Personal Financial Planning For Medical Residents

Matthew Lawson, M.D.

© 2006-2007 Matthew F. Lawson

What is

personal financial planning?

© 2006-2007 Matthew F. Lawson

What is personal financial planning

Is it…

- **Buying a house**
- **Paying for a car**
- **Purchasing stocks**
- **Paying off student loans**
- **Paying off credit cards**
- **Insuring your assets**
- **All of these?**

© 2006-2007 Matthew F. Lawson

What is personal financial planning

Personal Financial Planning is achieving an appropriate *balance* between saving and spending so that you and your family can live an enjoyable life, pay for education, and fund a dignified retirement.

© 2006-2007 Matthew F. Lawson

What is personal financial planning

- **Personal Financial Planning is about *choices*, and understanding the financial consequences of those choices.**
- **It is a *lifetime process* and there are rarely quick-fixes to financial difficulties.**
- **If you have not started thinking about these issues, do not worry! The important point is to start planning now.**

© 2006-2007 Matthew F. Lawson

Topic Outline

- **Basic principles of personal financial management**
  - **Saving, Cash Reserves, Budgets**
  - **Debt**
  - **Managing your credit rating**
  - **Cars**
- **Making *investor* an important and permanent part of your identity**
  - **Start investing for retirement now**
- **Special situations for residents**
  - **Things you *need to do now***

© 2006-2007 Matthew F. Lawson

Basic Principles

- **Pay yourself first**

© 2006-2007 Matthew F. Lawson

Basic Principles – Pay yourself first

- **This principle is about *saving***
- **Frugality must become part of your approach to life**
  - **"Frugal" does not mean being "cheap"**
  - **It requires you to *live within your means***
- **Your budget should include scheduled monthly savings as soon as possible**

© 2006-2007 Matthew F. Lawson

Basic Principles – Pay yourself first

Resident A

26 years old, plans on Cardiothoracic Surgery (8 years of training).

Saves & invests $200 per month for 10 years, starting with residency, then stops saving.

Total Saved = $24,000

Investment Return 9%

Age	Savings
35	$ 36,463
45	$ 86,321
55	$ 204,354
65	$ 483,780

Resident B

26 years old, plans on Interventional Cardiology (7-8 years of training).

Does not save any money in residency. Begins saving $200 per month once he gets a "real job" and saves until age 60.

