it were possible to meet the monthly payment, consider the absolute amount of money. What if your income falls—more overhead because of increasing malpractice costs or more office help to complete paperwork, the federal and/or state government increase taxes, the economy worsens, physician reimbursement continues to decline (Medicare reimbursement is mandated to fall for the next several years), you become ill, the payments for your employees benefits continue to increase—then what

was previously viewed as just a percentage of your income is, in absolute terms, a tremendous amount of money.

A mortgage payment of $6,543 for 12 months a year for 30 years = $2,355,480. After 30 years a million-dollar dream home costs about $2.4 million ($2,355,480 plus the $50,000 down payment). Ten years of your 30 years of practice just for mortgage payments. This does not include furnishings, upkeep, taxes, and insurance. The total cost is mind-boggling.

Here is my suggestion. The cost of a home should be such that the mortgage can be paid off by age 45. To accomplish this, there must be no pre-payment penalties on the mortgage. In fact, the physician investor should INSIST on no pre-payment penalties on all loans.

There is one situation that I do encourage the physician investor to purchase as much as they can afford. This concerns the amount of land around the home. I have spoken with several physicians who wished they had purchased more land around their home than they did originally or thought they could afford. This relates less to the investment aspects of the land and more to the ability to control the subsequent construction around their home. I have yet to hear a physician complain that they purchased too much land. If this were the case, you could just sell the land that appeared superfluous. Otherwise, purchase as much land around your home as you can afford. It is not often that you can control your neighbors (or lack of neighbors).

I remember shaking my father's hand when he paid off the mortgage in 1959. (The home was purchased in 1956). If a foreman at a foundry can pay off their mortgage by age 42, surely a high-income physician can pay off their mortgage by age 45.

I paid off my mortgage when I was 41 years old. Do not underestimate the feeling. It was spectacular. You and your family will always have a place to live. When the mortgage payments stop, which is similar to when your children have graduated from college and are self sufficient, it is as if an armored car drops a bag of money on your doorstep each month, money that can be invested.

Now for the practical financial reasons of the early payoff of a home mortgage. A mortgage is compound interest in reverse, compound interest working against you, to the determinant of the borrower (*see* Chapter Two, "The Magnificence of Compound Interest"). A $312,500 home is purchased with a 20% down payment and a $250,000 mortgage at 7% interest. In my opinion, you cannot afford a home without a 20% down-payment. Lenders agree and routinely require PMI with a down payment of less than 20% (*see* Chapter Fifteen, "Insurance").

Table 1 outlines the details of amortizing this mortgage over a period of 10, 20, or 30 years.

For merely $275 a month, two extra hours of work a month, 4 minutes a day, you can pay off the mortgage in 20 years rather than 30, saving more than $133,000 in interest alone. The difference in interest paid is money in your pocket. Also, remember to add 10% per year to the interest saved because this is money available to invest. The final results are astounding.

THE EARLY PAYOFF OF A HOME MORTGAGE CAN BE THE EQUIVALENT OF AN ENTIRE LIFETIME OF SUCCESSFUL INVESTING.

Please do not be concerned about losing the tax deduction on the interest. A dollar is spent on interest to save 35 or 40¢ on taxes. That is a loss of 60 to 65% on every

Table 1
$250,000 Mortgage Amortized Over Various Lengths of Time

	Monthly Payment	Principal/Interest	Principal paid in 10 years	Interest paid over life of loan
10-year payout	$2,902	$1,444/$1,458	entire amount	$98,325
20-year payout	$1,938	$479/$1,458	$83,065	$215,179
30-year payout	$1,663	$204/$1,458	$35,496	$348,783

Data courtesy of Dan Scotten, Boone County National Bank, Columbia, MO.

dollar of interest paid. I do not consider this to be particularly astute investing. This mind-set underscores our country's infatuation with debt, which is encouraged by the government through the taxation of profits, thus discouraging investment, and the granting of deductions for interest payments, thus encouraging debt.

Considering that interest rates are currently at multi-decade lows, I feel it would be advisable to take a fixed rate mortgage as compared to an adjustable rate mortgage (ARM) even though the initial rates on the latter are lower. One exception would be if there were a good chance you will be moving in 3 to 5 years. For example, you are just beginning your training with every expectation that when finished you will be moving back to your hometown to joining your father in practice. An ARM (or possibly even a balloon note), which does not adjust during the period that you plan to own the home, would probably be a better choice.

One minor caveat with an ARM : in the past it was not uncommon that the interest rate during the initial period was a "teaser" rate, i.e., it is set slightly lower than it would otherwise be to "tease" you to take the note. This is rarely done today, but do not be embarrassed to ask the lender this question.

Please note that all of the above discussion is not to discourage you from purchasing a home. To the contrary, home ownership is part of the American dream and should be one of your basic lifetime investment goals. Rather it is to discourage you from purchasing a home that is too expensive with financing that is disadvantageous to the borrower. Instead of paying someone else rent, you are accumulating equity in your own home. If the home is held long enough there is also a good chance that it will appreciate in value. One of the basic goals of an adult should be the purchase of a home that is financially within their budget at the earliest possible time, although this general recommendation is somewhat tempered by my concern about the current real estate bubble.

There are several other points to remember when purchasing your first home. Establishing a new household requires thousands of dollars in addition to the home mortgage, insurance and real estate taxes. There is furniture, kitchen utensils, yard equipment, and these cost thousands of dollars. Never borrow money to buy furniture (except appliances). Allow the rooms to sit vacant until there are sufficient funds to pay cash for the furniture (do not let vacant rooms embarrass you. People who are careful with their money will realize you are careful with your money). Purchase quality. It is a terrible waste of resources to buy furniture merely to fill a room and then 3 or 4 years later buy all new furniture. The resale value of used furniture is pennies on the dollar.

You must resist the temptation to buy a home as large as your parents or your senior associates. Remember that these people have worked 25 or 30 years to get where they are. A 30-year-old should not expect to have as much as a 60-year-old. Patience, patience, patience.

The majority of the above general comments regarding the purchase of a stand-alone home apply to the purchase of a condominium or townhouse as you principal residence. The concept of cooperatives is found in some large metropolitan areas. In co-ops, a corporation owns the building and then you purchase a share of the corporation. I admit I have no personal experience at all with a co-op, but from what I have read they sound pretty socialistic. I have never read of an investor whose opinion I respect or have I ever spoken with a person whom I feel is a wise investor that has purchased a share in a co-op. Avoid such a situation.

It is essential to limit the number of times you move. The average American family will live in three homes over their adult lifetime. This fits nicely with the following scenario. Purchase your first home when you begin residency or fellowship. I dearly hope the down payment will not be borrowed from your parents. If you do not have the money for a down payment, it means you cannot afford the home. More importantly, you are now in your late 20s or early 30s, and probably married. You are an educated adult, a medical doctor, a trained professional, a respected and privileged member of our society. It is time to start paying your own way in life. No one will develop an adequate sense of self-reliance if they must keep going to their parents for money. When will it ever end? The answer is never! In their spectacular book *The Millionaire Next Door*, Stanley and Danko have a pithy, sublime, and medically appropriate term for the above situation, which they refer to as "economic outpatient care (EOC)."

A 28-year-old has been a steelworker or teamster for 10 years. They lived with their parents for 5 years after high school graduation and rented a small apartment for 5 years. They have finally saved $24,000 for the 20% down payment on a $120,000 home. A 31-year-old medical or surgical sub-specialty Fellow is loaned $50,000 by their parents for the down payment on a $240,000 home. Who is to be more proud of their achievement?

It may be possible to borrow the down payment for your home from your retirement savings. It is extremely unlikely that a physician at this time in their life will have any retirement savings but it could apply to your spouse. You must consult the plan administrator or your accountant to see if this option is available. My completely unscientific but visceral opinion is not to pursue this. Borrowing from yourself just does not seem logical. I mention this for sake of completeness as this option is generally noted in books on financial planning.

Unless you practice in the same area where you performed your training, you will purchase your second home at the time you enter practice. Four to seven years later, after becoming a partner, you should be in a solid financial position and can purchase your final home.

A nice investment possibility is to keep the previous home (second home) as an investment. You know the area well and no one knows the home better. Staying in the area also makes it easy to keep a close watch on the property. Consider this possibility if the rent covers or nearly covers the mortgage. There is already a 6% gain by saving

the real estate commission. On a $160,000 home, this is a savings of almost $10,000. This all presumes that you have saved the 20% down payment for the final home. Looking back, I wish that I had done this. It now seems so easy and so obvious. We moved into our current home in 1987. If I had kept the previous home, the mortgage would be paid off and the home would be generating $1,500 a month in rental income. Four or five such opportunities would represent a lifetime of successful investing.

It is mandatory to resist the urge to move too often (this also applies to changing jobs too often, *see* Chapter Thirty-Three). Choose your home wisely and stay there. With every move there are commissions and fees, not to mention the inevitable remodeling and other expenses such as new furniture. Do not be diverted from your ultimate goal, which is to have your home paid off as early as possible, hopefully by age 45. I estimate each move delays this goal by 2 years or more.

Before concluding, let me discuss remodeling and additions. The first point to consider is finances. The most desirable way to pay for an addition or remodeling is with cash. If you cannot pay cash, then consider you may not be able to afford the addition. If you do borrow, I suggest the second mortgage be amortized over a very short period of time, such as just one or 2 years. Remember, any such borrowing just delays one of the most important financial goals of your lifetime, that is, paying off your mortgage as early as possible.

When planning a major addition or remodeling, it is important to keep in mind not only what you like but what other people need and desire and find tasteful since all homes, sooner (often sooner than you think or plan) or later must be sold. The first point is that in only very rare circumstance will there be a dollar for dollar increase in the resale value of the home. A more reasonable estimate is that a nicely planned remodeling or addition will realize 50 to 75% of the cost as an increase in the resale value of the home.

Poorly planned additions or remodeling have the capacity to actually decrease the value of a home. The addition must fit both the style of your home and the neighborhood. If you live in a neighborhood built before World War I, do not put on an addition that looks like a tribute to pop art. Not only will this decrease the value of your home, but you will also have some perturbed and upset neighbors.

Always use a general contractor. Do not try to supervise the work yourself. There are many reasons for this. I cannot imagine a physician has sufficient expertise to accomplish this. There are always codes that must be met and whenever there is structural work it is essential to know such things as if the wall being removed or moved is weight bearing. As a practical matter, a physician has no "pull or influence" with the subcontractors. Your project will always be last on their list, to be done at their convenience and on their timetable, not yours.

SUMMARY OF CHAPTER THIRTEEN

- The more expensive a home, the poorer the investment.
- Control ego when buying a home.
- Real estate is illiquid.
- If you do not have a 20% down payment that you have saved, you cannot afford a home.

- Take a 10 (or at most 15) year mortgage.
- Own your home by age 45.
- Mortgages (and all loans) should always be considered in terms of the absolute amount of money.
- Each move delays your ultimate goal of owning your home free of a mortgage.
- Do not look on your home as a piggy bank.
- Consider a home equity loan or line of credit only under very restricted circumstances.
- Insist on no pre-payment penalties.
- Avoid "creative financing."
- **The early payoff of a home can be the equivalent of a lifetime of successful investing.**
- Pay cash for remodeling or additions.
- A poorly planned addition can decrease the value of a home.

Chapter Fourteen
Funding Your Children's Education

I feel the best and most desirable way to fund your children's education is for your children to work hard, save their money, and pay for as much of their own education as possible. The greater the contribution that your child makes to their own education and to supporting themselves in life, the greater their sense of appreciation for what they have achieved. I paid my own way through college and medical school so it can be done.

However, considering that the current total cost at a private college or university is $30,000 or more a year and possibly the additional cost of graduate or professional school of another $100,000, or more, it is unlikely that even an 18-year-old clone of Warren Buffett would be able to completely pay their own way.

If you do wish to pay all of your children's educational expenses, encourage them to pay their own living expenses. Another option would be to make it the children's responsibility to provide their own spending money when they turn 16 and can thus have a part-time job, and that they are responsible for some percentage of their educational expenses—such as a quarter or a third—after scholarships, but before loans and your contributions. They could also be responsible for a percentage of the down payment and upkeep, including insurance, of the car.

Children can earn money before they are 16. They can mow lawns, wash cars, have a paper route, do any sort of errand, baby-sit (boys can baby-sit), or as several of my friends did, perform basic agricultural jobs such as hoe beans or cantaloupes. After turning 16, they can have after-school and weekend jobs. I worked between 32 and 35 hours a week at Graham's Book Store in Granite City during my junior and senior years in high school. There are the summers between college and many students also work during the college year.

FINANCIAL AID

Approximately three-quarters of college students receive financial aid as either grants, scholarships, or loans. Thus assistance is available for the majority of students. Aid is available from almost every level of government, from the schools, private and public companies, institutions, fraternal and charitable organizations, foundations, and individuals. The unifying factor for obtaining whatever aid is available appears to be just plain persistence in pursuing all options.

The standard financial aid formula assumes that 5.6% of the parent's assets and annual income, excluding money in retirement accounts or representing equity in a home,

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may be spent to pay college tuition. This same formula assumes approximately one-third, 35%, of the money held in the child's name can be used for tuition.

The search for information on financial aid may begin at anytime, but the general applications for aid from the schools directly, the state, or private organizations, is usually in the fall of the year prior to beginning college.

In January, as soon as possible after January 1st but not before, the student may submit the Free Application for Federal Student Aid (FAFSA). Federal aid is awarded on a first-come, first-served basis so it is essential to submit all data and applications at the earliest possible time. This application will be used to determine eligibility for federal government grants, Pell Grants, and loans such as Perkins Loans, Stafford Loans, Plus Loans, and other federal and private loans. Pursue all reasonable options. Persistence is the key.

If your child is extremely bright, or has a gift or special talent in sports, music, the theater, or in fact, almost any extracurricular activity, significant, and sometimes even full financial aid is available. Many colleges and universities often provide a significant discount or even full tuition if the parent is employed at or on the faculty of the school.

Approximately one-quarter of students do not qualify for any financial aid. If you make our presumed physician's salary of $250,000 per year and have been thrifty and invested wisely, there is a definite possibility that you will have to pay "full boat" tuition and fees.

Two additional factors must be considered in planning and saving for your children's college education. It has been standard to assume an undergraduate period of 4 years. However, a recent report published by the Education Trust (*see* "College in 4 years? Try 5 or 6," by Jeanne Sahadi, CNNMoney website, June 22, 2004) found that only 37% of first time freshmen entering a 4-year bachelor's program completed their degree within 4 years.

There are factors that prolong the time in college, such as switching majors, taking a double major, transferring schools, or inability to enroll in a required course. Many schools are also increasing the number of requirements for graduation, thus necessitating more time in school. Note that the best schools have the highest 4-year graduation rates. A good incentive to help your child remain focused on graduating in 4 years is to give them the responsibility of paying a higher percentage, or even all of their expenses—educational, living, rent, car, etc.—should their undergraduate education extend beyond the traditional 4 years (not including, of course, legitimate factors beyond their control).

For many years the cost of higher education has considerably outpaced the general increase in the cost of living in the United States. What seems like a grand and princely sum now, which would be adequate to cover current costs, may be quite inadequate in 10 or 15 years. Plan accordingly.

SPECIFIC TAX-ADVANTAGED OPTIONS TO SAVE FOR COLLEGE

There are so many investment and tax ramifications and so many nuances involving the various ways that one can save for their child's education that at the least one visit early on in the process with an appropriate professional—such as a financial planner—

is mandatory to determine what plan, or plans, best fit your circumstances. To invest in the 529 Plan without professional financial advice is to be discouraged.

One of the best sources of information to assist you in saving for your children's education is Joseph Hurley's website, www.savingforcollege.com. The website is extremely informative for both general concepts and details. Everyone that I have spoken with gives the website their strongest recommendation.

I will describe the various options available, in what I feel is an increasing level of complexity.

Series EE or Series I US Government Savings Bonds

Do not overlook this option. Savings bonds are easy to understand. They are liquid. They are backed by the full faith and credit of the US Government. Bonds are available in denominations as small as $50 with all levels of increments up to $10,000. Most bonds are issued at half of their face value, although the Series I bonds are issued at 100% face value.

The principle advantage of Savings Bonds as a tool to save for college is that the interest accumulated is not taxed until the bond is redeemed. This compares to a passbook savings account or CD, where the interest is taxed as it is received. There are also other factors to consider, including that the tax benefits may be limited by income and other conditions may apply.

In years past, the interest on US Savings Bonds was posted only every 6 months. If the bond was redeemed at an inopportune time it was possible to lose up to 5 months interest. All bonds issued since May 1997 accrue interest monthly. Since time is money, the best time to redeem a US Savings Bond is the day after the interest is posted.

US Savings Bonds may not be particularly glamorous but can be effective in saving for your children's education and could be appropriate for you.

Uniform Gift to Minors (UGMA)/Uniform Transfer to Minors (UTMA)

The UGMA is the principal method I used to save for my children's education. It was the easiest and best option available in the mid- to late 1980s when I began putting money away for the children. It is simple and does not require the advice of a professional.

The money is an irrevocable gift to the child, although the parent remains the custodian and thus supervises the investment of the money, until the child reaches the age of majority, which is 18 to 21 years old, depending on the state.

The principle financial advantage is that the money is taxed at a different marginal rate than the parents. Up to age 14, the first $750 of investment earnings are tax-free, the next $750 are taxed at the child's rate (usually about 10%), but investment income above this is taxed at the parent's rate. However, when the child turns 14, all of the investment income is taxed at the child's rate, which should be much lower than the average physician/parent's marginal rate.

The UTMA is very similar to the UGMA but the custodian can postpone the final distribution of the funds until the child reaches the age of 25. This variant may be advantageous if your child waits several years after high school before attending college or if they plan to attend graduate or professional school.

The principal shortcoming of the UGTA and the UTMA has always been that the gift is irrevocable. When the child reaches the age of majority (UGTA) or 25 (UTMA), the money is theirs, with no strings attached. If your child is destined to be a successful, productive member of society, they will presumably use the money for continuing their education or otherwise wisely and appropriately. If your child should turn out to your disappointment, the money is theirs, to potentially waste as they see fit.

A significant drawback of these accounts is that because the money is in the child's name, it is an asset of the child and will thus significantly decrease their chances of qualifying for financial aid.

Roth and Traditional IRAs

Money may be withdrawn for qualified higher educational expenses without paying the 10% penalty levied on withdrawals prior to age 59 and a half, but there are many rules, exceptions, qualifications, and exemptions that apply. Consult your tax professional.

Coverdell Educational Savings Account

This allows a yearly contribution of $2,000 into what is essentially an Educational IRA (the old name of this plan). Unfortunately, again, availability of this option is phased out at higher Modified Adjusted Gross Income (MAGI). Consult your tax professional.

Student Loan Interest Deduction

It is possible to deduct up to $2,500 annually of the interest paid on student loans, even if the student does not itemize. Again, the benefits are limited by income. Consult your accountant or tax advisor.

Repaying Student Loans

It is often possible to delay the repayment of the principal and/or interest on student loans while one continues further schooling and training. Contact the lender, the holder of the note, for details and for the appropriate paperwork. Consider a deferment if it is advantageous for you.

Likewise, when it comes time to repay, you must pay. Some people consider student loans to somehow be different than other loans. They are not. You were leant money in good faith and it must be repaid. Wages can be garnished if a student loan is not repaid. When you repay your student loan you are making money available for other students to continue their education just as this money allowed you to continue your education.

Student Loan Forgiveness

This advice is for both practicing physicians and their children. The average medical student graduates with $115,000 to $120,000 of debt. When entering practice (or even if already in practice) make every effort to have your employer, or the group you are joining, or the hospital(s) at which you will practice, help with your student loans.

There is currently a physician shortage, especially for specialists and sub-specialists. The situation will probably worsen. This allows the physician entering practice considerable

leverage, especially if the hospital or group you are joining needs your specific services. There is an excellent chance that the group or hospital will assist with some percentage of your student loans for each year that you practice.

This work is devoted to a physician's personal investments and finances, not to the finances or economics of the practice of medicine. However, I will make one comment. If you are in the private practice of medicine, avoid being an employee of a hospital. On the surface it may appear appealing, but in the end it is rarely advantageous.

Hope Tax Credit

A tax credit is different than a tax deduction. A charitable gift is an example of a tax deduction. A deduction decreases your taxable income. For example: a charitable gift of $1,000 to the Boy Scouts decreases your taxable income by $1,000, thus saving approximately 40% of the deduction, depending on federal, state, and local tax rates. A tax credit is much more valuable. A tax credit does not decrease your taxable income, it decreases your taxes. A tax credit of $1,000 decreases your taxes by $1,000. Essentially, $1.00 of tax credit = $1.00 of savings. With the Hope Tax Credit, you can receive up to $1,500 of tax credits per year for each qualifying full-time student. The credit is available if the student meets the following four qualifications:

1. No history of felony drug conviction.
2. Be enrolled at least part-time for at least one academic period a year.
3. The program must lead to a degree or other recognized educational credential.
4. First 2 years of post-secondary education.

There are also other limits, and the households MAGI affects the benefits. For both this tax credit and the Lifetime Learning Credit our standard physician's income essentially precludes eligibility. Consult your tax professional.

Lifetime Learning Credit

This is a tax credit that in 2003 was equal to 20% of the first $10,000 paid for qualified expenses for eligible students. The maximum credit per family is $2,000 annually. Again, MAGI will affect the amount of credit.

529 Qualified Tuition Programs

Many financial advisors consider these plans the premier option of the currently available tax-advantaged vehicles to save for a child's education. I will outline what I feel are the advantages and disadvantages of the 529 Plans. There are two basic types of 529 Savings Plans.

College Savings Plans

Anyone can open and contribute regularly to build a tax-free fund for college. The money grows tax free, it can be used not only for tuition but also other legitimate college expenses such as room, board, and fees. The money that is withdrawn and used for these expenses is tax-free. These are tax-advantaged investment plans, not prepaid tuition plans.

Each state has their own 529 Plan and the details vary state by state.

ADVANTAGES OF STATE-SPONSORED 529 COLLEGE SAVINGS PLANS

1. The tax advantages are unmatched, truly impressive. The money deposited is post-Federal tax (similar to the Roth IRA). The earnings grow tax-free and all of the money withdrawn, both earnings and original contribution, are tax-free.
2. Some states, to encourage residents to use their home state plans, allow the money contributed to be deducted from the state returns. If your state has, for example, a 6% state income tax, you have already saved 6%, more than half of a year's standard return on investment.
3. The limits that you may contribute are very high. Some states allow more than $200,000 to be saved tax free. This amount should fund your child's entire undergraduate education, even at the most expensive private schools. This should also be sufficient to fund at least part of a post-graduate or professional education.
4. The donor maintains control of the fund. Contrast this to the UGTA and UTMA.
5. Everyone is eligible. There are no income or age restrictions. If an adult would like to pursue further education, such a physician returning to school for a MBA, you may establish a plan for yourself.
6. The plans are extremely flexible. The beneficiary can be changed. Suppose you have saved an equal amount for two children. One child is lazy and barely finished high school. The other child is a star and wishes to pursue post-graduate training. The money can be transferred from one child to the other child's account.
7. It is possible to invest in other states plans if you feel there is a plan superior to the plan offered in your state of residence.
8. Some states allow the donor a degree of flexibility in determining the investments. In Missouri, if the donor wishes to allow the state to handle the investment, the money is sent directly to the money manager with whom the state has contracted. In Missouri this is TIAA-CREF. If the donor wishes to have specific input, some states allow the investment to be allocated among several stock or fixed income funds offered by the money management company.
9. The money in these plans may be used for any qualified higher educational expenses, including room, board and books and graduate school. Contrast this to the prepaid plans, which cover essentially only undergraduate tuition and fees.
10. There are no income limitations, a significant benefit for physicians, as compared to many of the other options described above.
11. Because the money is in your name, it has much less of a detrimental effect on your child's eligibility to qualify for and receive financial aid. Only 5.6% of the parent's assets are considered available to be spent per year on college tuition, as compared to 35% of assets in the child's name.

Overall, the advantages of these plans are impressive and it is easy to see why they are so popular.

Now for my reservations:

1. These plans are very complex. They vary from state to state. Expert advice is mandatory. I devote Chapter Eight and many further discussions throughout this book to the importance of understanding one's investments.

2. Impartial advice is mandatory. If you receive recommendations from a broker/agent or banker, who will recommend the options, which generate commissions for them, there are sure to be fees that would otherwise be avoided.
3. Because this is a gift, it must comply with all gift tax rules. These should be detailed in the general rules and guidelines you will receive. If a grandparent is making a gift to a grandchild, it must be within the guidelines of the Generation Skipping Taxes.
4. The government could change the rules at any time. This is my principal concern. Many feel that money already invested in the plans will probably be "grandfathered," i.e., a change in rules will not affect money already in the plans, but the possibility does exist. Note that the current tax-free treatment is scheduled to expire in 2010. Congress is apparently being lobbied to continue the current tax advantages, but it has not yet happened. Of course, rules could be changed to affect any future money placed in the plans.

   Let me provide examples from our past of when the government has changed the rules to the detriment of the citizen. In the 1980s, everyone, regardless of income, could contribute to an IRA. It was an excellent way to save for retirement. So many restrictions have since been added that the average physician no longer qualifies.

   Because money will be in these plans for many years, it is possible that economic or political conditions could change so significantly that the rules could be changed even on money already invested in the plans. The money would not be "grandfathered" but would be subjected to whatever changes were enacted. This point is made in addition to the potential 2010 expiration date as described above.

   There are examples from our recent history that demonstrate how significantly rules can be changed. Before 1933, gold circulated freely in the United States and the US dollar was "as good as gold." Any citizen could exchange paper money at the Treasury for gold. In March of 1933, in the depths of the financial crisis of the Great Depression, among Roosevelt's first actions after taking office were to close the banks and call in the gold. The United States effectively repudiated the gold standard.

   Also during the Depression the highest marginal income tax rate was raised to 90%. It is extremely unlikely but still conceivable that should an economic crisis arise, the government could be sufficiently hard-pressed for revenues from any source that the current tax advantages of the 529 Plans could be significantly changed. Or the government could mandate that 529 Plans, or for that matter, any type of tax-deferred account, place some percentage of it's assets in Treasury bonds to help finance the deficit.

   In 1964 the United States repudiated the silver standard. Prior to that time, dimes, quarters, half-dollars, and dollars were silver and $1 bills were "Silver Certificates." Now our coins are base metal with minimal intrinsic value.
5. As always, be aware of fees. There is no reason to purchase a 529 Plan through a broker or salesman because there will be fees. There is never any reason to buy a mutual fund with a load, either front end or back end.

Prepaid Tuition Plans

These plans allow you to lock in future tuition costs at today's levels. The money is invested either as a lump sum or a series of payments (i.e., amortized) and the state

guarantees to cover a specific number of tuition credits at a state school. In actuality, the money can be used at any school, including a private school, either inside or outside of the state.

I would recommend the 529 Plan as compared to these plans because of greater flexibility. The weaknesses of Prepaid Tuition Plan in comparison to the 529 Plans include the following:

1. The money is invested by the state with the goal that the anticipated rate of return will match the projected tuition costs at the state's schools. Thus investment performance often lags.
2. Tuition increases at many state schools have been accelerating far beyond what was anticipated in years past. This underestimation of tuition increases has caused some plans to be in a deficit. Some states are now even charging premiums over current tuition costs.
3. Because investment performance has often not kept up with cost increases, should your child decide to attend a higher cost private school, the funds in the account may fall far short of those required to fund their education.
4. Some plans do not allow the full benefit to be transferred should you choose an out-of-state college or university.
5. These plans cover tuition. Other costs, which are significant, such as room, board, books, etc. are not covered.

There is a variant of these prepaid tuition plans for private colleges, essentially a prepaid 529 Plan for private schools. Please consult www.savingforcollege.com for details.

PAY FROM YOUR OWN FUNDS

The above discussion not withstanding, you may consider funding some of your children's educational expenses from investments that you have earmarked in your portfolio for this purpose.

1. There is no doubt who controls the funds.
2. Should the government change the rules for any plan, it would have no effect on funds saved in this way. This is similar to my advice given elsewhere on the importance of having savings for retirement outside of defined retirement plans.
3. Sometimes one becomes so concerned, almost mesmerized, with tax potential advantages that they lose sight of the basic goal of investing, which is to maximize profits. This advice is similar to that given elsewhere regarding tax shelters.

SUMMARY OF CHAPTER FOURTEEN

- Encourage your children to pay for as much of their own educational expenses as possible.
- Take complete advantage of all financial aid.
- The length of a college education is often longer than 4 years.
- The cost of higher education is rising more rapidly than the general cost of living.
- There are many tax-advantaged options available to fund your children's education.

- Unfortunately, many of these are not an option for most physicians.
- Expert advice is mandatory.
- If the tax advantages become too favorable the government could change the rules.
- Paying for college from your own investments may be a viable option.

Chapter Fifteen
Insurance

Insurance works by determining and spreading risk. The amount of the premium is determined by an actuary who calculates the likelihood that an event will occur, and then the premium is set to adequately cover this possibility and provide a reasonable profit margin for the insurance company. Sometimes this is a fairly easy task, such as determining the life insurance premium on a group of 45-year-old, nonsmoking, well-educated, ideal weight, normotensive men or women. Sometimes the insurance companies do not adequately handicap risk, as Warren Buffett admits following the terrorist attacks of September 11, 2001. When risk has been handicapped many people then pay a premium, such as 100 homeowners, to fund the large payout when one home burns.

The function of insurance is to manage risk. It is to protect against a loss that an individual cannot afford to sustain, such as the permanent loss of income (disability insurance), loss of life (life insurance), or home (homeowners insurance).

Insurance is not meant to be an investment, it is not a viable vehicle to save money. Insurance is also not meant to make your spouse or children and heirs rich. It is meant to supply and fund their basic needs, to make sure they have a home and an education. To buy a $10 million life insurance policy for your spouse and children to live in luxury they never would have dreamed possible were you alive is not logical. This would be a terrible waste of resources. It is possible to be over insured, and if you receive all of the advice on the insurance you "need" from an insurance agent, who makes their money from the commission by selling insurance, you could be.

DISABILITY INSURANCE

It is not adequately appreciated that disability insurance is the most important type of insurance that a professional such as a physician must have. Your most valuable financial asset is not your home, your vacation condo, your car, or any other piece of personal property. Your most valuable asset is your skill as a physician and the earnings generated. Two hundred and fifty thousand dollars a year for 25 years is $6,250,000. This is a physician's most valuable financial asset, their capacity to work and produce income.

Becoming disabled occurs more commonly than you might appreciate. The average person is almost five times more likely to become disabled than have their home damaged by a fire. The average person is almost six times more likely to become disabled than to die prematurely.

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Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

There are general limits on the amount of disability coverage that may be purchased. Benefits are usually limited to approximately 60 to 70% of one's income. In addition, benefits are usually capped at $15,000 a month on an individual policy. You can have multiple policies but I see no need for this. The reason benefits are capped is if they become too "sweet" too many people would find it "easier" to become disabled.

What is the definition of disability? Is it a general definition of being able to perform any kind of work, or does it relate to your particular specialty? In insurance language, this concept is referred to as "owner's occupation" as compared to "any occupation." The former definition means that one is disabled if one can no longer perform one's current occupation. The later means that one is disabled only if one cannot perform any work at all. For example, a right-handed cardiac surgeon suffers a small embolic cerebrovascular accident (CVA) from unrecognized intermittent atrial fibrillation. Occasional palpitations had been noted but were dismissed. The stroke results in just enough loss of the manual dexterity in the right hand that the surgeon can no longer adequately perform in the operating room. He can walk and talk without a deficit, perform a general history and physical examination, provide consultations, teach students and give talks, read studies such as EKGs, echocardiograms, or vascular studies, but can no longer perform surgery. Clearly a physician needs an "owner's occupation" policy.

The above situation also emphasizes the importance of "residual benefits." Should you still be able to perform some physician duties, but not cardiac surgery, residual benefits guarantee a certain percentage of your previous income in comparison to the income of the new job.

Other important factors relating to disability insurance include the following:

1. The length of the elimination period (the equivalent of a deductible on automobile or homeowners insurance). The more quickly the policy provides benefits, such as 1 or 2 months, the more expensive the insurance. The longer the elimination period, such as 6 months, the lower the premiums. I recommend the longer elimination period. The average physician should have sufficient funds to cover the hiatus.
2. Disability insurance is expensive. If possible, purchase the policy through a group. The premiums will be lower as compared to an individual purchasing the same amount of coverage.
3. Obtain a policy that is non-cancelable and with guaranteed renewal. If you pay your premiums on time, the policy cannot be cancelled and the premiums cannot be raised during the life of the policy.
4. Some policies include a cost of living adjustment. Consider this option. If there is a period of significant inflation, such as occurred during the 1970s, the payout in the future may not have kept up with the cost of living. Even with inflation of only 2% per year, after 20 years the purchasing power of a dollar has dropped by almost 50%.
5. Be sure the policy is purchased with after-tax money. If the policy is purchased with pre-tax money, the benefits are taxable. If the policy is purchased with after-tax money, the benefits are considered after-tax and thus not taxed. You will be paying more on a small number (the premiums) to potentially save much more on a larger number (the benefits) should you become disabled.

6. Consider dropping the disability insurance when you reach your mid to late 50s, and have all or almost all of your major obligations funded, and/or are within a few years of retirement. You do not need to carry disability insurance right up to the day of retirement.

AUTOMOBILE INSURANCE

Everyone needs auto insurance. My principal suggestion is to make sure that you have sufficient liability coverage.

Allow me to make a comment about AAA (Automobile Association of America). Being a member of AAA can provide many benefits aside from the obvious ones should your car break down. Discounts for many expenses, including travel, rental cars, hotels and even some parking facilities are offered. On a recent trip we obtained enough discounts in these areas to cover our AAA premiums for the year. This is an example of how good planning and attention to detail can result in money in your pocket.

HOMEOWNERS INSURANCE

Everyone needs homeowners insurance. Also keep the following in mind:

1. You may insure for a natural catastrophe not covered in standard policies, such as a flood or earthquake. The most powerful earthquake ever recorded in the continental United States was in New Madrid, in southeast Missouri, in 1811. Because there are still occasional tremors in the area, we have earthquake insurance. It is not as expensive as you may think. Terrorism insurance is now available. Some homes are in areas where there is a high probability of a natural disaster, such as a flood, landslide, or hurricane. Appropriate additional insurance in such areas may be mandated and even if not mandated may be a good idea to limit your potential loss.
2. The possessions of a home are typically insured for a standard percentage of the value of the home, usually 50%. If you have particularly valuable, and non-standard home items—such as art, collectables, valuable musical instruments, antique furniture, etc.—be sure they are adequately insured. I have a large library of almost 700 volumes that is insured.

   An excellent way to record all of your household belongings is to make a videotape inventory of every room in your home and keep the videotape in your safe deposit box. This provides documented proof of your personal possessions.

   The replacement value of the clothes and other items that you have accumulated over time can be much more than you would imagine. Ten men's suits ($750 each), 10 dress shirts ($100 each), 10 men's sweaters ($75 each), 40 or 50 nice pieces of women's clothing, 5 or 6 formals and gowns, and several score of shoes will come to $20,000 to $30,000. There is also the children's clothing, replacement linens for the bed, kitchen utensils and supplies, and just all of the "stuff" that accumulates. With a videotape you have the best chance to receive adequate reimbursement. Some good friends just suffered a devastating house fire. It was terrible. What was previously an area kept spotless by weekly dusting, mopping and polishing is now a foot deep pile of cinders and rubble that you scoop up with a shovel and throw out the hole in the

wall that was previously the window. You must have an adequate inventory of your belongings in order to submit a complete list of items lost.

You should have a replacement cost policy as compared to an actual cost value policy. With the latter, the policyholder is reimbursed for the cost of the belongings minus depreciation. A nice living room couch purchased 10 years ago for $2,000 may now have a depreciated value of only $100. I suggest a replacement cost policy.

3. If you have multiple insurance policies with the same company—auto, life, home, etc.—they will typically offer a discount, which can be very substantial. Be sure you are receiving all discounts you are due.
4. Our home was built in 1939 and has many features of workmanship not present in most homes built today. The standard homeowners policy is for replacement value, in general, at current levels of workmanship with standard products. If your home has special features of workmanship, request a special rider to replace things comparable to what was lost, not comparable to current construction practices. This will cost more, and will probably require a visit by an underwriter who specializes in this area, but is worth the added expense.
5. Be sure that the total amount of coverage has kept pace with inflation and with the appreciation in the value of your home.

LIFE INSURANCE

The first step is to determine what amount of insurance is required. Financial planning and insurance guides provide several formulas for suggested amounts, the most common one being to have life insurance equal to 7 years' salary. I find this recommendation far too high and the use of such a formula too constraining. I will simplify things by posing this common sense question: what are your obligations?

You will often see recommendations that all adults should have life insurance. I disagree. If you are unmarried and have no dependents, as is the case with many medical students and even some house staff, I do not think life insurance is required.

Or you have reached your golden years and things have gone well financially (possibly because you read this book). You are 72 years old, the children are self-sufficient, there are no personal debts and you have $2.7 million of income-producing assets. At this point you do not need life insurance. From the time you first start to look for life insurance, anticipate that coverage will not be required beyond age 60. The reason is that premiums rise dramatically at this age because the risk of dying increases *pari passu*. This emphasizes one of the weaknesses of whole life. With whole life you have insurance for your whole life and there are clearly times that life insurance is not required.

If you own a home with an outstanding mortgage, are married and have children who are not yet self-supporting, then you have an amazing amount of obligations. I would suggest you have sufficient insurance to cover debts, such as the amount of your mortgage, car loans, student loans, and any other indebtedness. I also suggest sufficient insurance to cover loans on illiquid investments, such as limited partnerships or closely held companies. Outstanding loans on assets that cannot be easily converted to cash could result in a cash crunch, necessitating further borrowing or a distressed sale of the asset. You need sufficient insurance to fund your children's education and a sufficient

amount to fund the daily expenses for your spouse and children. Subtract from this the amount already accumulated in savings.

I would also suggest life insurance on your spouse. There are always expenses and disruptions when a spouse dies. If you do not have children and your spouse works, your life-style, expenses, amount of debt (such as a mortgage) are probably predicated on two incomes, necessitating some amount of insurance.

Whether your spouse works or not, if they are the sole or principal care-giver for the children, then their death will be associated with significant expenses and residual obligations. Your work will be disrupted for some time—weeks or more likely months—while you get your life back together. Your income will almost certainly drop significantly during this period. At this terrible time in your life your goal will be just to put one foot in front of the other, get through the day, and hold your family together. The further addition of monetary worries could make things unbearable, especially if you do not have family, such as parents, siblings, or in-laws, to help. Who will supply childcare, or go to the store and run errands? If you must pay for all of these it will be very expensive. A policy of about $250,000 on a non-bread-winning spouse is reasonable.

Before describing the types of life insurance available, I will make several recommendations about when life insurance is not required.

If a homebuyer has less than the traditional 20% down payment, the lender will require private mortgage insurance (PMI). The bank is doing this to protect their interests. Note likewise that PMI can be dropped when you accumulate 20 to 22% equity in your home.

However, if the bank "suggests" but does not require PMI, the answer is always no. In essence, you are buying an insurance policy for the bank. It is always a very poor investment for you, a good one for the bank. This does not negate my advice that you should personally have sufficient life insurance to cover major debts, where your heirs (and not the bank) are paid the benefits.

The loss of a child is incomparable and the pain must be unimaginable, but there is no reason to purchase life insurance on a child. When I was growing up it was not uncommon for parents to buy whole-life policies on their children, in effect, as a way to save for their college educations. As previously mentioned, insurance is not a viable vehicle for investing.

