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▼ PART II
Personal Financial Planning Skills

▼ CHAPTER 13
*The Economic Fundamentals of Financial Planning**

David Edward Marcinko

Living is more of a question of what one spends than what one makes.
—Marcel Duchamp

There is a major variable, dominant in any marketplace that pushes an economy in a forward direction. It is called consumerism. This became apparent while waiting in a doctor's office one recent afternoon. The front-office receptionist, who appeared to be about 21 years old, was breaking for lunch and her replacement, who appeared not much older, came over to assist. Realizing the propensity for a long wait, one was taken by the size of waiting room and the number of patients coming in and out of the office. Americans consume healthcare, and a lot of it. There was another notable peculiarity. The sample prescription bags being carried out the door were no match for the bags under everyone's eyes, including the doctor's. The office staff was probably working overtime, if not two jobs, and the doctor was working harder and faster in a managed care system. Why? So they all could afford to buy and voraciously consume for their children and themselves. Americans indeed work longer hours than citizens of any other industrialized nation.

Plus, as women medical professionals entered the workforce in unprecedented numbers, consumer confidence reached a 32-year high in the year 2001-2002, even as money was spent at a feverish pace in the current economic recession. As an example, DaimlerChrysler, Mercedes-Benz, and Nissan all reported record sales for 2001, as did U.S. automakers Ford and General Motors.

In fact, in a recent study by the Kaiser Permanente Foundation, in California, doctors there chose to work four hours longer each week rather than take a 10 percent pay cut.[1] Consumerism is what keeps economies alive and well. What a perfect way to describe medical and healthcare professionals, sans most concepts of financial planning.

§ 13.01 Basic Macroeconomic Concepts

Money lending, or extending credit, is probably one of the oldest professions. It precedes the creation of currency. It wasn't long ago that the term "usury" was used to describe the charging of interest on borrowed money. Today, it is associated with

* Lawrence J. De Noia, CPA, MBA, CFP™, was the co-author of the first edition of this chapter.
[1] Kaiser Permanente Foundation, Division of Research, Oakland, CA, 2000. For more information, see www.dor.kaiser.org.

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an unlawful rate of interest. The usury rate is the maximum rate that may be charged for loans made by non-regulated lenders. That rate is five and one half percent higher than the current cost of money measured by the average coupon on Treasury Bills maturing within six months. The rate is calculated and disclosed on the last day of each month by the Treasury commissioner.

[A] Federal Reserve Activities

The price of the commodity "money" is its interest rate. There are two types of short-term interest rates: the discount rate is what the Federal Reserve charges member banks, and the Federal Funds rate is what the member banks charge each other. A third rate, known as the prime rate, is what banks charge to their most creditworthy clients. Be aware, however, that the law of supply and demand determines long-term interest rates, not the Federal Reserve banking system. Some functions of member, and nonmember banks, are listed below.

FINANCIAL INSTITUTION FUNCTIONS

Commercial Banks
Must be members of the Federal Reserve
Loans to business, industry and government
Checking and savings accounts

Savings & Loan Association
Commercial, mortgage, and individual loans
Checking and savings
Credit cards
Now part of FDIC-covered institutions

Mutual Savings Banks
Commercial, mortgage, and individual loans
Checking and savings accounts

Credit Unions
Consumer loans
Savings and checking accounts
Credit cards

Brokerage Firms
Money market funds
Security trades and services
Underwriting new issues (IPOs)
Investment banking
SIPC

Perhaps the most vital functions of the Federal Reserve itself includes keeping member banks afloat; providing a system of check collecting and clearance; supplying member banks with paper currency reserve balances; supervising and regulating member banks; and regulating the supply of money and credit. The Federal Open Market Committee (FOMC) achieves these short-term goals in the following two ways:

1. By decreasing the overall money supply, the Federal Reserve sells government securities, forcing member banks to pay for them with dollars. This shrinks free reserves and the capability of banks to supply funds to personal and business owner, such as medical professionals. The borrowed money ultimately leaves the money supply. This is called a tight or contractionary monetary policy
2. By increasing the overall money supply, the Federal Reserve buys government securities paying banks with dollars. This expands free reserves and the capability of banks to supply funds to personal and business borrowers, such as medical professionals. The money ultimately enters the money supply. This is called an easy or expansionary money policy.