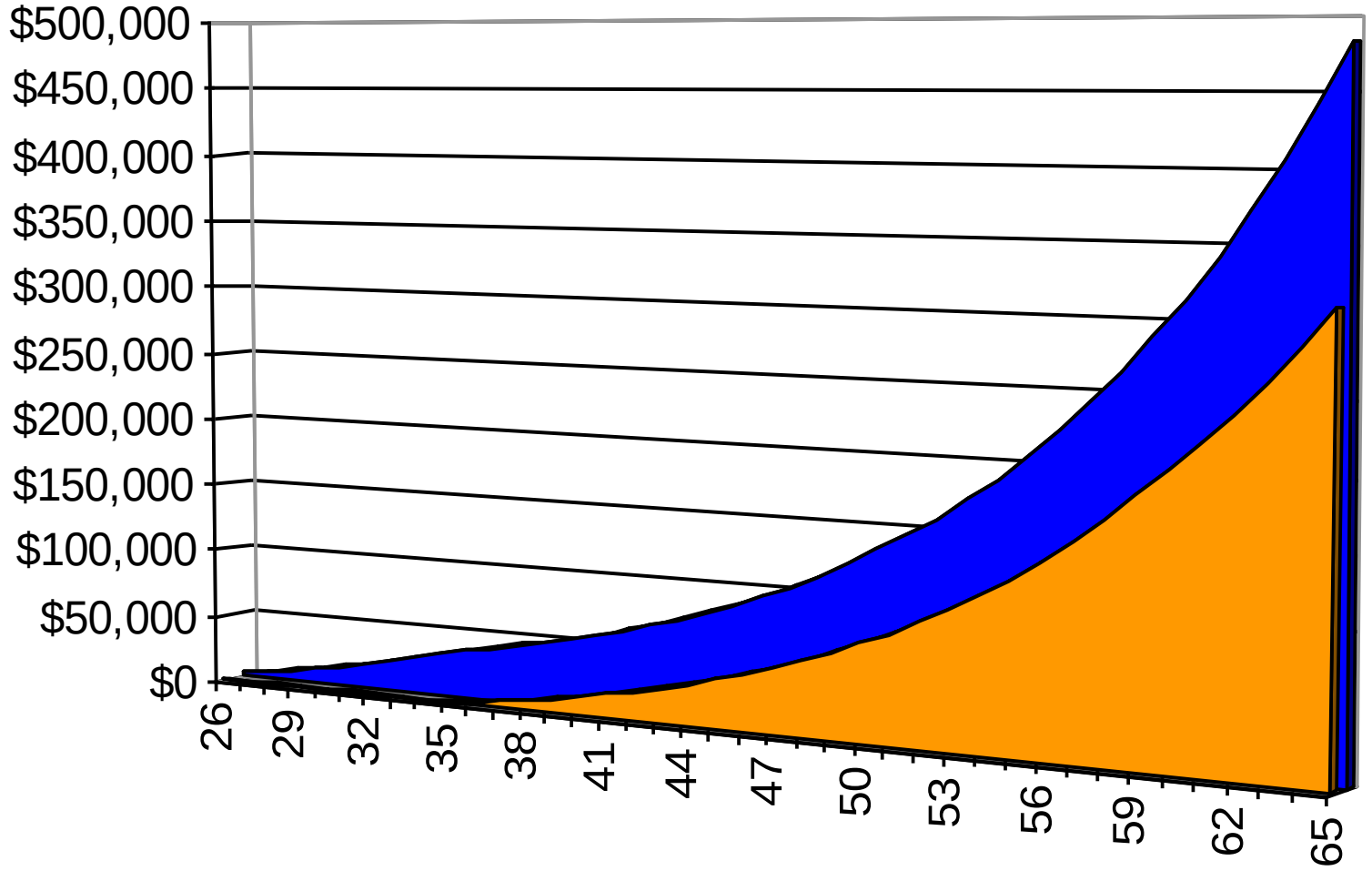
Total Saved = $60,000

Investment Return 9%

Age	Savings
35	$ 0
45	$ 36,436
55	$ 122,784
65	$ 312,775

© 2006-2007 Matthew F. Lawson

Basic Principles – Pay yourself first



© 2006-2007 Matthew F. Lawson

Basic Principles – Pay yourself first

- **Start saving as early as possible in your professional life.**
- **Early savings allows your savings to grow for a longer period of times and maximizes the principle of *compounding interest*.**
- **It is very difficult to make up for not saving money early in life.**

© 2006-2007 Matthew F. Lawson

Basic Principles

- **Pay yourself first**
- **Expect the unexpected**

© 2006-2007 Matthew F. Lawson

Basic Principles – Expect the unexpected

- **Keep 2 to 6 months worth of cash (or cash equivalents) for emergencies**

Account	Ave Interest
– Savings Account	1.50%
– Money Market Account	3.48%
– Money Market Fund	4.74%
– CD (1 yr)	4.97%

Our Fidelity Money Market fund (FGRXX) yields 4.99%

Source: Bankrate.com 12/4/06, Yahoo Finance 12/4/06, & Fidelity.com.

© 2006-2007 Matthew F. Lawson

Basic Principles

- **Pay yourself first**
- **Expect the unexpected**
- **Make a budget**

Then stick to it!

© 2006-2007 Matthew F. Lawson

Basic Principles – Make a Budget

- It is easy to make a budget
- It is hard to make a budget that you can live with
- How to…
    - Start with monthly income
    - Look at all monthly expenses
        - review old credit card statements
        - look at utility bills
        - keep track of cash expenses
        - mortgage, loans, credit cards, insurance, car payment, entertainment, …

© 2006-2007 Matthew F. Lawson

Basic Principles – My Family Budget

- **This is my family budget (from PGY 2 year)**
  - **Don't tell my wife I told you this**

Monthly Income	
Salary #1	**$2,521**
Salary #2	**$2,521**
TOTAL	**$5,042**

Total Expenses	
	$4,850

Monthly Expenses:	
Retirement Savings	**$ 660**
Other Savings	**$ 200**
Mortgage	**$ 1,336**
Home Ins	**$ 77**
Property Tax	**$ 395**
Utilities	**$ 515**
(electric, gas, water, phone, alarm, dues)	
Groceries & Household	**$ 550**
Dining	**$ 300**
Gas	**$ 120**
Auto Insurance	**$ 180**
Home Equity Loan	**$ 241**

© 2006-2007 Matthew F. Lawson

Basic Principles

- Pay yourself first – save now
- Expect the unexpected – have emergency cash
- Make a budget – then use it
- Avoid consumer debt

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt

Consumer Debt (major credit cards & store credit cards) can destroy your budget and destroy your ability to save for retirement.