One pitch often used to induce a parent to purchase life insurance on a child is that by doing so the child is assured of being able to purchase more insurance when they become an adult. This is a bogus argument. There is no need to purchase life insurance on a child.

The two principal types of life insurance policies are term and whole life.

Term life insurance provides a specific benefit to your heirs while the policy is in force, that is, during the term of the policy. The premiums are significantly lower than for whole life but there is no other cash or investment value to the policy itself.

Whole life provides lifetime death benefits to your heirs on your death, but also builds up a cash value as time goes on. The premiums on whole life are significantly higher than the term. Because whole life has a cash value, it is a real asset, and this does provide some options, such as the possibility to borrow against this cash value.

Hopefully this option will never be required and should not be a factor when one considers purchasing life insurance.

I do not like whole life and strongly recommend against it (except as described below). What one is doing, as compared to a term-life policy, is giving the insurance company your money to invest. The long-term return is rarely more than 5%. The average physician investor would be much better served buying a term-life policy and investing the difference in premiums in a mutual fund. My cousin refers to this as "termite"—term life for everything, invest the rest.

The agent's commission on whole life insurance is amazing. Of the first year's premiums, 80 to 90%—Yes, 80 to 90%—go to the selling agent as commission, leaving a dime and some change to build up as the cash value of your policy. In addition, the agent receives residual commissions on subsequent premiums. Because of these commissions and further administrative fees it can take 6 or 7 years for your whole-life policy to build positive cash value. The agent's commission is considerably less on term life than on whole life. It is safe to say that this is why the agent always mentions whole life first and gives it their strongest recommendation. Whole life is not a viable option as a savings plan and should not be considered as one.

I will give a real-life example of how terrible an investment whole-life insurance can be. Some friends recently asked me to review their general financial situation and provide advice. She is 42 years old and at age 24 purchased a whole-life policy for $100,000. The monthly premium is $23.26. Exactly 18 years later the cash value of the policy is $2,559.88. She has paid a total of $5,024 in premiums. This represents a return of negative 49%. Eighteen years and she is down 49%. Remember that it took our stock market exactly 25 years to return to it's 1929 level just to break even. In this real-life example, a whole life insurance policy is worse than the financial equivalent of living through the Great Depression. If this $23.26 per month had been invested at the standard 10% return, our friend would now have just less than $14,000.

I recommended that our friend buy an appropriate amount of term life insurance, cash in her whole-life policy and put the proceeds into a Roth IRA. When she supplied the insurance company the written notice, she was reminded that "we may defer this payment of net cash value for up to 6 months."

Consider the above scenario from another perspective. If I can help you avoid just one such situation, you have saved many times the cost of this book.

There are special circumstance that requires a significant amount of cash be available on one's death and if they are in their 60s or 70s or older, then a whole-life policy is appropriate. An example would be a buy–sell agreement. However, this is an estate-planning question rather than an investing question and should have been addressed by the lawyer who drew up the buy–sell agreement.

Should you be in the unfortunate situation that you have already purchased a whole-life policy, I recommend what I recommended to our friend. First purchase an appropriate amount of term life insurance. Then admit to yourself that you goofed up (it will be difficult), swallow hard, cash out your whole-life policy, learn from your mistake, and don't look back.

For the average physician investor, I recommend the purchase of an appropriate amount of term insurance for all of your life insurance needs. Do not even consider whole life.

LONG-TERM CARE INSURANCE

One tremendous personal benefit that I have received from writing this book is to critically evaluate my entire personal financial situation, my strengths and my weaknesses, my needs and what changes I should make.

This is no more apparent than regards long-term care insurance. I have previously given this no thought or consideration at all. I was clearly wrong. Long-term care insurance is an important issue, everyone should give this strong consideration, and I plan to purchase long-term care insurance in my late 50s but before age 60.

It is essential to consult a tax professional before purchasing long-term care insurance because if particular criteria established by the IRS are met, the benefits could be tax-free. For the self-employed (such as many physicians), long-term care insurance may be a deductible business expense.

There are several factors to consider when purchasing long-term care insurance.

1. You must be sure you can still afford the premiums after retirement. It would be an unmitigated disaster to pay on a policy for 20 years, and then in your seventies, when your need for the benefits may be imminent, be forced to drop the coverage because you cannot afford the premiums.
2. The best age to purchase a policy is in your mid to late 50s, but before age 60. This will help minimize the payment of premiums during a time when the need for long-term care benefits is unlikely to be required, such as before age 55, but allow a policy to be purchased for a reasonable premium while you are still in good health.
3. Purchase a policy that reflects the cost of a skilled facility in your area. The policy should have a provision for inflation, provide home–health coverage, and a 4- to 6-year (or even longer) period of benefits.
4. Since it may be decades before you may need the benefits, the company must still be in business 40 or 50 years from now. This is clearly not a situation to go with a start-up company because the premium may be a little lower. Independent companies such as Moody's, Standard and Poors, and several others rate the financial position of insurance companies that offer long-term care policies. Consult these ratings and consider only companies with superior financial positions.

EXTENDED WARRANTY

Expensive mechanical products, such as a car, washer, dryer, etc., come with a standard manufacturer's warranty, guaranteeing parts and/or service over some specific period of time and some specific set of conditions (be sure to retain all warranty information that comes with the product).

When the original warranty expires, you will usually receive an offer to extend the standard warranty. These should be evaluated on a case-by-case basis, but as a general rule, I recommend against them. They are rarely a good investment. The company selling the extended warranty (it is essentially an insurance policy) has set the cost of the product to both cover their costs and realize a profit. The latter is essentially a fee at your expense. Local appliance dealers will sometimes offer an extended warranty at a cost significantly lower than that offered by the company. Even though these are less expensive, they still represent a fee that can be avoided. The physician investor is better

off buying a quality product from a reputable dealer, taking good care of it, not purchasing an extended warranty, and saying an occasional prayer to the Whirlpool god that your icebox does not break down.

The function of insurance is to cover a loss that you cannot afford to sustain, such as your livelihood or home. Although washers, dryers, air conditioners, etc. are expensive, they do not need to be insured, which is exactly what an extended warranty is. Remember that such appliances are routinely built to provide good service for 15 to 20 years or longer. If they are breaking down in 4 or 5 years, the time usually covered by the extended warranty, you have unfortunately purchased a poor product.

Always buy quality. This relates not only to the performance of the product, but especially its durability and dependability. The average busy physician has so little free time that when you want to use something such as a tractor, a piece of wood working machinery, or whatever, you want it to work. If it breaks down, you either do not have the mechanical skill and knowledge to perform the repairs yourself or you are forced to spend your free time repairing the machinery instead of having fun.

MEDICAL INSURANCE

Everyone must have medical insurance and I am confident that all readers of this book do.

If both you and your spouse work, or for whatever reason you both have health insurance, make sure that you are not paying for overlapping (i.e., redundant and nonnecessary) coverage. The savings here could be substantial.

I suspect that even though medicine is your profession, you may not realize how expensive good medical coverage is. Any physician who draws a salary—academic medicine, private industry, employed by a hospital or large group or clinic, physician still in training—just receive this as a benefit and have little or no idea of the direct cost. Even physicians in a group practice, such as me, only note the cost of the insurance as just another (albeit quite large) expense on their monthly overhead statement. The full cost of medical insurance will not be truly appreciated until you must pay the costs directly out of your pocket. I suspect physicians underestimate how much quality medical care costs on the individual level.

UMBRELLA POLICY

Unfortunately, it sometimes seems like everyone wants to get into a doctor's pocketbook. You need not only sufficient liability limits on all standard policies such as home, rental property, auto, etc., but you also should have an umbrella policy that provides additional liability coverage above and beyond that in the standard policies.

Umbrella policies are not as expensive as you might think (they are for back-up, not your primary line of defense) and do provide a nice layer of protection between a plaintiff and your personal assets. Obtain these through the same company that writes your other policies and there will be even further cost savings.

SUMMARY OF CHAPTER FIFTEEN

- The function of insurance is to manage and spread risk.
- You must insure things you cannot afford to lose.
- You could be overinsured if you receive all of the advice on your insurance needs from an insurance salesman.
- Your most valuable asset is your ability to work and generate income. Good disability insurance is mandatory.
- Disability insurance should be purchased with after-tax money.
- A physician's disability insurance must be "owner's occupation."
- The amount of life insurance required depends on your obligations.
- There must be adequate life insurance on the spouse that provides child care.
- Avoid Private Mortgage Insurance.
- There is no need to purchase life insurance on a child.
- Termite—term for everything, invest the rest.
- Purchase term life insurance. Completely avoid whole life.
- No life insurance should be required after age 60.
- Consider long-term care insurance, but only from companies with strong financial positions.
- Everyone needs medical insurance.
- Avoid extended warranties.
- Consider an umbrella policy.

Chapter Sixteen
Funding Retirement

My first recommendation: do not rely on the government for anything! If Social Security and/or Medicare are still providing benefits when you retire, consider whatever received to be "gravy." If you expect either of these programs to provide any significant percentage of your retirement needs, you could be disappointed.

I would even raise a significant caveat about pensions and other benefits, such as medical insurance coverage, from employers. There are steelworkers who retired before age 65 (and thus do not receive Medicare) who now have no medical insurance. If you are a physician in Pittsburgh, Pennsylvania or Granite City, Illinois, or any other steel town, you are probably providing care for such patients. This could apply to a physician working in industry or to your spouse if they are not a physician. Five years ago the people at Enron probably thought they were "in like Flynn" (an expression referring to the handsome movie star of the 1930s and 1940s Errol Flynn) but now they have almost nothing.

There is a government agency that insures corporate pensions known as the Pension Benefit Guaranty Corp. This agency currently pays benefits to one million Americans (mostly retired steelworkers and airline workers) and insures the private pensions of 43 million more. If current financial conditions persist, this agency will run out of money in 2020. If it were a private agency it would already be considered insolvent (CNNMoney, September 14, 2004).

The one person you can always depend on for your retirement, for anything, is you. Plan accordingly. And start planning today to take every advantage of your greatest investment friend: compound interest.

You must have a defined strategy, these being your goals—when do you want to retire and how much money will you need? You can then define your tactics—the specific steps to be taken to achieve these goals.

I will mention but not discuss the general topic of estate planning. This is a subject in and of itself. Your age, your children's age, your financial situation, insurance, current tax laws, the state where you reside, what you would like to do with your money, your marital situation, how your will is structured, trusts, and everything. All are important.

I recommend the input of a lawyer who specializes in estate planning. Many lawyers say they can provide help with estate planning but seek the assistance of a specialist in this area. Accountants can provide tax advice, but this is an area that requires a grand, all-encompassing strategy or design, and this is best provided by a lawyer specializing in estate planning.

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

ANTICIPATED AGE OF RETIREMENT

Many non-medical people retire from their primary livelihood and then take a part-time job either in their previous area of employment or in a completely different field to supplement income. This is rarely an option for a physician in private practice. Because so much of a physician's overhead is fixed, such as office space, personnel, equipment and malpractice insurance, part-time work as a physician is generally not a financially viable option. Because medicine is a profession, mental and procedural skills are best maintained by constant use and practice. Being a part-time surgeon is really not a viable option.

As a practical matter, there are not many jobs that you can just walk into with no training that pay the $100 to $200 per hour that a physician can obtain for their time. A physician's skills are so specialized that they really do not lend themselves to many other types of work. Thus, except in special circumstances, a physician must practice full-time until they retire, and then just walk away. From both a financial and professional point of view, there are few other options for the physician in private practice.

Some physicians say they will never retire, although people do change their mind (sometimes involuntarily). Many physicians aim for the current standard retirement age of 65, some earlier, and some later. Whatever the age at which you hope to retire is your personal choice.

There are several important issues. The first is that if you do not make adequate financial plans, you may be working longer than hoped because you are forced to. This is not a desirable situation.

The second relates directly to being a professional. No professional is the same at age 75 as they were at age 35 or 40. This has been dictated by nature. The person who was the best neurosurgeon or best oncologist in the world at age 40 may still be an absolutely outstanding physician at age 70 or 75 or 80, but they are not what they were at age 40.

I attended my first professional baseball game in 1958 at "old" Busch Stadium (previously called Sportsman's Park) on North Grand in St. Louis. None of the superb athletes playing major league baseball in 1958 have played in a major league game for more than 25 years. Many of the stars of that time—Ted Williams, Mickey Mantle, Warren Spahn, Eddie Matthews, Roger Maris, and Ken Boyer—have died.

Mental and physical skills decrease with age. You should not allow your personal financial situation to dictate how long you practice. These comments are not a criticism of elderly physicians and should not be considered as such. There are physicians in their 70s, 80s and even 90s who are better physicians than I ever dreamed of being. The point is that you must manage your personal finances such that you are not forced to practice for financial reason when your skills may no longer be adequate.

HAVE ALL MAJOR OBLIGATIONS FUNDED

Hopefully this was obvious. Do not retire until being debt-free or near debt-free. If something goes wrong, there is no income stream to fall back on. You should own your home outright with no mortgage. The same for a vacation home or recreation property. Do not retire with two 10-year-old automobiles that each have 120,000 miles. Have new vehicles purchased and free of debt before retirement.

Every 10 or 20 years, all homes require major repairs and maintenance, such as a new roof, painting, replacement of windows and frames, outside wood, gutters, and major plumbing, electrical, and heating and cooling system work. Furniture wears out. Such major projects often cost $10,000 or $20,000 or more. Have these completed and paid for before retirement.

You can be a little more lenient in this circumstance with debt as it relates to investments. I would not be overly concerned if you have one or several pieces of rental property that have built up significant equity and a strong cash flow that easily covers the note expenses. I would be quite concerned with a highly leveraged investment where the absolute amount of debt represents a significant percentage of your net worth. If the investment failed, it could take you down. You could have the opportunity to become reacquainted with all of your old patients when you are hired on as a greeter at your local Wal-Mart.

The other principal obligation to be either completed or have funded is your children's education. Most likely your children will be out of school and self-supporting by the time you reach retirement age. If not, be sure that there are adequate funds specifically targeted to their education, including graduate or professional school if this is being considered.

HOW MUCH MONEY IS REQUIRED TO RETIRE AND LIVE COMFORTABLY?

One way to look at the money you have saved—retirement plan and non-retirement plan savings—in the same way a college or university uses their endowment. They spend a particular amount each year, but do not touch the principal and retain enough of the earnings so that the corpus of the endowment at least keeps pace with or preferably outpaces inflation. An investment that does not at least keep pace with inflation is a loss.

I would suggest you have enough income-producing assets to be able to live off an amount equal to 5% of the total value of the assets per year. Five percent of $2,000,000 is $100,000. If you do not have a mortgage or educational bills, could you live off $100,000 per year?

If you did not understand this concept, consider the inverse. Five percent equals one-twentieth of the whole. To determine what amount of income-producing assets are needed to retire, determine what yearly income you feel will be required to live the style you desire, and take that number times 20. If you would like a yearly income of $100,000, 20 × $100,000 = $2,000,000.

I do have one encouraging piece of information. Many retired physicians that I have spoken with say their financial needs are just not as great as they originally estimated. Much less for clothes, no drive or commute to and from work (it may even be possible to get by with one less vehicle), no practice related expenses, and the children are now self-sufficient. They have fewer expenses than originally anticipated. There does appear to be some hope.

I emphasize income-producing assets. One's home is certainly an asset but not an income producer. The same applies to recreational or vacation property, unless you are willing to rent or sell them. The same applies to collectables, art, and antiques. These

may all have a very significant value but produce no income unless you are willing to sell them. This is a viable option, especially with your home. Many people do not need or want as large a home after they retire. Many move to smaller homes or condo's or even sell their home and then rent (to their children and then rent it back from them; *see* Chapter Twenty-Eight). In this way some or all of the equity of the home may be converted into liquid assets.

Several people I have spoken with have lost the passion to collect as they grow older. They would rather use the money to help their grandchildren, travel or very often donate the proceeds to charity. In many people, altruism increases with age.

Many people do not realize that a dollar in a traditional IRA, Keogh or Pension or Profit Sharing Plan is not a dollar. Money in these vehicles has grown tax-free but the entire amount will be taxed when withdrawn. One dollar in such plans minus taxes is the money in your pocket. It would be more appropriate to consider money in these plans as future income rather than money already truly saved. I suggest you consider $1.00 in these plans to be worth about 70¢ or even less. If you do not understand this point, discuss it with your accountant or lawyer. It would be terrible to retire and only then realize that you have 20, 30, or 40% less than originally thought.

I recommend in the near future you read as much as possible and discuss with your accountant the alternative minimum tax (AMT). This was enacted by Congress in the 1960s because at the time several hundred taxpayers with multimillion dollar incomes were able to avoid paying any income tax. Congress rarely repeals tax laws once they are on the books. Because of the inflation of the last four decades, millions of Americans are now stung by the AMT. At the time of your retirement you will become well acquainted with the AMT (if you have not already).

Because of us and our research colleges, we are living longer, healthier lives. The person that lives to age 65 in the US can look forward, on average, to living another 15 years. This will hopefully continue to increase, although average life expectancy could start to drop due to the obesity epidemic. There is a good chance that the average physician could live 20 or 25 years, or even longer, after retirement. Take this into consideration. It would be terrible to run out of money at the most vulnerable time of your life.

SPECIFIC VEHICLES FOR RETIREMENT SAVINGS

It has been standard teaching that around the time of retirement you should change your asset allocation from "riskier, more aggressive" investments such as growth stocks or real estate to "more conservative, less risky" interest and dividend producing investments such as cash, CDs, bonds and high dividend stocks such as those of utilities. I will discuss in Chapter Twenty-Eight why I feel terms such as aggressive, conservative, more risky, or less risky do not appropriately characterize how you should evaluate any investment. All investments are associated with risk.

I do think it is appropriate to make some adjustments around the time of retirement and beyond toward more fixed rate investments such as CDs. The reasons for this are twofold. The first is that judgment, general mental capacity, stamina and desire decrease with age. You may not have the mental or physical capabilities to follow your investments as closely as in your younger years. Everyone's personal circumstances

are different, but when this situation arises, it would be reasonable, and advisable, to cut back on investments that require closer monitoring and input, such as a position in a specific stock, in favor of investments that do not require as much attention, such as an index mutual fund or a CD.

The other reason to consider increasing fixed income investments at this time is because of volatility; the increase or decrease in value that occurs with all investments through time. In a bear market, the average stock drops 20 or 30% or more. It could take several years, or longer, to recoup the losses. An 80 or 85 year old does not have the luxury of time and could have a major health event—illness, hospitalization or death—when the value of their assets is at its nadir.

I have avoided giving specific percentages for a change in asset allocation at this time because everyone's situation is different, making specific recommendations difficult or impossible. Use your judgment.

Although some change in asset allocation at this time is probably warranted, a major or especially an abrupt change is probably not desirable. Most fixed rate investments do not keep pace with inflation. If you could find quality fixed income investments that yield 10%, it would be possible to live off 5% and reinvest the other 5%. But such investments do not exist. Rather, your return will be 5%, which is your goal for living expenses, but there will be nothing left over to reinvest. Every year you will lose to inflation and if you should live another 20 or more years the relative value of your investment portfolio will be only a fraction of what it was earlier. Many do not realize this weakness of the "income-producing strategy" emphasized by many of the general works on financial planning for retirement.

Another reason to not significantly or precipitously change asset mix is because whatever you have done so far has been successful, you know it, understand it, and are comfortable with it. And it will hopefully allow you to maintain the relative value of your portfolio as compared to inflation.

If there are not many direct income-producing assets what is the source of money to meet the daily expenses of life? Say a retiree has a $2,000,000 portfolio with $1,200,000 (60%) in the S&P 500 Index mutual fund, $400,000 (20%) in fixed-income investments and $400,000 (20%) in real estate, as four properties of $100,000 each generating a rental income of 7 to 8% per year.

Just sell something. For 30 years you have income averaged into the S&P 500 Index Fund. Now just income-average out. Rather than send them a check each month, direct them send you a check for $5,000 every month. Add the income from the rental properties and the dividends from the income producing assets and you have $100,000 a year. Or at the appropriate time, sell a piece of real estate. The $100,000 represents a year of living expenses and during this year you would not need to withdraw anything from the stocks or fixed income investments. Thus you could generate the 5% for living expenses and may at least keep pace with inflation.

You should, ABSOLUTELY MUST, have significant savings outside of your retirement plans. If your average salary while working was $100,000, then probably most of the income-producing assets you will have at age 65 are in your retirement account. If you have made an average of $500,000 per year, so much money has been generated above that which can be contributed into retirement plans that non-retirement assets will probably be

greater than assets in tax advantaged retirement plans. As John D. Rockefeller said: "Save as much as you can." For the average physician making $250,000 per year, I suspect that the amounts in retirement and non-retirement assets will be fairly close, with probably somewhat more in the retirement plans.

Remember, a dollar in a traditional retirement plan is not really a dollar. In addition, by the time you retire, the rules governing retirement plans will probably have changed, possibly significantly, and quite possibly to the detriment of those who have worked hard and been thrifty and saved as much as they could. It is thus important to have as much savings outside of traditional retirement plans as possible.

TAX-FAVORED RETIREMENT PLANS

Three pieces of advice:

1. Contribute the maximum amount.
2. Invest as early in the year as possible.
3. Take full advantage of any matching contributions by your employer.

By investing as early in the year as possible, your earnings are tax sheltered for longer. Say you contribute $5,000 on January 1, 2004. Now say you procrastinate (this of course applies only to others, not you) and do not make the deposit until April 14, 2005. You have lost 15 months of tax sheltering of your earnings. Compare our standard 10% return (untaxed) to a 10% return that is taxed, thus netting proceeds of approximately 6%. A 40% difference. Do this for 30 years and you have made, or lost, an absolute fortune.

Consider another example. Suppose you invest $5,000 at the end of each year in a tax-deferred account at our goal of a 10% annual return. You begin your payments at age 35 (after finishing your training). Thirty years later (at age 65), you will have accumulated the tidy sum of $822,470. Not bad for your efforts. However, had you made the contribution at the beginning of the year instead of at the end, you would have amassed $904,717! This is a difference of more than $82,000, and you did it without contributing one additional red cent! ATTENTION TO SIMPLE DETAILS CAN PROVIDE FINANCIAL SECURITY.

There are several general points of importance, but be aware that there are even exceptions to some of these:

1. Continue to contribute to tax-deferred plans for as long as possible, literally up to the time of retirement.
2. You may begin to withdraw money from such plans at age fifty-nine and one-half.
3. You must begin to withdraw money from such plans–except Roth IRAs, where mandatory withdrawals are not required—by April 1 the year after you turn 70.
4. It is the government's desire for you to have all money withdrawn from tax-deferred accounts by the time of your death.
5. When there is an option, use money from non-retirement savings first, since taxes have already been paid on these funds. This allows money in the tax-favored accounts to continue to grow tax-deferred.
6. Because there are so many options, expert advice is mandatory.

INDIVIDUAL RETIREMENT ACCOUNTS (IRAs), 401(K), DEFINED BENEFIT PLAN, DEFINED CONTRIBUTION PLAN, PROFIT SHARING PLAN, MONEY PURCHASE PLAN, AND KEOGH PLAN

The general concept of all of these plans is similar. Pre-tax money is contributed, the investment grows tax-deferred, and most or all of the money, both the initial amount contributed (because it was not taxed at that time), and the earnings, are partially, or more typically, fully taxable when the money is withdrawn.

There are a myriad of details and exceptions with each one of these plans and they may change every year. Any further discussion of details is beyond the scope of this work. For further information, I refer you to your plan administrator, lawyer, or accountant and to appropriate works on financial planning.

I remind you of one point: seek other people's advice, make sure that it is correct, but this is your retirement money and thus your responsibility to make sure it is handled and invested properly.

ANNUITIES

The short story on annuities is:

1. Do not purchase an annuity.
2. They are very complicated. In Chapter Thirty-Two, I quote Peter Lynch's Principle #3—"Never invest in any idea that you can't illustrate with a crayon." Apply this rule to annuities.
3. The fees and commissions are terribly high. An annuity is profitable for the agent selling the annuity and the company. They are rarely as profitable for the investor.
4. An annuity is a tax-advantaged vehicle. If you have been sold an annuity within your retirement plan, i.e., already a tax-advantaged situation, you have been done a terrible disservice. This is similar to owning a municipal bond in a retirement account. It is in the interest of the sales agent or broker, not the investor.

Now for the long story on annuities:

Do not purchase an annuity.

Webster's Seventh New Collegiate Dictionary defines annuity as "an amount payable yearly or at regular intervals." Annuities arose in bygone times, before Social Security, company pensions and IRAs, Keoghs, defined benefit and money purchase plans. Before any type of formal retirement plans. For example, in 1924, at age 62, a man sells his Pierce Arrow automobile dealership for $9,000. He takes this lump sum to a large insurance company and purchases an annuity. The man and/or his wife will receive a particular amount of money every year or every month until they die. They have just purchased their pension, funded their retirement.

But 80 years later in 2004, there are IRAs, Keoghs, 401(k) plans, employer pensions and a variety of other options for everyone including the self-employed. There are also now many types of annuities and they are extremely complicated. With annuities, the earnings grow tax-deferred, similar to the other tax-advantaged retirement vehicles. Remember, annuities do not provide a death benefit, and are thus not a life insurance policy.

Annuities are usually purchased with a lump-sum payment. Annuities are not similar to a CD purchased at one's local bank or savings and loan and thus are not federally insured. A single-premium deferred annuity could possibly be considered if one desires income in their retirement years but does not wish to take any market risk and does not wish to pay taxes now but anticipates (remember the AMT) that they will be in a lower tax bracket after retirement. The price of lower risk is inferior return, further accentuated by the high commissions and fees of annuities. The payout of an annuity can be fixed or variable. There are also index annuities and split annuities, in addition to immediate, also called income annuities. These are complex!

When one annuitizes their investment, they receive a fixed monthly income from the insurance company for life. The most common type of annuitization option is "life only." This is essentially a bet on the purchaser's longevity. If one is 65 and purchases an annuity, the amount he pays in premiums and receives in monthly payout is determined by the insurance companies data on the expected life span for a person similar to the purchaser. The purchaser will receive this amount every month until he dies. If he dies in 1 month, the payments stop. Too bad. If he lives to 106, the purchase of the annuity was the best investment of his life.

When Einstein was asked about Werner Heisenberg's Uncertainty Principle, he said, "God does not play dice with the world." Warren Buffett detests risk. Einstein does not believe in uncertainty. Take their advice.

I do not recommend annuities. If you should even consider an annuity, obtain impartial advice from someone besides the salesman, broker or agent selling the product. The average physician will be much better served income-averaging into their favorite no-load actively managed mutual fund or an S&P Index Fund.

If you are currently in an annuity, I give advice similar to that given regarding whole life insurance—i.e., obtain impartial advice to determine if it is advantageous to extricate yourself from the situation.

ROTH IRAs

Roth IRAs have tremendous tax advantages and are a great vehicle to save for retirement. The principle features are:

1. The money contributed is not tax deductible, but the earnings grow tax free
2. All of the money—initial contribution (already taxed before contribution) plus accumulated earnings—is tax-free at the time of withdrawal. This contrasts to the traditional IRAs and pension plans described above, where there is a deduction at the time of the contribution but all the proceeds are taxed when withdrawn.
3. There are no mandatory withdrawals, i.e., one does not have to begin withdrawals at age 70. Money should be withdrawn from these last, if at all, to take full advantage of continued tax-free compounding.
4. There are several other advantages (with accompanying exceptions) to Roth IRAs. Consult Suzy Orman's book for further details.

The problem, as it relates to the physician investor, is that most physician's income is too high to allow one, or their spouse, to participate in a Roth IRA.

However, once your children start to work, they may have their own Roth IRA. We opened a Roth IRA for my younger son when he graduated from high school. The modest amount we contributed should be a pretty impressive sum after 50 years of tax-free compounding.

To encourage your children to open a Roth IRA, make them the following offer. Match dollar for dollar anything they contribute. Your children are encouraged to save, you are helping them, and they are learning more about investing. You have also just introduced your children to their greatest investment friend, compound interest.

MEDICAL BILLS

There is little doubt that the most expensive part of everyone's retirement will be medical bills. Not travel, your vacation home, your clothes or your automobile, food or your utility bills, but your medial expenses. Your doctor bills, your medications, and your hospital bills. Because of current government regulations, physicians often do not receive professional courtesy. You will no longer be able to go to the medicine cabinet for samples or sign for stock bottles that end up being for your personal use. Medical bills will be the most significant expense of your retirement.

Current estimates are that the average senior citizen will pay $175,000 for out-of-pocket medical charges. This is not total medical bills, but out-of-pocket charges. Considering that a physician desires the best medical care, what are your options?

1. Stay healthy. Don't smoke, exercise regularly, monitor your blood pressure, watch your diet, maintain ideal weight, keep your LDL less than 100 (preferably 60 to 70), have a colonoscopy performed at appropriate intervals, buckle your seat belt, use sun screen, obtain appropriate female and male tests and examinations, keep your vaccinations up to date, brush your teeth and floss as instructed by your dentist, etc.
2. Save as much money as possible, and intend to spend it on your health.

A new vehicle for this later option called health savings accounts (HSAs) went into effect January 1, 2004. The details are being outlined at the time of this writing and will not be finalized until later in 2004.

HSAs allow adults up to age 65 to save pre-tax money, a feature similar to traditional IRAs, for current and future out-of-pocket medical costs, including long-term care premiums. Earnings on HSA accrue tax-free (similar to the earnings of both traditional and Roth IRAs) and savings withdrawn at any age for legitimate medical expenses are tax-free (similar to the withdrawals from a Roth IRA). Contributing pre-tax money that grows tax-free with tax-free withdrawals is a unique way to save but was the standard of personal finance in our country prior to ratification of the XVI Amendment to the Constitution allowing the direct taxation of income.

There are specific requirements to allow the use of HSAs and they are significant. You must be enrolled in a high-deductible health plan ($1,000 for participant, $2,000 for family) that covers catastrophic expenses. You must not be enrolled in any other plan such as the more traditional comprehensive plans with lower deductibles or in Medicare. The difference in premiums from the traditional insurance coverage could be the money deposited into the HSA. The final details of these plans are not yet available. Consult your accountant.

SUMMARY OF CHAPTER SIXTEEN

- The one person you can count on for your retirement is you.
- You could live 30 years after retirement, plan accordingly.
- Have all major obligations funded before retirement.
- An investment that does not match inflation is a loss.
- Have sufficient savings such that you can live off 5% of your total assets per year.
- Make full use of every tax-advantaged opportunity and contribute the maximum.
- Make retirement plan contributions as early in the year as possible.
- Take full advantage of any matching contributions by your employer.
- Beware of the alternative minimum tax.
- A dollar in a traditional retirement account is not really a dollar.
- Continue to contribute to tax-deferred plans right up to the time of retirement.
- Plan to have significant savings outside of your retirement accounts.
- Help your children open a Roth IRA.
- Do not purchase an annuity.
- Medical bills will be the greatest expense during your retirement.
- Watch for details on health savings accounts.

SUGGESTED READING

Peltonen A. A Less Taxing Way to Pay. *Barron's*, April 19, 2004, p. 31.
Clark RW. *Einstein, The Life and Times*. New York, World Publishing, 1971.
Orman S. *The Road to Wealth: A Comprehensive Guide to Your Money.* New York, Riverhead Books, 2003.

V Pitfalls in the Quest for Your Financial Goals

Chapter Seventeen
Who Can You Trust?

I will first discuss whom I think can be trusted and then discuss people and circumstances where skepticism is warranted.

The people that can be trusted most, of course, are your family. I grew up with a boy who now owns a business that generates large amounts of cash. Do you know who counts the money at the end of the day and makes the bank deposits? His 80-year-old mother. Why trust anyone else when your mother can handle the money? Think of all the times you have heard or read of embezzlement and stealing. Just look at your local newspaper. This occurs every day. I think he is a genius.

Politicians will often have family members, or people who were their friends when they were young, before they rose to positions of importance, as their closest advisors and confidants. Examples include President Kennedy (brother Robert) and President Reagan (wife Nancy). They know that these are people they can trust.

As a reminder, the main goal of this book is to instill a sense of healthy skepticism. Everyone is happy when things go well. Hopefully with the lessons learned here, you can be protected when things do not go well.

The people that can be most trusted are your spouse, grandparents, parents, brothers, sisters, children and grandchildren. Aunts, uncles, nieces and nephews are one degree removed but should pass muster.

You must be a little more careful investing with in-laws. As a practical matter, if the marriage should end in divorce, they are no longer your relatives at all and are very unlikely to side with you in any dispute.

Investing with relatives refers only to worthy investments. Presumably you can trust your children, but when should you invest or loan them money? If a son or daughter has shown that they are a worthy person of integrity, that they are careful with their money and industrious and present a detailed business plan, then consider investing. They may have noticed an opportunity, a niche that is worth exploiting. If they have thoroughly researched a particular area and would like a loan to start the business, then this is an investment worthy of your consideration.

If an investment is made with a relative, everything must be absolutely business-like. Detailed papers and loan agreements must be drawn up and signed, and they must be followed. Everything must be conducted at arms length.

Do not invest just because they are your children, just to "help" them. The worst thing you can do is to support your child in a business venture that is unworthy. You are

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not only hurting yourself financially, you are also hurting your children. If things go wrong they may expect you to bail them out rather than looking for other ways to salvage the business venture and make it successful. When do you say no? How will this affect your relationship? If you have more than one child and you loan money to one, will the other children expect you to do the same for them? Can you afford to be a bank for all your children? (*see The Millionaire Next Door* in Suggested Reading list for an in-depth discussion of this topic).

Who can be trusted outside your family? About 7 years ago, when I kept a daily journal, I made a list of people outside my family that I thought I could trust with anything. There were seven people on this list, although if I had thought harder I probably could have come up with several more. I have investments with two of these people.

A person that can be trusted with anything is worth more than gold. Never lose that person as a friend. Is there anything in business, or in life, worth more than complete trust? I have also invested with other people but only after knowing them for a long time. They have earned my respect and trust.

One cannot be a physician without trusting their patients. From the first day of our training we are taught to trust our patients, their families, and our colleagues and in fact everyone we deal with. Only in this way can we ask our patients to trust us to be their advocate, to do what is best for them. Not what is best for us, or for anyone else, but what is best for them. It is a prerequisite for being a physician.

This nearly blind trust that serves us so well as a physician can lead to disaster in the real, financial, non-medical world. Our training and our goals as physicians must not change. Instead, we must be able to somehow turn off, to segregate this unquestioning trust when we venture outside of medicine.

Let me make an analogy to a prizefighter. Inside the ring, it is the boxer's goal to dominate his opponent mentally and physically. To intimidate him, to terrify him, to beat him as savagely, ruthlessly and relentlessly as possible around the head, neck and chest as to cause him to lose consciousness. These skills inside the ring can led to fame and fortune. Outside of the ring such behavior is not socially acceptable and does not serve a boxer well. It is the same with a physician. Implicit trust is mandatory in the practice of medicine. It can and does lead to disaster when physicians are investing their money.

I am indebted to my attorney B. Dan Simon for this point. I had actually come to this conclusion many years ago but had never heard anyone else voice this concern so I dismissed it and had not intended to discuss it here until Dan brought it up to me. A physician's training to implicitly trust everything they are told is one of the basic flaws that afflicts physicians in their financial life.

Who should not be trusted? A flippant answer would be everyone else. The practical answer is that you must be extremely careful.

There is one situation where you should be dogmatic, unyielding, and just plain hardheaded. If a person has a past criminal record or a record of any shady dealings, under no circumstances should you even talk to him.

Another less compelling circumstance where I would be hesitant to invest with someone is when I have invested with them before and lost money. The problem here is presumably not one of integrity, but rather they may not be a good businessperson. In any regards, why take the chance?

There was a recent article in *Forbes* entitled "Fool Me Twice" (June 21, 2004) which shows how truly devious some scamsters can be and why it is wise to further avoid investing with someone who has lost your money, whether honestly, or as in this example, dishonestly. In general, when someone has been the victim of a scam, they will look for assistance and advice to gain restitution. This article provides examples of crooks who were principals in the initial scam who then set up a second scam and contacted the victims to ostensibly provide them help and advice to get their money back. The fleecers knew these people were gullible and with the ruse were able to fleece them a second time. There are some very nasty people out there. Please be careful.

When investing with anyone, it is essential to determine their motives. How will they profit from the investment? Are their interests the same as yours? Will they make money when you make money or more importantly, can they make money even if you lose money?

I recently saw a piece on the television about Las Vegas. It was mostly about patrons who tried to cheat the house. But a good part of the program also concerned patrons who cheat or steal from other patrons. The man being interviewed made the following point: you are a middle-aged man sitting at the bar. You are balding and have an ample waist (e.g., you look more like Archie Bunker than Tom Cruise). A beautiful young lady comes up and starts to flatter you and flirt. You should immediately think—I am a balding, fat, middle-aged man with a wedding band, why is this pretty young lady flirting with me? Answer—she is either a prostitute, or she could even be a "trick roller," someone who slips you a "mickey" (tranquilizer) takes you up to your room and "rolls you"—steals everything.

Be cautious with salesman. Of course I am not suggesting they are dishonest, but rather they make their money from the commission on the sale, not from the return on your investment. Their motives are not the same as yours.

Essentially all of the shady operators that I have heard of or read about, and the few I have personally met, are uniformly described as charming. How else could they peddle a worthless investment, literally just junk, if they were not charming? I tend to prefer people who are a little rough around the edges, if for no other reason than they are more like me and I find them more believable. You would be wise to keep a tight hand on your wallet when someone seems just a little too slick and charming. The more expensive the Rolex, the flashier the jewelry, clothes, and cars. The talk of private jets and yachts, the more braggadocious, the more expensive the bottle of wine, the looser the money, the more caution you need to exercise. Proceed slowly. Do not be embarrassed to say "no."

As a practical matter, would you want the person who is managing your investments, who you want to be concerned with every 0.01% of return on your account, spending $500 to $1,000 on dinner to lure a new client? Warren Buffett's idea of entertaining clients is a cherry Coke and a steak and discussing a 25% return on their investment.

Since this work is meant mostly for physicians, let me conclude this chapter with a medically related example of the factors you should consider, the mental checklist that should be completed to determine whom you can or cannot trust.

When you or a family member were ill, how did you determine who would be the physician allowed to provide the care? How did you choose the person with whom you would trust your life? Their reputation was important, their credentials were important, you probably asked several colleagues and you may have even spoken with other patients.

If you saw someone locally, you probably knew this person for many years, saw them day in and day out, in the Emergency Ward, on the hospital floors, in casual conversation, in the doctor's lounge, at parties, at the grocery store, at the ballgame, or at your children's school. Only after all of these factors were taken into consideration was this person chosen to be your physician or the physician for a family member. Before investing with anyone, complete the same mental process you would to choose your physician.

SUMMARY CHAPTER SEVENTEEN

- Only trust people you know well and who have earned your trust and respect.
- Loaning money to a family member only to "help" them is actually doing them and you a terrible disservice.
- Our training as a physician to implicitly trust everyone does not serve us well when investing.
- Never invest with anyone with a criminal record or any history of shady deals.
- What are the "motives" of the person with whom you are investing?
- Choose the person with whom you invest the same way you choose your physician.

SUGGESTED READING

Stanley TJ and Danko WD. *The Millionaire Next Door: The Surprising Secrets of America's Wealthy.* Marietta, GA, Longstreet Press, 1998.

Chapter Eighteen
The Malevolence of Debt

Let me begin with this statement: no debt, no bankruptcy. You may not have much, you may not even have anything, but if there is no debt, you cannot go bankrupt.

