Achieving Financial Independence

It's all about ensuring you have enough money to retire comfortably.

BY JON A. HULTMAN, DPM, MBA

Studies from the *Aegon Center for Longevity and Transamerica Center for Retirement* revealed that when asked about their chief financial concern, 49% of those individuals surveyed cited running out of money in retirement. Regardless of whether your long-term financial goal is eventual retirement or achieving financial independence, a good way to become financially independent or "not run out of money in retirement"—is to have a financial plan that is doable within the constraints of your annual salary and ongoing financial needs. Ideally, this plan should start when you first begin to practice; yet, even if this is something that you have put off for years, it is never too late to begin.

The primary challenge in planning for eventual retirement is that most of us have no idea of when we will retire or how many years our money will need to last following full retirement. This makes it difficult to project how large our nest egg needs to be; yet, one clearly needs a plan in place for building a nest egg if s/he ever wants to achieve financial independence. If you were to ask a financial planner how long after retirement your money needs to last, s/he will likely tell you that in order to be safe, you should have enough saved to last until the age of 95, or even 100.

To be able to retire comfortably or achieve financial independence, regardless of the size of your annual income, you will need to save a percentage of your income regularly and invest it for long-term growth. If you were to meet with an investment advisor, s/he would typically begin the conversation by asking three questions: (1) "What are your

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TABLE 1

Investing $15,000 a Year Starting at Age 30

Annual Investment	15,000	15,000	15,000	15,000	15,000	15,000
Age	**30**	**40**	**50**	**60**	**70**	**80**
Growth Rate						
2%	15,300	205,205	417,674	676,674	992,392	1,377,251
4%	15,600	234,403	571,239	978,143	1,635,186	2,607,770
6%	15,900	259,379	689,937	1,445,147	2,797,614	5,219,675
8%	16,200	348,224	898,399	2,364,400	4,928,745	10,875,473
10%	16,500	404,625	1,178,145	3,318,773	8,871,010	23,272,084
12%	16,800	470,889	1,554,043	5,121,442	16,201,239	50,613,409

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investment goals?" (2) "How much money do you want to save and invest each year?" and (3) "What is your tolerance for risk?" It is important to have an answer for these questions before you meet with an advisor—definitely before you formulate your financial plan. Contemplating these questions is something that you can do on your own before meeting with a financial "expert". An electronic spreadsheet can help. Starting with this will not only give you important insight into your financial capabilities, but will help you feel more confident in understanding how the three critical questions above apply to your financial life.

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TABLE 2

Investing $30,000 a Year Starting at Age 30

Annual Investment	30,000	30,000	30,000	30,000	30,000	30,000
Age	**30**	**40**	**50**	**60**	**70**	**80**
Growth Rate						
2%	30,600	410,410	835,349	1,353,347	1,984,784	2,754,502
4%	31,200	468,805	1,142,478	1,956,286	3,270,371	5,215,539
6%	31,800	518,757	1,379,875	2,890,295	5,595,227	10,439,349
8%	32,400	696,448	1,796,799	4,728,800	9,857,490	21,750,947
10%	33,000	809,250	2,356,291	6,637,546	17,742,021	46,544,168
12%	33,600	941,778	3,108,087	10,242,883	32,402,478	101,226,817

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The Electronic Spreadsheet

As you know, courses in finance, investing, and financial planning are not taught in medical schools. This is unfortunate because a lack of knowledge in this area makes doctors too reliant on "others" for advice and assistance with critical financial matters—"others" who may be "pushing" financial products that they have

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ties to. Advice may be given based on the advisor's needs rather than the doctor's. Planning is much easier today than in the past with easy access to electronic spreadsheets. Unlike paper, the electronic spreadsheet is dynamic—enabling you to ask, "What if?" in numerous scenarios. You can easily change two key inputs: the percentage of your income you will invest each year and the expected rate of this investment's annual return. Every time you change one of these inputs, the spreadsheet recalculates to show the total projected investment value for each year going forward. Once engaged in this process, three things quickly become clear, (1) the percentage of income you should be saving each month, (2) the rate of return required to achieve your goals, and (3) the level of tolerance you have for risk. This process might actually give you a different perspective of risk. Many learn that being too "safe" is their greatest risk.

A suggestion for putting together a spreadsheet is to begin at your current age and see what would result from investing different percentages of your salary—projecting out to an age at which you may want to slow down or stop working. You can then pair these potential annual savings percentages with various rates of return. The formulas to accomplish this can be individually imbedded in the relevant cells (a specific location within the spreadsheet defined by the intersection of a row and column) in order to calculate the estimated total nest egg achieved at each year as you alter the savings or interest rates. As an example, if your income is $150,000 a year, and you want to project results of saving and investing 10% of your income each year using rates of return ranging from 2% to 12%, you will get the results as shown in *Table 1.* This first scenario already gives some good information about how much you will need to save and your tolerance for

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risk. It is clear that taking too little risk virtually guarantees that you will never achieve financial independence or sufficient savings to retire with the resources to last until age 100 without making a dramatic downsizing of lifestyle. The chart does not factor in inflation (formulas can be added to take this into account); however, if annual inflation were "only" 2%, you would need to earn a 10% annual return on your savings to achieve the outcome in dollars as shown with an 8% growth rate.