- **$20,000 on a credit card will usually have a minimum payment of $400 per month, most of which is *interest***

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt

- **Consumer Debt *counts against you* when you try to qualify for a home loan (mortgage) by affecting you debt to income ratio**
- **The average college graduate has over $3,400 in credit card debt at graduation**
  (median credit card debt from CNN.com "Debt: How do you stack up?")
- **The average household carries $8,940 in credit card debt**

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt

- **What to do about consumer debt that you already have?**
  - **Stop using cards with a balance (payments are applied to new purchases before the existing balance)**
    - **Use cash or debit cards instead**
  - ***Ask* for a lower interest rate or consider transferring the balance to a lower rate card (beware of *teaser* interest rates)**
  - **Paying down cards that have an interest rate above 10% *should be one of your top priorities***

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt

- **In general, there are only a few situations were taking on debt makes sense**
  - ***Buying a home***
  - ***Financing an education***
- **A few situations were debt *might* make sense**
  - ***Reasonable car purchases (if you can't pay cash)***
  - ***Home equity loans for home and/or self improvement***
  - ***Key life events that build relationships (eg weddings)***
- **Situations were debt *does not make sense***
  - **Credit Cards** **Vacations** **Luxury Cars**

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt
Credit Reports

- **What is a *credit report?***
  - **A history of *your financial dealings* with financial institutions**
  - **It includes:**

Open accounts	**Closed accounts**
Payment History	**Total Debt**
Delinquent Accounts	

- **Who maintains this financial document?**
  - **Three major credit bureaus collect data from a network of credit reporting agencies**
  - **TransUnion, Equifax, Experian**

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt
Credit Reports

- **A *Credit Score (FICO Score)* is a three digit number that *quantifies your credit worthiness*, and it is based on your credit report.**

It QUANTIFIES your credit worthiness

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt
Credit Reports

- **Ranges from 300 to 800**
  - **Higher is better**
  - **Outstanding is 720 – 800**
  - **Good is 660 – 720**
  - **Below 660 is bad**
  - **Below 600 is really bad**
  - **Your FICO Score can be…**
    - **A scarlet letter**
    - **A golden halo**

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt
Credit Reports

- **What five things contribute to the FICO Score?**

1) Past delinquency or timeliness of payments

35% of your overall score

2) How you use available credit (maxed out?)

3) Age of your financial accounts

4) Number of times you request new credit accounts

5) Your personal mix of *types* of credit

Home loan vs. credit card

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt
Credit Reports

- **You should check your credit report and FICO Score several times a year**
- **Go to:**

  www.annualcreditreport.com
- **These items should NOT be in your credit report:**

  Bankruptcies over 10 years old

  Negative information over 7 years old

  Credit inquiries over 2 years old

  Accounts *that are not yours!*

  Incorrect account histories

  Missing notation of *disputed charges*

  Closed accounts not listed as "closed by consumer"

© 2006-2007 Matthew F. Lawson

Basic Principles – Consumer Debt
Credit Reports

- **Why should I care about my credit report and FICO score?**
  - **FICO Scores *quantify* your credit worthiness, think of it as your Step I score for your financial reliability**
  - **It is a *major determinant* of qualifications for…**
    - **Home loans**
    - **Auto loans**
    - **Other loans**
  - **And it is a *major influence over*…**
    - **Insurance premiums**
    - **Mortgage interest rates**
    - **Credit card interest rates**

© 2006-2007 Matthew F. Lawson

Basic Principles

- Pay yourself first
- Expect the Unexpected – have emergency funds
- Make a budget – then stick to it
- Avoid consumer debt – start paying it off now
  - Keep up with your credit report
- Don’t lease your car