There are multiple problems with debt. The first is its seductiveness. Debt is the financial equivalent of the dark side of the force. It is like the song of the Sirens, ready to entice the unwary onto the rocks of financial destruction. Even the bravest man should not be ashamed to admit that he is afraid of debt.

Everything is driven by basic forces. The more insight and understanding you can gain into these basic forces, the easier it is to comprehend the concept and to profit, or to take steps to prevent problems or mistakes. The fact that money must be borrowed to make a purchase indicates that the purchase cannot be afforded in the first place. If we were required to pay cash for every purchase or investment we would make less mistakes.

It is impractical to buy some things with cash, especially your first home. Many people borrow to purchase their first car, although when I began driving in 1967 my father and I each paid $100 for a 1956 Chevrolet. The car broke down in 8 months but did get me to my evening job.

If a loan is made to purchase a car, keep the term of the note as short as possible. A 5-year car loan is a terrible drain on resources. Leasing a car is even more undesirable. You may be enticed into leasing to be able to drive a more expensive vehicle than you could otherwise afford to purchase. Leasing a car is literally throwing money away. It is infinitely better to purchase a less expensive car that you can afford than to lease a car. At the end of the lease you have nothing.

The remainder of this chapter relates to the use of debt for any other purchase or for an investment.

This is one of the most difficult areas of money management and investment advice: What is an appropriate amount of debt? Before providing a detailed discussion with many examples, I will make a general, easy to remember point: the less debt, the better.

Otherwise, let us begin with the item being purchased. Is it a depreciating asset or an income-producing asset? The former relates to consumption and taking on debt for such a purchase is to be strongly discouraged. A car or boat is a perfect example of a depreciating asset. Unless one has terrible motion sickness, boats are cool, truly a blast. But every day that goes by, every time the key is turned on, the boat is worth less. I suggest that depreciating assets be purchased with cash (if purchased at all).

I saw an advertisement in a Lake of the Ozarks real estate/boating circular freebee. It said that with proper credit, you could obtain financing for a new or used watercraft

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at a low interest rate with up to 240 months to repay. Two hundred and forty months = TWENTY YEARS.

Consider the math. You purchase a boat for $100,000 (which is not expensive. A 30- to 40-foot cabin cruiser is easily $300,000 or more). There is a down payment of 20% (less will be required with a proper credit rating such as a physician would have) with the standard interest rate of 7%. The note is amortized over seven thousand two hundred days (240 months times 30 days a month). The total is more than $186,000 of principal plus (non-tax deductible) interest. How many cars are still running after 20 years? If the boat is still sea-worthy, you have paid almost $200,000 (TWO HUNDRED THOUSAND DOLLARS) for a boat that is now worth just pennies on the dollar. You do not need many purchases such as this to live a life of never-ending debt and financial instability. I have heard an appropriately cryptic phrase to describe such a situation: "A nickel down, a nickel a month."

To carry this concept of paying as little as possible on a loan to it's illogical conclusion, consider an interest-only mortgage. Suppose you are 35 years old and purchase a home with an interest-only mortgage for $200,000. At age 45, you still owe $200,000. At age 55 you still owe $200,000. It would appear that both the borrower and the lender are assuming a terrible risk in such situations (I would never be in this situation because I would have worried myself to death).

Examples of income-producing assets include the farmer's purchase of a tractor or a physician's purchase of a piece of practice related equipment, such as an EKG machine for the office. Successful businesses operate by the purchase of income producing assets with a manageable amount of debt. The strategic use of debt can result in significant profit.

What is an appropriate amount of debt for you? There are a variety of formulas and recommendations that relate amount of debt to income or net worth. Lending institutions currently use the following guidelines. Up to 28% of gross income can be used for mortgage payments. Some lenders even stretched this to 32% of gross income. The other standard figure is that no more than 36% of gross monthly income can be used for total debt service (mortgage plus car plus credit cards plus student loans, etc.). I view these formulas with significant caution as they define the absolute maximum amount of debt that can be carried, which in my opinion, in our current society, is much too high. Should you wish to use such guidelines, I suggest that the maximum amount of debt allowed be reduced by at least 50%. I suggest that no more than 15% of gross income go to mortgage payments and no more than 20% of gross income go to total debt service. Remember, the less debt the better.

Let me make some practical suggestions. If "everything must go perfectly" to service debt, it will not. If your income drops by 50%, could the debt still be serviced? This happens all to often in two wage-earning families when one person loses their job. If the debt was to be serviced from the anticipated income stream from the investment, could the debt still be repaid if the investment failed completely? Always remember that debt mandates caution, that natural control mechanisms are being circumvented.

Borrowing money is easy, far too easy. You just sign you name. Fifty thousand dollars, one hundred thousand dollars, or even more. The amount seems like an abstract, just numbers on the page. But eventually and inevitably these numbers become real money that must be repaid. **ALL DEBT MUST EVENTUALLY BE REPAID**.

The first concern with any investment is not how much can be made (this encourages greed) but rather how much can be lost. If a $50,000 investment is made with cash on hand and it fails, that is of course terrible. Fifty thousand dollars is a great deal of money, essentially a full years' savings for the average physician. But put it behind you, learn from the experience, and move on. Do not attempt to "make it up" on the next investment, as this will only compound the errors. This is no different from a gambler who is losing doubling their bet after each loss in an attempt to get even. It is inevitable that you will run out of money before getting even. And if you just should happen to get even, it is very unlikely you will stop.

But if a $50,000 investment made with borrowed money fails, the bank is still owed the $50,000. What if you are unable to repay? The bank can, and will, use any means at its disposal to collect. You should be working for yourself and your family, not the bank. (*See* Chapter Twenty-Three on Dealing With Bankers.)

Let me make a comment about bankruptcy. The sanctity and protection of private property are one of the cornerstones of our democracy. Hayek noted that economic and political freedom are inseparable. Countries where private property is confiscated are called communists. Borrowing money is a contract. If you should loan someone money you certainly expect to be repaid. When you borrow money you are expected to repay it. To declare bankruptcy is to break your word. The most desirable way to avoid this is to never allow yourself to be in a position where it could occur.

Another word for debt is leverage, and it works both ways. If the benefits are doubled, the risk is doubled. Actually the risk is more than doubled. Consider as an example the purchase of a publicly traded security. A $10,000 position in the NASDAQ Index 100 Trust (QQQQ) is purchased with cash. A 10% increase in the value of the security represents a gain of 10%. A 10% drop in the value of the security represents a 10% loss.

But you borrow to increase the potential gain. Twenty thousand dollars of the QQQQs are purchased, $10,000 with cash and $10,000 on margin borrowed from the brokerage. A 10% increase in value of the QQQQs now represents a $2,000 profit (minus interest charges and commissions), which is a 20% return on $10,000. Just by signing your name the return has doubled.

But what if the security drops 20% in price? This represents a 40% loss. Just as a gain is doubled, a loss is also doubled. Remember to also consider the interest the brokerage firm will charge on the borrowed money. Not only can you lose more with debt (leverage), but the investment itself is less secure, less well capitalized. If the price of QQQQs drops by another 5% (or a total of 25%), because of the leverage the investment is now down 50%. At this point you receive a margin call from the broker. Either more money or securities must be deposited in the account (today!!) or the position must be liquidated, at, of course, the worst possible time. (The Federal Reserve sets the general margin requirements. Each specific exchange and brokerage house can set further margin requirements. These may change at any time. The brokerage house must, and will, liquidate some or all of your position if the margin call is not met). Now you have lost 50% and your position. The average physician investor has no business buying a stock on margin. If things go badly, do not blame the brokerage firm, blame yourself. As a general rule, when things go wrong you are much better served blaming yourself rather than others. You cannot change other people, but you can change yourself.

Let me give an example of leverage (debt) involving real estate. A piece of rental property is purchased for $200,000 with a 30% down payment, the remainder is borrowed. The value of the property drops 10%. There is still considerable equity and because of the solid down payment, the rental payments of $1,500 more than cover the monthly mortgage payment of $1,000. If the rental receipts also drop by 10% to $1,350 a month, there is still a strong positive cash flow.

Consider the same property with only a 10% down payment. If the value of the property falls 10% there is no equity and if sold at this time, the 6 to 7% real estate commission and other charges come straight out of the seller's pocket. Because more money was borrowed, the monthly mortgage payment is higher at $1,350. If rental receipts drop 10%, there is now only enough to cover the monthly payment. Should there be any additional expenses, and there always are, the difference will come directly out of the owner's pocket. Should rental receipts drop further, cash will be required every month just to cover mortgage payments. An excessive amount of debt can destroy an otherwise completely solid investment. Under-capitalization is one of the most common causes of business failure.

Until recently, banks only loaned money to people with other assets for collateral. Since local banks were loaning money to local people, the character and integrity of the borrower was also an important issue. The banks, quite appropriately, only loaned money to those they felt would pay it back. As the (now) old saying goes, banks only loaned money to people who did not need it.

Today, collateral is often not required, just an income stream. I feel that banks are far too lenient in their lending practices. Part of this problem is that the bankers are often not lending their own money. They just do the paperwork, sell the loan and take the fees. It is then someone else's problem if the note cannot be repaid. Considering that a significant percentage of the mortgages in our country are sold to Fannie Mae (FNM) and Federal Home Loan Mortgage (FRE), the problem is actually now everyone's.

Many years ago, when a bank made a loan, it was usually directly from their deposits and their capital, money right out of their depositor's and the bank president's pocket. And he or she had no intention of loaning money if it could not be repaid. Now, debt is just too easy to obtain.

Here is the problem that confronts physicians. Because of their high income and cash flow, banks are delighted to loan money to physicians, and often in large amounts. One hundred thousand dollars, a quarter-million dollars, or more. All that is required is a signature.

Debt can make otherwise solid investments unstable. In the following example, three highly leveraged rental properties are purchased with a 10% down payment, the remaining 90% of the purchase price being borrowed:

	Equity	Debt	Total
	$10,000	$90,000	$100,000
	$10,000	$90,000	$100,000
	$10,000	$90,000	$100,000
Total	$30,000	$270,000	$300,000

With only a $30,000 it is possible to own more than a quarter of a million dollars of real estate. The total rate of return, if initial projections are correct (beware of projected returns, they are sometimes correct, but more commonly too optimistic, rarely too low), including rental income, 5% appreciation per year (it is guaranteed that real estate always goes up) and depreciation, is 30%, or possibly even more, a year.

What if everything does not go as planned, the economy and the real estate market softens and the monthly mortgage payments cannot be covered from rental receipts? More ominously, what if the three investments were not rental properties with definite residual value but rather limited partnerships that have all folded and have no residual value (this has happened)? The dreams of riches have been replaced by the reality that the bank is still owed $270,000, or as with the physicians described in Chapter Three, $3 to $10 million.

The amount of debt on an investment is often considered as a percentage of the entire investment. This is quite reasonable in the situation with which most people are familiar, specifically their home mortgage. A 20% down payment is the standard. However, you must never lose sight of the absolute amount of debt. Say that $300,000 cash is invested and $700,000 is borrowed to participate in a limited partnership, or any kind of business. What if the investment goes bankrupt and there is no residual value or residual assets? What if the whole thing is a scam? Not only have you lost $300,000 you now owe $700,000. That is a lot of money! Our average physician makes $250,000 per year. Before this investment, there was a solid net worth of $1.2 million. Two hundred thousand of equity in a $400,000 home, $100,000 equity in a $200,000 vacation condo, $700,000 in retirement accounts and $200,000 of non-retirement investments. Now you wiped out. Never lose sight of the absolute amount of debt. It is real money that at sometime must be repaid. There is little reason for the average physician investor to take on a large absolute amount of debt, no matter how apparently solid the business or investment.

I will now change the focus from taking on debt to the question of paying off debt ahead of schedule, the early repayment of debt. You can rarely make a better investment than the early payoff of debt.

For purposes of continuity in this book, I propose that the average physician makes $250,000 a year, has purchased a $312,500 home on which was made a 20% down payment resulting in a $250,000 mortgage at 7% interest. The average anticipated return on investments is 10% per year.

What is the return by accelerating debt payments? Seven percent? Ten percent? No, it is 17% (7 + 10). Just examine the numbers. At the end of a year, one dollar minus 7% interest = 93¢. At the end of a year $1 plus a 10% return = $1.10. A slam-dunk 17% return. Your general financial position is also more secure because of less debt.

This is also an appropriate time to make a suggestion regarding the investment of an unexpected lump sum of cash, such as an inheritance, tax refund, bonus, or distribution from an investment. Pay off debt. An extra $10,000 placed on a mortgage represents essentially one year of principal payments.

If such a windfall is viewed as a chance to splurge, to buy something that would not have otherwise been purchased, you can stop reading this book right now and save yourself the time since you will be exceedingly unlikely to follow any of the other common sense suggestions that I make.

TOP REWARDS CARDS

Here are nine reward cards that live up to the name. None charge annual fees, and any restrictions imposed are minimal compared with those imposed by others in the field

Cash Back

Citi Dividend Platinum Select

Gas rebates

Discover Platinum with Cashback Bonus Plus

Car discounts

Citi Drivers Edge Platinum Select Mastercard

GM Card

Travel perks

Hilton HHonors Platinum Amex

Frequent flyer miles

Chase Travel Rewards Platinum Mastercard

College savings

Citi Upromise Platinum Select

Investment

Fidelity Investment Reward Mastercard

Mortgage savings

Citi Home Rebate Platinum Select Mastercard

Source: Curtis Arnold, CardRatings.com

Fig. 1. Reprinted with permission from Curtis Arnold, Founder of CardRatings.com, a website that provides free reviews of credit cards.

If you are paying on several notes each month, which should be paid off first? Here are several points to consider.

This is probably most important. Pay off the smaller note first. Suppose there are two notes, one for $100,000 (home) the other for $10,000 (automobile). The monthly payments are $1,000 on each note. Ninety-five thousand dollars can be paid on the mortgage yet there are still two monthly payments of $1,000. If $10,000 is placed on the second note, it is paid off. Monthly debt service has been cut in half.

What are the rates of interest? If one is 10% and the other 6%, pay off the note with the higher rate of interest first.

Does one note have a variable rate, especially a rate that can fluctuate frequently and by a large amount, such as a note tied to the prime rate? Pay this off first.

Is the interest tax deductible? Pay off the note with non-deductible interest first.

I would be remiss if I did not finish a discussion of debt without mentioning credit cards. Depending on how they are used, credit cards can be either very good or very bad. Credit cards are extremely convenient, and are a must when traveling. A credit card is required to rent a car. There is always a receipt. And if the balance is paid off in full, every month, then you actually have the use of someone else's money for a period 15 to 45 days, depending on the billing cycle.

Many credit cards even possess advantages, such as the accumulation of credits towards subsequent purchases, such as airline miles, discounts, etc. The critical point is the fine print. Are the rewards really as great as they initially appear or are they negated, or even more than negated, by other restrictions, fees, a higher interest rate, or any other type of requirement?

For further information, I refer you to a piece on CNNMoney from June 17, 2004 by Jeanne Sahadi. She interviewed Curtis Arnold of CardRatings.com regarding the best reward cards. Arnold recommended the following cards in the following categories (*see* Figure 1).

But just as in medicine, everything is associated with both risks and benefits. Credit cards make it so easy to spend money. You would almost certainly spend less if required to pay cash for all purchases rather than just opening your wallet and "flipping some plastic." Except for special circumstances, if a physician making $250,000 a year cannot repay credit card debt, in full, each month, there is a serious lack of financial discipline.

SUMMARY OF CHAPTER EIGHTEEN

- Debt is seductive—it can ruin your life.
- Debt has a message—you cannot afford what you are buying.
- **THE LESS DEBT, THE BETTER.**
- **ALL DEBT MUST EVENTUALY BE REPAID.**
- Do not lease a car.
- Avoid the use of debt for the purchase of depreciating assets.
- Current guidelines for allowable amounts of debt are far too high and should be reduced by at least 50%.
- Debt can make good investments unstable.

- The physician investor should not purchase stock on margin.
- The longer the repayment period, the greater the burden of debt.
- Never lose sight of the absolute amount of debt.
- Use unanticipated financial windfalls to pay off debt.
- There are few better investments than the early repayment of debt.
- Credit cards are useful, and essential, and if appropriately chosen, can even provide worthwhile rewards.

SUGGESTED READING

Hayek FA. *The Road to Serfdom.* Chicago, University of Chicago Press, 1944.

Chapter Nineteen
The Perniciousness of Fees

Because this work is directed primarily toward the physician investor, I will make a medical analogy. Fees are like a parasite. They are not virulent enough to destroy the host but over the course of one's lifetime fees can make the difference between a vibrant, healthy personal financial situation and just limping along, with a significant amount of the fruits of one's labor ending up in someone else's pocket.

John Bogle, who pioneered the S&P 500 Index Fund at the Vanguard Group, spoke here about 2 years ago at the University of Missouri-Columbia Business School. His principle thesis in starting the S&P Index 500 fund was that the average actively managed mutual fund does not beat the general market averages, mostly because of fees. Fees diminish the profit in funds with superior stock selection (the minority) and further aggravate the problem in funds with inferior stock selection (the majority). I think Bogle is correct. There is no doubt that some investors, such as Warren Buffett and Peter Lynch, can beat the averages, but I agree with Bogle's principal point that even apparently small fees, when magnified over time by compound interests, can devastate an investor's capacity to accumulate wealth. Minimizing fees is so important that I devote this chapter and multiple other discussions throughout the book to this topic. Only greed and debt have a greater potential to rob you of your hard earned money.

To emphasize the importance of fees, Bogle gave an example of a seemingly innocuous 1% difference in investment return over the course of one's investing lifetime. Examine Table 1. Ten thousand dollars is compounded at the standard 10%. Then, because of the fees, it is compounded at a 9% annual return.

It may seem like 30 or 40 years is so long that it does not apply to you. To the contrary, it is your investing lifetime. Age 35, when you start practice, plus 30 years is the standard retirement age of 65. Another 10 years is 75 years old, right in the middle of your retirement. You will hopefully live another 10 to 15 years or possibly even longer. What seems like a small, almost insignificant fee is magnified by compound interest (when working against you it is your enemy), over the course of your lifetime into an absolute fortune. It can mean the difference between a good, comfortable retirement and just getting by.

Fees are typically described as a percentage of the total amount of money at issue. This greatly camouflages the true significance and amount of the fees. I suggest you look at fees in comparison to the profit, not in comparison to the total amount of money invested. A 10% return on investment as compared to a 9% return on investment is a 1% difference when compared to the total amount invested. But it is a 10% difference in the fee and thus your profit!! Ten percent. It is in this context that fees should be considered.

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

Table 1
Ten Thousand Dollars

	Compounded at 9% annual rate	Compounded at 10% annual rate	Difference	Total amount
10 years	$23,673	$25,937	+9.5	$2,264
20 years	$56,044	$67,274	+20.0	$11,230
30 years	$132,676	$174,493	+31.5	$41,817
40 years	$314,092	$452,589	+44.0	$138,497

I will discuss fees under two circumstances. The first is directly related to investments, the second in the general context of fees as it applies to almost everything.

MUTUAL FUNDS

The majority of mutual funds, and the vast majority of mutual funds in which a physician should invest, are referred to as open-ended funds. There is no limit to the number of shares the fund may sell. Money can be deposited or withdrawn any day, with the price, or net asset value (NAV), of the shares being determined at the close of trading each day. In a closed-end mutual fund, the number of shares is established at the outset of the fund. Shares can only be purchased if another investor is willing to sell so the shares of closed-end mutual funds trade like a stock. The problem with closed-end funds is that sometimes the share price trades at a premium, or a discount, to the value of the underlying holdings. Because the average physician investor should probably avoid closed-ended mutual funds and utilize only the more familiar open-ended funds, the remainder of the discussion regards only the latter.

Open-ended mutual funds can be divided into the general categories of load and no-load. In the former, a commission, or load, is taken off the top. This can be as high as 8%, i.e., as little as 92¢ is invested for each dollar contributed. You have lost a good part of your first years' return before getting started. In a fund with no front-end load, the entire amount is invested.

To my knowledge, there has never been a study showing that load funds in general have a superior performance as compared to no-load funds. The only time you might even consider a fund with a front-end load is when this fund has shown a performance over the course of many years that has been superior both to the market and to its peers. This is usually owing to the fund manager being a star, such as Peter Lynch at Fidelity Magellan. Even then, it may take several years to make up the front-end load, and there is always the possibility that the manager could leave or retire early, as did Lynch. Or you may need to withdraw your money earlier than anticipated, resulting in insufficient time to make up the front-end load. For the average physician investor, there is almost no reason to buy a mutual fund with a front-end load.

A front-end load is not the only fee that may be attached to a fund. There can be a back-end load, exit fee or surrender charge. There may be no front-end load, but unless the fund is held for a specific period of time there is a charge to redeem or sell the shares. These are often around 5% and graduate downward with time, such as the full

5% the first year, 4% the second year and so on. Some funds charge redemption fees no matter how long the fund is held. There is no reason to invest in any fund that charges such fees.

Another type of redemption fee may be charged when buying a genuine no-load fund through a broker. Many no-load funds can be purchased through the broker directly into one's account. However, there may be a significant redemption fee if the fund is not held a particular period of time, such as 6 months. These restrictions are typically spelled out clearly when purchasing the fund. The easiest way to avoid them is not to go through a broker and invest in the fund directly.

Some genuine no-load funds will charge fees if one trades in or out of their account more than so many times per year. This is usually spelled out clearly and I consider these legitimate. The fund does have paperwork and trading expenses when shares are bought and sold. Likewise, there are no-load funds which do not discourage such attempts at "market timing" and some funds that are in fact structured specifically for investors who do try to "time" the market.

Yet another type of fee applies to many "no-load" funds sold through brokerage firms and insurance agents. Brokerage firms and insurance agents do not work for free. When they sell a product, they expect some sort of income. When they sell a load fund, it is obvious that they receive the load as a sales commission. However, when they sell a no-load fund, it is not so obvious how they may receive their compensation. The funds will pay a fee to the broker from a special account funded by annual payments from the fund. These annual payments, often called "12b-1 fees," are a distribution expense taken directly from the assets of the fund. As such, they directly reduce returns to fund investors.

The mutual fund industry can charge these fees because they convinced the SEC in 1980 that investors would actually benefit from paying higher fees! Their argument went like this: by selling more shares, the fund becomes larger and by economy of scale can reduce its other expenses by spreading them over a larger number of shareholders and assets. So total expenses should be lower even after considering the 12b-1 fees. Studies of mutual fund performance since 1980 have shown that investors were sold a false bill of goods! The evidence is that 12b-1 fees are simply extra costs paid by fund investors. There is absolutely no evidence that funds that charge a 12b-1 fee provide investors any greater returns than true no-load funds.

The typical 12b-1 fee is 1/4 of 1% of the fund's net assets per year. That does not seem like much, but remember that the fund pays the 12b-1 fee each and every year. If at age 25, you invest $100 per month in a true no-load fund returning 10% at age 65 you would have $46,000 more than if you had invested in a similar fund with a 12b-1 fee that reduced return to 9 3/4%! My advice is to stay away from funds with 12b-1 fees; there are plenty of true no-load funds to choose from. If you like a particular fund with a 12b-1 fee, there is probably a similar true no-load also available. The only reason to choose a fund with a 12b-1 fee is if you are particularly impressed with the fund manager's investment record and feel that the superior performance will continue in the future.

All mutual funds must charge some management fee to cover their legitimate expenses such as their rent, personnel, advertising, and trading costs and make a profit. Unfortunately, it appears that this desire for profit has resulted in excesses over the last 5 to 10 years at many money management organizations. Some funds have even participated

in blatantly illegal practices, such as allowing after-hours trading. New York Attorney General Eliot Spitzer and others have aggressively pursued many cases over the last several years of illegal profiteering in the mutual fund/money management/brokerage business. Mutual funds—in fact, all corporations—should be run for the profit of the shareholders, i.e., the investors such as you and I, not to enrich the executives or others at the shareholder's expense.

There are two general types of no-load funds, index (or passively managed) funds and actively managed funds. The former mirrors some index, the best known being the S & P 500 Index. These funds are commodities. No decisions of what positions to buy or sell are required. The fund just stays balanced to the particular index. As an illustration, the expense ratio of the Vanguard S&P 500 Index is approximately 0.18%. In *Barron's* (Sept. 6, 2004), there is a note that in the prior week, Fidelity, the nations largest mutual fund company, announced that they would cap the expense ratios on their five largest equity index funds at 10 basis points = 0.1% (A basis point is one one-hundredth of a percentage point). The average S&P 500 Index Fund has an expense ratio of 0.4%. These are the benchmarks against which the fees of all mutual funds should be measured.

The management fees at legitimately run actively managed mutual funds is usually around 1% or less. There is a definite place for actively managed no-load funds in the portfolios of the physician investor. Some can out-perform the index to which they are compared. Some (many) lag the passively managed index funds. It is clearly fund-specific.

One to several times a year, the principal financial publications, such as *The Wall Street Journal*, *Barron's* and *Forbes*, publish rankings of the mutual funds. This is the best place to obtain information on the premier no-load actively managed mutual funds, the ones that truly demonstrate superior long-term returns. Study these lists intently. They will make you money and simplify your investing decisions. Another good place to find general information on mutual funds is the website Morningstar.com.

Some funds unfortunately charge "management" fees that are much higher. It can be difficult or even impossible to determine the exact amounts, even after reading the prospectus. Unfortunately, these higher management fees do not result in superior performance.

Fees obviously count a great deal when buying mutual funds. What seems like a tiny number, when magnified over the course of your investing lifetime, can result in a significant amount of money in your pocket—or in someone else's.

STOCKBROKERS

When choosing the type of stockbroker that best fits your needs, first determine if you want someone's advice and recommendations, or if you make your own decisions. With a full-service broker, you work with your broker, just as you are someone's physician. The stockbroker can give suggestions and provide information, based on his or her expertise and judgment and the research to which they have access. It is probably the access to research and information that is the greatest advantage of a full-service broker. The commissions (fees) on any trade are much higher than if you make your own decisions.

If you make your own decisions and just need the broker to execute the trade, then you should use a discount broker. But, if you require a broker's advice to make recommendations regarding which stock should be purchased, use a full-service broker.

Before discussing discount as compared to full-service brokers, I must warn you of something. Never, under any circumstance, purchase a stock or any investment from a "cold call," someone who calls and wants your business, no matter how legitimate they or their firm may sound. I suggest you read *Born to Steal: When the Mafia Hit Wall Street* by Gary Weiss to see what can happen in such situations.

There is never any reason to buy anything from a telemarketer's "cold call." The first reason relates to the above scenario. The overwhelming majority of telemarketers are legitimate. Some may not be. Why take a chance? If you passed someone on the street whom you thought could even remotely be a crook would you stop and talk to them, much less consider buying something from them?

The other reason never to deal with any cold caller is based on logic. Someone who knows nothing about you is telling you what you need, what is best for you. If I need a new pair of shoes I go out and buy them. Imagine a cold-caller saying, "Robert, you should buy some new shoes today." Now substitute the name of a stock or a real estate investment or a limited partnership for a pair of shoes. Buying anything from a cold-call telemarketer is illogical.

Rather than make a blanket statement, I suggest you do whatever works for you, although I feel the vast majority of people are adequately served by a discount broker. There is a spectrum in the quality of stockbrokers just as there is a spectrum in the quality of physicians. I make my own decision and do not require this level of service.

In fact, I will relate why I do not use a full-service broker. As mentioned previously, I collect baseball cards and sport memorabilia. In the late 1980s, Topps (TOPP), the largest baseball card company, went public. I was convinced the stock would do well. This was the exact time that the baseball card hobby was absolutely exploding. I called my full-service broker three times over the course of several months. Three times he talked me out of buying the stock. Over the course of the next 4 to 5 years the stock went up four to five times. Ten thousand dollars would have grown to $50,000. I could have made $40,000 on baseball cards! I said to myself, "forget full-service brokers." I decided if I was going to make or lose money, I would do it by my own decisions, not by doing what someone else told me.

It is not an exaggeration to say that this was one of the two or three most important events of my investing career. It was the realization that I know as much, or more, than an "expert." I am an expert on baseball cards and I clearly knew more about this subject than this Wall Street "pseudo-expert." Burton Malkiel's first recommendation is his new book *The Random Walk Guide to Investing* (*see* Chapter Thirty-Two) is "fire your investment advisor."

If you choose to use a full service broker you must be sure that the expertise, the research information, the "hand-holding" received from the full-service broker more than makes up for the significantly higher fees to allow you to out-perform the market.

For the significant majority of physician investors you will make more money in the long-run, in fact, significantly more money, investing in a no-load index fund (such as S&P 500, S&P Mid-Cap, Wilshire 5000, etc.) or true no-load actively managed fund with a long history of superior performance, than trying to beat the market with the stock suggestions from a full-service broker.

If you do decide to use a stockbroker you must decide if you want to speak directly to the stockbroker or place the trade on-line yourself. The options include (remember, they are not providing advice, they are just executing the trade) calling the broker and saying, "I would like to buy 100 shares of Newmont Mining (NEM) at the market." Commission = $64. (The price of Newmont at the time of this publication is approximately $44 a share). The other option is to place the trade yourself on-line with no broker assistance. Commission = $19.95. If you make your own investment decisions, all that matters is an adequate execution of the trade at the lowest possible commission. From time to time *Barron's* reviews the on-line brokers and makes recommendations.

My recommendation is if you wish to buy specific stocks make your own decisions and execute your own trades on-line. Otherwise, income average into an index fund or major no-load mutual fund with a long-standing track record of superior performance and with the lowest fees. Avoid full-service brokers.

OTHER FEES

There are fees and commissions for everything. Fees are a financial four-letter word. Everyone wants a piece of your hide. The word fee should immediately alert you that someone wishes to separate you from your money. Many things may not be called fees but are fees nonetheless. In general, anything added to the basic cost of an item is in one way or another a fee. One must always be vigilant. Question all charges on a bill, not only because it may be a fee but because honest mistakes can be made. It may have a funny name but it is often just a fee. A fee is either money in your pocket or someone else's. Which would you prefer?

Let me provide an example of how ubiquitous fees are in one's everyday life. One of my children recently purchased a cellular phone. Fee to initiate the service—$50. It does cost the company something to initiate the service, but this is still a fee (I always wonder why so many fees are a round number such as $50. The true fee could have been $31.87 "rounded up" to $50. You can be sure that it was not $57.18 rounded down to $50). Our child had never taken out or paid on a loan or credit card and thus has no credit history. Because of this, an additional $150 deposit was required. The customer service rep told our child that only two of the 31 people who purchased a cellular phone that day did not require a deposit. (It would be interesting to know the exact criteria for a deposit). The deposit will be returned after one year (hopefully). What if the phone company goes out of business within a year? What if our child dies? What if the paperwork is lost? In essence, the phone company has an interest-free loan for one year. Ten percent of $150 = $15. There are people who do not honor their contract, and they are presumably the genesis of the security deposit. Likewise, it seems that the company has quite liberal criteria (favoring them) for requiring a deposit. Whatever the reason, the "fees" on this phone contract represent the equivalent of three days pay on our child's summer job. Minimize fees whenever you can.

The above example is essentially an escrow. Escrow is when a third party holds money that will eventually be paid to whom it is owed, essentially for safe keeping. The average physician investor will most likely encounter an escrow as it relates to paying expenses on a home, such as insurance and real estate taxes.

For example, the real estate tax of $2,400 is due in December. The bank will require the person they loaned money for a mortgage pay $200 to the bank every month with

their mortgage payment. The bank will keep the money in an escrow account (some are interest-bearing, but most are not) so that by December sufficient money ($200 × 12 months = $2,400) has accumulated to cover the bill for the property tax.

For the average physician who makes the average physician's salary and pays their bills on time, there is no reason to make escrow payments. The reason is not only that you do not have control of your money, but you lose the interest, dividends and capital gains (i.e., average 10% annual return) the money would have generated. Another real problem with escrow accounts is that examples have occurred where the lender has collected the money but failed to make the payout, resulting in the lapsing of the homeowners insurance. If an escrow account is suggested, say no! A bank should not require an escrow account for a preferred customer such as a physician. If the bank says it is required, take your business elsewhere. An escrow account is no more than a fee.

There are occasional situations where an escrow account is appropriate. When entering into an investment, where your commitment is required now (say April 1st) but the investment partnership does not officially start until June 1st, the money for the investment (say $100,000) will be held in escrow until that date. Assuming the standard 10% return, each day $100,000 is out of your possession, not working for you, is a loss of more than $27. Make the commitment whenever it is required, but do not deposit the money until the last possible day.

Remember this simple rule: **ALL FEES ARE NEGOTIABLE**. This could save you money every time you walk into a bank and a good deal of the time that you conduct any business. A physician has financial clout. Use it! Banks and businesses want your business! You are not a 16-year-old part-time worker who comes to the bank, hat in hand, in hopes of obtaining a car loan. You are a physician, a respected member of the community, making a six-figure salary and hopefully with a very solid financial position. Use this clout to minimize fees, to obtain lower interest rates on loans, to obtain perks of all kinds.

Some banks give "points or rewards" for the total amount of business with that bank. For example, if you have a particular amount of points the bank will add 0.1% to the interest rate on a CD. This is free money, take full advantage of it. Likewise, make sure this does represent real value. If this bank offers a 4.0% interest rate on a 5 year CD and with your points the rate is increased to 4.1%, yet a bank next door offers a rate of interest of 4.25% on the same CD, then it may not be the bargain that it appears. You should always make sure that the CD is insured by the FDIC or FSLIC. The limit of this insurance is dependent on how the ownership of the asset is titled. The institution will provide you with details.

Insist on lower fees and you will receive them. The average physician should have enough financial clout to potentially negotiate away points on a mortgage. When applying for a mortgage loan, the loan officer will often tell the physician, especially new physicians in town, that they must open a checking account or accounts at the bank to receive the loan. This is not the case. If you do wish to open further accounts, use it as leverage. If you do not, just say no. If you do not receive what you want, take your business elsewhere, where you will receive lower fees. The end point of every business deal is whether you do it or not, whether you say yes or no (*see* Chapter Twenty-Two). If you do not receive the terms you wish, the lower fees, the better interest rate, say no and take your business elsewhere. You are a preferred customer.

If you are in private practice you may have further influence with banks, lawyers, accountants, and almost any business that your practice does business with. Use this as leverage to your advantage.

Never be afraid or embarrassed to ask. The worst that can happen is someone says no. It is more likely you will receive what you request, or even more. Even if the person says no, they will almost certainly respect you more for asking. In fact, they will realize that you are not "The Mark" but rather a physician with some business savvy and some guts.

One dollar here, $5 there, $50. Fees are everywhere and if they can be minimized you can save a good deal of money almost every day. Over the years the power of compound interest will magnify by many times every penny saved on commissions and fees. The great Benjamin Franklin was almost right. A penny saved is more than a penny earned.

SUMMARY OF CHAPTER NINETEEN

- Fees are like a parasite. They can drain you of your financial health.
- Even apparently "tiny fees" can represent large amounts of money over time.
- Do not invest in a mutual fund that charges a "load."
- Many "no-load" mutual funds have considerable fees. Read the fine print.
- Stay with open-ended mutual funds. Avoid closed-end funds.
- Core investment positions for all physician investors should include index funds with the lowest fees and true no-load actively managed mutual funds with a long-term record of superior performance.
- Full service brokers rarely justify their higher fees.
- If you make you own investment decisions, execute your trades as cheaply as possible.
- Fees are everywhere. They must be minimized.
- Anything added to the basic cost of an item is a fee.
- **ALL FEES ARE NEGOTIABLE**.
- There is never any reason to buy anything from a cold-call telemarketer.
- Avoid placing money in escrow whenever possible.
- Physicians are preferred customers. Use this to minimize fees and obtain perks.
- Fees are either money in your pocket or money in someone else's pocket.
- Just ask and you will be amazed how much you can receive.

SUGGESTED READING

Malkiel BG. *The Random Walk Guide to Investing: Ten Rules for Financial Success.* New York, WW Norton, 2003.

Weiss G. *Born to Steal, When the Mafia Hit Wall Street.* New York, Warner Books, 2003.

Chapter Twenty
Tips
Real Opportunities or Useless Information?

The best way to illustrate how to differentiate a worthless tip from a real opportunity is to describe three situations where I dismissed advice that was, in fact, a significant opportunity. By examining these three lost opportunities I have learned a great deal. The factor common to each example was that the person was giving advice in their area of expertise.

The first involved the president of a local bank, then and now a very good friend. His bank was owned by a holding company that also owned several other banks around the state. Over the course of several years he suggested that I buy stock in the holding company. His approach was very low key. The only time he directly mentioned this to me was when he told me of it initially. Over the next several years I was sent quarterly statements and other financial data. I looked at several, but I am very sorry to admit, just discarded the rest of the information and did not take action.

This was at the beginning of the consolidation in the local/regional/superregional banking industry. This holding company was taken over by another bank and this bank was taken over by another bank. My investment would have grown from five to ten times over. Ouch! This man knew what he was talking about. Banking was, and is, his business.

The second involved a patient. I took care of his father and I take care of him. He was a medical device salesman for more than 20 years. He once told me that a privately held medical instrument maker was soon to come public. He already carried the product of a competitor, but thought they were a well-run company and that their product would do extremely well. (Note that there are very few stronger recommendations than praise for a competitor). After the initial public offering in the early 1990s, I proceeded to watch the stock go straight up. I finally bought and made some money but I missed a good part of the move. The advice he gave me was in his area of expertise.

The third opportunity involved a local businessman who inherited a building. I know this man and his family well, I had a previous investment with him, and he is still a very good and dear friend. He is in real estate and I still rely on his advice when considering any real estate investment. He asked me if I would go in with him for half of the building. I thought it was a great opportunity but I let someone dissuade me from investing (this is the second to last time I have gone against my own judgment). The building has more than doubled in value and my initial investment would have increased on order of magnitude (i.e., 10 times).

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All three of the above situations were not tips but actual, real opportunities that I missed. All three were from reputable people dealing in their area of expertise.

SUMMARY OF CHAPTER TWENTY

- Real opportunity vs worthless tip—consider the source.

Chapter Twenty-One

Areas Where Caution is Essential or That Should Be Completely Avoided

I will discuss this from two points of view—the first psychological, the second practical. Remember all advice in this section is in the context of invest only in what you know.

A simple rule—the more chic, the more glamorous an investment, the greater the chance for loss. The more an investment plays to ego, the more caution is mandated. Remember the doctor's lounge/cocktail party rule—do not invest to impress others. The goal of investing is to make money. For some people the glamour of an investment seems to be more important than the return on the investment. I would prefer a sheep farm or a concrete plant or a necktie factory that generates a 15% annual return, an investment that will double my money in 5 years, to a syndicate buying a thoroughbred horse that "might" be a Kentucky Derby winner, or that is producing a play on Broadway.

Another simple suggestion. I would consider "traditional" investments to be a passbook savings account, a certificate of deposit, the stock or bond of a major corporation, a mutual fund offered by a major reputable firm, or a piece of real estate that you own directly. The majority of physician investors should understand such investments. The further one gets away from such "traditional" investments, the greater the chance of loss.

The following terms and phrases should immediately raise the red flag of caution.