Of course, the ability to make new loans and increase the money supply is controlled by FOMC reserve requirements. For example, an increase in the reserve requirement lowers free reserves, reduces the ability to borrow, and is contractionary. On the other hand, a decrease in the reserve requirements, raises free reserves, and is expansionary.

■ Example

Total of all bank reserves	$50,000 MM
Required reserves	49,400 MM
Excess reserves	600 MM
Reserves borrowed from FOMC	300 MM
“Free” reserves	300 MM

1. Reserves = percentage of deposits banks must keep on hand.
2. An increase in reserves multiplies $$ banks can lend.
3. A 20% reserve requirement means $5 to loan every $1.
4. Bank loans create new deposits and increase the money supply.
5. Banks borrow from the FOMC to meet reserve requirements.
6. But only “free” reserves are available to create new loans.

Therefore, reserves drive deposits, as indicated by the various money supply measures. If the FOMC removes additional reserves, this extraction could begin a painful contraction process as interest rates rise, potentially causing stock market prices to fall.

[B] Money Supply Measures

M1 = demand deposits (checking accounts) + money in circulation (cash and coins), plus NOW (negotiated order of withdrawal) accounts.

M2 = is the most reliable measure of the money supply. It equals M1 plus savings accounts + money market accounts (4 × M1). M2 grew a sedate 5.5% in 2000 and no acceleration is apparent throughout Y2001. Of course, since equity investors have decided that holding cash is unwise in a bull market, valuations may rise but not much purchasing power is left over for consumption.

M3 = M2 + other large financial institutions and large time deposits

[C] The Velocity of Money

The velocity of money is the rate of circulation in the money supply. The more often money changes hands, the greater the level of commerce. The velocity of money is determined by money supply, interest rates, inflation, commerce, and the Federal Reserve. Medical professionals, like most consumers, tend to hold less money as interest rates and inflation increase, and therefore the velocity of money increases. Velocity is reduced when people increase their money holdings. This occurs in periods of low interest rates and low inflation; the opposite when rates and inflation are high.

[D] Monetary and Fiscal Policies

Government intervention attempts to bring a social and economic justice to a system that tends to distribute its resources efficiently, in the manner supply and demand naturally creates. Democracy and capitalism work as countermeasures within our economic system. Economic policies can have a dramatic effect on financial planning results for the medical professional, and it is important to understand them in order to position investments accordingly.

By controlling interest rates and the money supply, the Federal Reserve Board tries to entice or suppress the consumption spending in the economy. In some cases, monetary policy is designed to stimulate the economy, thereby avoiding a recession. In other cases, it is designed to suppress economic growth and slow down or lower inflationary pressures.

Congress, on the other hand, controls taxes and government spending. Congress and the president are not always in agreement with the Federal Reserve Board. For example, after the Great Depression of the 1930s, Congress believed that deficit spending would revitalize the depressed economy. In 1936, John Maynard Keynes introduced the concept of demand-side economic policy. The government would become the ultimate consumer and therefore push up the system's capability for production. This would increase employment and wages, and push the economy forward. This pump-priming policy was used to solve a demand-side problem. When inflation occurred, the government would enact policies to retard the economic system, thereby suppressing inflation. This did not

work in the 1970s when monetary manipulation, combined with government's fiscal stimulus, actually caused inflation to increase.

Tax policies were also used to achieve economic justice. Congress could stimulate the economy by striving for certain social initiatives. Hence, the marginal income tax rates (MITR), which became progressively higher with higher incomes; allowed tax payers to only keep the percentage of income that was left over, and above, their tax rate (1-MITR), or (1-28% = .72), for example. This redistribution of wealth was seen as fair and a way to stimulate growth. With the 1970s only a memory, Congress adopted a new fiscal strategy that later became known as supply-side economics. Congress needed to boost productivity capacity and proceeded to cut income taxes. The idea was that the prevailing high tax rates were creating a disincentive to invest, save, and produce. It was later found that, although tax rates were lower, tax revenues increased. Because after-tax revenue was now higher, this created an incentive to work harder and longer. Lower taxes were levied on greater revenue, thereby increasing tax receipts.