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **Over a lifetime, many people will spend more money on cars than on their home**
- **Monthly budgets usually have a large portion devoted to car payments**
- **Cars are often overlooked when considering your financial planning**
- ***ELIMINATE the mindset that you will always have a car payment – this is what the auto dealers want you to think!***

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **It is usually better to buy than to lease**
  - **Leasing often has mileage restrictions which can be *costly* if you exceed them**
  - **Financing and leasing subsidiaries of auto makers are typically *the best money makers in the auto industry – this should tell you something!***
- **Consider buying late model used cars (one to two years old) rather than new cars**
  - **Still have warranties**
  - **Check the vehicle history online**
  - **May be able to afford a nicer car for less**

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **Example – new Toyota 4 Runner vs. one year old model**
  - **New 2007 Toyota 4-Runner Sport V6 4x2**
    - **MSRP $31,320**
    - **Cars Direct $26,884**
  - **Used 2006 Toyota 4-Runner Sport V6 4x2**
    - **Total miles… 8,236**
    - **Asking Price $23,990**
  - **This represents a savings of almost 11% by purchasing a car that is one year old.**
    - **You may save 20% if you shop around!**
      - » **Source: Carsdirect.com search for new and used 4-Runner (4/8/07)**

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **When making a purchase, pay cash if you can**
- **Most residents will not have the savings to pay for a vehicle in full**
  - **Get the best possible loan, consider credit unions and banks *before* considering the dealer's financing offer**
  - ***Separate* the decision to buy a car from the decision to finance the purchase**

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **Several of my friends went out and leased a *luxury car (BMW)* in their first year of residency…**
- **Why do I drive a 1999 Toyota with 100,000 miles, and why does my wife drive a 1997 Honda?**

Rome

Destination wedding in Colorado

Boston

Retirement Savings

© 2006-2007 Matthew F. Lawson

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **Remember, personal financial planning is about *choices* and understanding the consequences of those choices**
  - ***My wife and I choose to drive older cars and live life the way we want***
  - ***Several of our friends could not attend our wedding because the cost to travel to Colorado was too expensive***
    - ***I'm sure the BMW payment had nothing to do with it***
    - ***NEWS FLASH: Residents who make $40,000 per year cannot afford luxury automobiles!***

© 2006-2007 Matthew F. Lawson

Basic Principles – Cars

- **You don't need to have a car payment**

  If you have a working car…try to keep it!

  You will avoid a monthly payment

  With this extra monthly money you could

  - **Save for retirement**
  - **Save for a vacation**
  - **Pay down credit card debt**
  - **Qualify for better mortgage**