1. Limited partnership. In a limited partnership, the general partner makes the business decisions and conducts the affairs of the business. They may or may not have invested their own money. The profits are divided between the general and limited partners by whatever formula is agreed on when the partnership is established. The general partner has unlimited liability whereas the limited partner is liable only for the amount they have invested or have signed in notes (thus the term limited partnership). An investment structured as a limited partnership is a completely legitimate way to conduct business. However, I think more physicians have lost more money with limited partnerships than through any other type of investment. I admit I have lost money in limited partnerships but I have learned. A detailed discussion of some aspects of a limited partnership is warranted because the potential for disaster is great.

   a. Making money requires knowledge and hard work. Doctors should know this because they work hard. A limited partnership requires no work from the limited partner, aside from the initial evaluation of the investment itself, so the returns may be limited. I suggest that every word of the partnership agreement

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be read and fully understood. I would also suggest that an attorney be routinely consulted before signing any partnership documents or contracts. Do not be afraid to ask questions. It is your money. If you are currently an investor in a limited partnership, did you read the entire prospectus before investing?

b. OPM—Other people's money. Many limited partnerships are structured such that the general partner personally does not invest any of his own money. All the money for the investment comes from the limited partners. Caution is indicated in such situations. The general partner's interests are not exactly the same as the limited partners, and if things get tough, they could conceivably abandon the investment and just walk away. I was in a limited partnership many years ago where this occurred. I am currently in only two limited partnerships. Both are local with people I know and trust. Both general partners have invested their own money, and in one circumstances it is a substantial percentage of their net worth. I can sleep at night knowing that he is staying up at night to make sure things go well. In both of these investments the general partners interest is very similar, almost identical, to mine. We both make money for the same reasons.

   This brings up a general concept that applies to all investments. Have the general partners/executives invested their own money? Seek out such investments. These people want the investment or company to succeed as much, or usually more, than you. You can feel safer in such situations that your money is being protected.

c. You must understand how the profits are divided. Does the general partner receive a disproportionate percentage of the initial profits? Does the general partner's share of the profits remain the same no matter how great the profit? Or do the limited partners receive a disproportionate share of the initial profits with the general partner receiving a greater percentage as the profits rise? The latter variant may be "safer" for the limited partner but will serve to cap the possible gain should the partnership be extremely profitable.

   Another variant on this theme is where dividends, short-term capital gains, long-term capital gains and deductions, depreciation or tax credits are distributed on whatever particular formula has been agreed on. Be sure you understand the formula, and that it is equitable and not "stacked" in the favor of the general partner.

d. Completely avoid all limited partnerships sold by a salesman, broker or agent. The salesmen make their money at the time of sale from the commission, which is typically 8 to 10%. I have been unwise enough to make two such investments and both were 100% loses. A full year's standard return on investment is gone before the game has even begun. Whether the investor makes money is of no consequence to the salesman who has already made their commission. The mere fact that the investment must be sold through a salesman indicates that the general partner did not have sufficient personal funds or was not able to raise the money from knowledgeable insiders or by borrowing from banks.

   Without exception, do not invest in any limited partnership sold through a salesman or broker or where the general partner makes their money through an up-front fee. You will be infinitely better served buying a CD at your local bank or savings and loan.

e. Your money is tied up for years; 3, 5, 10 years, or even longer. Limited partnerships are almost completely illiquid (i.e., cannot be sold at all), much more so than real estate, which is illiquid. Even if a piece of real estate cannot be sold quickly, it may be possible to borrow against the property if there is sufficient equity. It would be much more difficult to borrow against a position in a limited partnership.

f. There is often a graduated buy-in, such as one-third at the time of the investment, one-third in 1 year, one-third in 2 years. This can be seductive because you may receive the full benefits of the investment but do not have to put up the entire amount of cash up front. Notes are often signed for the amounts due at the later time and thus represent borrowing. I have seen investments fold in less than a year. But the notes that were signed are valid and the payments are still due. It is discouraging indeed to owe $25,000 on an investment that has already gone broke.

g. There is often the exclusivity angle. Because of the large buy-in—$25,000, $50,000 or more—very few are eligible to invest. The investment itself often has an aura of glamour, such as a prominent piece of real estate, the purchase of an artwork or some other collectible or a venture in a foreign land. These factors are all tailor-made for a high earning but naïve physician to be separated from their money.

The above not withstanding, you may still consider investing in a limited partnership but it is essential to know the investment and the general partner. Many legitimate and profitable deals are structured as limited partnerships. But remember my initial statement—I feel that more doctors have lost more money through limited partnerships than through any other type of investment. I remind you of the story in Chapter Three regarding the South American partnership that cost each participant between $3 and $10 million. Please be extremely careful.

2. Tax shelters. There are three problems with investments structured only to avoid taxes:

a. There is no such thing as a true tax shelter. There are ways to delay taxes and to minimize and decrease taxes but there is no way to truly avoid taxes. You make money, you owe taxes. You can make money on Mars but you still owe taxes. Never believe anyone who claims to have an investment opportunity that will allow you to avoid taxes.

b. They are illogical. An investment should be structured to make money. If there are favorable tax consequences, such as legitimate depreciation or tax credits, all the better. But if an investment is structured only to generate losses, motives are misdirected. As a result, the business tends to be flimsy at best.

c. The more egregious and abusive the tax shelter, the more upset the IRS. Shelters meant only to evade taxes are a red flag to the IRS. You could be exposing yourself not only to interest and penalties, but to detailed auditing of your entire return, back auditing, and future audits. The IRS is making a concerted effort to crack down on shelters they consider abusive, as many doctors and dentists who purchased a variety of products from Xélan are discovering. I would rather be standing at the bar next to an inebriated, thoroughly upset heavyweight-boxing champ than have the IRS on my case (at least you could offer to buy the champ another drink). I suggest you invest with a goal to make money and pay the taxes from the profits.

3. Restaurant. Dilettante rhymes with restaurant. *Webster's* definition of a dilettante is a "person who cultivates an art or branch of knowledge as a pastime, especially sporadically or superficially, for synonym see amateur."

   What do you know about running a restaurant? It sounds glamorous but the time commitment is prodigious. What do you do if you are performing a mitral valve replacement and the restaurant pages because a customer is upset. It is essential to hire good help and keep them. Who cooks, who goes to market to buy the fresh food and vegetables? Who keeps the books? Who cleans the dishes, the floors, the tables, and the toilets? It is very difficult to operate a profitable restaurant, just as it is very difficult to be a good physician. Forget about owning a restaurant.

   This also applies to any type of storefront business. Examples would be a bed-and-breakfast, an antique shop, a knick-knack store, anything that requires time and knowledge. If your spouse wishes to open a business, are they a dilettante or a serious businessperson? After considering leases, construction costs, furniture, inventory, etc., it often costs $100,000 or more to start a business. If your spouse is business-minded and has investigated all aspects of the business venture and has the time and skill to manage the business then it may be a good investment. Maybe your spouse will hire you after you retire.

   Viewed from a different perspective, it is very unlikely that any business you might imagine will be as profitable as your primary business, i.e., your practice. If you really wish to increase your wealth and income, spend at least 30 minutes to 1 hour every week studying your investments and see one or two more patients a week (your overhead is already covered so these patients are pure profit) and forget about opening a restaurant or any other business (except as a potential transition in your post-medical retirement years).
4. International investing. This does not refer to a mutual fund managed by one of the large companies—such as Vanguard or Fidelity—that invests outside the United States, either in a general international fund, or in specific areas or countries, such as Europe, Asia, Japan, China etc. This also does not refer to a legitimate money manager who trades in foreign securities, currencies, or businesses. It also does not refer to the stocks of large foreign companies that may be purchased on our stock exchanges as ADRs (American Depository Receipts), such as GlaxoSmithKline (GSK) or Novartis (NVS), etc.

   Rather I refer to a direct investment in a company or venture in a foreign land. This may sound thrilling or even enchanting but is fraught with hazard.

   a. A foreign country can change the rules at any time and often does. Many countries have a long and sordid history of the repudiation of sovereign debt. The assets could even be nationalized and there is absolutely no recourse. It is very unlikely that the President will call out the Marines for you.
   b. Our financial markets and institutions are in general the most efficient in the world. Other countries may be much different. It may be difficult to get money into the country and difficult or impossible to get it out. There may not be adequate banking services to conduct the business appropriately and you may not even be able to sell your business.
   c. Contracts must be drawn up. They will be long, detailed—and, correspondingly expensive. The legal fees could easily be $100,000 or more.

d. Do you speak the language? This is a perfect example of investing in what you know, or more likely, what you do not know. Have you ever traveled to the country? What if something goes wrong? How could you find out anything about anything? Do not invest in a gold mine in China if you cannot speak Chinese. The mine might not even be there. The purchase of a duplex down the street is more likely to be profitable than a direct venture in a foreign land.
e. Just traveling to the country could be hazardous to your health. Americans are beginning to realize that the freedoms we take for granted are not the norm in many parts of the world. Graft, corruption, bribery, and intimidation are the standards of business in many countries.

5. Art, or any other collectible (*see* Chapter Thirty for a detailed discussion of investing in collectibles). A great eye and tremendous knowledge are required to realize a reasonable return from collectables. Buyers and sellers fees at auction houses often total 20%; dealer's mark-ups may be even greater. If you do possess detailed knowledge in a defined area it is possible to do well, but collect because you like something, not as an investment *per se*. Suppose you spend $50,000 for a painting by a prominent pop artist. You find the painting plain or even bizarre but are convinced (hope may be a more appropriate term) it will be a good investment. Unfortunately, 5 years later the painting is appraised at only $15,000. Every time you walk into the living room it is impossible not to look at the painting that now appears absolutely hideous to you because you have lost $35,000. It may seem glamorous to display the painting of a famous artist on your wall, but it is not often profitable. As a final nail in the coffin, all of the people you hoped to impress with your savvy eye for art now know for certain that you have absolutely no eye for art. If you really wish to impress the right people, donate the $50,000 to the Red Cross, the Salvation Army, the Boy Scouts, or your alma mater instead of buying a piece of art.

   There was a piece on CNNMoney on August 11, 2004 entitled "The Art of Investing in Art." The article describes how a new breed of mutual funds will allow even the small investor to diversify their risk and own shared interest in a portfolio including Old Masters, Impressionists, and other artists.
   This may sound glamorous but the potential for profit is likely to be limited:

a. There will be the fees to buy and sell the works. These are always significant and will decrease the potential for profit.
b. Add the management fees of the operators of the fund.
c. Add the fees of storing, insuring, transporting and displaying the art.
d. The greatest collections, which in the end are always the greatest investments, are built over the course of many years or even decades, typically the collector's adult lifetime. Sometimes, as with the Garrett or Norweb coin collections, over several generations.

Contrast this to the proposed funds, where a large amount of money is available for investment. The purchases will be made over a much shorter period of time. A large buyer in any market with limited supply can artificially force prices up. It is also unlikely that many premium yet under-priced pieces will come to market over a short period of time, resulting in the purchase of some works with limited profit potential.

e. Even though you may own a (minute) fraction of a Renoir or a Picasso, it is safe to assume that it will never be hanging on your wall. Where is the glamour in that?
f. Whenever a small investor—i.e., the unknowing public—enters any market, it is invariably at the top. In such situations, guess who is selling? The knowledgeable insiders who bought many years ago and are now cashing out to realize their 15–20% compounded annual profit.

6. All the potential investors are physicians. This is a guaranteed loser. This is probably one of the ten best take-home points of this book. When all the potential investors in the room are physicians, the investment is a guaranteed loser. Run the other way as quickly as possible. Several other physician friends who are solid investors and careful with their money have also made this observation. If there is only one physician (you) and the other potential investors are solid, successful businessmen or women, then consider investing.
7. Hedge fund. All aspects of a hedge fund appear tailor-made to trap an unwary physician. Hedge funds may have the capacity to surpass the limited partnership as a vehicle for physicians to lose their hard earned money.

   There is the glamour angle. Just being able to say you have invested in a hedge fund is guaranteed to generate "oohs" and "aahs" in the doctor's lounge or at the County Club. There is the exclusivity angle. This plays to ego and arrogance. The purported potential for 20 or 30% or even incalculable gains generates greed.

   A hedge funds allows the manager to invest in almost anything—stocks, bonds, currencies, commodities, futures, options, real estate, etc. They can go long or short and typically hold long and short positions at the same time. They often employ leverage (i.e., borrow money) to enhance the potential gain. The amount of leverage can sometimes be enormous, almost beyond the limitations of sanity, such as ten to one or even greater.

   I remind you that leverage has the potential to magnify losses even more than it magnifies gains. In the late 1990s, a group named Long Term Capital Management, with several Nobel Prize-winning economists on their staff, was employing leverage of 100 to 1 or even greater on some trades. They presumed markets were efficient and their safeguards were adequate to limit losses. But the markets were not efficient and their position fell apart, just as the concept of "portfolio insurance" was not able to prevent the stock market crash of October 1987. The debacle precipitated a crisis that required central bank intervention to stabilize the currency and financial markets.

   Being able to invest in anything and everything greatly increase the possibility that the hedge fund manager will be investing outside of their area of expertise. The hedge fund phenomenon could have an ugly ending.

   I have five very significant concerns with hedge funds:

a. Twenty years ago, there were relatively few hedge funds, and they were often managed by veteran investors such as George Soros, Jim Rogers, and Julian Robertson. Some generated spectacular long-term records. Now there are thousands of hedge funds, more than 7,000 at last count, almost guaranteeing some are directed by managers of questionable competence. Say that in one year

Major League Baseball doubled in size. Players the year before who were in the minor leagues at the Double A or Triple A level are now wearing a big league uniform. They may be in the major leagues but are still minor league talent.

The entire hedge fund concept is becoming so trendy and moving so quickly that it may be approaching the mania stage. As Shiller notes in *Irrational Exuberance*, manias always end in a bloodbath for the last to buy in.

b. The fee structure of the typical hedge fund is Draconian. There is usually a 1 to 2% annual management fee. Remember that the management fee of well-run index funds (such as the S&P 500 funds) is typically less than 0.5%. The basic fee is already more than double to quadruple the fee of the passive index mutual funds. However, there is an additional management fee of 20%—yes, TWENTY PERCENT—of profits. The hedge fund manager must out-perform the average by more than 25% just for the investor to keep pace with the average. This math is correct. If the total profit is 12.5%, taking 20% of the profits leaves a 10% gain for the investor. However, 12.5% is 25% higher than 10%. It is unlikely there will be many hedge fund managers savvy and proficient enough to beat the averages by a whopping 25% year in and year out.

   Moreover, in years where there is a loss rather than a profit, the hedge fund manager does not receive the 20% share of profits because there are not any profits, but likewise, they do not kick in to make up 20% of the losses. Talk about all gain and no pain. Many funds are structured so that the loss must be recouped before the above fee structure on the profits pertains but the basic point is the same.

   But wait, there's more. Hedge funds often trade very aggressively, buying and selling positions on a monthly, weekly, or even daily or hourly basis. Not only are the transaction fees (the commissions to execute trades) significant, but the fees are considered fund expenses and passed on directly to the investor. Because of the frequent, almost frantic trading, many of the gains are short-term, which are taxed at a higher marginal rate than long-term gains.

   There are also now "funds of funds," hedge funds that do not hold positions directly but only invest in other hedge funds. The initial hedge fund could generate a 15% profit but after their fees, and the fees of the manager of the fund of funds, and commissions and your taxes, you have a nickel. Five cents. Try to brag about that at the Country Club or in the doctor's lounge.

c. Hedge funds are unregulated. This will encourage abuse. Securities traded on the major exchanges and standard mutual funds are very closely regulated by the SEC. Hedge funds are not currently regulated, although the SEC is considering instituting some degree of regulation. I presume the vast majority of hedge funds are honestly run and managed but you could be in the minority that gets clocked by a shyster.

d. Do not be unduly impressed that a hedge fund is offered by a major, absolutely reputable financial institution or brokerage. The investment could still be junk, maybe just "high class" junk.

e. The price of investments are often more related to expectations than to reality. Because of the market mania of the late 1990s, many investors came to believe 20% per year gains were the norm rather than the exception. Since 2000, many

of these same investors have taken a terrible beating. This expectation and addiction to 20% annual gains has caused many investors to embrace an inordinate amount of risk, as exemplified by the concept of a hedge fund. Many of the more recent hedge fund investors may lack insight into the potential risks.

Overall, the average physician investor will do much better income averaging into their favorite S&P Index Fund or no-load mutual fund than chasing the probably illusionary gains promised by a trendy hedge fund.

8. Penny stocks. As the name implies, these stocks sell for less than or close to a dollar, sometimes for pennies. In general, when the price of a stock or the total capitalization of the company drops below some minimum value it is "de-listed" off the major exchanges. Likewise, the company may never have been large enough to have gained a listing. Such penny stocks typical trade in the "pink sheets" or the over-the-counter (OTC) market and have a five-letter ticker symbol. One would be wise to steer clear of penny stocks—stocks that sell for close to or less than a dollar.

   The usual reason the stock is so cheap is that the company is in trouble. Penny stocks are typically the ones hyped by promoters. It is very safe to say that a promoter will not call to suggest the purchase of Berkshire-Hathaway (BRK), currently selling at about $85,000 per share. Rather they will recommend, no, strongly recommend, Acme Computers and Software, trading at 9¢ per share. Ninety thousand dollars could purchase almost one million shares of Acme Computer and Software. Wouldn't it be impressive to own a million shares of a company?

   The only time I would consider buying a penny stock is if you have a very intimate knowledge of the company, such as if you work there, or it is a local company and you can see the business and talk to the people first hand. Otherwise, it is best to avoid stocks that sell for close to or less than a dollar, for pennies.

   This is an appropriate time to discuss stock splits. If a company's stock has performed well, the Board of Directors may decide to split the stock. There is a mystique associated with stock splits but it does not represent any more money in your pocket. One hundred shares of a stock that sells for $100 = $10,000 worth of stock. The company splits the stock 2 for 1 (it may be any multiple, 3 for 2, etc). You now own 200 shares at $50 per share = $10,000 worth of stock. Voilà. No difference.

   I mention stock splits under the general heading of penny stocks because of a maneuver called a "reverse stock split." This only occurs when a company is doing poorly. The price of a stock falls to 50¢ per share and the company's board declares a "reverse stock split" of 1 for 20. Instead of owning 100 shares of a stock that trades at 50¢ = $50 worth of stock, you now own 5 shares (100 ÷ 20) of a stock priced at $10 = $50 worth of stock. Caution is clearly indicated when there has been a reverse split.

9. How about this? If something sounds bogus, it is bogus. I am not referring to poor investments that fail, I am referring to out and out scams. A great many of the scams that I have read about and heard of, and a few of which I have personal knowledge, are generally based on such a flimsy assumption they should appear obviously bogus to even the casual observer. If you wonder how you could make money on something, your concern and skepticism are certainly warranted.

10. Do not be concerned about "getting in on the ground floor." This desire will significantly increase, not decrease, your mistakes. Over the years, there have been more than 1,000 automobile manufactures that started in the United States. There are now only General Moters and Ford (Chrysler is not a stand-alone company). Position purchased in all of these along the way would have resulted in a significant loss. Waiting for the winner to become apparent will greatly increase your chance of success. A medically related example is in the area of biotech. Purchasing a position in all of the biotech companies when they came public would have resulted in significant losses whereas waiting for the winners to emerge, such as Amgen (AMGN) or Genentech (DNA), would greatly increase the chance for profit. Peter Lynch repeatedly emphasizes this point (*see* Chapter Thirty-two).
11. Venture capital. Some businesses, even after the initial capital contributions and borrowing from banks, do not have the funds required to expand. People may have a truly great idea, but need financing to buy the machinery and equipment, to hire other people or do further research to bring their ideas to fruition before they an earn a penny of profit. Venture capitalists will provide this financing in exchange for some amount of equity (ownership) of the company.

    The allure of venture capital is that you may be getting in on the ground floor of the next Cisco or Microsoft. As always in such situations there is also the angle of exclusivity. A fifth grade teacher or secretary cannot invest in a venture capital firm. The principal downside to investing in start-up businesses is that most businesses are never profitable. It takes amazing business acumen and skill to be a successful venture capitalist. The average physician investor is probably better off trying not to be a (ad)venture capitalist.

SUMMARY OF CHAPTER TWENTY-ONE

- The more glamorous an investment, the more caution needed.
- Avoid limited partnerships sold by a broker or salesman or where the general partner has not invested any of his own money.
- Avoid tax shelters.
- Forget about owning a restaurant or any storefront business.
- Avoid direct foreign investments.
- Art, or any collectible, may be glamorous but is rarely profitable.
- Be cautious of investing in a hedge fund.
- Avoid penny stocks.
- Do not be concerned about "getting in on the ground floor."
- Completely avoid anything where all the potential investors are physicians.

Chapter Twenty-Two

Yes or No

There are three components to all business deals. The second and third are the final agreed on price and details, the terms. Everything in the final agreement is important, but there is something even more important than the price or the terms, and that is whether you do the deal or not, whether you say yes or no. The price and terms are immaterial if the deal is never consummated. The best way to avoid an investment with inferior terms and/or price is to say no, to not invest.

I devote this very short chapter to this point because businessmen understand this concept very well but physicians have little insight into the power of being able to say no, to just walk away from the table. This inability not only affects physician's personal investments but also is important in their professional life when physicians deal with businessmen in a variety of situations, such as in negotiations with insurance companies or hospital administrators.

A basic element that characterizes a physician's poor business ability is they do not realize they have an alternative. They will negotiate, in fact, often barely negotiate or not negotiate at all, and think they have obtained acceptable price and terms, but the real problem is that they should not have done the deal for any terms or any price.

Let me provide an analogy. You have a vegetable garden full of weeds. A physician will spend hours of their valuable time meticulously picking the weeds from between the vegetables. After several days of hard work the final product is still inadequate, and in fact, may never be adequate, no matter how much time and effort are expended. Sometimes the best or only reasonable course is to just plow things under and start over.

Good businessmen, if they do not receive acceptable terms and/or an acceptable price, will walk away. They will consider alternatives. This takes a lot of gumption, extra time and effort, and a lot of willpower, but they will walk away.

I am not sure why this is such a problem with physicians, but at least a part of the problem relates to the time pressures on a physician. A physician works 60 or 65 hours or more a week. They have spent every spare hour of the last 2 weeks, time away from their family, looking into purchasing a local rental property. They feel they must complete the purchase now because the next month is completely booked with call and other time commitments. The purchase is made for a price and terms that seem reasonable but the real problem is that the purchase should not have been made in the first place.

For a businessman, the goal is to make money. They will put in whatever time and effort required to make a good product or service, and thus generate a profit. A physician practicing medicine will expend whatever time and effort is required to take good

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care of a patient. For a physician and his investments, often as little time as possible is devoted to the task. Being a successful businessman requires time and effort. Being a successful physician requires time and effort. Being a successful investor requires time and effort. A physician will work 60 hours a week for a year to generate $50,000 of investment capital and then not spend 1 hour studying how to invest that money. This is just plain stupid.

Take your time. Do not be afraid to say no. Remember, real opportunities occur once or twice a year or less. Unless something is begging you to go ahead, just forget it. Wait. Even after all of the time and effort, if the terms and price are not acceptable, you must be willing to say no and walk away. There are alternatives but it takes time and effort to pursue them. Businessmen understand this; physicians often do not.

SUMMARY OF CHAPTER TWENTY-TWO

- There are alternatives. It is far better to say no than to enter into an inferior agreement.
- Being a successful investor requires time and effort.

Chapter Twenty-Three
Dealing With Bankers

I began Chapter Two with a quote from Einstein. I will start this chapter with a quote from the great American writer, wit, and social and political commentator Mark Twain. He said, “A banker is a fellow who lends you his umbrella when the sun is shining and wants it back the minute it starts to rain.” This is more than an idle comment by Twain since later in his life, in 1894, his personal financial problems became so acute that he declared bankruptcy, affording him considerable experience in dealing with creditors.

I admit at the outset this chapter was the most difficult of this book for me to write. As already stated, one of the main goals of this work is to generate in the reader a healthy sense of skepticism and to give you the information to make your own decisions. My concern is that the following comments may seem almost beyond skeptical, with the result that my arguments will lose credibility. However, after discussions with many friends whose advice I respect, and several people who have been forced to deal with creditors on unfavorable terms, I have made my comments stronger than originally intended.

Before dismissing the following comments as having no basis in reality, I ask that you *personally* speak with someone who has suffered a foreclosure—such as a farmer who has lost his land, or your grandparents, or a friend of your grandparents, who witnessed first-hand the foreclosures of the Great Depression—or someone who has had a note “called in” by the bank. Only then will you appreciate my advice.

I am not criticizing creditors for wishing to be repaid after making a loan. I have already clearly stated that the sanctity of private property and the repayment of debt is a cornerstone of our democracy. Be assured that if I loan someone money I expect to be repaid in full and on time. If I were a banker, I would do everything they do, everything honest and within the law, to protect my interests.

It is important to have a good relationship with many bankers. The critical point is that the relationship must be on your terms, not theirs. You must realize this in order to protect yourself from potential problems.

Note the word bankruptcy. To be bankrupt, you must be in debt, and it is the bank that has loaned the money to allow this to occur. Banks make money by charging fees for various services (*see* Chapter Nineteen) and by loaning money and charging interest. Auto dealers sell cars. Grocery stores sell food. Banks “sell” money. In my opinion, in our current society, banks have been far too lenient and aggressive in “selling money” and encouraging debt.

Just as a physician understands medicine, bankers understand money. They understand finance, they understand how to lend money and how to invest it. They understand

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all of the practical aspects of money. Bankers understand the power of money. If you have money, you have influence with creditors. When you have money, you will be amazed how much you can receive from a banker. When you do not have money, or when you are in debt, they have the upper hand.

Banks are delighted to loan money to a big wage earner such as a physician. Just as a salesman cultivates and courts a client, bankers will cultivate and court physicians in hopes of loaning them money. The physician will be charmed. Charmed into borrowing money, often in large amounts, often more than I believe is prudent. You will be invited to dinners, parties, and receptions. You will receive free tickets and favors. You will be treated with deference to the point of punctiliousness. You will never be called by your first name. Instead, you will always be addressed as "Doctor," even by the president or chairman of the board of the largest banks. Three or four short years before you were a resident taking call every second night, vacationing only at a relatives home to avoid a hotel bill, and now you and your spouse are at the opera seated next to a bank president.

Bankers will play to your ego. Do not be seduced. Do not be charmed into more debt than is prudent. You should be working for yourself and your family, not for the bank.

The charm and deference with which your are treated when borrowing money belies the treatment if you are unable to repay. If bankers looked more like *Australopithecus afarensis* than *Homo sapiens* and it was known from the outset that you and your entire family line would disappear from the face of the earth were you unable to repay your debt, then there would be no misconceptions and you could prepare and protect yourself accordingly. Do not be charmed into complacency. I assure you that the banker who took you to the ball-game or the opera, who introduced you at a private reception at their home to your United States Senator or the Governor of your state, will use absolutely every means under the law to get their money back, including forcing you into bankruptcy. Please, do not forget this.

But if debt is kept to a minimum, if you have a Fort Knox personal balance sheet, it is possible to deal with creditors on your terms, not theirs. It is an interesting feeling indeed to be able to say "NO" to a banker. In fact, they will want your business and respect you even more. Banks very much want your deposits, this is how they have money to loan, and they know if they loan you money they are likely to be repaid in full.

Every word counts when signing a loan document. Logic suggests that anything there is there for a reason. Do not allow any question to be brushed aside with a response such as "oh, that's not important" or "that almost never happens" because it is important and it can happen. Do not sign the note. Find a new banker.

Some of the terms that may be included in a loan document include various requirements for collateral and the possibility that the bank can "call in" the note. We recently refinanced the note on a building. A clause in the note stated that even after a partner had sold their interest back to the partnership, their name would still be on the note and thus liable for repayment. I insisted that the clause be removed and it was.

Never sign a note that can be "called in." This refers to the bank having the option to **DEMAND** "accelerated repayment" of the note. On written notice the bank can demand payment of the entire loan balance, usually within 30 days. What if $150,000 is owed on an investment and the bank "calls" the note? Even if you are in a solid financial position and the investment is going well, how is it possible to raise $150,000 cash in 1 month? In general loans are not called in when things are going well. Instead notes are called in when the situation is dire, when the borrower is not doing well or when the

economy is collapsing, such as during the Great Depression. It could very well be impossible to repay and the borrower could be forced into bankruptcy. There are few financial situations that require more caution than a note that can be "called in."

I will share a personal experience that shows my (previous) naiveté. Some years ago I was in an investment that went bad. It was the last time I made an investment against my better judgment and the last time I had to talk myself into something. It was also the last time I really did not know all of the details of the investment. The whole project was a terrible mess and everyone involved lost a good deal of money.

Shortly thereafter I spoke with the bank officer who was supervising the loan on this project. I said, "Did you know there were problems with this project?" He replied, "We knew the project was considerably over budget and we had our concerns." I was so incensed I felt like punching him in the nose. This banker, and his bank, knew all of the investors, had dealt with us for years, and yet did not voice their concern and therefore we ended up taking a significant loss.

It had previously been my impression that a bank loaned money because they thought the investment for which the money was being borrowed was sound. I admit my error. A bank loans money for only one reason—because they think the money can be repaid. This statement is true.

Over the next several months I asked the following question of four bankers (two presidents and two executive vice-presidents). "If I were borrowing for an investment that you thought might not be profitable, would you still loan the money if you knew I was capable of repaying it?"

Three said categorically and without hesitation "yes." The fourth said, "Bob, I would try to talk you out of it, but in the end I would make the loan because I know that someone else would."

If the reader prefers to dismiss everything I have said as unwarranted skepticism, I suggest you ask the above question of the bankers with whom you deal. There will probably be a pause before the question is answered. They will ask why you are asking the question. And then, the answer will be in slow and measured words. And do not forget to speak to someone who has had a loan called in or who has been forced into bankruptcy or forced to sell the family farm. These are the facts of life as it relates to dealing with creditors.

SUMMARY OF CHAPTER TWENTY-THREE

- Your goal is to be able to deal with bankers on your terms, not theirs.
- Do not be seduced into inappropriate amounts of debt.
- Every word in a loan document is important, read it closely.
- Do not sign a "callable" loan.
- To gain perspective, you should personally speak with someone who has suffered a foreclosure or had a note "called in."
- The only reason a bank loans money is because they feel it can be repaid.

SUGGESTED READING

Kaplan J. *Mr. Clemens and Mark Twain: a Biography.* New York, Book of the Month Club, 1990.

Chapter Twenty-Four

Asset Allocation and Diversification

It would appear that the two major sections of this chapter provide disparate advice and reach different conclusions. They are and they do. The difference in applicability relates to the level of sophistication and knowledge of the investor.

The less knowledgeable the investor, the more important it is to diversity your investments. The majority of physician investors will probably be better served by the advice provided in the first section.

Likewise, let me give a disclaimer. I am providing the advice in the first half of this chapter on the importance of diversification because this is "standard" advice as provided in the vast majority of works relating to the general topic of investing. I feel that such traditional investment advice places far too much emphasis on diversification. I believe you can maximize your return by concentrating assets in your area of expertise with little need for the security blanket of diversification. As detailed below, the quest for diversification can induce you to make investments outside of your area of expertise, reducing the potential for adequate return. My final recommendation is the advice I provide throughout this book. Read, study, and make up your own mind.

THE IMPORTANCE OF DIVERSIFICATION

The principal goal for the average investor is not to maximize gains. That is desirable, but not your main concern. The principal goal is to realize the standard 10% annual return on investments. The first step toward this goal is to minimize losses. This is what counts. One huge loss, such as 100% of a particular investment, will negate many gains. I have heard people say you just need to be right 60% of the time to be a successful investor. This can only be done by minimizing losses, and the best way for the average physician investor to achieve that is to diversify.

Examine Table 1. Each person makes five investments. The first investor hits four grand slams that realize gains of 50, 40, 30, and 20%. There was one investment outside the physician's area of expertise that resulted in a complete loss. The four spectacular investments are almost negated by the one debacle, resulting in an overall gain of 8%.

The other investor has four positions that generate modest, attainable gains, two positions showing 15% gains and two realizing 10% gains. One position just breaks even. But the overall gain is 10%, a full 25% more than 8%. The first rule of investing is similar to the first rule of medicine: **FIRST, SUFFER NO HUGE LOSS**.

A general grouping of assets into financial assets, such as stocks, fixed income, and cash, real estate and other, would be appropriate. The "other" category includes

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Table 1
Difficulty in Overcoming a Complete Loss

Investor A	Investor B
$100 × 50% gain = $150	$100 × 15% gain = $115
$100 × 40% gain = $140	$100 × 15% gain = $115
$100 × 30% gain = $130	$100 × 10% gain = $110
$100 × 20% gain = $120	$100 × 10% gain = $110
$100 – 100% loss = $ 0	$100 × no gain = $100
$540 = 8% gain	$550 = 10% gain

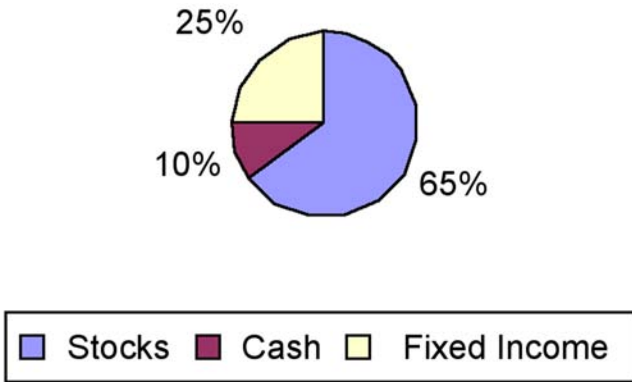

Fig. 1. Asset allocation of traditional financial investments.

essentially anything of value, such as gold, art, collectibles, and limited partnerships of any kind. The less your expertise and investment knowledge, the more you should stay away from "other" and stick to traditional financial assets and real estate. Burton Malkiel makes the same point in Chapter Thirty-Two.

Figure 1 provides my general recommendation of asset allocation for traditional financial investments.

You will see other recommendations for asset mix or allocation, especially with a higher recommendation for fixed income investments. As detailed elsewhere, I am not a fan of bonds as fixed income investments so my recommendation in this area is lower than most. You will hear on the financial shows or through reading that a brokerage or investment firm has suggested some change in their recommended asset allocation, such as increasing stock exposure from 55 to 65% and decreasing fixed income exposure from 40 to 30%. This is what they are referring to.

The most desirable asset mix changes over time, often significantly. It would have been very desirable to have been completely out of the NASDAQ from 2000 to early 2003, just as it would have been very desirable to have been in the NASDAQ from 1995 to 1999 and to have been in gold or silver from the early 1970s through 1980.

I continually emphasize the importance of cash. The long-term return on cash is inferior to almost other asset classes. At present money market accounts are paying an interest rate of only about 1%. But cash has a power that nothing else has—you can

buy anything and you can buy it right now. I am not referring to using cash for consumption, such as buying a new DVD player, but rather for making investments. When you discover one of those real opportunities that occur approximately once a year (*see* Chapter Twenty-Five), unless there is cash available, or you can borrow money, the only options are to miss the opportunity or be forced to sell another investment (remember the commission to both buy and sell the investments will decrease your profit).

I consider a Certificate of Deposit (CD) at a bank both cash and a fixed income investment. It is certainly the latter since you will receive a specific rate of interest for a pre-determined period of time and will also receive the principal when the CD matures. It is also cash because it can be redeemed at anytime, although there is an interest penalty if cashed prior to the date of maturity. It is also cash because it can be used as collateral. Suppose you wish to make a real estate purchase. You have a CD that matures in 3 months and you wish to use this money as the down payment. The bank will provide a bridge loan to cover the down payment until the money from the CD is available.

I love CDs and feel they should represent the vast majority (or even all) of the money allocated to fixed income investments. I have never seen a similar recommendation so I will detail why I prefer CDs to bonds:

1. Spread your money around. Try to have CDs at several banks in town. You have influence with the bankers where you have such deposits, and you also have influence with the bankers where you do not have deposits because they see that you have money and want your business.
2. Everyone understands a CD.
3. There are no commission charges to purchase or redeem a CD. You just walk in and walk out. Contrast this to the direct ownership of a bond, where there are commissions (fees) to buy and sell, or even the best managed, most efficient bond mutual fund, where there will always be some management fee. If a bond mutual fund pays an aggregate interest rate of 5% and the management fee is 0.5%, you have lost 10% of your profit.
4. CDs are not "callable." Except for Treasuries issued since 1985, most bonds have call features. If you do not understand this concept, you should not be buying an individual bond.
5. CDs at the vast majority of local banks or savings and loan are insured by the government for up to $100,000 at each institution. Some bonds are insured, some are not. Even for bonds that are "insured," there is no guarantee that the insurer will be able to pay if things go really bad.
6. A physician does not have the ability to evaluate the credit worthiness of each individual bond issuer. There are bond rating agencies, such as Standard & Poors and Moody's, but they are not perfect as evidenced by how inappropriately slow they were in downgrading the debt of Enron.
7. I do not feel liquidity is a significant problem with a CD. If you absolutely must have the money, there is generally an interest penalty for early withdrawal, but you do have your money. You may have multiple CDs and stagger the maturity so that cash is almost always available. If you have twenty CDs, all of 5 years maturity that

have been purchased at different times, one CD will be maturing every 3 or 4 months.

8. You do not need to be concerned about interest rates. No one can control interest rates or predict them, so why worry about them? With a CD, you know how much money you have and the interest rate. In fact, some banks do allow you to "step up" to a higher interest once during the term of the CD.
9. CDs can be purchased in your stock brokerage account. Just be sure they are government insured.

Considering all of the uncertainty of bonds and all of the certainties of a CD, I suggest the average physician avoid the purchase of individual bonds. Be wary of investing in a bond mutual fund (Suzy Orman's book makes the same recommendation) and utilize CDs as the vehicle of choice for your fixed income investments.

The second principal reason to diversify assets is that different classes of assets can move independently of each other. I emphasize **can**. You may read that when stocks go up, bonds go down, and vice-versa. There are periods, often long periods, where stocks and bonds move in the same direction, and periods when they move in the opposite direction. The point is that they can move in opposite directions, so that a loss in one area may be at least partially offset by a gain in other asset areas.

I feel strongly that the portfolio of the physician investor should contain real estate and devote Chapter Twenty-Nine to investing in real estate. I would not consider the equity in your home as part of your real estate investment portfolio, but I would consider any vacation or recreational property in this category. I would suggest 10–15%, or even more if you are comfortable with this, of your entire investment portfolio be in real estate.

At the time of writing, the stock market has been doing well for the last year. However, I am very concerned about 2005 and 2006. The government has been quite successful in devaluing the dollar. Our economy is awash in debt. I am concerned that the stock market lows of October 2002 are not the final lows of this bear market (*see* Chapters Twenty-Eight through Thirty). I feel "hard" assets, such as gold and other commodities and natural resources and collectibles, have an important place in the portfolio of the average investor. I would recommend at least a 5% position in this area (*see* Chapter Thirty).

A reasonable asset allocation for a well-balanced investment portfolio is outlined in Fig. 2. Please remember that these are only general numbers, they should differ depending on general market, economic conditions, and the needs of individual people. Choose what you are comfortable with and what seems right for you.