By 1993, the new tax act put a damper on supply-side economics by increasing the marginal tax rates on income and the capital gains rates. Currently, the pendulum is swinging back the other way with the recent reduction in capital gains rates and the Economic Growth and Tax Reduction Reconciliation Act of 2001. Physician financial wellness may yet be determined by actions taken in response to upcoming monetary and fiscal policies.

[E] Major Economic Theories

The above led to the development of the two dominant economic theories today.

[1] Monetarists

Monetarists believe the FOMC reserve should not be used to influence the business cycle or economy. Money supply is believed to be the prime mover of the U.S. economy. Monetarists control demand, and money becomes more or less expensive, in relation to domestic or foreign markets via the International Monetary Fund (IMF).

INTERNATIONAL TRANSACTIONS via INTERNATIONAL MONETARY FUND

Money leaving the USA	Money coming into USA
USA purchases foreign currency	Foreign purchases of US currency
Current account payments by USA	Current account payments to USA
Goods and services imports	Goods and services exports
Merchandise trade imports	Merchandise trade exports
Service Payments	Service fees
Foreign aid payments	Foreign aid receipts
Capital account outflows	Capital account inflows
USA private investments abroad	Foreign investment in USA
Central bank debt	Central bank credit

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STRONGER US $ DOLLARS = MORE EXPENSIVE GOODS/SERVICES

- **Example 1** To illustrate how foreign currency exchange rate fluctuations may affect consumers purchasing power, consider the example of auto aficionado, Dr. M. Rappaport, whose auto dealer contracted to import 20 BMWs, each at a price of 40,000 German marks. If the current exchange rate was 2 marks per U.S. dollar, upon placement of an order, the dealer told Dr. Rappaport to expect to pay about $20,000 for a car. Dr. Rappaport agreed to pay upon delivery, three months later. However, the exchange rate fell to 1.5 marks per dollar, and the BMW now costs Dr. R. about $26,666. Of course, if the price of a dollar, in terms of the mark were to rise, the cost in dollars would fall. Fortunately, currency risk may be mitigated somewhat by forward transactions in which traders purchase marks at a fixed price for delivery one to three months in the future.

- **Example 2** Another illustration of currency fluctuations occurs when dealing with American Depository Receipts. An ADR represents individual foreign shares of a company that are held by a custodian bank. They are available from the NYSE, AMX, or Nasdaq; and may be either sponsored, or unsponsored. The former provide American-style financial information, while the latter do not.

[2] Keynesians

Keynesians believe the FOMC should not be used to influence the business cycle or economy. Supply and demand is the prime mover of the U.S. domestic economy. Fiscal policy uses spending and taxes to control supply.

[F] Gross Domestic and National Products

Gross Domestic Product (GDP) and Gross National Product (GNP) are measures of the total amount of money changing hands. GDP is the dollar value of all goods and services produced during one year. GDP is a measure of a country's productivity when shown on a per capita basis. To get this number, divide GDP by the number of productive workers in the country. It does not include income earned by workers overseas.

In December 1991, the Bureau of Economic Analysis began using GDP instead of GNP, as the primary measure of U.S. production. The GNP measures output of all multinational companies that are U.S.-owned, where the profits are expected to return. In GDP, the profits are attributed to the country where the product is produced or located, even though profits would eventually wind up in the country that owns the factory. It includes the manufacture of tangible personal property such as vehicles, durable medical equipment, furniture, bread, and services used in daily living such as education, healthcare, and auto repair. The accounting shift facilitates comparisons between the U.S. and other countries, which is the standard used in international commerce accounting. Other important definitions, for medical professionals, include:

Current (Medical) Dollar GNP (nominal GNP) is slightly different and uses medical service values. It measures changes in actual physician production.