With enough "What if?" testing, you will see that a significant percentage of your investments will need to be in the stock market in order to potentially gain high enough returns to outpace inflation. This is true even after retirement. You will likely need your investments to continue growing during retirement even as you are taking withdrawals from those investments. It turns out that it is actually too risky to not be in the stock market or comparable investments over the long-term. Another way to think about risk is to consider what would happen if you did not earn a 10% return and accumulate $8,871,010 in investments by age 70 (Table 1). Consider the odds that you would have accumulated only $2,797,614, or less, by taking greater risk over that 50-year period. This would be the same amount that you would have earned had you invested more conservatively, achieving a 6%, or lower, return. The main difference between these two approaches is that the "less risky" investment has no possible upside.

Table 2 shows "What if?" you were to invest $30,000 a year (20% of your $150,000 income, rather than 10%). Obviously, the projected numbers for each decade double. Taking the "riskier" route actually gives you a shot at financial independence. *Table 3* shows "What if?" you wait until age 40 to begin investing, and at that time are able to invest $30,000 a year. You can test any type of scenario you want, including increasing your investment amount each year as your income increases or at a time when your financial obligations such as raising and educating children decline. What you will learn by running multiple scenarios with numbers that are based on your actual income is the percentage of income you will need to save each year, based on your actual starting age and the rate of return you will need to achieve each year to reach your personal goals. This will also give you a good idea of your tolerance for risk and realization of the value of not overspending or wasting money along

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the way on depreciating assets such as luxury cars. Fortunately, one of your biggest advantages is that you are in a profession where it is often possible to continue working part-time to supplement these earnings—even well into your eighties.

I am not a big proponent of "rules of thumb;" yet, I believe that sometimes utilizing these guidelines commonly cited by "experts" and being able to compare where you are financially with some type of benchmarks can have some value.

"Rules of Thumb": What Should Your Net Worth Be?

According to Thomas J. Stanley, author of *The Millionaire Mind* and *The Millionaire Next Door,* one way to determine what your net worth should be is to multiply your age by your annual income and then divide by 10.

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Utilizing this formula, a 40 year old who earns $150,000 a year should already have a net worth of $600,000, and by age 60, that number should be $900,000. Sam Dogen, founder of the Financial Samurai blog, recommends that your net worth at age 30 should be two times your average income, by age 40 it should be ten times, by age 45, 15, and by age 60 it should be 20 times. Applying this to our example $150,000 income, this doctor's net worth at 60 should be $3,000,000. As you can see, when comparing these two "rules of thumb" there is a large variation in benchmarks—in this case, ranging from $900,000 to $3,000,000. That being said, if you compare these two benchmarks with *Table 1*—saving 10% of $150,000 and investing it each year at the conservative 4% investment return rate—results in reaching the $900,000 benchmark range by age 60. The more aggressive investment at the 10% return rate results in hitting the $3,000,000 benchmark range at this same age. There are financial experts who split the difference between these two rules—recommending that you have 10 to 12 times your annual income saved at retirement age. This would put the nest egg number at retirement for someone earning $150,000 between $1,500,000 and $1,800,000. According to the Federal Reserve, if you want to compare your retirement nest egg with that of the average American, his/her median amount saved by retirement is $187,300.

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TABLE 3

Investing $30,000 a Year Starting at Age 40

Annual Investment	0	30,000	30,000	30,000	30,000	30,000
Age	**30**	**40**	**50**	**60**	**70**	**80**
Growth Rate						
2%	—	30,600	372,363	788,970	1,296,811	1,915,867
4%	—	31,200	468,805	997,439	1,851,044	3,114,588
6%	—	63,648	476,098	1,271,769	2,696,693	5,248,516
8%	—	67,392	539,314	1,796,799	3,996,406	9,097,306
10%	—	69,300	611,529	2,112,082	6,004,133	16,099,110
12%	—	71,232	693,994	2,745,078	9,115,432	28,900,784

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One of the more reliable "rules of thumb" is the 50/30/20 budget rule. This rule is good because if you follow it consistently, you should be able to have money to invest and achieve your long-term financial goals. The 50/30/20 rule stipulates that 50% of your income go to fixed expenses (such as rent and utilities), 30% to variable ones (such as food and entertainment), and 20% to savings and paying off debt. Note that both saving and paying off debt increase your net worth. Saving at least 20% of your earnings each year and investing it over the length of your career virtually assures that you will not run out of money in retirement—even if your returns are less stellar than hoped for.

Benchmarks

If you want a benchmark for determining the percentage of income you should be saving, Fidelity Investments recommends saving 15% of your income to reach a savings goal of 10 times your salary by the time you are 67. A concern with this benchmark is that saving 10 times your income by retirement may be too low a target if you are still active and healthy when you reach that age. It might be best to shoot higher than 10 times, and if you do not hit that number, the fall back is still likely to be higher than if you had set a lower target.

The ideal is to achieve financial independence so that if you continue working, the decision to do so is out of choice and not necessity.

Because everyone has a specific salary, age at which s/he initiates a plan, and target retirement age, the place to begin one's personal financial planning is with an electronic spreadsheet. As you plug in your actual numbers and keep running "What if?" scenarios (using different saving percentages and investment returns), you will begin to see quite clearly what will be required to achieve your personal financial goals. If you have difficulty setting aside money each month, a good habit to develop is to "pay yourself first." Also, whenever you have an increase in income, you can accelerate your plan by adding half of that increase to your investments. You will not miss this "new money," and you will still have half of it to spend as you choose.

Each year after retirement, you can use this same spreadsheet to see the amounts you can safely withdraw (don't forget to factor Social Security into any withdrawal calculation), the rate of return you need to earn from your remaining investments as you draw down your accounts, and whether you might need to consider working—even part-time—following retirement. The ideal is to achieve financial independence so that if you continue working, the decision to do so is out of choice and not necessity. **PM**

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