Let me make a point about the discipline of investing. You must always have cash for daily bills and emergencies. This would include your routine daily checking account and very possibly a money market account. I consider everything else investments—CDs, stock market accounts, mutual funds, everything else of value. Once I get something into the "investment" category, I am loath to pull it out, except to use for another investment or for some other absolutely unavoidable, unexpected bill that must be paid on time, such as taxes. This self-imposed discipline helps prevent the purchase of large, often impulse-driven items such as a boat or motorcycle. It also makes you a more successful investor. In general, investments must be held for months or years to have a reasonable chance for a profit. If you are constantly buying and selling investments to

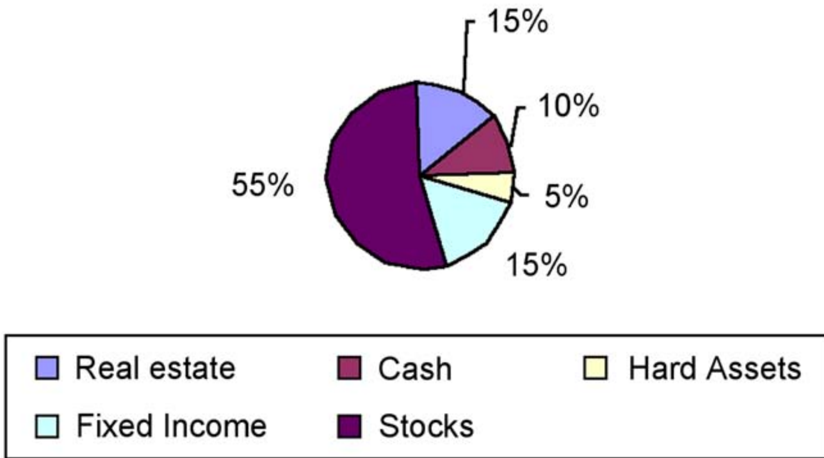

Fig. 2. Asset allocation of entire investment portfolio.

have cash available for daily bills, the commissions/fees will be very significant and there will be little chance to realize a profit.

SUMMARY OF THE IMPORTANCE OF DIVERSIFICATION

- **FIRST, SUFFER NO HUGE LOSS.**
- Investing in many different types of assets may help minimize losses.
- The most desirable asset mix changes over time with general economic conditions.
- All portfolios should contain cash, stocks, fixed income investments and real estate.
- I prefer CDs to bonds as the vehicle of choice for fixed income investments.
- Once money is in the "investment" category, leave it there.

THE MYTH OF DIVERSIFICATION

It is considered dogma that your home is your best investment. In Chapter Thirteen I explain why this may or may not be the case. Similarly all standard advice states that it is mandatory to diversify to protect investments. In this section I explain why I disagree with this statement, which I refer to as "The Myth of Diversification."

Many investment advisors in the late 1990s were stating as fact there was not a need to diversify. Stocks were the only game in town, the road to riches. Just buy stocks, almost any stock, but especially those in the area of technology. The internet, computers, software, semiconductors, you can't lose. Forget price to earnings ratios, price to sales ratio, dividend yield (I discussed in Chapter One why dividends are important). Such traditional methods for valuing stocks were no longer applicable. These were replaced by phrases such as "the new paradigm." Cash, bonds, gold, and old economy stocks were for old fogies. Value investors, such as Warren Buffett, and bond mavens, such as Bill Gross, were clearly so out of touch with the new paradigm as to be considered almost archaic. The thought of owning a gold or copper mine was antediluvian.

The people making such recommendations were probably in diapers in the late 1970s and early 1980s when the previous generation of such savants were recommending only hard assets—gold, silver, energy, natural resources and commodities. They predicted financial assets such as stocks and bonds would be dead forever.

The suggestion not to invest in other classes of assets routinely comes at the wrong time, at the market top, at the exact time a prudent investor should be taking profits from the investments being hyped and rotate to other types of assets. I do not call this diversifying. To take profits in one class of assets that has had their multi-year run, that has topped out, to move on to another class or group of assets, is a normal evolution of investing.

I believe to truly diversify, to own many positions in many different types of asset classes, is illogical. To diversify is to invest in many different areas—stocks, bonds, real estate, art, gold, timber, and commodities or whatever. **This is the Myth of Diversification—it mandates investments outside your area of expertise**. I submit this will increase, not decrease, your investment mistakes. The problem is further compounded by timing. The recommendation to diversify or not diversify is routinely made at the wrong time.

Peter Lynch has a term for such a practice at the corporate level (*see* Chapter Thirty-Two). When successful businesses move out of their area of expertise, to diversify, Lynch refers to this as "deworsification." The business invariably stumbles.

Mark Twain said, "You can keep all of your eggs in one basket, but you must watch that basket closely." A coin dealer once told me the best collection, presuming, of course that one has chosen very wisely, is one coin.

The best example of sticking to what you know, of not diversifying, is the Great One, Warren Buffett. It was suggested that he diversify from stocks, into, for example real estates. He said essentially—"Why? I can make 30% a year in stocks, why should I even consider anything else."

Invest in what you know and stay with it. I do think it is possible to maximize returns by concentrating investments in a small number of positions in just one or several areas. I must emphasize that this requires tremendous knowledge in that area and tremendous patience. It requires taking profits at the appropriate time, sometimes holding cash for months or even years, and then buying when prices are such to maximize profits.

How many good ideas are required for a successful lifetime of investing? If it is a spectacular idea, only one, such as purchasing positions in Wal-Mart (WMT) or Microsoft (MSFT). No one has a hundred good ideas, or a good idea every day. Four or five good investment ideas, recognized and taken advantage of, are enough for a lifetime of successful investing.

John D. Rockefeller (Standard Oil), Andrew Carnegie (United States Steel), Sam Walton (Wal-Mart), Bill Gates (Microsoft) were certainly not diversified yet made amazing fortunes. These people were not investors, they were the companies. They built them and controlled them. They had one spectacular idea and stayed with it.

I will make a suggestion. Just as many physicians specialize and sub-specialize, you can specialize or sub-specialize in a particular area of investing. By taking larger positions in fewer areas I think it is possible to produce superior returns. I again emphasize it is essential to know a great deal about these areas. To place a big bet in an area where you have little knowledge is just stupid. You will lose money, probably a great deal.

Table 2
Hypothetical Portfolio With Twenty Stock Positions

1 × $100 + 40% = $140
2 × $100 + 30% = $260
2 × $100 + 20% = $240
3 × $100 + 15% = $345
4 × $100 + 10% = $440
3 × $100 + 5% = $315
2 × $100 + 0% = $200
2 × $100 – 10% = $180
1 × $100 – 20% = $80
$2,000 + 10% = $2,200 (10% return)

Table 3
Hypothetical Portfolio With Nineteen Stock Positions and a CD

1 × $100 + 40% = $140
2 × $100 + 30% = $260
2 × $100 + 20% = $240
3 × $100 + 15% = $345
4 × $100 + 10% = $440
3 × $100 + 5% = $315
1 × $100 + 0% = $100
2 × $100 – 10% = $180
1 × $100 – 20% = $80
1 (CD) × $100 + 5% = $105
$2000 $2,205 = (10.25% return)

CD, Certificate of Deposit.

Consider the stock market. If you do not wish to spend much time on investments and would like to just track the market, then I recommend an index fund. Over a long period of time you should realize the standard 10% compounded annual return. This is not glamorous but it is quite adequate and is infinitely better than losing money on an investment that was not understood. Since these funds track a particular index, such as the S&P 500, they are essentially commodities and expense ratios are critical (as thoroughly discussed elsewhere).

But say you do wish to spend more time and begin to invest in individual stocks. For practice purposes, a portfolio of 40 or 50 different stocks is so diversified that it will probably just track the market. It is actually more likely that such a portfolio will under-perform the market because of both poor stock selection and commissions and trading expenses, especially if you are not patient and over-trade (a good summation of the reason why the majority of actively managed mutual funds under-perform the market).

Consider the following examples. Table 2 details 20 equal positions. The market is up the standard 10% for the year, and of course, some stocks out-perform, many do about average and some under-perform.

Now, drop one of the 0% returns and invest the $100 in a CD at 5%. (Table 3).

Table 4
Hypothetical Portfolio With Nineteen Stock Positions

1 × $105.26 + 40% = $147.37
2 × $105.26 + 30% = $273.68
2 × $105.26 + 20% = $252.63
3 × $105.26 + 15% = $363.15
4 × $105.26 + 10% = $463.15
3 × $105.26 + 5% = $331.57
1 × $105.26 + 0% = $105.26
2 × $105.26 – 10% = $189.47
1 × $105.26 – 20% = $84.21
$2000 $2210.49 = 10.52% return

Remember that a 0.25% increase in return is actually a 2.5% increase in profit (10.25% compared to 10%).

Now drop one of the 0% returns and distribute the $100 evenly among the other nineteen positions (Table 4).

Of course, no one can say beforehand which positions will be the poorest performers. But I suggest that at the end of the year, when looking back; in general, at the time of purchase, the investor was more confident in the positions that ultimately out-performed and less confident in the positions that under-performed.

Or consider the situation from a different perspective. At the beginning of the year, would you prefer to invest more money in your favorite number one stock or more money in your twentieth choice?

What is the best stock portfolio, the best collection, the best real estate portfolio, and the best investment portfolio in general? I believe it is the portfolio with a relatively small number of positions, in your area of expertise, that you were absolutely sure would be winners at the time of purchase.

SUMMARY OF THE MYTH OF DIVERSIFICATION

- Over-diversification may increase your investment losses.
- The suggestion to diversify, or not diversify, is routinely given at the wrong time.
- Diversification is illogical. It forces you to invest outside of your area of expertise.
- Investing is like medicine. The greatest way to maximize returns is to specialize. Know more about one area than anyone else.

SUGGESTED READING

Orman S. *The Road to Wealth: A Comprehensive Guide to Your Money.* New York, Riverhead Books, 2003.

Chapter Twenty-Five

How to Identify Real Investment Opportunities

Your goal should be to realize a 10 to 15%—or more of course, if possible—annual return on investments. To realize this goal it is mandatory to be able to recognize real opportunities. They do exist. The first chapter not-withstanding, there will be chances to make investments that can return 15, 20%, or sometimes even more per year. Only three or four such investments are needed for a lifetime of successful investing. How can these true, real opportunities be recognized when they do arise?

I will make two suggestions. The first is practical, a simple rule of thumb. The second fits my personality and psyche, but does have a very considerable basis in fact and at a minimum will generate ideas that will allow you to formulate your own criteria. I cannot emphasize this later point enough. Do not do just what I say, do not do just what anyone says, or you will make mistakes. It is mandatory for you to make your own investment decisions (*see* Chapter Nine).

HOW OFTEN DO REAL OPPORTUNITIES ARISE?

For some time I kept a daily journal. It was interesting and fun. I not only recorded the events of the day, but as it relates to this book I also tried to analyze what had happened. This allowed me to gain some insight into many things, such as who can and cannot be trusted (*see* Chapter Seventeen).

I once looked back through my life to determine what opportunities—financial, personal, social, and professional—I had taken advantage of (some) and what I had missed (many). It was an epiphany. Here is point number one of this chapter—real opportunities occur infrequently. Sometimes twice a year, sometimes a real opportunity does not arise for several years. On the average, real investment opportunities occur approximately once a year.

This will tremendously simplify your investing life. Real opportunities do not occur every hour, every day, every week, or every month. That is just noise, non-statistically significant jiggle. Let them go by. Do not jump at everything; in fact, jump very rarely. Simple patience may not even be sufficient. Tremendous patience is mandatory. Real opportunities only occur about once a year.

You read financial publications such as the *Wall Street Journal, Barron's* (my personal favorite) *Forbes, Money* magazine*, Investors Business Daily*, or whatever other financial publications interest you. There are financial shows on the television and NPR

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on the radio. An infinite amount of financial information is available on the internet. Your stockbroker calls with a tip or suggestion, a salesman calls with an opportunity (hang up immediately), or you talk with friends who mention something. You are literally bombarded with hundreds of (apparent) opportunities. The more you read, see and talk to people, the more possibilities for investments arise. Pay attention to those that seem interesting, study for yourself, but remember that the absolute overwhelming majority of these apparent opportunities will prove disappointing.

Some time ago I read a statement by Warren Buffett (*see* Chapter Thirty-Two). He said that a person only needs to make 20 or 30 investment decisions in their lifetime. Of course he is right. The importance of patience seems to be a recurring theme for success in almost all aspects of life. As it relates to investing, I define patience as one real investment opportunity a year.

HOW TO RECOGNIZE REAL OPPORTUNITIES

I discovered that whenever I had to talk myself into anything it invariably failed. If I equivocated, I wasn't sure. I said yes, then no, then yes; if someone else had to talk me into something, it was always a loser. Always!

When I looked at something and said instantly, "this is the greatest thing since sliced bread"—these were the winners. There was no equivocating and no wringing of hands. The decision was so easy. Every time I had this feeling the investment was not always a winner. No one has winners all the time. But every time I did have a successful investment I had this feeling from the outset.

Let me make several analogies to illustrate this feeling of when you are sure, when you are convinced from the outset. I will begin with sports. Even from the bleachers, where I prefer to sit, it is possible to see the batters' eyes light up when the pitcher hangs a curve ball belt high, right down the middle of the plate. Here comes a pitch, 20 miles an hour or more slower than a fast ball, but it does not curve or move at all. It just sits there like a lollipop, seemingly begging to be rocketed into the bleachers (hopefully where I am sitting). It is thrown so poorly that the batter can count the stitches and read the name of the league president on the ball. This is the major league equivalent of Little League T-ball.

Ted Williams was a great hitter and a great student of hitting. Williams divided the strike zone into little squares and estimated what he could hit with a pitch in each particular area of the strike zone. Belt high, inside corner, a pitch he could pull, better than .400. Low outside area of the strike zone, about .200. Williams also had a tremendous number of walks. He let the balls out of the strike zone and the pitches of low yield but in the strike zone go by. He was patient and waited for the ones he could hit for a .400 clip. However, in baseball, three strikes and you are out. Williams eventually was forced to swing even at the pitches of low yield if there were two strikes and the ball was in the strike zone.

This is the beauty of investing. You can take ten, twenty or even a thousand pitches and they do not count against you. Just keep your money in a money market, a passbook, or a Certificate of Deposit. The money earns some interest, but more importantly, nothing is lost. Just wait for the belt high hanging curve ball on the inside corner of the plate and then swing as hard as you can.

Because I am a very impatient person, and I realize this, I have thought a good deal about patience. Impatience is good when you need to get things done quickly, such as

with a very ill patient. Impatience is not good when investing. I would suggest that an appropriate synonym for patience could be pain. It can be difficult to wait, sometimes it actually hurts. Years can pass in an instant whereas seconds, minutes, and hours may seem like an eternity.

You have saved enough for an investment. You are fairly knowledgeable about real estate and begin to look at some properties. You read the real estate section of the local paper each Sunday. You have even spent five afternoons or evenings in the last two months looking at property with a real estate agent or just driving by on you own. There were several that were OK and one that looked pretty good but you just could not quite talk yourself into making the purchase. Another month passes and you continue to look. Now the money is starting to burn a hole in your pocket. You want to get this investment out of the way so that you can move on to something else. But you must be patient.

A stock was purchased a year ago at 37. It now trades at 32. You are convinced it is a good company but find it increasingly difficult even to look up the daily closing price because it is down almost 15% one year after the purchase. Or some stocks were sold for a profit because you feel the market is over-priced. However, the market remains over-priced and your money is just sitting in (unexciting) cash earning only 1 or 2% interest. More new money for investment is coming in all the time. Patience is painful. But to be a good investor you must often just wait and wait and wait. And wait.

Warren Buffett is currently holding more than $30 billion dollars in cash at Berkshire Hathaway. He realizes it is being under-utilized, but says "It's a painful condition to be in, but not as painful as doing something stupid."

Let me provide an example from history of how painful, yet necessary, patience can be. In the third century BCE, the city of Carthage, on the northern coast of Africa, battled Rome for dominance of the Western Mediterranean. In the first Punic War, the Carthaginian forces were commanded by Hamilcar Barca. In the Second, and more famous Punic War, the leader of the Carthaginian Army was Hamilcar's son, Hannibal.

Theodore Ayrault Dodge considered Hannibal to be the greatest General of antiquity, superior even to Alexander or Caesar. Hannibal repeatedly mauled the Romans and at Cannae in June 216 BCE put the entire Roman army, except the Consul Varro who fled, a total of almost 70,000 brave stout-hearted Roman warriors, to the sword.

It was the Roman dictator Fabius Maximus who eventually devised the strategy to defeat Hannibal. The strategy was simple—not to fight him. Offense and aggression were in the Romans' blood. To decline battle, to display continuous caution, to remain forever on the defensive, was equated with weakness. The Romans began to doubt Fabius and lose faith in his strategy. It was only after years, and more stinging defeats at the hands of Hannibal, that the Roman's realized the wisdom of the patience of Fabius Maximus.

Now I will provide a medical analogy of patience. You are a cardiac surgeon. It is of no consequence how often you operate, a successful result is all that matters. You evaluate an 88-year-old man with left main disease and three-vessel coronary artery disease, unstable angina pectoris, and a left ventricular ejection fraction of 25%. You pass. You evaluate a 65-year-old female who suffered an inferolateral myocardial infarction 6 days before that is now complicated by a ruptured papillary muscle resulting in wide-open mitral regurgitation. An intra-aortic balloon pump is inserted to stabilize her hemodynamics and she is intubated. You pass. You evaluate a 62-year-old who looks

92 because they continue to smoke. Their blood gases and pulmonary function tests are terrible. They have closed all of the grafts, including both internal mammary grafts, from their two previous surgeries and are now in need of their third bypass operation. They have no conduit remaining. You pass. You evaluate an otherwise healthy 11-year-old girl with a secundum atrial septal defect (ASD). The chance of a successful outcome is 999 out of 1000. You operate. Recognizing real opportunities can be that easy, but patience is clearly mandatory.

Warren Buffett says real opportunities are so obvious that they will "grab you by the throat."

I was once invited to speak to a group of physicians in a community more than an hour from Columbia. When the physician called to extend the invitation, I said, "Jack, you can give this talk as well as I can." He said, "Bob, you live more than 50 miles away, that makes you an expert."

Real opportunities do not just arise elsewhere. They can occur locally, literally in your back yard. Real opportunities can occur in Bay City, Michigan, Weston, Ohio, Collinsville, Illinois, or Columbia, Missouri, just as they can occur in New York, Boston, Chicago, or San Francisco. In fact, because they are local you can have a significant advantage by discovering them before everyone else does.

There is a local artist named Paul Jackson (Paul did the art for the cover of this book). I fell in love with his work as soon as I saw it. Paul is the youngest person every elected to membership in the American Watercolor Society, beating out by several months the great Winslow Homer. I think Paul is a genius and we have purchased several of his works. Real opportunities can occur anywhere, including right down your street.

Kirk Kirkorian has made billions through investing, mostly in real estate and hotels in Las Vegas. Ever few years he will make a purchase or a sale. The article I read about him made an analogy to an alligator lying on the bank with its mouth wide open. The alligator just sits there, motionless, still and relaxed, soaking up the sunshine, not wasting any energy chasing potential prey. It just waits and waits and waits. And if the alligator must, it just waits some more. Finally something walks right into its mouth. It just clamps down those powerful jaws and swallows.

A successful investor must be patient. And I have just supplied, in both time frame and psychology, a practical definition of patience.

SUMMARY OF CHAPTER TWENTY-FIVE

- Real investment opportunities occur only occasionally, approximately once a year.
- Likewise, real opportunities may occur anywhere and any time. Keep your eyes open.
- Real opportunities should be so obvious that you never have to "talk yourself" into them.
- Patience is difficult because it is painful.

SUGGESTED READING

Dodge TA. *Hannibal: A History of the Art of War Among the Carthaginian and Romans down to the Battle of Pydna, 168 BC, with a Detailed Account of the Second Punic War.* Boston, Haughton–Mifflin, 1891; Boston, Da Capo Press, 1995.

Chapter Twenty-Six
When to Buy

There are separate chapters for when to buy and when to sell because the rules and the psychology are quite different.

A local hotel owner told me that the profit on an investment is made when an asset is purchased, not when it is sold. The first rule of investing is that it is impossible to make money when overpaying for an asset.

But you are tempted to buy none-the-less because things just look good. Consider the stocks of Microsoft (MSFT) and Medtronic (MDT). I choose these as examples because they are excellent companies with excellent products, great management, and a sound financial base. There is no argument about the quality of the company or their products. The issue is price. To overpay for the stock of even a great company, or any asset, precludes a profit. You are investing to make money. The glamour, prestige, or trendiness of a stock or any asset is immaterial. In fact, these features almost always detract from the potential for profit.

Suppose the stocks of the Dow Jones Industrial Average (DJIA) were purchased in August 1929. The market was high, but times were so good it just seemed mandatory to own stocks. The DJIA did not return to its 1929 peak until 1954. Twenty-five years, an investing lifetime, just to break even.

The stocks of the Nikkei average purchased at its peak in 1989 are still down 75%. It will probably take the Japanese market longer to recover than it did our market. (The Japanese market would need to go up by more than 14% per year for the next 9 years to regain it's previous high.)

Now for the psychology of being able to "buy low." There are several phrases worthy of mention:

1. "Buy when there is blood in the streets" (Baron Meyer Rothschild).
2. "When other people are greedy, you sell. When other people sell, you should be greedy" (Warren Buffett).
3. My favorite: "When other people are yellin', you should be sellin'. When other people are cryin', you should be buyin'."

Just because something has fallen in price, because it is less expensive than it was earlier, does not necessarily mean it is a good buy. Salesmen often use this as an inducement. A home was originally listed at $250,000 and the price has been reduced to $225,000. A collectable was $7,000 3 years ago but is now only $5,000. Even though something is less expensive than before, possibly much less, it may still be very overpriced. Cisco Systems

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(CSCO) peaked at approximately $82 in 2000. The stock may have appeared a great buy at $60, more than 25% off its peak. It bottomed in the teens. It now trades in the twenties. This represents a 70% loss after buying a stock that "looked cheap."

The phrase "buy the dips" was immortalized in the bull market of the late 1990s. "Buy the dips" reached paradigm status and was the rule of the day for momentum investors. I think "the bear" has clearly exposed the fallacy of this concept. "Buy the dips" could be buying the abyss. Momentum investors can make money, sometimes very large amounts of money, but they must be first out of the door or run the risk of being trampled in the stampede. As Warren Buffett has proven, it is much safer and more profitable to buy an asset when it is undervalued. The one sure way to be wiped out is to add to losing positions. Buy on strength, not on weakness.

Let me provide several examples of someone who is "cryin'." Susan and I were in southern Florida in February 2003. There was an advertisement in the local paper for condo units at a newly constructed luxury high rise. No down payment, no rent for 18 months. This person is "cryin'."

The auto companies (early 2003) are "cryin"—zero down, 0% interest, and zero payments for 6 months. They may actually make less than zero since some people will drive the car for 6 months, return it to the dealer and just walk away.

Being a contrarian is the essence of buying when everyone else is selling. People will be lamenting their losses, stating empathically they have no desire to ever purchase stocks or bonds or real estate again. In general, it is fairly easy to determine when things are bad, when there is "blood in the streets."

The real issue is having the courage to buy when things look bad. The more dire the situation, the worse things look, the more money that can be made, but the more courage that is required. Your study and knowledge of an issue shows that it is undervalued, and it is time to buy, but it is this exact moment that you begin to question your judgment. You will think, "If this is such a bargain, why aren't five other people lined up in front of me to buy? Am I missing something? Am I wrong? This seems such an obvious bargain to me, why isn't it this obvious to everyone?" In the end, it just amounts to confidence in your judgment. It is not easy, it is really very difficult, but it is the essence of buying low.

I once recognized a real opportunity, but in the end lost it because I did not have enough confidence in my judgment. As mentioned previously, I collect baseball cards and sports memorabilia. Six or seven years ago, one of the most important baseball cards in the hobby was up for auction. At that exact time there was some weakness in prices. The bidding was going very slowly. It was obvious that the card would bring much less than what I thought it was worth. Instead of making me even more eager, I admit I was scared away. Are prices collapsing? Is something wrong with the card? In the end, I did not even place a bid.

What a mistake. The card went for one-half of what I though it was worth and would now bring four to five times what it sold for then. It would be the proud centerpiece of anyone's collection. I wish very much that I had the card but I also learned to have more faith in my judgment.

This is the essence of investing; buying something for less than it is really worth. Eventually, and eventually may be a painfully long time, the market will recognize this value and a profit will be realized.

Do not be overly concerned that an investment goes down after purchase, although this should certainly stimulate a re-evaluation of the reasons for the purchase. Specifically, has there been a change in fundamentals? It is absolutely mandatory to ask such questions if a large investment quickly turns sour. Did the stock go down because of an analyst downgrade? To me (and Peter Lynch; *see* Chapter Thirty-Two) this is not a change in fundamentals and means nothing. Compare this to a biotech company that has only one product. The CEO has just been indicted for falsifying research data and the FDA does not approve the drug. Mice were being injected with prune juice rather than a new genetically engineered monoclonal antibody. This is a change in fundamentals.

An asset may very well go down in price after the purchase. Do not try to buy at the absolute bottom since this will result in missing many opportunities. Trying to buy at the absolute bottom and sell at the absolute top is motivated by greed and will invariably result in losses.

This is not to say that when negotiating a price or making a purchase you should not try for as favorable a price and terms as possible. Of course you should. The point is to not miss an otherwise good, or great, opportunity, by holding out for the last penny. It is like loosing a dollar, or possibly more, to save a nickel.

Consider again Cisco (CSCO). You feel that a fair value for Cisco is $20 (these numbers are used for example. I do not know the fair value for Cisco). The stock drops to $18. Your in-depth analysis suggests that this is under-priced so you must step up and buy. In one month Cisco falls to $16. Was the purchase a mistake? No. What really matters is the value of the stock in one or 2 or 3 years.

If several years later the stock is still $17, was the purchase a mistake? No. If the purchase had been made after a through analysis, it was just not a profitable investment. But analyze the situation so that some knowledge can be gained. More likely the stock is up and has produced a nice return.

Personal confidence is critical, but faith in our system is also required. Times will improve. It may take a long time, such as the Great Depression, but they will improve.

SUMMARY OF CHAPTER TWENTY-SIX

- The money is made when an asset is purchased.
- It is impossible to make money by overpaying for an asset.
- Buy on strength, not weakness.
- Never buy just because the price is down.
- A sure way to be wiped out is to add to losing positions.
- Try to buy assets for less than they are worth.
- You must re-analyze the fundamentals of any investment that takes a downturn.
- Buy when there is blood in the streets, but this requires tremendous personal confidence.

Chapter Twenty-Seven
When to Sell

Bernard Baruch made a fortune in the stock market in the 1920s and had the presence to take profits before the market dropped into the Great Depression. He subsequently served as an advisor to Presidents until his death. His quote: "I got rich by taking profits too early." This is the psychology of taking profits-sell too early, not too late. Knowing when to sell is the most difficult aspect of being a successful investor.

I will make an analogy to show how truly difficult it is to "sell too early." How many people can you name who retired "too early," when they were still on top. George Washington retired on top. Johnny Carson and Jerry Seinfeld retired on top. Jimmy Brown of the Cleveland Browns (the Browns were named after Coach Paul Brown, not after the player Jimmy Brown) retired on top. Rocky Marciano retired as undefeated heavyweight champ. After this the list gets pretty short. Selling too early, like retiring too early, is not easy.

Let me provide an everyday example of when I did not sell too early. A year and a half ago, over the winter, we had intended to trade in one of our cars. However, another major expense came up so we waited. Within 6 months, the transmission fell out of the car. Having your trade-in towed to the dealership does not put you in a particularly strong negotiating position.

You may have heard the term "locking in" your profits. A profit has not been truly realized until an asset is sold. The investment may have appreciated ten-fold but this is just a number on paper. In general, you must sell to realize a profit. (There are hedging techniques involving options, futures, etc., that allow you to lock in profits without selling an asset. I do not understand them and mention this only for completeness.)

It is not uncommon for a stock to perform well for a period of 3 to 5 years because business and investment cycles often last a similar period of time. The safest period to buy and sell a stock is during the middle of this time, because there is a margin of safety on both ends.

But rather than be content with a nice gain, greed rears it's ugly head and an attempt is made to hold out for every last penny of profit. Now it is possible to lose everything. The problem is psychological. The price at which you purchased an asset, or at which you hope to sell, has no meaning to anyone else in the entire universe. It has no basis whatsoever in fact. The market does not care what you paid for a stock or at what price you wish to sell or what your profit or loss may be. To believe otherwise is fantasy.

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

The stock drops in price, but being tough, an attempt is made to ride it out. You are sure it will come back and even break to new highs. To sell now would like putting your tail between your legs and running away. You are now a goner. The stock drops further in price. Intransigence bordering on belligerence replaces an impartial evaluation of the situation. The price drops further and is now below the purchase price. Only now do you sell—for a loss! What was once a significant profit on paper is now a real money loss. It is human nature. It can and must be conquered. Do not try to pick the absolute top or the absolute bottom because it is impossible. The desire to milk an investment for every cent is just greed. Remember this—bulls can make money, bears can make money, but pigs get slaughtered. Take your profit out of the fat part, the easy part, the middle.

This is done by selling at the time when every fiber in your body wants to hold on for more profit. What if the price rises another 10% after the asset is sold? You may be tempted to say, "I could have made another 10%." I would say this sounds greedy. The sale was made at a perfect time, i.e., you did not sell too late. What if the price increases another 50%, or doubles, or rises even further? If the asset was sold for intelligent reasons, then further increases in price suggest speculation and you should be very happy indeed for selling and realizing a profit.

A beautiful example of selling "too early" is illustrated by Sir John Templeton. He made great profits for his shareholders by selling several years before the end of the Japanese stock market bubble of the late 1980s. During those last several years before the top he was criticized for getting out too early, for missing the great Japanese bull market. Critics were saying he had clearly lost his touch, after all this was a new era of investing in Japan. Old measure of valuation—price-to-earnings ratio, dividend yield, etc.—no longer mattered. Now 15 years after the peak, the Japanese market is still down almost 75%. Templeton's selling "too early" was clearly one of the great stock market calls of the twentieth century. Just as it takes courage to buy when things look terrible, when there is blood in the streets, it takes courage to sell and take profits too early, before it is too late.

Schiller's book *Irrational Exuberance* is included on my list of suggested readings. He examines manias such as the Japanese market of the late 1980s and our stock market of the late 1920s and late 1990s. How many dot.com investors, who for a brief period of time were millionaires or centimillionaires on paper, now wish they had sold "too early."

Making and accumulating money is not easy. It is very hard. As noted in Chapter One, 10% a year is a reasonable return on investment. When you have made more money from an investment than you ever dreamed possible, when you are congratulating yourself for being so smart, for being such a genius, when you have dollar signs in your eyes, when you are calculating your percent per year (or per month or per week) gain, when everything is going right, when you are dreaming of retiring early—then sell!! You actually may be able to retire early!

How does the above discussion of selling too early not contradict a saying that everyone has heard, namely, cut losses but let profits ride? Buying a stock and then selling 2 months later for a 10% gain is clearly not letting profits ride. Selling a stock after it has appreciated five- or 10-fold over a 3- to 5-year period or 30-fold over a 10-year period is an example of letting profits ride.

In the early 70s, before the terrible bear market of 1973 to 1974, there was a group of stocks called the "Nifty Fifty," which included such well-known names as International Business Machines (IBM), Avon Products (AVP), Xerox (XRX) and the now bankrupt Polaroid Corporation. They were called "one decision" stocks, the only decision being to buy and hold forever.

There is no one decision stock, even for Warren Buffett. When asked his favorite holding period for a stock, he replied forever. This may be Buffett's favorite holding period but it is not his only holding period. In 1969, the "go–go" stocks were being hyped and recommended regardless of price. Buffett thought the market was so overpriced that he liquidated his limited partnership and offered his investors the option of a return of their money or staying with his new investment vehicle, Berkshire Hathaway. Buffett, of course, was right. The market dragged on for several years and even rose to new highs and closed above 1,000 in early 1973 before descending to the depths of the second worst bear market of the twentieth century. Everyone has to take profits at some time.

Just before the October 19, 1987 crash, Buffett quietly sold all of the stocks owned by Berkshire Hathaway except his three core positions—Washington Post (WPO), Capital Cities (ABC television network) and GEICO Insurance. Buffett held these not only because of the business itself, but because he personally knew and trusted the management. On about October 12th, Buffett also cashed out the stock portfolio of Berkshire's profit-sharing plans. So even Warren Buffett does not hold all stocks forever. It is mandatory to take profits along the way.

Do not get "shaken out" or "scared out" of a good investment. Nothing goes straight up. Your self-confidence will be severely tested. Almost all stocks at some time can and will go down 20 or 30%, occasionally as much as 50%. If fundamentals suggest that the investment is sound, then hold. Otherwise the investment will be sold at the worst time, at its low. A panic sale is always a loser, the worst time to sell.

Likewise, when a decision has been made to sell a stock that is truly performing poorly, it is invariable that too small a portion will be sold. The stock will drop further and another small portion, rather than the entire position, will be sold. This is the financial equivalent of Chinese water torture. If the decision has been made that a stock is a loser, just sell the whole position and forget it. If this was an error and the stock again moves upward, it can be repurchased.

There is no better way to describe how to cut losses than a conversation between Mayor Richard J. Daley of Chicago and President Lyndon B. Johnson. Daley was at the White House lobbying for federal aid for various Chicago projects. As he began to leave, Johnson stopped him. "Listen, Dick, I've got a lot of trouble over there in Vietnam" the President said. "What do you think about it?" Daley thought for a moment and said, "Well, Mr. President, when you've got a losing hand in poker, you just throw in the cards." "But what about American prestige" Johnson asked. "You put your prestige in your back pocket and walk away" replied Daley (taken from Cohen and Taylor, *American Pharaoh*). If you have a loser, forget the darn thing, sell it, and live to fight another day.

A variant of a loser is a non-performing asset. Everyone has some. They should be searched out and aggressively sold. Non-performing assets are essentially "dead

money," an asset that is not earning any gains or dividends. The reasons that one tolerates non-performing assets are inertia and emotion. The lawn mower that gave you good service for 12 or 13 years is kaput and you have purchased a new one. Instead of allowing the old lawn mower to just sit in a corner of your garage taking up space, sell it. People and shops that repair lawn mowers will usually give $20. They repair them or otherwise use them for parts. Twenty bucks is twenty bucks. Or you have clothes that have not been worn in 3 years. Give old clothes to charity and take the tax deduction (my preference) or put them in a garage sale.

The above advice is not to suggest that you become a regular at the local pawnshop or junkyard. That would be personally, and professionally, very unwise. But it could be a nice introduction to capitalism, and entrepreneurship, for your children. If you have something that fits the above description, tell your children "sell it and you get to keep half." You get one half of the sale price but they may get the experience of a lifetime.

Or you collect something (*see* Chapter Thirty for a detailed discussion of collecting). Items purchased when you began your collecting career may no longer fit your tastes or style, or the focus of your collection. This is an absolutely normal evolution of collecting. You have 10 items worth $100 each. They are really of marginal quality, they are not particularly rare or desirable, and they do not fit your long-term collecting plans. There is little doubt that in 5 years they will still be worth $100 each. Sell them all. Invest the money in your favorite mutual fund for the standard 10% compounded annual return or buy a more desirable collectible worth $1,000. One $1,000 collectible is at least twice as valuable as 10 $100 collectibles.

Another possible way to evaluate if an asset currently being held should be sold would be to consider that if you did not own the asset but had the cash, would you buy it? This has little to do with whether the asset is up or down in price, but is a way to force you to evaluate the fundamentals. If an asset has become so over-priced that you would never pay this amount to purchase it, you feel it is clearly not worth the price, then sell. If something is down in price, is it down just because of the price fluctuations that occurs from time to time? Selling at this time would be the wrong decision. But, if a stock is down in price because the company is performing badly and you would never purchase the stock, then consider selling. Another example would be a stock that you rode all the way down. In the current market this would be tech or telecom stocks. These are "dead money." It could be years (or as with tulip bulbs, never) before these stocks will return to where they were purchased or their previous highs. Sell them and reinvest the money in a position that has a brighter prospect of price appreciation.

There is one time that an immediate sale should be considered. If there is evidence of malfeasance, wrongdoing, criminal activity, cooking the books, or any sort of dishonesty, sell. Do not look back, but learn from the experience. If this is an investment with little or no liquidity, such as a limited partnership or other closely-held entity, obtain legal advice immediately to protect yourself and limit your liability.

SUMMARY OF CHAPTER TWENTY-SEVEN

- Get rich by taking profits “too early.”
- A profit on paper is just that. An asset must be sold to lock in a profit.
- Your perception of the value of an investment has no basis in reality and means nothing to any other investor.
- When you are congratulating yourself on your investment genius—SELL!!
- Selling too early takes courage.
- There are no one decision investments.
- Do not fall in love with an investment.
- No investment goes straight up. Your willpower will be tested.
- Aggressively sell non-performing assets.

SUGGESTED READING

Shiller RJ. *Irrational Exuberance.* Princeton, NJ, Princeton University Press, 2000.

Lowenstein R. *Buffett: The Making of an American Capitalist*. New York, Broadway Books, 1995.

Cohen A, Taylor E. *American Pharaoh: Mayor Richard J Daley, His Battle for Chicago and the Nation.* Boston, Little Brown and Company, 2000.

Chapter Twenty-Eight
Stocks and Bonds

STOCKS

For this general discussion, stocks refer to the shares of corporations that are traded on the major stocks exchanges, the New York Stock Exchange (NYSE), the National Association of Security Dealers Automated Quotations (NASDAQ), and the American Stock Exchange (ASE).

A significant percentage of the entire investment portfolio of the physician investor should be invested in stocks, either by directly owning shares in specific corporations, or indirectly, by investing in a mutual fund(s).

It is important that you be able to evaluate specific stocks as well as the general stock market and economic picture as a whole. Both are important since as a general rule, about 70% of the price of an individual stock is determined by the fundamentals of the company and 30% is influenced by general market conditions.

To provide two extreme examples. The stocks of even the best-run companies, with great management and great products, were ravaged by 1932. Likewise, the stocks of even the most worthless dot.com companies, with little sales and no profits and sometimes not even any products, companies that are now just memories, were carried to preposterous highs by the stock market mania of the late 1990s. But, in general, good companies outperform bad companies and with a well-chosen portfolio you can still make money even when general market conditions are poor. In the end, it is the company's ability to generate profits that determines how well their stock performs.

The two general categories of factors to consider when evaluating both specific stocks or the market in general are called fundamental factors and technical factors. There are many who feel technical factors are not important and that you cannot determine the direction of a stock, or the overall market, by looking at numbers and charts. I disagree. I believe technical data is helpful in determining which stock to purchase and when to buy and sell. As an example of how to utilize fundamental and technical data, I will give my general impressions for the direction of the stock market in the next 1 to 3 years (2005–2008).

For a discussion of fundamental analysis, such cash flow, debt, book value, etc., I refer you to Graham and Dodd's classic, *Security Analysis*. I believe that the average physician investor can do a better job than they think in evaluating the fundamentals of a company.

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Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

In Peter Lynch's book *Learn to Earn*, Appendix Two is a 15-page discussion in beautifully simple terms on how to decipher a corporate balance sheet. He reviews everything: depreciation, liabilities, assets, book value, retained earnings, profits, etc. One result of writing this work is that I have learned a great deal that will help me with my personal investments. There is no better example than this.

What do you personally think of the company's product? Have they opened a new frontier, such as Amgen or Genentech 15 years ago; or a new way of doing business, such as Wal-Mart 20 to 25 years ago; or are they a leader in a new industry that will revolutionize society, such as Microsoft or Cisco 10 to 15 years ago? The company may make a quality product but be in a dying industry. It is of no consequence who manufactures the best butter churn.

You must also consider macro-economic factors, conditions at the level of the national and international economy. After World War II, Japan and Germany were in shambles, Great Britain and France were on the winning side but were essentially broke and had been devastated. The Soviet Union had been laid barren by fighting the Wehrmacht for 5 years and was ruled by Stalin. China was mired in a civil war between the nationalists, led by Chiang (and Mrs.) Kai-shek, and the communists, led by Mao Tse-tung. The United States was the only industrial country left standing. Not surprisingly, the 1950s in the United States were characterized by a spectacular bull market fueled by our productive, military, financial, and technological superiority. There was almost no inflation and essentially full employment. The United States represented 30% of the world's industrial output.