Constant (Medical) Dollar GNP (real GNP) is adjusted for medical inflation and uses an implicit price deflator (index) to arrive at a realistic inflationary adjustment

[G] Consumer Price Index and Producer Price Index

There are various indices to track economic growth. The Consumer Price Index (CPI) is a measure of the average change, over time, in the prices paid by urban consumers for a predetermined market basket of consumer goods and services from A to Z. It is the most commonly used economic indicator of inflation. However, it is not to be confused with the Cost of Living Index (CLI). The CPI is an index of price changes only. For example, the CPI would exclude income taxes and social security taxes. The Bureau of Labor Statistics chooses over 200 specific items within selected business establishments. One of the items measured is the average fee to visit a doctor's office.

The Bureau of Labor Statistics set the base average index level for the CPI using the 36-month period from 1982 to 1984. That period is said to have a base of 100. Changes are measured in relation to this base figure. The index level for March 2000, for example, was 168.2. This means that there was a sixty-eight and one fifth-percent increase in average price since the base period.

CONSUMER PRICE INDEX FOR THE PAST DECADE

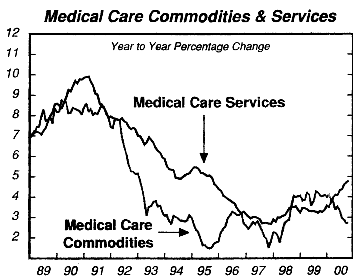
Year	Index (1982-1984 = 100)	Average (12-Month Increase)
1988	118.3	4.4
1989	124.0	4.6
1990	130.7	6.1
1991	136.2	3.1
1992	141.9	2.9
1993	145.8	2.7
1994	149.7	2.7
1995	153.5	2.5
1996	158.6	3.3
1997	161.3	1.7
1998	164.0	1.5
1999	166.0	1.3
2000	168.5	1.4
2001	169.5	1.2*

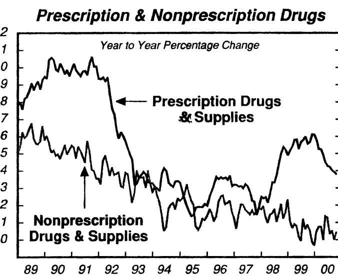
*Estimate

Medical care prices, and their relative importance, are listed below for August, 1999.

Medical Care Prices And Their Relative Importance

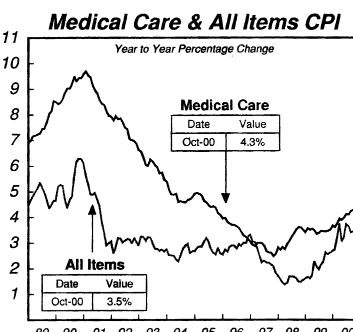
Data Released 11/16/00; October 2000

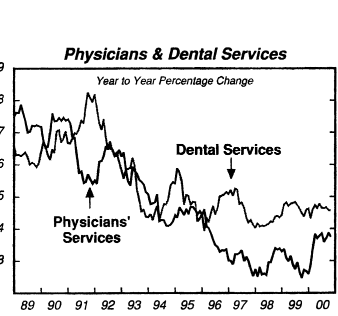


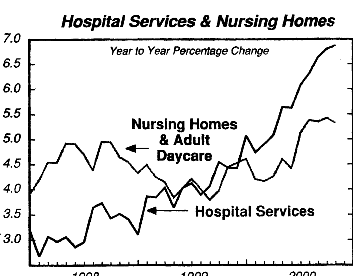


Relative Importance

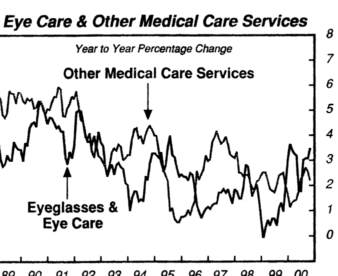
Medical Care	**100%**			
Medical Care Commodities	22.0%	**100%**		
Prescription Drugs & Supplies		68.8%		
Nonprescription Drugs & Supp.		31.2%		
Medical Care Services	78.0%		**100%**	
Professional Medical Services			63.7%	**100%**
Physicians Services				51.2%
Dental Services				29.7%
Eyeglasses & Eye Care				9.7%
Other Medical Care Services				9.4%
Hospital and Related Services			30.8%	**100%**
Hospital Services				96.2%
Nursing Homes & Adult Daycare				3.8%
Health Insurance			5.5%	







The information contained herein is based on sources we believe to be reliable but its accuracy is not guaranteed.



