Dollars & Sense

Three Things Every Young Medical Student and Physician Needs to Know

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I gave this lecture at the 2017 Scientific Assembly, but there are many people who find it hard to attend the meeting, especially the target of the lecture, young medical students and physicians. In that vein, here is the first of three things every young medical student and physician needs to know.

1. You can't control the investment markets, so focus on the two things you can control — investment costs and your asset allocation.

No one, and I mean no one, knows what is going to happen in the investment markets. Study after study have shown that the overwhelming majority of people who try to beat the markets fail. Because of this, you should forget about trying to predict the markets, and focus on things you can control — investment costs and your asset allocation.

All investments have costs, and the impact of these costs on your investment return compounds over time, taking a larger and larger bite out of your investment returns. If you invest $100K for 25 years and earn 6% per year, without costs you'd have $430K. With just a 2% annual cost you wind up with only $260K. That 2% annual cost consumed $170K, almost 40% of your potential investment! (Source: Vanguard.com)

In addition, because they have to overcome higher costs, investments with higher costs lag the performance of similar investments with lower costs. If you look at stock and bond mutual funds in the highest and lowest cost quartiles, you'll see what I mean:

Type of Fund	Highest Quartile of Cost	Lowest Quartile of Cost
Stock	6.9%	7.8%
Bond	4.0%	4.4%

Average yearly return from 2004-2014. (Source: Vanguard.com)

If you want to take one step that will guarantee that your costs are among the lowest in the industry no matter what you invest in, you should invest with Vanguard. Vanguard is actually owned by its own investors (you), and they leverage this corporate structure to provide the lowest investment costs across the board. With over $4 trillion (yes, trillion) under management, you can't go wrong by just investing in Vanguard.

If you can't invest with Vanguard, perhaps because your employer's retirement plan doesn't offer Vanguard investments, then you need to get into the weeds on your investment costs. While there are many different potential investment costs, the easiest one to look at is the expense ratio of your potential investments. According to Morningstar.com, the expense ratio is "the annual fee that all funds or ETFs charge their shareholders. It expresses the percentage of assets deducted each fiscal year for fund **expenses**, including 12b-1 fees, management fees, administrative fees, operating costs, and all other asset-based costs incurred by the fund."

Wow. That was a mouthful. Bottom line … high expense ratio bad, low expense ratio good. You should be able to find your investments' expense ratios on your investment website or Morningstar.com.

In addition to investment costs, the other things that you can control is your asset allocation. While there are many asset classes you can invest in, the two most basic are stocks and bonds. Here are some of the returns for stocks and bonds from 1926-2013 in commonly utilized portfolios:

Annual Return	50% Stocks & 50% Bonds	60% Stocks & 40% Bonds	80% Stocks & 20% Bonds	100% Stocks & 0% Bonds
Highest	32.3%	36.7%	45.4%	54.2%
Average	8.3%	8.8%	9.6%	10.2%
Lowest	-22.5%	-26.6%	-34.9%	-43.1%

%(Source: Vanguard.com)

As you can see, the higher your allocation to stocks over bonds, the more risk you are taking and the bumpier the ride. Along the way, though, you have historically been rewarded for this bumpy ride with a higher average annual return. Just like the extra 2% cost that was previously discussed compounds to make a huge difference, so will a small difference in your returns. In other words, the more risk you can take, the more money you will probably end up with.

The application of these principles is that you should take as much risk as you can. In other words, you should invest as much of your portfolio

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in stocks as you can while still sleeping at night and not lying awake worrying about the stock market's ups and downs. There will be another market downturn, and when that occurs you need to keep buying stocks because they are on sale, not sell out because you can't handle seeing your net worth and portfolio value decrease.

Invest in as high a percentage of stocks as you can without making the critical mistake of selling stocks during the next market downturn. For me, that has been 100% stocks for the majority of my career, but for some people they'll panic even at a much lower percentage of stocks. If a 50% stock and 50% bond portfolio is the only one that will keep you from selling during the next market downturn, then that is the right portfolio for you.

If you have been investing for long enough, look at your actual behavior during the 2007-2008 market downturn and what your asset allocation was at the time. Mine was 100% stocks and I kept on buying. Your allocation and actions will tell you a lot about your own risk tolerance.

In summary, you can't control the market, so focus on controlling investment costs and your asset allocation. Next issue we'll discuss the other two points every young medical student and physician need to know:

2. Your savings rate is the most important determining factor of your eventual net worth, and it should be at least 20-30% of your gross income.

3. You are your own financial worst enemy.

If you have ideas for future columns or have other resources you'd like to share, email me at jschofer@gmail.com.

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