Contrast this to the 1970s. There were several oil/energy crises. Inflation became the norm. There were temporary price controls. The stock market, adjusted for inflation, dropped approximately 75%.

Nothing goes straight up or straight down. In general, you want to be invested in stocks when they go up and at least decrease exposure (i.e., by taking profits along the way) when the market goes down. A correction is defined as a 10% drop in a major average. These have occurred on the average of every 15 to 18 months since World War II. They are part of the normal market process and attempting to avoid them would almost certainly be counterproductive and result in under-performing the market.

A bear market is defined as a 20% or greater drop in a major market average. Bear markets occur on the average of every 4 years, specifically every 50 months. With just a little common sense, taking profits at the appropriate time, and paying attention to both fundamental and technical factors, it is possible to minimize losses, or even profit by going short, during a bear market. But, even if you do not try to avoid these cyclical bear markets, it is possible to do well in the long term because the market averages usually return to their previous highs and even make new highs within 1 or 2 years.

Three or four times a century a devastating, or secular, bear market occurs, where losses may be 50% or greater. These usually occur at times of major social, political, economic, or cultural disruption, such as the Great Depression, and the first oil crisis and inflation of the mid-1970s. I believe we are currently experiencing such a bear market now. These can and must be avoided. If the value of a stock drops 50%, it must double from this depressed value just to get back to baseline. The period of time required for this to occur can represent an investing lifetime. It took the DJIA 25 years (1929–1954)

to recover from the Great Depression. The Japanese market peaked at 39,000 in 1989. Fifteen years later it is around 11,000, a loss of almost 75%. This is one of the few situations in investing where patience can be counterproductive. Secular bear markets must be avoided.

Since 1900, we have had four secular bear markets in the United States. From January 1906 to November 1907, the DJIA dropped from 103 to 53, a loss of 48%. It took 10 years to recover and it was not until the mid 1920s that the market was able to break out and stay above this level for a significant period of time. From 1929 to 1932, the DJIA dropped from 381 to 41, a loss of 89%. As mentioned earlier it took 25 years to recover. From January 1973 to December 1974, the DJIA dropped from 1051 to 577, a loss of 45%. However, when inflation was factored in, the loss was almost 75%. It took 8 years to recover. The Dow had actually touched 1,000 in 1966, and was still below 900 in August 1982 before exploding upwards. Thus the period of (non-inflation adjusted) dead money lasted 16 years.

From August 1987 to October 1987, the DJIA dropped from 2,772 to 1,738, a loss of more than 36%, with a 508-point, 22% drop on October 19th, the greatest single day loss in our market's history. It certainly would have been desirable to avoid that calamity. People such as Martin Zweig and Warren Buffett did, but the market regained this lost ground in approximately 2 years and then exploded upward during the 1990s. The economy was basically sound and the market recovered.

Unfortunately, I feel we may be in the fourth such secular bear market now. The NASDAQ has by anyone's definition suffered a vicious bear market. It peaked on March 10, 2000 at 5,048 and bottomed in October of 2002 at 1,108. This represents a loss of 78%, almost as severe as the loss the DJIA suffered from 1929 to 1932. The NASDAQ is currently around 2,000, still a loss of more than 60%. The NASDAQ would have to go up 10% per year for the next 10 years to regain this lost ground. Your guess is as good as mine as to when the NASDAQ will surpass it's previous high. The DJIA was off more than 30% during this same period. My concern is that we have not yet seen the final low of this bear market. Whether I am right or wrong remains to be seen, but this discussion outlines the general critical thinking process that every physician investor should consider when making an investment in the stock market.

One of the most basic ways to evaluate a specific stock and the market in general is to consider the price-to-earnings (P/E) ratio. This is exactly what it says: take the price of the stock—say $20—and divide it by the earnings of the last year—say $1—to obtain a P/E of 20. This number represents what an investor is willing to pay for $1 of earnings. But people try to look ahead. If a well-run company with a great product in a great area has demonstrated increasing earnings, then an investor is willing to pay a higher price for this stock and it's presumably bright future.

You should only consider the P/E ratio of the last year, the "trailing" P/E. There are several reasons. First is that this is the traditional method, allowing easy comparison to previous data. Second is that evaluating a stock by "forward-looking" price to earnings ratio is fraught with hazard. Earnings in the future, even just the next 12 months, are no more than someone's estimate (guess is a more appropriate choice of words) and are often overly optimistic. In addition, the use of the future P/E can be used to justify almost anything. One could say "the P/E on the last year's earnings may be 147, but if

extrapolated to 6 years from now, it is only 27." I prefer a more realistic approach. Reasoning such as this is often used to justify speculation.

Another basic measure of a stock is the dividend yield. Mention has already been made of the importance of dividends, especially of a corporation that is steadily increasing it's dividend. Dividend yield is particularly useful in determining when the stock market as a whole is overvalued, undervalued or fairly valued.

Over the last 100 years, the average dividend yield of the DJIA and the S&P 500 has been approximately 4.5%. The average trailing (i.e., previous year) P/E of the S&P 500 has been 15 to 16. I will use various data to illustrate the degree of the stock market mania in the US in the late 1990s and early 2000 and why I remain concerned that we have not yet seen the final lows of this bear market.

At the market peak in early 2000, the dividend yield of the S&P 500 was 1.2% (only a quarter of the historical yield). The P/E of the S&P 500 was at least one-third higher than the P/E in September 1929 (the high point of the market before it descended into the depths of the Depression). The P/E of the NASDAQ 100 was almost 100. Note that even these numbers are significant underestimates of the P/E as compared to previous time periods:

1. Some companies reported earnings were just plain bogus, examples include, but are not limited to: Enron, MCI, and two quasi-public companies, Federal National Mortgage (Fannie Mae; FNM) and Federal Home Loan Mortgage Corp (Freddie Mac; FRE). Corporate executives, often with the collusion of their accountants, fabricated numbers to appear that there was steady, or even accelerating, earnings growth.
2. Earnings used to calculate P/E in the past were referred to as GAAP earnings (Generally Accepted Accounting Principles). Companies in the late 1990s often reported earnings as pro-forma, i.e., earnings before little nasty, but real, details were subtracted. Earnings reported using the traditional GAAP standards would have been lower and the resulting P/E correspondingly higher.
3. In 1993, the Financial Accounting Standards Board (FASB) recommended that companies place a value on options and treat them as an expense. After intense lobbying, the proposal was killed. The FASB has again recommended to Congress that companies be required to expense stock options. Reported earnings of the companies of the S&P 500 would have been at least 5 to 7% lower (I have seen one estimate as high as 20%) were they required to expense stock options. This would result in a correspondingly higher P/E ratio.
4. In 2000, as much as 12% of the earnings growth of companies was from income on their pension plans. With the bursting of the bubble, this has disappeared. Again, the P/E ratio appeared lower than it really was.

The end result is that the stock market of March 2000 was probably 50% to possibly 100% overvalued **as compared to the market of 1929**.

After you read Stanley and Danko's book *The Millionaire Next Door*, the next book on your financial reading list should be Shiller's *Irrational Exuberance*. Shiller reviews the most famous investment manias of the last four centuries:

1. The tulip mania in Holland.
2. The South Sea mania in England.

3. The US stock market of 1929.
4. The Japanese stock market of the late 1980s.
5. The US stock market of the late 1990s (Shiller's book was published in early 2000).

Shiller concludes the subsequent bust after a mania mirrors the mania itself, i.e., there is a crash. Manias never end nicely. There is pain, despair and a significant economic recession or even depression, such as in the early 1930s.

The following points are taken from several interviews with Richard Russell of the Dow Theory Letters in *Barron's* in 2000, 2001, and 2004. Russell points out that at true secular bear market bottoms in the US, the dividend yield of the DJIA and the S&P 500 is 5 to 6% or even higher, and the P/E ratio of the DJIA and S&P 500 is between 5 and 10. Secular bear markets typically retrace at least 50% of the gain of the previous bull market. At the 2002 market lows the dividend yield of the S&P 500 was 1.9% and the trailing P/E ratio of the S&P 500 was slightly more than 30. The current dividend yield of the DJIA (September 2004) is just above 2%. The DJIA would need to drop 50% for the dividend yield to rise to only 4%. Russell uses these numbers and a variety of other data to suggest that the DJIA and S&P 500 could fall as much as 70% from current levels.

Consider the fundamentals of our economy. Our entire society, Federal government, State governments, corporations, and individuals are awash in debt. In spite of record low interest rates, personal bankruptcies are setting new records every year. The dollar is suffering a significant devaluation. It is already down 35% vs the euro and Richard Russell feels it could lose another 50% of its value. Warren Buffett said recently he would rather keep money in cash, earning just 1%, than buy stocks, even of companies in which he already holds a significant position.

Considering both the technical and fundamental data just cited, the stock market lows of October 2002 (DJIA = 7,197 S&P 500 =768, NASDAQ = 1,108) may not be the final lows of this secular bear market. Sometime in 2005 or 2006 the person with cash could have the buying opportunity of the next quarter century.

BONDS

Bonds represent an IOU. Money is being lent to a government entity or a corporation. The borrower agrees to pay the lender a predetermined rate of interest (referred to as the coupon(s) rate because in past years coupon(s) were on the side of the bond. The coupon(s) had to be clipped off and redeemed for the bondholder to be paid) for a defined period of time. The lender is then repaid the face value of the bond at the end of that period.

Another type of bond that has appeared more recently is called a "zero-coupon(s) bond." These bonds do not pay interest along the way to the bondholder. Instead, the bond is sold at a deep discount to its final redemption value. As any example, using round numbers, the Treasury sells a 30-year $10,000 for bond $3,000. No interest is paid to the holder but the Treasury will redeem the bond in 30 years at the face value of $10,000. If the holder of the bond wishes to sell the bond before maturity, its value is determined by current market interest rates and time to maturity. Because of the way interest is determined on zero-coupon(s) bonds, they are best suited for retirement accounts as compared to non-retirement accounts. As always, consult your accountant. Because no interest is paid along the way, if the bond issuer should go bankrupt before

the bond matures, the investor has nothing. The only zero-coupon bond I would consider are Treasuries. (This is my opinion. The advice of others may be different).

The value of a bond is determined by two principle factors, referred to as credit risk and interest rate risk. The more credit worthy the customer, such as currently the US Government or General Electric (GE) or Berkshire Hathaway (BRK), the lower the interest rate they must pay because the greater the likelihood they will be able to repay the debt. Contrast this to the local loan shark, who must charge 20% interest per week because of the unreliability of his clientele. Higher risk requires higher rates; lower risk with better credit rating can obtain lower rates.

The other main factor that determines a bond's value is interest rates. In general, the longer the maturity period of the bond, the higher the interest rate. The lender must receive greater compensation since their money is tied up for a longer period of time.

Bonds and interest rates move in opposite directions. When interest rates rise, the value of a bond drops. It took me some time to understand this concept, so I will provide a very simplistic explanation. Suppose one year ago I purchased a $10,000 bond paying interest at a rate of 5%. The current rate of interest on a similar bond is 6%. No one will purchase my bond for face value and paying 5% interest when they can go next door and buy a bond paying a 6% rate of interest. My bond has lost value.

If I wish to sell the bond before maturity, I must accept a lower price. The face value of the bond falls so that the buyer will receive market interest rates. A $10,000 bond paying a rate of interest of 5% yields $500 of interest income in one year. If interest rates have increased to 6%, I would need to sell my bond for $8,333 ($8{,}333 \times 6\% = \$500$ interest). A similar explanation holds if interest rates drop. My bond is now paying above market rates, so I could sell the bond for more than face value.

You may have heard that bonds are less risky than stocks. If you define risk simply as the possibility of losing all of your money, then that statement might be true. I prefer to look at risk as an overall concept so I do disagree with the statement that bonds are less risky than stocks. Over the very long term, stocks out-perform bonds, but over shorter periods of time, this may not be the case. There are times, often lasting 5 years or longer, when bonds out-perform stocks, but more periods when stocks out-perform bonds, and some periods when they both do well or both do poorly. Cash may be a "conservative, risk-free" investment over the course of a day or a week or a month but over the course of 20 years cash is "very risky" because of the inferior rate of return. In the end, all investments have risk.

From 1929 through the 1930s, bonds, if the borrower could repay the debt, out-performed stocks. This may be when the perception that bonds were less risky than stocks arose. Contrast this to a 30-year bond purchased in the mid-1960s when long-term interest rates were less then 5%. By 1980, the prime interest rate was 21% and the rate on the 30-year Treasury bond was 15%. A bond purchased in the mid-1960s was decimated by 1980.

The principle problem with bonds is that no one can predict the direction of interest rates, especially over the short-term. Now, I will actually partially contradict that statement by saying that interest rates move in very long-term trends. Figure 1 is a graph of the yield on the 30-year Treasury bond from the mid-1920s to present. Rates peaked in the 1920s and then dropped and stayed low throughout the 1930s and until after World

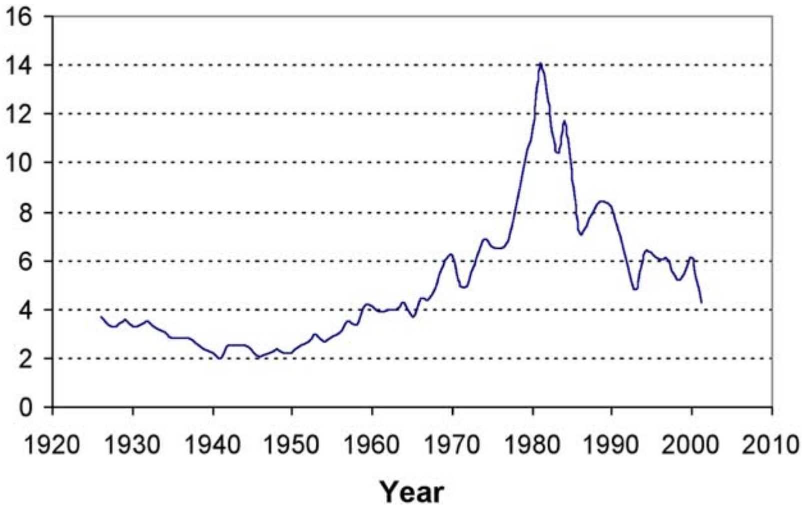

Fig. 1. Yield on the 30-year Treasury Bond from the mid-1920s to present.

War II. Rates then began to rise again until peaking in 1981. Rates have now fallen, spasmodically, nothing goes straight up or straight down, over the last two decades and are again at multi-decade lows.

So now for the ultimate question: where do interest rates, and thus bond values, go from here? The answer is that rates could go lower, but the Federal Reserve discount rate is now only 1.75%, so they cannot go much lower. Rates could stay in this general range for some time (note how long interest rates stayed low in the 1930s and 1940s), but at some time rates are going to rise significantly. For the investor currently holding bonds, especially with longer maturities, there may be some room for gain, and at some time, the possibility of great pain.

For these reasons and the additional caveats detailed in Chapter Twenty-Four, I feel the average physician investor should not purchase individual bonds and should be hesitant to buy into even the best managed bond mutual fund. Instead, the physician investor should utilize Certificates of Deposit as the vehicle of choice for their fixed income investments.

MUTUAL FUNDS

In Chapter Nineteen ("The Perniciousness of Fees") I introduced the general topic of mutual funds in the context of how mutual funds charge fees, what to look for and what to avoid. I will now discuss the types of mutual funds and provide some recommendations.

My first recommendation is there is no reason for the physician investor, or any investor, to buy a mutual fund with a load, or commission. This includes front-end load, back-end load, surrender charge, and 12b-1 fees. The following discussion concerns only no-load mutual funds.

The first general category of mutual funds are referred to as Index Funds. These funds track a particular index, such as the S&P 500, the S&P 400 Mid Cap, the S&P

600 Small Cap, the Wilshire 5000 Index, etc. Index funds have a very important place in the portfolio of the average investor. Because they are passive, no decision is required on what to buy or sell, the fund just stays balanced to the particular index, and management fees are low. Index funds allow you to participate in the long-term growth of our economy.

There are other benefits. All dividends and gains should be re-invested. There are two small boxes on the application that asks if you wish to re-invest all dividends and gains. Check yes. This allows your gains to be a magnified by compound interest. Another advantage is that almost no capital gains are distributed, and thus liable to taxes. This is especially true for the S&P 500 Index Fund. It is rare for a corporation that has been performing well (and thus generated capital gains) to be dropped from the S&P 500. The only reasons for an index fund to realize a capital gain would be to sell stocks to rebalance the fund's portfolio so that it continues to match the index or if a company is taken over by another company. In practice, these effects are very minimal. Thus almost all the accrued capital gains of companies such as General Electric (GE), Pfizer (PFE) or Microsoft (MSFT) remain in the fund as unrealized, and untaxed, capital gains. Do not overlook this subtle, but very significant, advantage of index funds.

Although they are not mutual funds, this is an appropriate place to discuss Exchange–Traded Funds (ETFs), because they are best considered in comparison to no-load index mutual funds. ETFs are similar to index funds because they track a particular index, such as the SPY (S&P 500 Index) or the DJIA (Dow Jones Industrial Average). There are ETFs for almost all major indexes. ETFs are stocks and can be traded throughout the day as compared to a mutual fund, where one only receives the price at the end of the day. Another advantage of ETFs is they may be purchased on margin (I note this for completeness; the average physician investor should not be buying stocks on margin). ETFs may be sold short, and sold short on a minus tick (*see* detailed discussion of short selling in Chapter Twenty-Nine). Another minor advantage of ETFs as compared to the index mutual funds is that there are usually no capital gains distributions. ETFs are a basic investment vehicle that is gaining in popularity and importance daily so it is worthwhile for the physician investor to understand the concept.

The other general category of mutual funds are actively managed. These may be general funds, which invest in any sort of security they feel will generate a profit, or sector funds, which invest in some specific predefined area. There are sector funds for every area imaginable—health care, electronics, banks, REITs (Real Estate Investment Trusts), gold, natural resources, etc. Because at any one time some sectors are outperforming the general economy and some are underperforming, sector funds should probably not be considered a core holding in your portfolio, as an index fund or a well performing actively managed no-load fund would be. Rather, they should be considered as intermediate-term holdings, such as 1 to 5 years, to capture the gains of a sector during its strong cycle, then take profits and move on.

There are also bond mutual funds of all types—government bonds, corporate bonds, municipal bonds, high-yield (junk) bonds, etc. For the larger states, there are municipal bond funds restricted to that state, allowing you, for example, in

California or New York, to invest in a fund that is free from both federal and their states taxes. Some bond funds focus on specific maturity periods, such as 5 years, 10 years, etc.

International funds invest in all areas of the world. Some invest in all major areas and countries of the world, some invest only in one area, such as Europe or Asia, and some invest in only one country, such as Russia, China, Japan, etc. It is quite reasonable for the average physician investor to have some percentage of their entire stock market portfolio, say 10 to 20%, in international funds. If the dollar continues to depreciate, as I am very concerned that it will, investing in foreign countries and currencies would be an excellent way to preserve capital.

There are funds that are leveraged, i.e., they move 1.5 or even 2 times a particular index. These are very volatile. The expense ratio is often quite high and they are not suitable for the average investor. There are even "bear" funds, funds that go the inverse, i.e., in the opposite direction, of a particular index. If the index, such as the S&P 500 goes down, these funds increase in value (*see* Chapter Twenty-Nine for a detailed discussion of such funds).

One potential disadvantage of an actively managed fund as compared to an index fund is if the fund has had a good run and sells some positions for gains. These gains are distributed to the investor. This is usually done once a year, towards the end of the year, generally in December (funds cannot pass on losses to the investor, only gains). This compares to an index fund, which often has little if any capital gains to distribute.

A very significant tax liability could arise if you buy into a fund just before it distributes a large amount of gains. Say you purchase shares on December 1st and the fund makes its yearly distribution on December 2nd. An investor could be unlucky enough to have 5% or even 10% or more of the money just invested given right back as taxable gains. In one day you are down 2 to 5% (or possibly more) because of the tax liability incurred. This is a good example of where attention to detail can save an investor money.

There are two situations involving a genuine no-load but actively managed mutual fund that should prompt one to re-evaluate their investment. First is when the fund manager changes. In my opinion, Fidelity Magellan has never really been the same since Peter Lynch departed. The other situation is when a poorly performing fund is merged into another fund. Violà. No more record of that fund's inferior performance. I suggest a quick exit when this occurs.

So what is my recommendation for the majority of physician investors? Choose one to three index funds. If you just choose one, it should be the S&P 500 Index Fund. Choose one to three no-load actively managed funds with long term track records of superior performance. In specific situations (such as now, with a gold fund), consider a sector fund. Send in a check **every** month. This is called income averaging. Less shares are purchased when the market is up, but more shares are purchased when the market is down (i.e., buy low). With this disciplined, common-sense approach, keeping in mind that there are three or four times a century that you want to significantly decrease your stock market exposure, you should have the greatest chance of attaining your primary investment goal—financial security.

SUMMARY OF CHAPTER TWENTY-EIGHT

- The fundamentals of a company and the general economic conditions both influence the price of a stock.
- Technical factors are important.
- Stock market corrections occur on average every 15 to 18 months.
- Cyclical bear markets occur an average of every 4 years.
- Secular (devastating) bear markets occur three or four times a century. They can and must be avoided.
- Consider price-to-earning ratio (P/E) and dividend yield when evaluating the stock market.
- We may not yet have seen the final low of this bear market.
- Bonds are not necessarily "more conservative" or "less risky" than stocks. All investments are associated with risk.
- The principal factors affecting a bond are credit risk and interest rate risk.
- No one can predict the direction of interest rates.
- Do not purchase individual bonds and be hesitant to invest in bond mutual funds.
- Index mutual funds and actively managed no-load mutual funds with a long-term record of superior performance should be the core holdings of most physician's stock portfolio.
- ETFs offer flexibility not available with index funds.
- Consider a position in international funds.
- Income averaging—disciplined consistent investing—is the best approach for the physician investor to accumulate wealth.

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Chapter Twenty-Nine
Real Estate

Real estate should represent a significant position in every investor's portfolio. Before detailing why real estate should be a core holding in all portfolios, a discussion of the potential negatives is warranted.

I feel we may currently be experiencing a real estate bubble, similar to our stock market bubble of the late 1990s, similar to the Japanese stock market and real estate bubble of the late 1980s. Schiller, the author of *Irrational Exuberance* has recently voiced similar concerns. This bubble is due at least in part to the historically low interest rates that we have had for several years and the great amount of liquidity (i.e., money) being pumped into the economy.

One way to measure the real value of your home is to compare what the property could be rented for in comparison to the price and then compare this to the return on any investment. As an example, if a home costs $100,000 and can be rented for $800 a month ($9,600 a year), this 9.6% return represents a solid investment. However, say the price of the home has risen more than 15% a year for 5 or 6 years and would now sell for $200,000. But the rent has actually dropped slightly to $750 a month because so many people now qualify for mortgages so there are less renters. The rate of return on the home as a rental has dropped to 4.5% ($750 × 12 months is $9,000, which is 4.5% of $200,000). Considering the amount of money invested, the illiquidity of real estate, the sales commission, expenses such as insurance, taxes, maintenance etc., a 4.5% return is probably not adequate. To be able to realize a more usual rate of return from the property, either the rent must rise or the price must drop (the more likely scenario).

When the only hope of return on a real estate investment is from the favorable tax consequences (such as depreciation) or "potential appreciation," it is very likely that the property is overpriced. When there have been multiple years of gains and within the last year prices are up another 25 to 30%, as at multiple sites in the United States, (homes in Las Vegas are up more than 50%, the greatest annual increase in any metro area on record), then you must be concerned about the possibility of a "blow-off" top. This is the upside equivalent of a "panic sell." You are almost certain to be buying at the top.

With this in mind, at present I would only buy a piece of investment real estate if the circumstances were especially compelling. Otherwise, keep your powder dry. There could be some real bargains in several years.

Other general investing principles, of course, also apply to real estate. Do not overpay. It is impossible to make money on even the best property if the purchase price is

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Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

too high. Nothing ever goes straight up and it is possible to lose money on any investment. Location, location, location. What 10 or 15 years ago was in the most fashionable area of town may now be in an area that is not as desirable or even undesirable. Even a great property in a great location may not do well if it is over-leveraged or poorly managed.

There are several reasons that real estate traditionally does well and will continue to do well in the long-term. As they say, they are not making any more land. The supply is clearly limited. This fact is already quite apparent in the center of large cities, such as Manhattan, Boston, San Francisco and Washington DC. Because of the financial, educational, business, and government base of these areas, it is a prerequisite that people live in close proximity. As society continues to progress and the population continues to increase, there will be an even greater demand for real estate, especially in desirable areas.

In general, the longer an investment is held, the greater the potential for profit. An investor buying the average stock has an almost infinitely higher chance of realizing a profit if the position is held for 1 year as compared to if it is held for just 1 day. Stocks can be traded on-line by literally a touch of the button.

Compare this to real estate. Selling a piece of real estate is cumbersome. It may take weeks or months, or longer in a down market or if the property is overpriced, and the commissions are significant. You do not sell your home in a panic as sometimes occurs when the stock market drops and stocks are sold in a panic. These factors essentially force you to hold real estate longer, which in the end increases the likelihood of a profit. Think of this as a sort of system enforced patience.

The leverage of a mortgage increases the profit. A piece of real estate is often a sound investment with only a 20% down payment. Compare this to purchasing a stock with only 20% down and 80% margin (the average investor cannot make such an investment since this is greater than the usual margin requirements allowed by the Federal Reserve. However, hedge funds sometimes do use this amount of leverage). The purchase of a stock on 80% margin would be a terribly flimsy investment.

Consider the following as a reasonable example of the finances and profit potential of the purchase of a rental property. A $200,000 property is purchased with a 20% down payment of $40,000. If the property was chosen appropriately, the rent should just about cover the mortgage payment on a 15-year note. After 15 years, your $40,000 has grown to $200,000, a more than 11% compounded annual rate of return.

But the gain could be even greater. There is also the following:

1. Depreciation, with its favorable short-term tax consequences.
2. The interest on the note and the expenses to maintain the property are tax-deductible.
3. Hopefully there will be an increase in the value of the property itself.
4. It should be possible to raise the rent as time goes on, such that at sometime, or possibly even from the outset, there is positive cash flow over and above debt service for the mortgage and expenses.

This is identical to a corporation that regularly increases dividends. This excess cash flow can be used for anything such as paying off the note early or for other investments. A properly chosen piece of rental property may produce a 15% compounded annual

rate of return. The limiting factors to such profit are straightforward, namely, having the money for the down payment, choosing the right property, paying an appropriate price, the work and time of managing the property, and patience.

Real estate traditionally performs well in an inflationary environment. During inflationary periods, financial assets, such as bonds, cash and stocks, lose value. People turn to hard assets, with real estate and gold being the prime examples. In addition, if the property is financed with a fixed rate note, the debt is being paid off with cheaper dollars that are easier to come by.

The inverse can occur in a deflationary environment. Real estate can be devastated. Fortunately, periods of deflation occur rarely, but they do occur. The only period of deflation in living memory in the United States was The Great Depression. Japan has had mild deflation for the last 5 years, and Japanese real estate is still down approximately 30% from its late 1980s peak (real estate can go down in value). The problem with real estate and deflation is not only the property is worth less, but because almost all real estate is purchased with some amount of debt, the dollars used to pay off the loan are both more dear and tougher to come by than those borrowed. The US was barely able to avert a deflationary recession in 2002 and 2003. Considering my concern that we may not have yet seen the final low of this bear market (*see* Chapter Twenty-Eight) and the degree of debt in our society, (the national debt is currently more than $7 trillion and increasing at a rate of $50 million an hour) we still may not have yet completely dodged the bogey man of deflation. If the reader should have further interest in learning about deflation, I refer you to the book and article by Robert Prechter referenced at the end of the chapter.

History shows that debt bubbles typically end in a deflationary crash. At present, the total amount of government, corporate and personal debt in the United States is equal to three times the GDP (gross domestic product). Every many, woman, and child in the United States of America would have to work 3 years just to pay off this debt. Paul Volcker, possibly the most capable Chairman of the Federal Reserve ever, who's actions in the late 1970s and early 1980s many feel literally saved the dollar, was recently quoted as predicting a 75% chance of a Third-World style debt crisis in the United States within the next 5 years. Few people in the world have more credibility in financial circles than Paul Volcker. "Vigyáz" means "look out for danger" in Hungarian.

OWNING A PROPERTY OUTRIGHT

There are several situations, in addition to your home, that you should strongly consider the direct purchase of real estate as an investment.

The first is vacation or recreational property. A typical example is a home or condo in areas you like to go to on vacations or just relax. Examples include anywhere on water, whether that be a seacoast, riverbank or lake, such as Lake of the Ozarks in this area. I must make one recommendation. The desirable properties are the ones right on the water. Do not purchase a "second tier" property, one that is not directly on the water. These will never be as desirable as the properties directly on the water and it is quite unlikely they will appreciate as rapidly. You do not want to be forced to look around someone else's trees or shrubs or home to see the water. You want that unobstructed view, those gorgeous sunrises or sunsets, the sounds of

the waves, to be right outside your window, balcony, or piazza. Real estate is like collectibles. People want the best and there will always be someone willing to pay for the best. Buy the best property you can afford (note I emphasize "afford." Do not get carried away!). These will be the most fun and have the greatest potential to appreciate in value.

Other obvious examples of desirable areas include snow skiing areas, resorts, golf courses, land for hunting or hiking, islands, and properties in general in areas that are warm during the winter, such as the southeast, south, gulf coast, and southwest.

Remember there is a practical aspect to vacation property. Not only is cost important, but how long it takes to get there is much more important for the vast majority of people looking for a second home, or any piece of recreational property. A 75-mile drive can be easily accomplished two weekends a month as compared to a full day's travel with multiple airplane connections to get from the upper Midwest or Northeast to a beachfront home in the Florida Keys.

I believe that as our society becomes wealthier more money will be spent on vacation/recreational property. Only so much money can be spent on a home (albeit sometimes very much), car, electronics, and other basic needs. This leaves more discretionary income to be funneled into recreational property. I also believe this will apply to collectibles (*see* Chapter Thirty). Anyone can buy a new car but there are only so many pieces of antique furniture to go around. Look at the late 1990s. The price of recreational property went bonkers. I believe this is only a sample of what will occur in the future as more people accumulate wealth and look for enjoyment, recreation, and relaxation.

One question that always arises with vacation and recreational property is if you should purchase a stand-alone home or a condo. The majority of people probably find stand-alone homes more desirable. The appreciation potential is almost always greater than a condo because you own the land. The principle features that make condos desirable are the lower price and lack of maintenance. Unless you are willing to pay others to perform the maintenance on a stand-alone home, a good part of your precious vacation time will be spent on maintenance and upkeep such as mowing the lawn, raking the leaves, or painting, etc. Whatever you choose should suit your preference and needs but do not forget this very important and practical issue.

You can own a property for personal use only or for both personal use and as a rental. The great part of the later option is that you can cover some portion of the mortgage payments with the rental income. There are real estate firms that will rent/manage the property. As with everything there is a down side. If you rent the property, the IRS limits personal use to no more than the greater of 14 days or 10% of the days that the property is rented. Some people do not like the thought of other people sleeping in their beds. To some people this is not an issue. It is completely up to you.

There are other factors to consider with vacation property. It is not uncommon for people, after they retire, to sell their home and move into what was previously their recreational/vacation property. This is especially common if the property is in a warmer area. This is an excellent example of how patience and good planning can pay long-term dividends.

Or, you may not move to the area, but know the area so well from years of vacations that you purchase a second unit as a full-time rental investment. Susan and I did this 2 years ago when we purchased a second condo unit at the Lake of the Ozarks as a full-time rental property.

The second situation where you should consider buying a property outright and then renting is when you can rent to a relative or close friend, essentially an "inside deal."

The best place to start is with your parents. There are several possibilities. If your parents are middle class, lower middle class, or of more humble origins, it is probable that a good deal of their wealth is the equity in their home. Your parents may have a net worth of $250,000, but $200,000 is the value of their home and $50,000 are CDs in the bank. They could afford a better life style if they could tap the equity in their home.

There are two options. One is a "reverse mortgage" at the bank. These are so financially unfavorable that I will not discuss them. They should be avoided. A much better option, presuming your parents' home is a reasonable investment in and of itself and your parents wish to continue to live in their current home, is to purchase the home and rent it back to them. You have a perfect tenant and it should be possible to structure things such that, with an appropriate down payment, the rent covers your mortgage payments. Or if your parents wish to move into a smaller or different home or a condo, you could purchase this and rent it to them. There is almost no reason for your parents to rent from anyone but you.

By doing this you have a great investment and a nice piece of rental property that will hopefully be paid for free and clear in 10 to 15 years. You do not need many such investments to accumulate significant wealth. And your parents have $200,000 (or whatever the equity in their home) to do anything they have always dreamed of, but never pursued because they did not have the money. I have one physician friend who is such an astute investor that he was able to help his parents invest the money they received when he bought their home that the income generated from their investments not only covered their rental payments but allowed them more spending money.

One suggestion—be sure your siblings are fully aware of how everything is structured so there are no hard feelings down the line.

Another great possibility for renting to a relative would be when your children go to college. Our daughter will be leaving for college in about a year. Rather than paying for room in a dorm or apartment, with nothing to show after 4 years of college, Susan and I are considering the possibility of buying a condo in the area of the school and renting it to our daughter. It seems that we are not the first ones to have this idea. There was an article in *Barron's* (April 5, 2004) with the catchy title of "Kiddie Condos." The children have a nicer place to live during college (if it is a two bedroom, the other bedroom can be rented to a roommate, further helping to defray the costs or even showing a profit). The parents can accumulate equity and also gain from depreciation and hopefully appreciation of the unit. The key to any rental property is to keep the property rented to a tenant who pays their bills on time and takes good care of the property. To rent to a relative or close friend or acquaintance, someone you can trust, is money in the bank. Remember that this property, as with any piece of real estate, must be purchased with the realization that it will at sometime be resold. The property must not only fit your needs but also have features potential buyers find desirable.

Granted, such opportunities do not occur often, but you do not need many such opportunities to accumulate real wealth. For example say you identify one such opportunity every 5 years—twice a decade. You purchase your first rental property (as a reminder, not selling a previous home is a real possibility here) at age 40 with a 10- to 15-year note. You buy a property every 5 years at a cost of $150,000. When the first property is paid off the rental income can be applied to help pay off notes on the later purchases. By age 65 you own five properties free and clear worth at least 5 × $150,000 = $750,000 (plus potential appreciation) with a net rental income of $40,000 to $50,000 per year. One half of your retirement. It can be this easy. To be Warren Buffett or Bill Gates or Peter Lynch requires genius. But mere discipline and patience can be enough to allow the average physician investor to retire with comfort and financial security.

I have one other suggestion for a near "no-brainer" real estate investment. This involves buying into the real estate of your practice. There are two important reasons to consider this:

1. If you think it is nice when someone else pays you rent, wait until you pay yourself rent. It is financial ecstasy.
2. Because this involves your practice, you maintain a degree of input and control, both financially and as it relates to the politics of your practice *vis a vis* your partners.

But there can be two significant negatives of buying into the real estate of your practice. The first concerns the size of the partnership. These are typically set up as partnerships where everyone has an equal vote. When there are two to four partners it is usually, but not always, easy to reach a consensus. But if there are 25 or 30 partners, you will quickly realize why our forefathers established our great country as a republic rather than a democracy. The more people, the more difficult it is to get anything accomplished.

It is also essential that the criteria for the buyout when one leaves or retires be clearly stipulated. If they are not, you may be dealing with retired partners who now live in Arizona or Florida and do not have the same interests as you. Or worse, if a partner has died, you could be dealing with an estate lawyer or bank trust department or family member whom you have never met. These situations can be terribly messy. This also illustrates a general point: it is always easier to get into something than it is to get out. Be careful.

Of course, you may purchase any other piece of rental property such as a home, condo, duplex, small apartment building, or office building. Either a relative, such as your spouse, a grown child or a sibling or a retired parent could manage the property for you, or there are professional rental management firms whose job it is to manage such properties. Although I incessantly preach self-reliance, I do not recommend you personally attempt to manage rental property while actively practicing medicine. Your time, worth $100 to $200 per hour, is much better spent taking care of patients. In addition, I am sure you already receive enough phone calls about patients with headaches, constipation and nausea without receiving calls that a sewer has backed up.

I suggest the physician investor avoid the direct purchase of undeveloped land as an investment. I am not discussing recreational land, but undeveloped land. There are two reasons. The first is financial. Undeveloped land produces no income, as compared to a

rental home or condo or office building. Because of insurance and taxes and other expenses and payments on the note (if the land was not purchased with cash), there is a negative cash flow. Second, land cannot be depreciated, as compared to the favorable tax consequence of depreciating a structure such as a home. Third, the profit is in the development. One of the basic ways to profit from any investment is to be able to unlock value not apparent to others. The profit potential in developing land is not in the land but in the developing. Being a successful developer is quite difficult. The successful developers I have met are really solid business people. It would be very difficult if not impossible for even an astute physician investor to be a successful land developer.

You may also invest in any other type of real estate in any way that a company or partnership may be structured. These must be evaluated on their own merit, but remember my comments elsewhere regarding the frequent problems with physicians and limited partnerships, especially those sold through a broker.

REAL ESTATE INVESTMENT TRUSTS (REITS)

REITs are companies that own and manage real estate. They have a specific structure that mandates 90% of the profits be paid out as dividends. Because of this, the dividend yield is high, typically in the range of 5 to 10% per year.

There are two general types of REITs:

1. Equity REITs invest in real estate properties, manage them for rental income, and sell them.
2. Mortgage REITs invest in real estate mortgages and make income from the interest they earn from the mortgages.

In general, equity REITs more closely follow the real estate market and should be the ones in which a physician invests. Equity REITs, by their nature of being investments in property ownership, have shown much greater long-term returns than mortgage REITs. (This nicely illustrates Peter Lynch's point that in the long run it is more profitable to own the company than lend it money). One hundred dollars invested in equity REITs in 1971 would have grown to $4,871 by the end of 2003. Over the same period, a $100 investment in mortgage REITs would have grown to $1,010. Figure 1 shows how the $100 investments would have grown over the 1971 to 2003 period and are based on the NAREIT (National Association of Real Estate Investment Trusts) indexes of equity REITs and mortgage REITs.

There are REITs for every type of real estate. Apartments in large cities, small cities, office buildings nationwide or in Boston, Chicago, or San Francisco, industrial complexes, malls, warehouse, even medical office buildings.