Sources: Bureau of Labor Statistics; Copyright © 2000 Crandall, Pierce & Company

All data expressed as cost growth from a year ago.

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The Producer Price Index (PPI) is a group of indexes that measure the change, over time, in the prices received by domestic producers of goods and services. It measures price changes from the perspective of the seller rather than the consumer, as with the CPI. The CPI would include imported goods, while the PPI is relevant to U.S. producers and therefore would not include imports. The PPI measures over 10,000 products and services. It reports the price changes prior to the retail level. This information is useful to the government in formulating fiscal and monetary policies. The data gathered from the PPI is often used in escalating purchase and sales contracts. That is the dollar amount to be paid at some time in the future. Long-term managed medical care contracts of the future will seek escalation clauses for increases in prices.

[H] The Business Cycle

The business cycle is also known as the economic cycle and reflects the expansion or contraction in economic activity. Understanding the business cycle and the indicators used to determine its phases may influence investment or economic business decisions and financial or medical planning expectations. Although often depicted as the regular rising and falling of an episodic curve, the business cycle is very irregular in terms of amplitude and duration. Moreover, many elements move together during the cycle, and individual elements seldom carry enough momentum to cause the cycle to move. However, elements may have a domino effect on one another, and this is ultimately drives the cycle. We can also have a large positive cycle, coincident with a smaller but still negative cycle, as seen in the current healthcare climate of today.[2]

1. First Phase: Trough to Recovery (production-driven)
   Scenario: A depressed GNP leads to declining industrial production and capacity utilization. Decreased workloads result in improved labor productivity and reduced labor (unit) costs until actual producer (wholesale) prices decline.
2. Second Phase: Recovery to Expansion (consumer-driven)
   Scenario: CPI declines (due to reduced wholesale prices), and consumer real income rises, improving consumer sentiment and actual demand for consumer goods.
3. Third Phase: Expansion to Peak (production-driven)
   Scenario: GNP rises leading to increased industrial production and capacity utilization. But, labor productivity declines and unit labor costs and producer (wholesale) prices rise.
4. Fourth Phase: Peak to Contraction (consumer-driven)
   Scenario: CPI rises making consumer real income and sentiment erode until consumer demand, and ultimately purchases, shrink dramatically. Recessions

[2] Historically, contractions have had a shorter duration than expansions.

may occur, and economists have an alphabet used to describe them. For example, with a V, the drop and recovery is quick. For U, the economy moves up more sluggishly from the bottom. A W is what you would expect: repeated recoveries and declines. An L shaper recession describes a prolonged dry economic spell or even depression.

[I] Bull and Bear Markets

A bull market is generally one of rising stock prices, while a bear market is the opposite. There are usually two bulls for every one bear market over the long term. More specifically, a bear market is defined as a drop of twenty percent or more in a market index from its high, and can vary in duration and severity. In the bear market of Y2001, for example, the PE ratio of Standards & Poor's fell from a high of 36, to a low of about 22. The PE for the Dow DJIA fell to about 19, from its high of 28. Recall, that PE is a measure of share price value relative to earnings per share. Historically, it has been about 15-16, according to most analysts. Do not worry however, for the average bear market has lasted only about a year. The bear markets of the past fifty years are listed below, using the Dow Jones Industrial average as a benchmark.

December 1961 to June 1962:
Days lasted: 195
Decline: 27%

February to October 1966:
Days lasted: 240
Decline: 25%

December 1968 to May 1970:
Days lasted: 539
Decline: 35%

January 1973 to December 1984:
Days lasted: 694
Decline: 45%

September 1976 to February 1978:
Days lasted: 525
Decline: 27%

April 1981 to August 1982:
Days lasted: 472
Decline: 24%

August to October 1987:
Days lasted: 55
Decline: 36%

July to October 1990:
Days lasted: 86
Decline: 21%

[J] Whither the Bear?

As a doctor, your action plan in a bear market depends on many variables, with perhaps your age being the most important:

In your 30s:
- Pay off debts, school, or practice loans.
- Invest in safe money market mutual funds, cash, or CDs.
- Start retirement plan or 401-K account.