© 2006-2007 Matthew F. Lawson

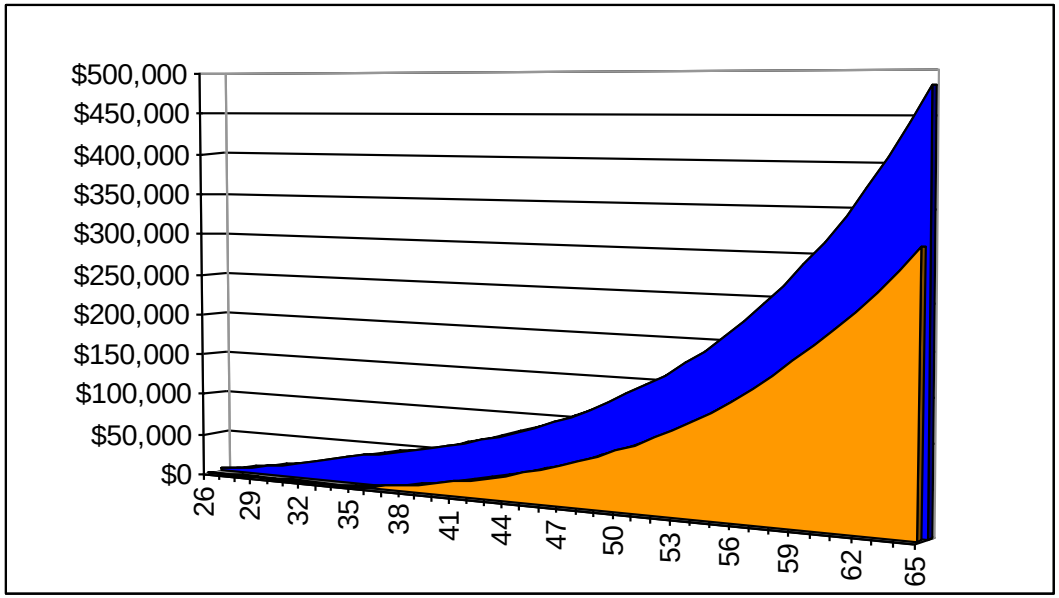
Basic Principles

- Pay yourself first
- Expect the Unexpected – have emergency funds
- Make a budget – then stick to it
- Avoid consumer debt – start paying it off now
  - Keep up with your credit report
- Don’t lease your car

© 2006-2007 Matthew F. Lawson

Lifelong Investing

- **Remember *Pay Yourself First***
  - **Example of residents A & B**
  - **"A" saved for 10 years and then stopped**
  - **"B" saved waited 10 years and then began to save**