There are several desirable features of REITs. First is the dividend yield. Second is that the shares of the company trade on the major stock exchanges, just as the shares of General Electric (GE) or International Business Machines (IBM). This provides liquidity; that is, they can be sold at any time, in comparison to your home or condo or rental property, which takes much longer to sell. The companies are professionally managed, but just as with any management team, there are above average and below average performers. Just as there are mutual funds which invest in specific sectors (such as

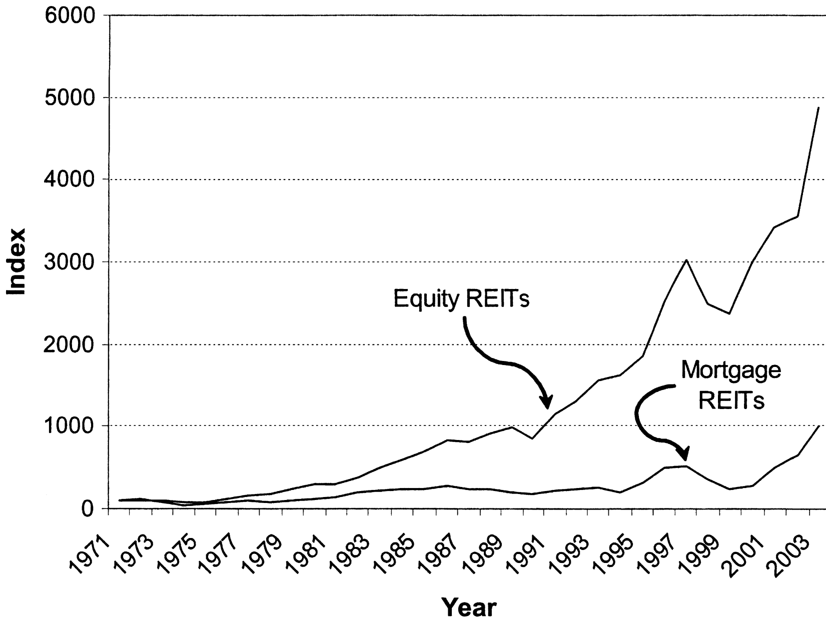

Fig. 1. Relative performance of equity and mortgage REITs.

electronics, health care, etc.) there are mutual funds devoted to investing in REITs. Again, some general and some in very specific sectors of the REITs market.

An investor may purchase the stock of a specific REIT (the largest two being Equity Office Properties [EOP] and Equity Residential Properties [EQR], both controlled by billionaire Sam Zell) or buy shares in a mutual fund that specializes in REITs. This allows you to invest in real estate with a tiny fraction of the money that would be required to purchase even a small condo.

The stocks of REITs trade every day, and thus the prices change daily, although usually not very much. Compare this to your home or a rental property. It is very unlikely that when you drive up to your home in the evening you say "my home has gone down $237 in value today or my rental property is up exactly $8 in value today."

The general REIT market tends to out-perform or underperform the broad stock market for a period of several years. Thus if REITs have gone through a period of underperformance, it may be a time to buy. Likewise, if one is ahead 40% in 3 years (20% total dividends and 20% capital appreciation) it may be time to take profits.

If you prefer capital gains rather than paying taxes on dividends every year (REIT dividends are not subject to the reduced tax rate of dividends of other companies because they already receive a tax break), you might prefer to invest in a REOC (real estate operating company). These do the same thing as REITs; buy, sell, and rent real estate. The difference is that they purposely elect to forego the tax break offered to REITs and thus do not have to payout 90% of their profits as dividends. By foregoing this structure, they gain flexibility in financing. Many REOCs, such as Marriott

International, Inc. (MAR) operate hotels and are not allowed to be classified as REITs. *Forbes* (October 18, 2004, p. 76) reviewed REOCs and made several recommendations. They are able to retain earnings to invest in new real estate projects. REITs, on the other hand, cannot reinvest earnings and must finance new investments by borrowing money. For the investor, REOCs pay reduced (or no) dividends but grow in value faster than REITs. Examples of REOCs include American Realty Investors, Inc. (ARL), and Tarragon Corp. (TARR).

SUMMARY OF CHAPTER TWENTY-NINE

- Every investment portfolio should contain real estate.
- The United States is currently experiencing a real estate bubble.
- Owning your own home is part of the American dream.
- Real estate traditionally performs well in an inflationary environment but can be devastated by deflation.
- Strongly consider the purchase of recreational/vacation property.
- Always buy on the water. Avoid second-tier properties.
- People want the best and there will always be someone willing to pay for it.
- Look for opportunities to rent to family or close friends.
- If your parents rent, they should be renting from you.
- Do not attempt to manage or develop real estate yourself.
- Buy into the real estate of your practice.
- REITs and REOCs offer the possibility to invest smaller amount of money and liquidity not possible when owning a property outright.
- The long-term performance of equity REITs is superior to that of mortgage REITs.

SUGGESTED READING

Prechter RR. *Conquer the Crash: You Can Survive and Prosper in a Deflationary Depression.* Hoboken, NJ, John Wiley and Sons, 2002.

Prechter R and Kendall P. In Synch to Sink: Liquidity Matters: A Contrarian View on Inflations Prospects. *Barron's*, May 17, 2004, p. 44.

McTague J. Murder by Debt: Why are Voters so Complacent About our Enormous Deficit? *Barron's*, September 6, 2004, p. 31.

Chapter Thirty
Other Types of Investments

I believe gold will be one of the best investments in the United States in the next 3 to 5 years. It will be the primary beneficiary of the devaluing of the US dollar and other fundamental problems affecting our economy.

At present, gold has a bad image with the general public. Gold purchased in 1980 at more than $800 an ounce is still down approximately 50% 24 years later. Gold has clearly experienced a secular bear market. This secular bear market is over. In the last three years gold has risen from less than $300 an ounce to more than $420 an ounce. I would also point out that those who purchased gold in 1971 at $35 an ounce did quite well if they sold in 1979 or 1980, realizing a compounded annual gain of approximately 40%.

Being able to compare one thing to another, when the other is well-known, will help place things in a perspective that is otherwise unavailable when viewing something in isolation. As an historical example, from biblical times to the present, an ounce of gold is the equivalent of the cost of 300 loaves of bread. To provide a more contemporary perspective, I suggest that the price of one ounce of gold be compared to the DJIA. I will use round numbers for the following discussion to simplify comparisons. In 1966 the DJIA on an intra-day basis touched 1,000 and in January 1973 closed above 1,000. From the end of World War II until 1971, the price of gold was fixed at $35 per ounce by the Bretton-Woods agreement. This is an approximate ratio of DJIA/gold of 30:1. However, the value of various currencies began to change, including a devaluing of the dollar, and currencies were eventually allowed to "float" as they do now. The price of gold rocketed upward and with the terrible inflation in the United States in the 1970s, gold continued to move higher. In 1980, an ounce of gold brought $800 and the DJIA was about 800. The 30:1 ratio of the early 1970s was now 1:1. This represented the high point of gold. The financial markets exploded upward for 20 years and gold dropped and stayed down for 20 years. In 2000, the DJIA was above 11,000 and gold was mired at about $300 an ounce; essentially back to the DJIA:gold ratio of 30:1. This represented the high point of financial assets and the low point of gold. Therefore, gold is very cheap at a 30:1 ratio, and at its greatest relative value at a 1:1 ratio, compared to the DJIA.

I have no idea of the fair price of gold nor do I know what it will be in the future, but I suggest it could move to attain a DJIA:gold ratio of 2:1 or 3:1. At that time, financial assets would again be cheap and the price of gold would be very dear. For this discussion, assume a 3:1 ratio of DJIA to gold at sometime in the next 2 to 5 years. If the

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Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

DJIA stays at 10,000 (I think it will not), then gold could move up to $3,000 per ounce. If the DJIA drops to 6,500 or possibly lower, then a 3:1 ratio would be equal to gold at $2,000 per ounce. Whatever the final numbers, history suggests that by this measure gold at present is cheap and financial assets are expensive.

How can the average physician investor profit from gold, and other precious or semi-precious metals such as silver? The best option is a no-load gold sector mutual fund. All of the major mutual fund companies have gold funds and more are coming all the time. It is possible to invest directly in the shares of gold mining companies, but investing in a gold sector mutual fund is probably the better choice for the average physician investor. There are at least twenty different mutual funds specializing in gold and other precious metals and one publicly traded fund on the New York Stock Exchange (ASA, Ltd., ticker symbol ASA), which owns South African Gold Mines.

The other possibility is to purchase gold directly. There are two options. The best is to purchase shares of the ETF Street Trackers Gold that trades on the NYSE under the ticker symbol GLD. Each share is backed by one-tenth of an ounce of physical gold on deposit with the Hong Kong Shanghai Bank in London.

The only other option I would consider for the direct purchase of gold (i.e., you are holding the gold in your hand) is the purchase of United States-minted 1 oz. Gold Eagles from a REPUTABLE dealer. In the 1970s gold boom, many people were taken by purchasing "gold" that was supposedly being kept in a vault or warehouse somewhere that really just did not exist. For more on the prospects for gold, I recommend the first five references at the end of this chapter from which most of the above discussion was taken.

COLLECTIBLES

Collecting is fun and enjoyable. It can be a great way to spend quality time with the family. As our society becomes wealthier, I think more money will be directed into collectibles of all kinds. However, there is no other area of investing where knowledge of the subject is more critical to success. Although I encourage you to consider collecting as a pleasurable and potentially profitable way to spend your free time, I will point out that few people realize a reasonable return from the money spent on collectibles. The only difference between an adult's toys and children's toys is that adult's toys are more expensive. Be sure that the money spent on collectibles either generates sufficient enjoyment or an adequate profit.

There are three factors that determine the value of all collectibles:

1. Desirability. The baseball cards of Charles "Whammy" Douglas, Clarence "Choo-Choo" Coleman, Bob "Ach" Duliba, Alex Grammas "The Golden Greek," and Stan "The Man" Musial were all produced in similar quantity. Who's baseball card do you think is more valuable?
2. Condition. A 1959 Topps Bob Gibson rookie card graded PSA-10 Gem Mint would realize at least $12,000 to $15,000 at auction. The same card that was affixed to the fender of your bicycle with a clothespin to generate a "putt-putt" noise when you rode around the neighborhood might not even be sellable.

   I had a friend who was a Yankee fan. In 1961, he took his Mickey Mantle and Roger Maris cards, put the backs of the cards to each other and stapled them

together so he could keep them in his back pocket. These cards in mint condition would be worth more than $5,000 today. Even if he still has these cards, their only value is in his memories.

3. Rarity.

There are many issues to consider when collecting:

1. A collection must be focused. The terms superior profitable collection and eclectic are mutually exclusive. A collection of cars will probably just be a bunch of cars. But a collection of 1969 Chevrolet Chevelle SuperSports with a 396-cc engine could be a world-class collection. The best, most focused collections are the most profitable investments.
2. Knowledge. This has already been mentioned but is worthy of repetition. If you recognize value not apparent to others, you can profit. The successful dealers and auction house personnel know as much about their area as physicians know about medicine. The knowledge base of some dealers and collectors is astounding and never ceases to amaze me.
3. Quality. Everyone wants the best and there will always be someone willing to pay for it. A beautiful piece of jewelry in 2004 will still be desirable in 2104. What is junk in 2004 will be junk forever.
4. Patience. The premier pieces may be unavailable for years or even decades. The most spectacular collections, with the best items, often become available only when the collection is broken up after the death of the collector. Do not purchase an inferior item just to fill a slot. In the end it is a terrible waste of resources. Wait for what you really want and then go for it.
5. Prices on the most desirable pieces, at the absolute top of the scale, increase geometrically, not arithmetically. Coins are graded on a scale of 4 to 70. Say there are 20 coins graded MS-64. They may sell for $1,000 each. There are seven coins graded MS-65. They may sell for $5,000 each. But there is only one coin graded MS-66. This coin could bring $20,000 to $25,000 or more. If someone wants the best collection, they must have this piece. Everyone wants the best, and someone will pay for it.
6. Never buy anything from a cold-call or a promoter (discussed in detail in Chapter Nineteen).
7. Buy only from reputable dealers. This is one of the most difficult aspect of collecting. Who are the reputable dealers? I would suggest you re-read Chapter Seventeen, "Who Do You Trust?" In the end, the only thing that every collector can rely on is their own judgment and knowledge base. You and you alone will be able to determine the reputable dealers.
8. Forgeries abound. Again, the only expert you can truly rely on is yourself.

The above not withstanding, there are many honest, reputable dealers and auction houses that stand behind the items they sell. If something is ultimately shown to be a forgery, they will refund the purchase price.

9. Third party grading services. In the last 15 to 20 years, third party, hands-off (i.e., they do not trade in the product) grading services have had a significant impact in coins, baseball cards, comic books and other areas.

Using baseball cards as an example, a card can be sent to a company known as Professional Sports Authenticator (PSA) and for a fee they grade the card by their predefined grading scale (note, I am not recommending PSA over any other third-party service. I just use them as an example). If they feel the card is authentic and unaltered, it will be assigned a grade of 1 to 10 (10 being the highest) and encapsulate the card in a hermetically sealed plastic holder (quite light-weight and barely larger than the card).

These services have had a tremendously positive impact. Grading has become much more standardized and the vast majority of forged and altered material has been weeded out. Significant credibility has been created where very little existed before.

These services have also generated a Population Report (essentially a census), noting how many cards have been graded and how many were assigned to each grade. Using the 1933 Goudey Babe Ruth #181 card as an example, more than 400 cards have been authenticated with 6 receiving the grade of PSA-9 Mint and 1 receiving the grade of PSA-10 Gem Mint. The latter is arguably the best 1933 Goudey Ruth #181 in existence. Such grading and the publication of these census reports has unlocked the value of these items, especially the premium material. Everyone wants the best.

10. Larger works are generally more desirable than smaller works. This applies to almost all areas of collectibles. A $20 gold piece is much more valuable than a nickel or dime of similar quality and rarity.
11. Control ego. If it is your desire to have the best, most prominent, most important collection, you are sunk. There will always be someone with more money to spend and a better collection than you. It is like trying to be the richest person. Someone else will always have more. Dealers know very well how to play to ego. Do not be seduced.
12. Have good personal relationships with the quality dealers. Physicians have favored referral sources. Businesses have favorite customers. Dealers offer the premium material to their favored clients first. Many of the best collectibles never see the open market. Many pieces are "sold" before the dealer buys them. A client offers a piece to a dealer. Before purchasing the item the dealer will call a customer they know collects these items to determine their level of interest. Many times the final sale is consummated before the dealer makes the purchase.
13. Bid for yourself. Either attend the auction personally, bid over the phone or directly on the internet. Never submit a written bid that allows the auction house to bid for you. Your bid may not be executed fairly and there is an excellent chance that you will purchase the item for your limit bid and not a penny less.
14. Dealers' opinions of other dealers' material. Most dealers will "talk down" other dealers' material. The dealer who gives you their true opinion (good or bad) of another dealer's material is worth their weight in gold.
15. Hype. The more hype, the more reticent I am. When you buy a piece the description of it will be glowing. A year later when you wish to sell it back to the same dealer you could be stunned to find what an undesirable item you have. This is a game and you must learn how to play it.

16. The more original, the more desirable. You must resist the urge to have your collectible changed, refinished or altered in any way.

COMMODITIES

I would not purchase commodities directly, since I am not sure what you would do with ten tons of cocoa or copper. But commodity prices have been exploding for almost two years and many (including me) think they still have a way to go.

You can purchase shares of commodity-related companies, such as copper, iron, or nickel mining companies. Energy producers and explorers. Oil service companies, the large integrated oil companies. Coal companies, uranium mines, or even timber and forest product related companies. Futures allow you to invest directly in commodities (*see* below). A better way for the average physician investor to invest in commodities would be a no-load natural resource or similar mutual fund offered by many of the major mutual fund companies. I suggest the two articles referenced at the end of the chapter for a well-reasoned discussion of why commodities may perform well for some time to come.

DERIVATIVES

Warren Buffett said recently that he does not understand derivatives. He even went so far as to refer to them as financial weapons of mass destruction. I do not understand them and make no attempt to even explain a derivative. I do not recommend them. If you understand derivatives, Buffett would probably appreciate your phone call.

FUTURES

With futures, you buy or sell a contract that fixes the ability to buy or sell something at a specific price at a specific time in the future. These can be extremely leveraged, i.e., a small change in the price of the underlying asset results in a large change in value of the contract. Depending on the amount of margin, the leverage may be minimal or could be 10:1 or more. As mentioned in Chapter Eighteen, leverage works both ways. When things are good, they can be great. When things go bad, it can be unimaginably ugly.

An intimate and detailed knowledge of the market is required. The investments, depending on the degree of leverage, may be extremely volatile and require almost minute-to-minute attention. It would be difficult indeed to care for patients and simultaneously follow the pork belly (bacon) market.

In his book *Starting Out in Futures Trading*, Mark Powers begins with a discussion of one's suitability for trading. This is an insightful and masterful discussion and beautifully sums up many of the general aspects of investing that are made elsewhere in this book. Powers says:

- "Commodity futures trading is not for everybody.
- You should not trade unless you are psychologically suited to taking large risks.
- You should not trade unless you are sure that you can control your ego and your greed.
- If you cannot discipline yourself well enough to admit a mistake on a trade and close it out at a small loss or to be satisfied with a moderate gain on a winning trade, do not trade.

- If you tend to live on hopes and dreams instead of the realities of hard facts, do not trade.
- If you think you can make money trading futures without doing some hard work, do not trade."

When opening a futures account, the multi-page document states that 80% of people who invest in futures lose money. Hopefully this alone will be sufficient to discourage you from even remotely considering a direct investment in futures. Please do not consider this a challenge to see if you will be among the anointed 20%. More likely your wallet will be much lighter.

However, there are managed futures accounts. The options include managing the account yourself but relying on a broker or advisor to assist you, have an account managed by Commodity Trading Advisor (CTA) or invest in a limited partnership managed by a professional CTA. The fees on the latter are especially high, similar to hedge funds, i.e., 1 to 3% of assets, 15 to 20% of profits plus sales commissions plus brokerage fees. Minimum investments are often in five figures. Managed futures accounts do provide asset diversification and represent an investment in commodities. A physician investor may consider such an investment but only if he has a very significant net worth (such as $5 or $10 million) and a personal knowledge of the fund managers.

The two general groups that trade in futures contracts are called, collectively, hedgers, and speculators. The former includes the producers and users of the commodity, such as copper. Producers such as Phelps Dodge (PD), and major industrial users of copper, such as companies that produce or use copper wire or copper tubing, utilize futures contracts to protect against price fluctuations, insure supply, free up capital and reduce the cost of storage, in general, as a business management tool. It is very unlikely that a physician will know more about the copper market than Phelps Dodge.

Now consider the speculator, such as a physician. Webster's provides several definitions for "speculate," including "to review something idly or casually and often inconclusively, to assume a business risk in *hope* [my italics] of gain or to buy or sell in expectation of profiting from market fluctuations." Mark Powers's definition of a successful speculator is "one who picks the right time to die." These definitions should clarify why 80% of people lose money trading futures.

Before you consider trading in futures you should watch the movie "War Games." As pointed out in the movie, the only way to win "is not to play the game!"

OPTIONS

There are two kinds of options contracts. A "call" gives the purchaser of the option the right, but not the obligation, to purchase the underlying stock at the exercise, or strike, price. Calls are purchased if one thinks the underlying stock will rise in price. A "put" gives the person the right, but not the obligation, to sell the underlying stock at the exercise price. There is an inverse correlation between the price of the stock and the value of the put. As the price of the underlying stock drops, the value of the put increases.

An option has a term, or life-span, and thus a predefined expiration date. One option represents one hundred shares of stock. Because of this multiplier effect, options are

very leveraged. A small change in the price of the underlying security results in a large change in the value of the option.

Not only is there a commission to both buy and sell the option, but the bid–ask spread is often significant. The value of the option is dependent on the intrinsic value and the time premium. If you do not understand these concepts, do not trade options.

Seventy-five to eighty percent of options expire worthless. This statistic alone should convince you not to trade in options. Professional options traders, in fact, professional investors of all types, are often referred to as the "smart" money. The non-professional, the amateur, such as a physician trading in options, is referred to as "dumb" money. I wonder how people got that idea?

SELLING SHORT

Everyone knows how to profit on a "long" position. Buy low, hope the price goes up, and then sell high. You pocket the difference. Selling short is doing the exact same thing but in reverse order. Sell high, hope the price goes down, then buy it back at a lower price. You pocket the difference. Selling short is not complicated and allows you to make money when something goes down. It is a basic technique of investing that is worth your time and effort to understand.

There are many misconceptions associated with short selling. In the bear market of 2000 to 2002, the short sellers took a great deal of (inappropriate) heat and criticism. They were referred to as vultures, profiting from other people's losses, they were at least partially blamed for the market decline itself (a great example of blaming others for your own errors) and some even went so far as to call selling short un-American.

To the contrary. Short sellers provide an important financial function. Short sellers help prevent unwarranted speculation. Selling short helps cap speculative price rises. Because a short seller must buy back a stock to cover their position, they provide support in a down market. Short selling helps contain volatility on both the high and low end of the price spectrum.

Selling short is not complicated, it is not wicked, and it is not un-American. If we have not yet seen the bottom of this bear market (which is Alan Abelson's and Richard Russell's and my concern) it will not only help protect the value of your investment portfolio, but allow you to possibly even make money while other investor's portfolios are being ravaged.

Do not underestimate the importance of short selling as a tool to preserve capital, or even make money, when the market drops significantly. If the market drops 20%, and by selling short, you can break even, you have protected 2 years of standard return. In a secular bear market, when the averages drop 50% or more, if you can break even (or even gain) by short selling it is possible to protect an entire decade of standard investment gain. Ten years or more of gains. Being able to preserve capital, or even profit, when others suffer significant losses could be the seminal event of a lifetime of successful investing.

Throughout this book I continually stress the importance of patience as one of the cornerstones of the accumulation of wealth. It typically requires 1 to 2 years to realize a 10 to 20% gain. Because things *always* go down more quickly, often much more quickly, than they go up, it is possible, in fact often the case, that you may realize a 10 to 20% gain in several days, weeks, or months on a short position.

This is how selling short works. You "borrow" the shares of a particular stock and sell them on the market. This is where the first misconception arises—how do you "borrow" stock? The brokerage firm does this. Suppose I wish to sell a stock short. Rather than name a specific stock, I will use as an example one of the exchange-traded funds, the QQQQ (representing the NASDAQ Index 100 trust). I just place an order with my broker to sell short 1,000 shares of the QQQQs. The brokers have thousands of accounts. Many individuals and institutions that have accounts with the broker sign as part of their account agreement that the shares in their account may be "borrowed" for exactly this purpose. Sometimes the broker borrows the shares from their own account or occasionally must borrow the shares from another broker. The broker does the paper work, borrows the shares for you, and then executes the trade (it is all done electronically, you just press a button).

Suppose you short the QQQQs at 40. One month later the QQQQs have fallen to 34 (a 15% gain). You are satisfied with this profit and decide to "cover" your short position. You place an order to buy 1,000 shares of the QQQQs to cover your position to replace the borrowed shares. The broker executes the trade as they do any other. The ability to sell short allows you to make money when a stock or the market goes down.

Things that are essentially "unique" cannot be sold short because at sometime in the future it must be repurchased. One cannot sell a piece of real estate short. Note though that Schiller (of *Irrational Exuberance*) and Allen Weiss (a former student of Shiller's) have founded a firm named Macro Securities Research (MSR) (CNNMoney, August 6, 2004) that may allow just this possibility. The firm has filed with the SEC to offer securities to high net worth individuals that would allow one to hedge against falling home prices in their own real estate market, and to speculate on other markets without having to own property. Another firm named Hedge Street is considering a similar product. Of course, I have no way to evaluate these products and I am not recommending them, but it does appear that other people have concerns similar to mine about the real estate market.

Likewise, you cannot short a specific collectible, such as a specific painting or piece of antique furniture or baseball card. If you think the price of this type of asset were going to drop significantly, they would just be sold.

As with everything, there are negatives. What are the negatives of selling short?

1. The possibility of loss is infinite! Many discussions I have read on selling short state this so definitively at the outset as to apparently preclude any further discussion of the subject. To provide a medical analogy, I would note the typical discussion in the lay press of the group of cholesterol-lowering medicines know collectively as the "statins." Great emphasis is placed on the relatively rare occurrence of rhadomyolysis, yet barely a word is written that statins can significantly decrease the risk of stroke, heart attack, and death.

   With a "long" position (if not leveraged) all that can be lost is the investment. If you purchase a stock at 10 and it goes to 0, you have suffered a 100% loss. If a stock is shorted at 10 and it goes to 50, you have lost 400%. You would have either covered or been forced to cover by the brokerage house long before such a loss occurs, but it is possible.

2. Margin requirements for short selling tend to be higher than on long positions.
3. It may be difficult, or even impossible, to short a stock that is thinly traded. Stocks that trade millions of shares a day—such as Applied Materials (AMAT)—may be shorted instantaneously, whereas thinly traded stocks, stocks with poor liquidity, may be difficult or impossible to borrow and sell short.
4. In years past, but rarely today, there may be a "short squeeze." This can occur on a stock that is thinly traded and heavily shorted. Say a stock appears so clearly overvalued to so many investors that a very significant percentage of the float (total number of shares available to be traded) are sold short. The stock starts to go up, and the short sellers, to prevent further losses, must buy shares back. But because there are so few shares available, the price is forced higher. Now more shorts need to cover, and the price is forced ever higher. This was a routine maneuver during the 1920s when speculators formed "pools" to manipulate prices up or down. It is instructive on how the stock market works, but, for the most part, is not a practical consideration in the heavily traded stocks of today.
5. Do not short a stock just because it is overvalued. You could still get clobbered. Your research suggests that a stock is fairly valued at $10 per share. The stock goes to $20 a share and it is sold short. But the stock continues to go up and up—and up, such as occurred with the dot.com stocks of 1999 and early 2000 or the Japanese market of the late 1980s. Do not short a stock just because it appears overvalued. It could rise even further to become tremendously, ridiculously overvalued. A stock must break in price before selling it short. For example, a stock sold short at 20 one year later has fallen to two. But in the interim it went to 70. You were forced to cover at 40 for a 100% loss. You were completely correct in your appraisal of the stock but were killed by poor timing.
6. Stocks can be sold short only on a "plus" or "zero plus" tick. A "tick" compares the current price to the last trade; if it is up or down or equal. If the last trade on a stock was 32.0, the stock could be sold short at 32.01 or higher, because the sale would represent a "plus" tick, that is, a price higher than the previous trade. A stock may also be sold short on a "zero plus" tick, where the sale is not different from the previous sale but is up from the last price that is different. A stock cannot be sold short on a "minus" tick, a price that is less than the last trade, or a "zero minus" tick, where the price is less than the last price that was different. This rule is both wise and important because if stocks could be sold short on "minus" ticks, the stock, and the market, could be driven lower, spiral down and even crash because of the self-reinforcing selling. (Since this is a work directed to physicians, think of positive feedback loop). This is a strong point of ETFs (exchange traded funds, such as the QQQQs or the Spiders-SPY—Standard & Poors Depository Receipts) and futures contacts. They can be shorted on a "minus" tick.
7. Short selling requires exceedingly close, essentially day-to-day, monitoring of the position. To make big money on a standard long position, patience, often measured in years, is required. With short selling, just the opposite is mandatory. The typical duration of a short position is days, weeks, or months. Take your 10, 20, or 30% profit and get out.

It is both easier and safer to make money shorting a stock when it is closer to the bottom than to the top. A stock tops at 55 and is sold short at 50. But such a drop may only represent a period of correction, as occurs with all stocks. The stock breaks to new highs and you are forced to cover for a loss. But say you are correct and the stock drops 15 points, and you cover at 35 for a 30% gain. Great job. But consider this. The stock gets the absolute tar beat out of it and keeps going down and down and down. You short it at 15. The stock goes down 7.5 (one half of 15 points) and you cover at 7.5. A 50% gain. It is the same story with going long. Getting in too early is risky. Wait until the story is clear and then jump. Take the easy money.

I consider the ability to go short a standard tool in the portfolio of even the average investor. If you think prices will go up, you buy long. If you think prices will go down, you sell short. It is a basic technique to protect capital and even make money that the average investor should understand.

Several mutual fund companies offer "bear" funds for both stocks and bonds. They move the inverse of some particular benchmark. The S&P 500 goes down, their value correspondingly increases. Or for bonds, interest rates go up (the value of bonds and interest rates move in opposite directions), the value of the fund increases. There are even mutual funds that are leveraged bear funds; they move twice the inverse of the average they are tracking. I would recommend the average investor avoid these leveraged funds. They are very volatile. In addition, the expense ratios are extremely high and over a period as short as several weeks the results may "decay" (they do not track the benchmark exactly).

I believe you should keep the non-leveraged bear funds (i.e., they move just one times the inverse of a specific average) in mind. I feel the greatest utility of these funds is in a retirement account. The standard retirement account does not allow short selling (because margin is not allowed in the standard retirement account). The only way you may avoid losses in your retirement account, if you feel a significant decline is in the offing, is to sell your long positions and stay in cash (there is nothing wrong with this. It certainly beats a loss). But "bear" mutual funds are just mutual funds so they are allowed in retirement accounts. Such funds can help protect gains that have taken years to realize.

Overall, the average physician investor should only consider the possibility of going short for 5 to 10% of their investing lifetime. But during vicious bear markets that do occur, selling short may allow you to prevent the loss of years of savings. For more information on how you may profit when stocks, or the market in general, drops, see the reference by Case at the end of this chapter.

STOPS

A stop is an order that can be placed instructing that a position be sold if the price drops to a certain point. Its function is supposed to be, as the name implies, to stop further losses. It sounds like an absolutely logical technique that a careful prudent investor would use to prevent serious losses. But in actuality, it guarantees that you will sell at a low price, you will "stop" when you are behind.

Nothing ever goes straight up. Even the strongest, best performing investments experience corrections, where the price may drop 20 to 30% or even more. Say a stock purchased at 30 has risen to 50. You wish to lock in profits (actually, if that is the case, sell now, "too early" and keep the entire profit) so a stop loss order is placed at 37.5, 25%

below the high. The stock enters a period of correction and it goes to a low of 37.4, thus triggering your stop loss order, and then goes right back up. You are "stopped" out at the low price. Remember the saying "quit when you are ahead." Stop and stop loss orders force you to "quit when you are behind."

This does not mean that you should not sell losers. To the contrary, you should know what criteria you will use to determine when a position should be sold. Suppose the above stock clearly breaks downward and you sell at 32, rather than at 37.5. The few extra points that you lose on the real dogs will not make up for the many times that you are stopped out of the winners.

I recommend you do not use stop or stop-loss orders. Peter Lynch gives the same recommendation.

LIMIT ORDER

These may be considered in specific situations. There may be limit orders to buy or limit orders to sell. In the former situation, you have researched a company and determined that they have a superior product, superior management and are in a growing industry. However, you feel that the current stock price of 50 with a P/E of 20 is too high, essentially precluding the chance to realize a reasonable profit. The dividend yield is 2.5%. But if the stock could be purchased at 35, the P/E would be 14 and the dividend yield would be 3.8%, providing an excellent chance to profit. Thus an order is placed to purchase the stock at a limit (i.e., no higher than) of 35. Considering the spontaneous fluctuations in the price of specific stocks and market corrections, or even bear markets that occur, this may allow the purchase of a good stock with a good dividend yield and good profit potential at an appropriate price.

With a limit order to sell, an order is placed to sell a position, but only if it reaches a particular price. Just as a stop-loss order forces you to sell "when you are behind," a limit order may force you to sell "when you are ahead." Limit orders may be considered in specific situations when you wish to cash out and take profits "too early."

DIFFERENT VARIANTS OF COMMON STOCK

Preferred Stock

A preferred stock is similar to a common stock in that it represents partial ownership of a company, but there are many differences. With a preferred stock, the dividend is fixed, so they perform more like bonds than stocks. The upside of a preferred stock is that the dividend on preferred shares must be paid before dividends are paid on the common shares. Should there be a bankruptcy, preferred shares have a claim on the company's assets that is superior to that of common stock. The downside of preferred shares is that since they behave more like a fixed income investment, they benefit very little from the growth of the company.

Convertible Shares

I do not understand the nuances of convertible shares and recommend they be avoided. Invest in what you know. If you do not understand convertible stock, do not invest.

Super-Voting Shares

This typically occurs when the founding person/family/insiders still wishes to retain control of the company yet "cash out" by selling a portion of their stock. For example, the Class "A" shares may have 10 votes per share controlled by the original owners, and the Class "B" shareholders put up an equal amount of money but have only one-tenth vote per share.

Each situation should be evaluated on it's own merits, but I am somewhat uncomfortable with this situation since a person is being asked to invest their hard-earned money yet not have an equal say. If things get tough who do you think will come out on top?

SUMMARY OF CHAPTER THIRTY

- Gold could be the best investment in the United States over the next 3 to 5 years.
- Collecting is fun but is usually not profitable.
- The value of all collectibles is determined by desirability, condition and rarity.
- There is no area of investing where knowledge of the subject is more important than in collecting.
- Always buy the best.
- Consider investing in commodities.
- Avoid derivatives.
- Avoid futures.
- Avoid options.
- Avoid anything that you do not understand but that promises instant wealth.
- Do not be "dumb money."
- Understand the concept of selling short. It is not complicated. It allows the investor to protect their capital (or even make money) in bear markets.
- Avoid stop-loss orders. They assure that you will quit "when you are behind."
- Consider limit orders in occasional situations.
- There are many variants of common stock. They should be avoided unless completely understood. Invest in what you know.

SUGGESTED READING

Ward S. Midas Touch: An Interview with James Turk. *Barron's*, October 15, 2003, pp. 29–31.

Ward S. The Buck Drops Here: An Interview with James Turk. *Barron's*, October 4, 2004, pp. 26–28.

Alan J. Grizzly Thoughts: Dow Theorist Richard Russell Sees Bear Tracks on The Beach. *Barron's*, March 22, 2004, p. 26.

Brammer R. 24-Karat Play. Newmont Mining is the Class Act in Gold. *Barron's*, July 5, 2004, pp. 14–15.

Ward S. Buying into Gloom: An Interview with David Richards. *Barron's*, September 20, 2004, pp. 35–37.

Rogers J. The New Bull Market Commodities Will Do Well For Years To Come. *Barron's*, November 10, 2003, p. 39.

McGee S. Can-Do Commodities. *Barron's* June 14, 2004, p. 24–25.

Fullman SH. *Options: a Personal Seminar.* New York, New York Institute of Finance, Simon and Shuster. 1992.

Powers MJ. *Starting Out in Futures Trading.* 5th Ed. Chicago, Probus-Publishing, 1993.

Case CJ. *Tools of the Bear: How Any Investor Can Make Money When Stock Go Down.* Chicago, Probus Publishing, 1993.

Chapter Thirty-One
Obtaining Investment Information

In medicine, the more you read, the more you study, the harder you work, the more you know and the better your performance. It is the same with just about everything, including investing. The more you read, study and the harder you work, the better your chance of attaining your primary goal—financial security. Spending 10 or 15 minutes a month on your investments is not sufficient time to expect to realize a 10 to 15% return on your money.

For the young physician investor just starting out who may have no investment knowledge at all, an excellent, and inexpensive place to begin would be to read the business section of your daily newspaper. This will provide general information on the economy, the market, and general financial news of significance. In addition, in the evening, there are many shows on the television that summarize the day's financial events. Choose one that seems right for you and watch it.

I do not subscribe to the *Wall Street Journal* but it contains so much information and has so much influence that it should be considered. Because the *Journal* comes every day (and is considering a weekend edition), finding sufficient time to read it and thus justify the expense may be problematic.

The *Value Line* has a stock market analysis that has been published for decades. I no longer subscribe, but did several times in the past. It is of the highest quality. They analyze approximately 1,700 stocks on a weekly basis. It is not only a tremendous source of information and data, but will help you understand the process of how stocks, and the market, are critically evaluated. They have a 13-week introductory offer that should be strongly considered. Note that I am not giving an opinion on their specific stock recommendations; whether you follow their advice or not is your decision. Rather I am recommending the *Value Line* as a first-class source of information to help you make your own decisions.

My absolute personal favorite for investment ideas and critical analysis is *Barron's*. Alan Abelson, who pens the weekly column "Up and Down Wall Street," is the Mark Twain of our time. He is witty, sublime, and at the same time perceptive (Abelson is just as bearish as I am as it relates to both the current real estate bubble and the stock market in the long term). The column on the back page of *Barron's* is written by Thomas Donlan. I consider him one of the great social commentators of our time. I give *Barron's* my strongest recommendation as a source of both information and analysis.

The money you pay for financial and investing information *may* be tax deductible. Discuss this with your accountant.

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

I have subscribed to *Forbes* for many years and it is my second favorite after *Barron's*. *Forbes* has a significant social and political slant but contains very important financial information, stories, analysis and opinions. The articles in the money and investing section by James Grant (he is my kind of guy, absolutely direct and to the point) Kenneth Fisher, Gary Shilling, David Dreman, and others that appear towards the back pages are especially informative. Almost every issue contains at least one story about a scam or some sort of nefarious activity perpetrated against investors. These are instructive (and frightening). They will help you develop your own sense of healthy skepticism and help you learn how to identify potential investment scams.

As a physician, you will receive, free of charge, periodicals that are directed towards economic and financial issues facing physicians. I am neutral-to-negative on these. They do provide some information but I think your valuable time can be better spent elsewhere.

During the weekday, I use the CNNMoney website to obtain quotes and monitor the market. It is really excellent. This site also features many of the articles from its parent, *Money* magazine. I do not subscribe to *Money* but because of the website I have looked through several issues. The articles have a nice mix of both practicality and detail. Consider *Money* magazine.

For many years I have subscribed to *Daily Graphs*. They are my number one source of data on stocks. The *Daily Graphs* include information on sales and earnings, daily volume, debt, and all sorts of other statistics and technical data. The same company publishes *Investor's Business Daily*. Both publications highlight two statistics. The first is an earnings per share (EPS) rating. An EPS of 90 means that the earnings of the company are growing more rapidly than 90% of the companies in their database. Their relative strength rating (RS) compares the change in price over the last 12 months to the other companies in their database, with a greater weight given to the last 3 months. Both of these publication emphasize momentum investing, as epitomized by the relative strength statistic. My suggestion would be to focus on the voluminous data supplied by the *Daily Graphs* to allow you to make your own investment decisions.

There are literally thousands of other financially related publications, surveys, newsletters, and forecasting services. I will not even begin to evaluate these but there are two that I feel are worthy of mention.

The first is the *Lowry's Reports*. I subscribe to this. The fact that they have been in business since 1938 (66 years is a long time) should suggest that their analysis and recommendations are insightful. They have proven to me that technical data can help predict the general trend of the market. Their principle thesis is that by looking at the buying power (accumulation) and selling pressure (distribution) and a variety of other indicators that one can quantify the basic driving force of capitalistic financial markets, namely, supply and demand. In the May 20, 2002 issue of *Barron's* (pp. MW 15–19) there was an article written by Paul Desmond of the *Lowry's Reports* entitled "Identifying Bear Market Bottoms and New Bull Markets." I very strongly recommend you read this article (it is available, at minimal cost, at www.lowrysreports.com). It is the single most useful, informative article on the stock market I have ever read! Desmond stated that the stock market low of September 2001 was not the final market bottom. He was correct. *Lowry's* has an introductory offer which should be considered. The service

provides both daily and weekly market updates and analysis. The latter should be sufficient for the average physician investor. I give the *Lowry's Report* my strongest recommendation.

The other investment letter worthy of your consideration is the *Dow Theory Letters* written by Richard Russell. I do not personally subscribe to this, but this is because I only have so much money to spend on investment advice letters. Russell is a genius. I have mentioned him multiple times elsewhere. In a two-part interview in *Barron's* in June 2000, he predicted the ensuing bear market, the reasons why it was occurring, and even predicted its depth and duration. In a recent interview in *Barron's* (March 22, 2004), he feels that we have not yet seen the final market lows and that gold will be a great investment going forward. Russell has tremendous credibility with me.

SOURCES OF INFORMATION THAT ARE OFTEN NOT HELPFUL

On Tuesday morning, at the market open, an important company announces their quarterly earnings. They are terribly disappointing, far below analysts' expectations. Because this company is such a bellweather the market drops 150 points. After the announcement, four analysts downgrade the stock. After the market closes, one of these analysts is interviewed and states "the market dropped 150 points today because Acme Computers and Software reported disappointing earnings." When I hear such things I must admit I am not very impressed.