In your 40s:
- Increase your pension plan or 401-K contributions.
- Stay weighted more toward equity investments.
- Review your goals, risk tolerance, and portfolio.

In your 50s:
- Position assets for ready cash instruments.
- Diversify into stock, bonds, and cash.

Retirement:
- Maintain three years of ready cash living expenses.
- Reduce, but still maintain your exposure to equities.

[K] Economic Indicators

There are 12 leading, 6 lagging, and 4 co-incidental indicators for the U.S. economy. As seen in the table below, their purpose is to help evaluate which period of the business cycle is in play.

Leading Economic Indicators

1. Average work week for manufacturing production workers
2. Layoff rate in manufacturing

3. New orders for consumer goods
4. Vendor performance and slow/on-time deliveries
5. New business formation
6. New building permits for private housing*
7. Contracts and orders for plants and equipment
8. Net changes in inventories
9. Change in sensitive prices
10. Change in total liquid assets
11. Stock prices
12. Money supply

Co-incidental Economic Indicators

1. Employees on non-agricultural payrolls
2. Personal income
3. Industrial production
4. Manufacturing and trade sales

Lagging Economic Indicators

1. Average duration of unemployment
2. Manufacturing and trade inventories
3. Labor costs per unit of output
4. Average bank prime interest rates
5. Commercial and industrial loans outstanding
6. Ration of consumer installment dent to personal income

*Often considered the leading, leading economic indicator.

Other important economic indicators for medical professionals, include:

1. Medical Labor Production is a measure of medical professional output per hour, or per each unit (patient) of labor. Managed care has decreased labor production cost in medicine.
2. Unit Medical Labor Costs represent the cost of physician labor (treatment), per unit (CPT code) of output.
3. Capacity of Medical Utilization is a percentage of the maximum rate at which a medical office, clinical hospital, or surgi-center can operate under normal conditions. As the rate nears 100 percent, efficiency declines, due to mechani-

cal breakdowns, burnout of doctors and employees, and less experienced medical care extenders and para professionals.

§ 13.02 Basic Microeconomic Concepts

Now that some macroeconomic concepts have been reviewed from a medical perspective, important microeconomic concepts can be reviewed.

[A] Short-Term Assets

Short-term goals (less than 12 months) require liquidity or short-term assets. These assets include cash, checking and saving accounts, certificates of deposit, and money market accounts. These accounts have two things in common. The principal is guaranteed from risk of loss and pays a very low interest rate. As an investment, they are considered substandard and one would only keep what is actually needed for liquidity purposes in these accounts.

[B] Long-Term Assets

Longer-term assets (more than 12 months) include real estate, mutual funds, retirement plans, stocks, and life insurance cash value policies. Bonds may also be an appropriate long-term investment asset for a number of reasons: for example, if you are seeking a regular and reliable stream of income or if you have no immediate need for the amount of the principal invested. Bonds also can be used to diversify your portfolio and reducing the overall risk that is inherent in stock investments.

[C] Short-Term Liabilities

Short-term liabilities (less than 12 months) include credit card debt, utility bills, and auto loans or leasing. When a young doctor leaves residency and starts practice, the foremost concern is student debt. This is an unsecured debt that is not backed by any collateral, except a promise to pay. There are recourses that an unsecured creditor can take to recoup the bad debt. Usually, if the unsecured creditor is successful obtaining a judgment, it can force wages to be garnished, and the Department of Education can withhold up to 10 percent of a wages without first initiating a lawsuit, if in default.

It is also probable that young medical professionals have been holding at least one credit card since their sophomore year in college. Credit card companies consider college students the most lucrative target market, and medical students hold their first card for an average of fifteen years. There are several other types of other unse-

cured debt, including department store cards, professional fees, medical and dental bills, alimony, child support, rent, utility bills, personal loans from relatives, and health club dues, to name a few.