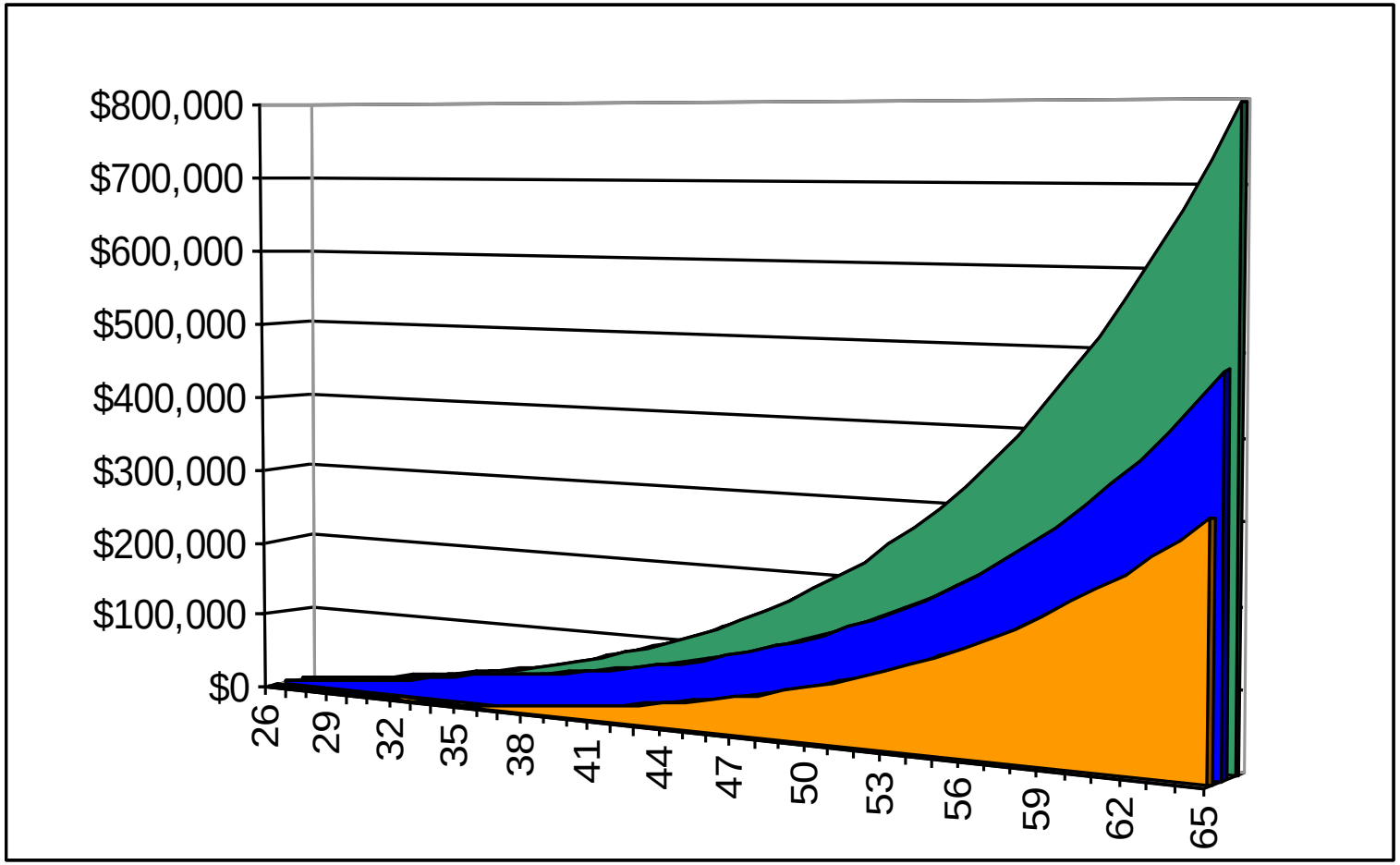
© 2006-2007 Matthew F. Lawson

Lifelong Investing

- Now consider resident "C"
  - A lifelong investor
  - Starts saving during residency and continues throughout life
  - Invests in a diverse selection of stocks, bonds, and real estate
  - Earns the same return of 9% per year as the other guys
  - Saves from day one of residency and keeps saving until age 60

© 2006-2007 Matthew F. Lawson

Lifelong Investing



© 2006-2007 Matthew F. Lawson

Lifelong Investing

- **Steady, lifelong investing is the only reliable way to amass wealth**
- **The previous model assumes a monthly investment of only $200 per month ($2,400 per year)**
- **Life has started! Start saving as soon as financially possible.**
- **But where should you save?**

© 2006-2007 Matthew F. Lawson

Lifelong Investing
Roth IRA

- **US Law provides many different ways for people to save for retirement.**
- **The most important type of account for many people is the *Individual Retirement Account*, or IRA.**
- **There are two types of IRA**
  - **Traditional**
  - **ROTH**

© 2006-2007 Matthew F. Lawson

Lifelong Investing
Roth IRA

- **To encourage Americans to save money for the future, the government provides tax incentives to save money in an IRA**
  - **Traditional IRA**
    - **Contributions are *tax deductible now***
    - **Savings grow tax deferred**
    - **Withdrawals will be taxed at your income rate in the future**
  - **Roth IRA**
    - **Contributions are not tax deductible**
    - **Saving grow tax free and there is no tax on withdrawals**
- **Contributions are limited to $4,000 per year (per person)**

© 2006-2007 Matthew F. Lawson

Lifelong Investing
Roth IRA

- **The best place for a medical resident to save and invest is a Roth IRA, *hands down!***
- **IRAs are actually *brokerage accounts***
- ***Brokerage accounts* allow you to purchase**
  - **Stock**
  - **Bonds**
  - **Mutual Funds**
  - **Other Investments (commodities, options, futures)**
- **In an emergency, you can withdrawal *prior contributions* from your Roth IRA without penalty**
  - **Not recommended**
  - **Not possible with a Traditional IRA**

© 2006-2007 Matthew F. Lawson

Lifelong Investing
Roth IRA

- **Many brokerages and mutual fund companies offer *no fee* or *reduced fee* retirement accounts if you make regular monthly investments**
- **Fidelity Investments** ***www.fidelity.com***
  - **No fee IRA and waived minimum investment with a scheduled contribution of $200 per month**
  - **Largest mutual fund company in the world**
- **Vanguard** ***www.vanguard.com***
  - **Pioneer of the index fund**
- **E*Trade** ***www.etrade.com***
- **Charles Schwab** ***www.schwab.com***

© 2006-2007 Matthew F. Lawson

Things to do *NOW*

5. **Check your credit report now**

   Fix any errors **Get your FICO score**

4. **Create a *budget* for your monthly expenses**

   Make you best guess at expenses

   Try to live by this budget

   Be realistic! Update your budget every few months to keep on track!

3. **Start your "emergency cash" savings immediately**

   Best option is a money market account, but a savings account will do

   As a *minimum*, have 2 to 3 months of living expenses saved

2. **What you do next depends on your financial situation**

   Pay off high interest credit cards

   Start an IRA (remember "pay yourself first")

   Purchase a home

© 2006-2007 Matthew F. Lawson

Things to do *NOW*

1. **The biggest obstacle to acquiring wealth is to spend money like you are wealthy *before you actually are*.**

© 2006-2007 Matthew F. Lawson

© 2006-2007 Matthew F. Lawson