I would be very impressed if at 7:00 AM that morning, before the announcement, and before the market opened, an analyst would say, "Acme Computers and Software will report disappointing earnings, provide in detail the reasons for his or her concerns and predicts that the market will drop 150 points. I am downgrading the stock." This would be very impressive indeed and I would pay attention to what this person said in the future.

Of course the whole subject is one of credibility. Who do you believe? What is useful information and what is worthless psychobabble. The people whose opinion carries weight with me are the people who have been correct in the past. A good example of credible people are those who have a track record of making money. When Warren Buffett, Richard Russell, Paul Desmond of the *Lowry's Report*, or Peter Lynch make a statement or prediction, I listen. Several times a year *Barron's* has a roundtable where 10 to 12 people, all with long, credible, successful financial careers provide their opinions. I read this intently for ideas. Or you may read a financial publication, which has particular columnists (such as those sited above in *Forbes*) who have given sage advice over the years. These people have credibility.

The people I do not listen to are the analysts who work at brokerage firms. Sometimes they are right, there are certainly a few who are good, but much more often they are wrong. As you know, there have been several high profile analysts from the late 1990s market mania that have even been indicted and convicted for giving contradictory, self-serving, not-impartial opinions. So and so upgrades or downgrades a particular stock or a particular sector of the market. I just yawn, try to completely filter these things out and not let them influence me one way or the other. The best example of this sort of worthless advice from a brokerage firm analyst is provided by Peter Lynch in his book *One Up on Wall Street* (*see* Chapter Thirty-Two). Lynch has framed on his wall a

report from a brokerage firm that says "Due to the recent bankruptcy, we are removing this stock from our buy list." As Homer Simpson would say "D'OH!"

Another source of information that I do not allow to influence me is an interview with the CEO or officer of a company commenting on their company. Do your really believe this person will say something bad about their company? My ears would perk up a little bit, though, if they have praise for a competitor.

SUMMARY OF CHAPTER THIRTY-ONE

- Just as in medicine, the more you read and study, the more you will know.
- There are many great financial publications, choose the one(s) best for you.
- What is the credibility of the person giving financial advice?
- Be wary of the opinion of brokerage firm analysts and officers speaking about their own company.

SUGGESTED READING

The Wall Street Journal. 100 Liberty St., New York, NY 10281 1-800-JOURNAL (1-800-568-7625)

The Value Line Investment Survey. Value Line Publishing, Inc. 220 East 42nd St., New York, NY 10017 1-800-535-9648

Daily Graphs. Published by Daily Graphs, Inc. P.O. Box 66919, Los Angeles, CA 90066-0919 1-800-472-7479

Barron's. Published by Dow Jones and Co. 200 Liberty St., New York, NY 10017 1-800-544-9648

Forbes. Published by Forbes, Inc., 60 Fifth Ave., New York, NY 10011 1-800-429-0106

Lowry's New York Stock Exchange Market Trend Analysis. Published by Lowry's Reports, Inc., 1201 U.S. Highway One, Suite 250 North Palm Beach, FL 33408 1-561-799-1889

Dow Theory Letters. www.dowtheoryletters.com

Money Magazine. Published by Time, Inc. P.O. Box 30607, Tampa FL. 33630-0607 1-800-633-9970

Following is a short list of books covering many general aspects of finance, investing and economics of general interest not already referenced elsewhere:

Schiller RJ. *The New Financial Order: Risk in the 21st Century.* Princeton, Princeton University Press, 2003.

Schwager JD. *The New Market Wizards: Conversations With America's Top Traders*. New York, Harper Business, 1992.

Train J. *The New Money Masters: Winning Investment Strategies of: Soros, Lynch, Steinhardt, Rogers, Neff, Wanger, Michaels, Carret*. New York, Harper and Row, 1989.

Headley P. *Big Trends in Trading: Strategies to Master Major Market Moves*. New York, John Wiley & Sons, 2002

Cassidy DL. *It's Not What Stocks You Buy, It's When You Sell: Understanding and Overcoming Your Self-Imposed Barriers to Investment Success*. Chicago, Probus Publishing, 1991.

Graham B. *The Intelligent Investor: A Book of Practical Counsel,* 4th Ed. New York, Harper & Row, 1984.

Levy L with Linden E. *The Mind of Wall Street: A Legendary Financier on the Perils of Greed and the Mysteries of the Market*. New York, Public Affairs, 2002.

Kazanjian K. *Wizards of Wall Street: Market Beating Insights and Strategies From the World's Top-Performing Mutual Fund Managers*. New York, New York Institute of Finance, 2000.

Rogers J. *Investment Biker, On the Road with Jim Rogers*. New York, Random House, 1994.

Geisst CR. *Wall Street, A History, From its Beginnings to the Fall of Enron*. New York, Oxford University Press, 2004.

Karrass CL. *The Negotiating Game*. New York, Thos Crowell, 1970.

Karrass also conducts seminars on negotiating. I have never attended one but his books are informative. For more information call 1-323-866-3800.

Frank RH. *Luxury Fever: Why Money Fails to Satisfy in an Era of Excess*. New York, The Free Press, Simon and Schuster, 1999

McCormack MH *What They Don't Teach You at Harvard Business School. Notes From a Street-Smart Executive*. Toronto, Bantam Books, 1984.

Sloan AP. *My Years with General Motors*, McDonald J with Stevens C, eds. New York, Anchor Press (Doubleday), 1972.

A fascinating history of the early automobile industry in the US by possibly the greatest corporate executive of the twentieth century.

Chapter Thirty-Two
Investment Strategies of the Pros

I love to read history. I especially love to read about great people from all walks of life, political leaders, scientists, intellectuals, and military leaders. Since there are really not many truly new and original ideas, you can learn a great deal from studying people who have been successful and what made them successful. I have chosen to profile three individuals. Warren Buffett and Peter Lynch are two of the most successful investors of the post-World War II era. Burton Malkiel is one of the most important investment/economic theoreticians of our time. Much can be learned from studying these men and their investment styles and philosophies.

WARREN BUFFETT

I consider Mozart to be not only the greatest musical mind ever, but possibly the greatest genius ever. There have obviously been many, many great composers over the years. Hadyn (who said when Mozart died "there will not be another talent like him in a hundred years") von Weber, Rossini, Wagner, Verdi, von Suppé, John Philip Sousa, George M. Cohan, Irving Berlin, and Richard Rogers to name just a few.

But Mozart towered even over these people. He had a mind that was simply the most amazing musical computer ever. He never rewrote or changed a piece to obtain the final product. The piece was just in his head, he wrote it down once and that was it. No changes, just an instantaneous finished product. Imagine an author such as Ernest Hemmingway writing all of the works of his life just once, never, ever changing even a single word.

By age 6, Mozart's father Leopold took him on tours of Europe. He would hear a piece and then, sitting at the clavier, begin to play, improvising and playing constantly with variations, changing the passages, even mimicking the local style, for hours at a time. Consider what you were doing at age 6. It is unlikely you were reading the *New England Journal of Medicine*. Or the time, apparently after hearing the piece just once at the Vatican, Mozart was able to write from memory the entire score of Allegri's *Miserere*.

I consider Warren Buffett to be the financial and investing equivalent of Mozart. I think he understands the science of money as no one else can. Even though Buffett operates on a different plane than the rest of us mortals, there are many things that can be learned by studying his career. Most of the following information on Buffett is from the book *Buffett: The Making of an American Capitalist* by Roger Lowenstein. I have also added some bits of information (and information cited at other points in this book) or things that have occurred since Lowenstein's book was published in 1995.

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

I would compare Buffett to Einstein. Many of the ideas and concepts that ultimately resulted in the theories of special and general relativity were the results of Einstein's thought experiments. Buffett conducts similar thought experiments with money. He constructs scenarios, such as if there were two islands. He will then interject a variable such as a tax, a dividend, a change in productivity, a change in the business model, a change in the savings rate or whatever and play out in his mind the result and draw conclusions from this.

It was obvious from the beginning that Buffett (and Peter Lynch) was interested in making and investing money. I make this point to contrast what I have seen and heard about flim-flam men, who routinely have a checkered and spotty past. People who are the greatest successes in any field do not do this or that and then suddenly at age 25, 30, or 40 decide they are going to be the greatest investor in the world. Their genome directs them to their area of genius, just as Tiger Wood's genome directed him to golf and the Big O's (Oscar Robertson) genome directed him to play basketball. If someone should come to you and promise 25 or 30% returns, similar to Warren Buffett or Peter Lynch, but their past shows that they sold insurance, then shoes, then were a cattle rancher, then a missionary or preacher (watch out here) and now at age 45 they are a financial advisor, it would be wise to be skeptical.

Most people feel (myself and Peter Lynch included) that one of the defining points in Buffett's career occurred in 1969 when he liquidated his partnership and returned all the money to the investors. No one in recent memory had done any thing like this. In May of 1956, Buffett started his partnership in Omaha, Nebraska with seven investors who put up a total of $105,000. Buffett invested $100 and directed the investment. By the end of 1968, the assets of Buffett's Associates, Ltd. was $104 million dollars. The 1960s were characterized by the "go-go" stocks and by ill-advised conglomeration, possibly the best example of what Peter Lynch refers to as "diworseification." Buffett felt the entire market was so overpriced and could find no good bargains that he sold all of the partnership's positions and returned everyone's money. Can you imagine any other investment advisor giving people their money back, closing up shop, and thus not generating fees, because they could not find any good investments? From 1957 to 1967, the DJIA was up at a 7.4% compounded annual rate. Buffett's partnership was up at a 29.5% compounded annual rate.

Not only was Buffett's act of returning his investor's money unique, but it also dramatizes that even the Great One feels there are occasional times that it is not wise or prudent to be fully invested, that stocks (or any asset) may be so overvalued that the only direction is down. Buffett was not only correct in his assessment of the market but was "too early." The market peaked almost 4 years later in January 1973 and then over the next 22 months lost almost 50% of its value (actually much more than 50% after factoring in inflation).

Buffett said recently that two of his largest positions, Coca-Cola (KO) and Gillette (G), in retrospect, were so overvalued at the market top in 1999 and 2000 that they should have been sold. He felt constrained because he was on their boards, and had such a prominent position in the investment community, that he could not liquidate the positions. In occasional circumstances it appears that success and prominence can be counterproductive.

Buffett was the premier student of the father of value investing, Benjamin Graham. Graham looked for companies selling below book value or below the amount of cash on their books, for 50¢ on the dollar. Buffett took this concept a step further. He looked for something that could not be duplicated, that was unique, that was essentially a monopoly. An example would be where there is only one, or a very dominant newspaper, in town. They can command what they want for advertising. Or there is a brand name. There is only one Coca-Cola, only one Gillette. And, of course, not forgetting value investing, Buffett never overpays.

Buffett continually emphasizes that he invests only in what he understands. No software, no computers, and no disk drives. Just newspapers, soda pop, chocolate candy, ice cream sundaes (Berkshire Hathaway owns Dairy Queen), razor blades, and money. This is what Buffett understands. Invest in what you know.

Buffett understands the science of money, how to best put it to use. This is apparent in the structure of Berkshire Hathaway. When Buffett invests, he either buys very large positions, or more recently buys the entire company. But he always leaves management in place. Buffett lets people who know how to make candy make candy, who know how to sell carpets sell carpets, who know how to run gas pipelines run the pipelines. Buffett understands money, so he uses his genius to control the distribution and allocation of capital.

Buffett's grasp of the basic science of money gives him insight into evaluating many general trends in investing and finance. And because of his track record, and his reputation of integrity, his opinion carries great weight. He is especially adept at identifying fads and other deviations from standard investment principles that so often appear to block the logical thinking process of others. He commented early and strongly on the importance of expensing stock options. He commented on the excesses that afflicted many corporations, and their executives, in the last 5 to 10 years. Obscene salaries and bonuses, parties and lavish offices, all at the expense of the person who should be profiting, i.e., the shareholder. Contrast this to Buffett, who receives a $100,000 annual salary from Berkshire and who has never sold a single share of his Berkshire Hathaway stock.

Buffett invests in insurance companies because he was the first one to truly recognize the potential of the "float." (A great example of the more basic the process one can understand, the better the chance for profit). You pay the insurance company a premium on your homeowners insurance. Your home may never burn. You pay the premium on your life insurance policy. Hopefully it will be decades before you die. In the interim, the insurance company has the money to invest. Insurance companies usually put this money in treasury bills or similar low risk, fixed-income assets. Buffett puts this money to work at a 25 to 30% return.

Both Buffett and Peter Lynch emphasize that you must have the appropriate temperament to invest in the stock market. An investment can and will be down 20 or 30%, or even more, from time to time. If the investor cannot cope with this volatility they will sell at the wrong time. Selling out of fear, panic, and disgust is always the wrong time to sell.

Would you want to be on the other end of a business deal with Warren Buffett? By definition you will be selling too cheap or paying too dear. I applied this logic in a local

business situation. A friend and I looked at a piece of land in town, prime development land, but the price seemed pretty stiff. The seller was one of the most solid, well-regarded businessmen in town who had built up and sold several large companies. I said, "Look at his record. Do we want to be on the other end of a business deal with Bill?" We passed.

One final point about Buffett—He admits his mistakes. This is often terribly lacking in the corporate executive of today. This is the main reason I suggest elsewhere (*see* Chapter Thirty-One) that you should put little or no emphasis on what a corporate executive says about their own company. In his book *How to Win Friends and Influence People*, Dale Carnegie devotes an entire chapter to the importance of admitting one's mistakes.

SUMMARY OF WARREN BUFFETT'S INVESTMENT STYLE

- Patience, patience...and more patience.
- Invest in what you know.
- Never, ever overpay for an asset.
- Occasionally things become truly overpriced—then sell.
- Admit your mistakes.

PETER LYNCH

The second investor I have chosen to profile is Peter Lynch. Lynch has written three books, *One Up on Wall Street*, *Beating the Street* and *Learn to Earn*. I have used these as the source reference for the following discussion and for many of the other references made to Lynch throughout this work.

Lynch was the manager of the Fidelity Magellan Fund from 1977 through 1990. One thousand dollars invested in 1977 had grown to $28,000 by 1990, a compounded annual return of approximately 27%.

I have chosen to examine Lynch's investing style and philosophy for many reasons. The third reason is because he was so successful. The second reason is by writing these books he has outlined in detail his decision-making process. But the most important reason I have chosen Lynch is that every investor can profit from many of the points he makes. Lynch is clearly a genius, but the way he evaluates investments and provides explanations that are so clear and logical, and disarmingly simple, that it merits a full discussion. For example, Lynch defines a leveraged buyout as "a company purchased with borrowed money by people who really can't afford it."

I devote a chapter to investing in what you know. Lynch devotes a quarter to a third of his books to this point. Lynch actually uses as one of his basic examples to illustrate this point the fact that physicians rarely look to medicine for their investments. A doctor, who obviously should be investing in a drug company or medical instrument maker or a company that in some way can control health care costs, is more likely investing in an oil company. The example he uses relates to the release of the first true medication to block stomach acid secretion, the histamine 2 (H2) receptor blocker Tagamat (cimetidine) by SmithKline Beckman in 1977. Lynch also, bless him, points

out that the managers of the oil company are more likely investing in the stock of a drug company than in the oil business. Invest in what you know.

I suggest you take the following comment from Lynch, which he refers to as Peter's Principle #3, as one of the 10 most important points of this book and consider it every time you evaluate an investment.

Never invest in any idea you can't illustrate with a crayon.

There are several other general themes that permeate Lynch's message. The first I would not have considered and shows his insight, and his courage, to state so directly. Lynch proclaims, with no hesitation, that amateurs have an edge. Many professional money managers' performances are determined by how they compare to their peers, such as funds with a similar focus or some standard benchmark, such as the S&P 500 or the DJIA. Lynch feels this often results in not being as concerned with not winning but to be more concerned with not losing. For example, if a money manager buys the stock of a small unknown company and the investment fails, he or she is open to criticism. Compare this to taking a position in a large, established, quality company such as Intel (INTL), a stock that almost every large fund holds. If it goes up, it goes up. But if it goes down, one cannot be criticized because everyone else purchased the stock. Lynch feels this mindset guarantees mediocrity.

Lynch feels that the more Wall Street analysts that follow a stock, the less likely it is to be profitable. In essence, when everyone knows all of the information, it is difficult to have an advantage. When you have information that few others possess, you have an edge. Lynch's eyes light up and his mouth begins to water when he discovers a company that no analyst, or at most a few, follow. Obviously, just because a company is not followed by the analysts does not mean it should be purchased, but he feels it is a great starting point to investigate and learn more about the business and their product.

Another recurrent theme of Lynch's is that the amateur who keeps their eyes open will learn about companies, typically local or regional companies, 6 months to 1 year before the Wall Street professional. Just as a physician should look first to medicine, a person should first take a look around them.

Lynch feels the average person comes across good investment opportunities in their daily lives two or three times a year (*see* Chapter Twenty-Five on recognizing opportunities). He uses as an example the auto parts retailer Pep Boys—Manny, Moe, and Jack (PBY). He notes that anyone with any familiarity with the company, such as lawyers, executives, accountants, clerks, or even the carpenters and plumbers who were building all of the new buildings for the company's expansion, should have seen how well the business was going and purchased the stock.

Lynch provides other examples of investment opportunities from his daily life. His wife brings home L'eggs panty hose so he buys Hanes. He eats at Dunkin' Donuts and stays at LaQuinta Inns. He also emphasizes these are just ideas and one must do more research, but these examples typify to him the advantage that amateurs have over professionals.

Several other general points that Lynch makes reinforces those made earlier regarding Buffett. Look for companies with little or no competition. Competition is great for

the consumer, resulting in good products, great selection, and great price. It is one of the basic strengths of our capitalistic system. Competition is not that good for a company. Rockefeller and Carnegie despised competition.

Lynch also emphasizes the importance of patience. With many stocks, often his famous "ten-baggers," a stock that appreciated tenfold, he did not make the big money until holding the stock for 3, 4, or more years. Patience pay$.

Lynch makes four or five other points worthy of comment. The more glamorous a stock, the hotter the industry, and the more discussion he hears, the more he avoids it. The more mundane, the more he loves it. Lynch, of course, looks at many, many factors when evaluating a company, but in the end, it is a company's profitability, how much money they make, that eventually determines their final value. He emphasizes many times that the earlier you invest in a company, the greater the risk. Let the company demonstrate that their business model works, and can be effectively duplicated outside their original geographic area, before investing. This time period is typically 1 or 2 years. There is usually plenty of time. Do not jump in too early. I feel this advice can be directly applied to the IPO (initial public offering) phenomenon of the market mania of the late 1990s, a phenomenon that appears again to be making somewhat of a comeback. The average investor will be best served by staying away from an IPO, unless they have an intimate knowledge of the company.

Lynch stresses many times, and is quite correct, that in the long term, stocks outperform bonds. As he notes, it is better to own the company than to lend it money. But Lynch also provides examples that over periods, sometimes lasting up to 5 to 10 years, that bonds out-perform stocks. From 1982 to 1990, despite the amazing bull market in stocks, because of the drop in interest rates from historic highs, bonds actually performed slightly better than stocks.

There is one point on which I beg to differ with Mr. Lynch. He feels that you should always be fully invested in stocks. I have already explained in detail why there are times that a fully invested position is not warranted.

SUMMARY OF PETER LYNCH'S INVESTMENT STYLE

- Invest in what you know.
- **Be able to explain your investment using only a crayon.**
- Amateurs have an edge.
- In the end, profits determine the value of a company.
- You can discover investment opportunities in your daily life, so keep your eyes open.

BURTON MALKIEL

I had originally intended to profile only Buffett and Lynch. The text of this book was more than 95% complete when I purchased Malkiel's recent work *The Random Walk Guide to Investing: Ten Rules for Financial Success*. Malkiel's discussion, always direct, sometimes bordering on the irreverent, supports and further details many of the

points already made in this book. I feel a detailed discussion of Malkiel's work would profit the physician investor.

Malkiel spent several decades employed as a market professional with one of Wall Street's leading investment firms. As he says, it takes one to know one. Following this he was Dean of the School of Organization and Management at Yale and is currently the Chemical Bank Chairman's Professor of Economics at Princeton. Malkiel notes that he has been a lifelong investor and successful market participant. He is thus able to back up his impressive academic credentials with an ability to make money in the real world.

In 1974, Malkiel published *A Random Walk Down Wall Street*. The book is now in its eighth edition and is clearly one of the most influential works on investing in the last 50 years. I suggest both of Malkiel's books be on your shortest reading list. Malkiel's principal thesis is that the vast majority of professional money managers (not individuals, but professional money managers) cannot consistently, over the long term, beat the general market averages as represented by the index funds. This is the exact point made by John Bogle (who pioneered the S&P 500 Index Fund at the Vanguard Group) and has been made by me multiple times throughout this book.

The best way to cover Malkiel's recent work is to review the book point by point.

- *Basic Point no. 1* (this is what originally caught my eye): Fire Your Investment Advisor. I remind the reader of the full-service broker who thrice dissuaded me from buying stock in the baseball card company Topps (TOPP). Malkiel emphasizes that the advisor's primary interest is to make money for themselves and their company, not for the investor. He notes that the advisors always push the products on which they make the greatest commissions. He states that financial "experts" know little more than you and that "A blindfolded chimpanzee [or 'bare-assed ape' as he refers to them in *Random Walk*] throwing darts at the stock pages can select individual stocks as well as the experts." He also directs the investor to "tune out the TV investment gurus who dispense worthless advice."
- *Basic Point no. 2:* Focus on Four Investment Categories—Cash, Bonds, Collectibles, Common Stocks, and Real Estate. Aside from my comments regarding collectible, gold and hard assets (where I recommend a 5% position) Malkiel's recommendations are almost identical to mine. He notes that over the long term, the return from common stocks (8–10%) is superior to the return from high quality bonds (5–6%). This observation is similar to Peter Lynch's general point that it is more profitable to own the company than to lend it money. Malkiel emphasizes, as do Buffett, Lynch, George Soros and almost all successful investors, that investing in stocks requires a temperament that can endure significant pain because from time to time the investment will (not can, will) be down significantly.

Malkiel states that "For the most part, the stock market does a remarkably good job of pricing stocks efficiently so that they reflect the degree to which future growth is anticipated." I disagree with Malkiel on this point. I do not think that markets are as efficient as Malkiel suggests. In the next paragraph, Malkiel then essentially contradicts his own statement with a discussion of investment bubbles of the past and says, "Investors do need to know, however, that the stock market takes occasional trips to the loony bin."

A collectibles dealer once told me that at any show 90% of the items for sale are overpriced or fairly priced, but 10% are underpriced. This is how I would view the markets. Most of the time, most stocks are reasonably priced. Sometimes, most or all stocks are overpriced or terribly overpriced (our market in 1929, Japan in the late 1980s, our market in the late 1990s), and sometimes they are significantly underpriced (1932, late 1974, and 1982). The efficient investors, such as Buffett, Lynch and Soros, can determine when the market is not efficient. This is the secret to investing, when you can realize significant profits.

The remainder of Malkiel's points are:

- *Basic Point no. 3:* Understand the Risk/Return Relationship.
- *Rule 1:* Start Saving Now, Not Later. Time is money. *See* Chapter Two on the magnificence of compound interest and my comments noting that the younger the person, the more valuable their money and the fact that lost money will never be recouped.
- *Rule 2:* Keep a Steady Course. The only Sure Road to Wealth is Regular Savings. I have already pointed out the importance of discipline and that the best investors are the best savers. Income averaging will lead to financial security.
- *Rule 3:* Don't be caught empty handed. Insurance and cash reserves.
- *Rule 4*: Stiff the Tax Collector. Malkiel, of course, is not recommending that you not pay the IRS their due but he does recommend that you make full use of all tax-advantage options to save for your retirement, such as IRAs, Keoghs and other pension plans, and for your children's education. And he recommends that the "Best Tax Strategy of All" is to own your home rather than rent. I remind you that one of the basic financial goals of an adult is to buy a home as early as financially feasible with the goal of having the mortgage paid off by age 45 to 50.
- *Rule 5*: Match Your Asset Mix to Your Investment Personality: How to Allocate Your Assets.
- *Rule 6*: Never Forget that Diversity Reduces Adversity. Please *see* Chapter Twenty-Four for my impression of the weakness and strengths of diversification.
- *Rule 7*: Pay yourself, not the Piper. As already emphasized, fees are either money in your pocket or in someone else's. In this section Malkiel describes the importance of fees, especially as they relate to mutual funds. Malkiel quotes John Bogle "a low expense ratio is the major reason why a (mutual) fund does well...the surest route to top quartile returns is bottom quartile expenses." As I continue to remind you, fees are a financial four letter word.
- *Rule 8*: Bow to the Wisdom of the Market.
- *Rule 9*: Back Proven Winners: Index funds. This is where Malkiel's and Bogle's observations and recommendations coalesce. The stock selection of most professional money managers does not even keep up with the general market, much less outperform it. Add to this the fees and it is unlikely that over the long term most actively managed funds will out perform an index fund. This does not even include the various front-end and back-end and other fees associated with many funds. (There is no reason to buy any mutual fund with a front-end load, back-end load, surrender fee or 12b-1 fee). Malkiel and Bogle's point is compelling: The best way for

the average investor to participate in the stock market is with the index fund with the lowest expense ratio.

- *Rule 10*: Don't be Your Own Worst Enemy: Avoid Stupid Investor Tricks. This is the principal goal of this entire book.

SUMMARY OF BURTON MALKIEL'S INVESTMENT STYLE

- Don't listen to experts.
- Focus on cash, stocks, bonds and real estate.
- One can profit from the efficiencies, and inefficiencies, of the market.
- Time is money.
- Discipline. The best saver is the best investor.
- Use all available tax-advantaged options to save for retirement and your children's education.
- Index Funds are the preferred vehicle to invest in the stock market.

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Chapter Thirty-Three
Some Miscellaneous Tidbits of Advice

These various subjects do not warrant full chapters but are worthy of discussion.

CHARITY

I feel that physicians need to expend more effort in their support of charities, fraternal organizations, and public service in general. Physicians are somewhat more generous with their money than their time, but overall I would categorize their effort as somewhere between less than average to poor.

By any standard, physicians make a significant amount of money. Your children enjoy the Boy Scouts, Girl Scouts, and the YMCA. If there were a disaster, the Red Cross would help you just as they would anyone else. You enjoy the opera, the symphony, the arts, and the parks in your community. Someone has to make these things work, to spend their time and money to make their community and their country a better place to live. Physicians make their living, by any standard a great living, from the community, and I feel should give back to the community more of their time, energy, and money.

Other people cannot be asked to contribute their time and effort if you are not willing to do the same. You say you are busy. Well, who the heck isn't? Make time to help out and contribute your money. If you do not wish to contribute, I suggest that you not allow your children to join the Scouts, that you stop going to the park or to the museum or the symphony, and that you not allow the Red Cross to help you.

How much should you donate? My general rule is that you are at least starting to reach your charitable potential when you personally begin to do without things you desire. Aim to donate at least 3 to 5% of your income to charity, hopefully more. If you do, I congratulate you and I am proud of you.

One of my personal heroes is John D. Rockefeller. He, along with Andrew Carnegie, another one of my heroes, defined philanthropy in the United States. Rockefeller, and his son John Jr., endowed the University of Chicago (my medical school alma mater), Spelman College (Rockefeller's wife's maiden name was Spelman. Rockefeller supported education for black women almost a century before it became chic and fashionable), Rockefeller University, The Rockefeller Institute for Medical Research, The Rockefeller Sanitary Commission (hookworm project), Rockefeller Park (and multiple other charities in Cleveland), Jackson Hole National Park, Acadia National Park, Grand Teton National Park, Colonial Williamsburg, Shenendoah National Park, and Great Smokey Mountain's National Park. The Flexner

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

Report, which defined medical education in the United States, was implemented with $130 million of Rockefeller money. Rockefeller and Carnegie were not "robber barons." They were great men who helped build this country, and who provided the jobs for the immigrants to this country, such as my grandparents.

Rockefeller said, "Make as much as you can, save as much as you can, give away as much as you can." Physicians need to give more back to their community. You can make a difference, a big difference, and it will make you feel good inside. Please be generous.

MEDICAL SCHOOLS

Peter Lynch begins the preface to his third book *Learn to Earn* with, "The junior high schools and high schools of America have forgotten to teach one of the most important courses of all. Investing. This is a glaring omission."

So have the medical schools. I place a significant degree of responsibility for physician's difficulties with investing their hard earned money on the medical education establishment.

Medical schools produce superbly trained physicians, a training that lasts more than a decade, physicians who save lives every day. Physicians are as comparably trained and skilled as any professional athlete, as well trained as any professional in any field of endeavor. Yet, to my knowledge, they are not given any instruction on how to manage the large sums of money they earn. As they say, money does not come with instructions.

Secondly, and I think just as important, any discussion of money is looked on with disdain, as if the person is just a pathetic moneygrubber who does not deserve to be in the fraternity of medicine. Yet this occurs in an environment where medical school tuition is $30,000 or more per year. The current United States medical school graduate has an average debt of $115,000 to $120,000. Obviously, since this is the average, many students graduate with an even greater debt load. Having to repay so much debt has the potential to cause one to make poor choices, including field of practice (i.e., higher-paying fields such as orthopedics or cardiology, as compared to pediatrics or internal medicine), location of practice and even style of practice (i.e., to perform more procedures to generate more fees and thus income).

Medical schools make significant profits from continuing medical education courses and all sorts of agreements with pharmaceutical companies (*see* retired Harvard President Derek Bok's book referenced at the end of this chapter). Medical school administrators are more than happy to profit, both personally and professionally, from our capitalistic system, and yet supply their students with no instruction on how to invest the hard earned fruits of their labor.

Should you not believe this statement, I suggest you speak with the Dean of your medical school or Chairman of your department. There is a very good chance that they are on the board of directors of a bank, a pharmaceutical company, medical instrument maker or some other for-profit corporation or have consulting or speaking agreements that result in a very significant degree of remuneration.

Money is important. It is never as important as your patient. It is never as important as your family, your health, your freedom, or your integrity. But it is important. Honest hard work to make a good living and get ahead is what America is all about. I speak

from personal experience because my family has lived the American dream. Financial security has advantages. Financial instability can destroy your family and your health.

I do not criticize without having a recommendation. We need not go so far as to discuss the daily stock market quotes at the bedside rather than the differential diagnosis of clubbing or macroglossia. Rather, I suggest that medical schools implement a course providing instruction to assist a physician to handle and invest their money. One to two hours per week for one semester would be sufficient, probably during the last semester/quarter of the fourth year, just prior to graduation. I encourage medical students and their parents to demand such instruction.

I am happy to say that the University of Kansas in Kansas City is organizing just such a course. I am fortunate to have been asked to speak there. Hopefully other medical schools will follow their lead.

CHANGING PRACTICES

Choosing the best practice is obviously one of the most important decisions of a physician's life. Everything—tangible and intangible—goes into making this decision.

Before commenting on the financial consequences of changing practices, allow me to give some advice. There are no perfect practices. They do not exist. This realization usually occurs about 6 months to a year after starting practice and is like hitting a brick wall. Things are not what you imagined, something was supposedly promised, the older guys are taking advantage of you (possible, but actually fairly unlikely). One uniform refrain from young associates is that they are working hard, seeing many patients and the older guys are making money from their toil and labor. The young physician lacks the perspective of time and does not realize that the older guys (I use this as a generic term for male or female) have been working for 10, 20, or 30 years to allow the young physician to enter a ready-made practice where they are busy from the outset. The older guys were fighting battles and doing things 20 years ago to start the practice that the new associates would now probably consider below them. The bottom line is that you must think very long and hard before changing practices. There is no perfect practice.

If things truly are not working out, you must be brutally honest with yourself. Is the problem them or me? If the difficulty is the later, then changing practices is not the answer and will not solve the problem.

The financial consequences of changing practices are devastating! If changing practices necessitates moving, there are all of the financial losses involved with selling a home and buying a new one, uprooting the family, and other related expenses.

Changing practices will also delay by at least several years when the big salaries will be made. You do not lose the first year's salary, but rather it is the last year's salary, the big salaries, that are lost. This seems counterintuitive but is true.

Suppose an associate starts at $125,000 a year with partnership in 2 years:

2004—$125,000
2005—$125,000
2006—$250,000}
↓ } 20 years at $250,000 per year
2025—$250,000 Total 22 years of practice

Now suppose you work for one year and change practices. You start all over again.

2004—$125,000
2005—$125,000 Start over
2006—$125,000
2007—$250,000}
↓ } 20 years at $250,000
2026—$250,000 Total 23 years of practice

The person who changes practices actually loses three times. Up front there is the loss of the difference between $125,000 and $250,000. There is also the loss of the compounding of this difference for all subsequent years ($125,000 compounded at 10% annually for 20 years is more than $840,000). In addition, you must work an extra year to make the last $250,000.

The young physician must think very, very hard before changing practices. It will cost 2 years or more of your financial life. Someone once told me that the best and easiest way to get rich is to keep your first home and your first job.

As a footnote, let me relate that our group is always looking for good cardiologists. Our group is currently comprised of ten cardiologists and two cardiac surgeons. I would let anyone in our group care for my family or me. They are all people of integrity and practice excellent medicine. Fortunately, our group also does well financially. There are currently two physicians in our group, myself and another, who are on Senior status (i.e., we do not take call and will be retiring in less than 2 years). Columbia is a great community. If you are a cardiology Fellow looking for an outstanding practice opportunity or a cardiologist currently in practice but are considering changing (I hope that you have read and pondered the above discussion very carefully) please consider our group. We are extremely busy, and because of the two pending retirements, there will be a ready-made practice.

VACATIONS

The most expensive part of a vacation is not the travel, lodging, meals, and entertainment but the income lost from not working. So, within reason, go where you want and have a good time.

GAMBLING

It is called gambling because one can, and almost always does, lose money. A person works too hard for their money to just throw it away. Do not underestimate the addictive power of gambling. It has the potential to destroy your life.

An occasional person does strike it rich by gambling. For every person who has become wealthy by gambling (this money will also be lost sooner rather than later), a thousand, a million people, get ahead by hard work and saving their money.

If you are insistent on gambling, at least pursue a game where there is a chance to win. Games where one will not win in the long term are those that involve independent events over which the participant has no control. A perfect example is the roulette wheel. There are 38 spots on the standard roulette wheel, 1 to 36 plus zero and double zero (some wheels have only one zero, the gambler loses their money only two-thirds as fast).

Although there are 38 spots, the payoff of a bet on any specific number is 35 to one. Thus the house has a greater than 6% advantage. No matter if on the last 8 spins the ball landed on 10, the chance of the ball landing on 10 the next spin is still one in 38.

The state lottery gives pathetic odds. They usually pay out about half of the entire take in prizes, and if you are the big winner, you are third in line to collect the payoff (after the IRS and your state Department of Revenue take their cut of taxes off the top). You could be the first doctor to win the lottery. You would be on TV and in the newspapers and even on billboards along the highway.

There are some card games where skill, strategy and knowledge can result in being able to win over the long term. These include bridge, poker, and blackjack. Skill at cards, especially bridge, is a capability that is even desirable when some companies are recruiting an executive (Warren Buffett loves to play bridge). This is because being able to consistently win at such games indicates a good capacity to identify, handicap, control, and manage risk.

In the end, you are almost certain to be much better off just watching the World Poker Tour on TV and putting money into your favorite mutual fund.

SPEAKING FOR PHARMACEUTICAL COMPANIES AND REVIEWING MALPRACTICE CASES

I discuss these together because I do the same thing with the money received. I donate it to charity. This completely negates any semblance, real or otherwise, of a conflict of interest.

About once a year I review a malpractice case. I never review cases for the plaintiff, always for the defense. Likewise, I always give my true opinion. If the defense has significant liability and I cannot help them, I say so up front. The number one desire of the defendant's insurance company is to know their exposure, their risk. I hate to do it but it is a part of modern medicine.

Charge whatever you wish for your time but state clearly that the compensation received is donated directly to charity. You have instant credibility.

Whenever doing this sort of legal work, I would strongly suggest that you insist on a retainer (i.e., some payment up front). A retainer is mandatory if you have not worked with the attorney before. I do know of one instance (not me, fortunately) where a physician was stiffed on their fees.

Over the years, I have spoken for, and received honoraria from, almost every major pharmaceutical company. I tell the people up front I donate the money to charity. In this way you do not feel "beholden" to them or that you owe them anything in return. I also keep my talk completely generic. I am disappointed when I hear people who sound more like "hired guns" than a physician.

CUT YOUR OWN GRASS

There is only one reason to hire someone to mow your lawn. This relates to one of the most important aspects of being an executive. That is, to push all tasks and responsibilities as far down the line as possible. From the purely financial point of view, it is not logical for a physician, whose time is worth $100 to $200 an hour, to mow their own lawn, when someone else can be hired to perform the job for one-tenth the cost.

But even after taking this into consideration I feel that you, or a family member, should mow your own lawn. I see people out jogging while they pay someone else to cut their grass. The exercise is just as good or better and $30 or $40 has been saved. A little manual labor from time to time that is smelly, hot, loud and boring is good for everyone. It helps a high-income professional such as a physician maintain perspective on what the vast majority of the other people in the world must do to make a living.

SUMMARY OF CHAPTER THIRTY-THREE

- Give more of your time and money to charity.
- Medical schools should instruct students on investing.
- Be very hesitant to change practices.
- Do not gamble.
- Donate money from speaking and malpractice case review to charity.
- Mow your own lawn.

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Summary

I have learned a great deal from writing this book. It has forced me to critically evaluate my own investment style. I have already admitted that my greatest weakness is impatience. Investments must be viewed in the context of years, not minutes, days, weeks, or sometimes even months.

There are some areas in which I have always done well, such as thrift and controlling debt. I have learned many lessons along the way in my investment career, usually the hard way. My greatest investment failures have been when I invested outside my area of knowledge and expertise or when my ego was involved or I got greedy. Invest in what you know. I have learned to trust my own judgment and avoid as much as possible the advice of "experts." I have learned the importance of dealing with bankers on my terms, not theirs. I have become much better in recognizing real opportunities when they do arise.

I had never appreciated the magnificence of compound interest. Its capacity to build wealth is astounding. My greatest revelation, though, relates to fees. They are everywhere. Do not underestimate the capacity of fees to sap your wealth. Fees are a financial four-letter word. Minimizing fees is much easier than you think and is a basic tool in the accumulation of wealth. Fees are either money in your pocket or in someone else's pocket.

I have repeatedly emphasized the importance of making you own decisions, of self-reliance, of not being overly influenced, or even influenced at all, by the advice of "experts." If this is the case, why should you follow my advice?

The answer is fairly straightforward. You should not uncritically follow my advice or anyone else's. I am a physician with a reasonable amount of financial acumen who has had a reasonable degree of success along the way. I have also experienced my share of failures and what I have learned from these failures has provided some insight that I may hopefully pass along to help other physicians avoid such mistakes.

My goal has been to provide a basic framework from which you can make you own decisions. Hopefully most of the advice I have provided here is correct. I am sure some is not correct and some probably just does not apply to you. Please take this book in that context.

I have two short lists. The first are the factors that I feel are most important and helpful in attaining your ultimate goal of financial security. I am convinced the first two factors are in appropriate order. After that, determine what is most important for you.

1. Thrift.
2. Compound interest.
3. Patience.
4. Discipline.
5. Invest in what you know.

From: *The Physicians Guide to Investing: A Practical Approach to Building Wealth*
Written by: R. M. Doroghazi © Humana Press Inc., Totowa, NJ

And now for the five most important factors that destroy wealth, and potentially your life:

1. Greed.
2. Debt.
3. Fees.
4. Trusting everyone.
5. Not making your own decisions.

Good Luck!

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