[D] Long-Term Liabilities

A secured debt, on the other hand, is debt that is pledged by a specific property. This is a collateralized loan. Generally, the purchased item is pledged with the proceeds of the loan. This would include long-term liabilities (more than 12 months) such as a mortgage, home equity loan, or a car loan. Although the creditor has the ability to take possession of your property in order to recover a bad debt, it is done very rarely. A creditor is more interested in recovering money. Sometimes, when borrowing money, there may be a requirement to pledge assets that are owned prior to the loan.

For example, a personal loan from a finance company requires that you pledge all personal property such as your car, furniture, and equipment. The same property may become subject to a judicial lien if you are sued and a judgment is made against you. In this case, you would not be able to sell or pledge these assets until the judgment is satisfied. A common example of a lien would be from unpaid federal, state or local taxes. Doctors can be found personally liable for unpaid payroll taxes of employees in their professional corporations.

Be aware that some assets and liabilities defy short or long-term definition. When this happens, simply be consistent in your comparison of financial statements, over time.

[E] Personal Net Worth

Once the value of all personal assets and liabilities is known, net worth can be determined with the following formula*: Net worth = assets minus liabilities.* Obviously, higher is better.

In *The Millionaire Next Door,*[3] Thomas H. Stanley, Ph.D., and William H. Danko give the following benchmark for net worth accumulation. Although conservative for physicians of a past generation, it may be more applicable in the future because of current managed care environment. Here is the guide: Multiple your age by your annual pre-tax income from all sources, except inheritances, and then divide by ten.

■ **Example** As an HMO pediatrician, Dr. Curtis earned $60,000 last year. So, if she is 35, her net worth should be at least $210,000.

How do you get to that point? In a word, consume less and save more. Stanley and Danko found that the typical millionaire set aside 15 percent of earned income annually and has enough invested to survive 10 years, at current income levels if he stopped working. If Dr. Curtis lost her job tomorrow, how long could she pay herself the same salary?

[3] Longstreet Press, 1996.

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[F] Common Liability Management Mistakes

A common liability management mistake is not recognizing when you are heading for trouble. If doctors are paying only the minimum payments on credit card debt, while continuing to charge purchases at a rate faster than the paydown, trouble is brewing. If you don't categorize your debt, you could find yourself paying down non-priority debt while ignoring priority debt. A priority debt is one that is essential or subject to serious consequences, if not paid. Examples include rent, mortgage payments, utility bills, child support, car payments, unpaid taxes, and other secured debt. If in one month, a doctor had to choose between paying his accounting bill or his rent, it would be essential to pay the rent. A doctor cannot practice from the street.

§ 13.03 Income Taxation

The following income tax changes occurred in 2001.

- *Capital Gains.* Medical students and healthcare workers in the 15 percent bracket were eligible for an 8 percent capital gains rate on investments held more than 5 years.
- *Retirement Plans.* Section 457 limits, for state and local healthcare workers, rose from $8,000 to $8,500. SIMPLE plans increase from $6,000 to $6,500, and the annual contribution limit for self employed Keogh plans jumped from $30,000 to $35,000.
- *Student Loans.* Up to $2,500 interest paid for college and medical school loans was deductible.
- *Luxury Car Tax.* For established physicians, the luxury excise tax on cars costing more than $38,000 dropped to 4 percent from 5 percent.
- *Car Deductions.* The standard mileage rate for business use was 34.5 cents, up from 32.5 cents.
- *Social Security Tax.* Assessed on the first $80,400 of wages, up from $76,200.
- *Inflation Adjustments.* The personal exemption was $2,900, and the standard deduction was $7,600 on a joint return and $4,550 for single filers.

§ 13.04 Home Mortgages

Before you apply for a home mortgage, review your credit history and then prequalify before you begin house hunting. A big car note, excessive credit card debt, medical school or residency loan burdens, are big obstacles to securing a favorable mortgage.[4]

[4] See www.iown.com/.

For buyers of moderately priced homes, Fannie Mae and Freddie Mac raised the mortgage limit for single-family homes to $252,700, from $240,000 in 1999. Jumbo mortgages above this amount can be privately arranged, but at a higher interest rate. A Web site, like www.realtor.com, will assist in finding a home since it claims to list more than 1.3 million homes for sale throughout the country.

Also, consider using a buyer's agent to find your dream home, since it probably won't cost you a thing, but may require a retainer for a very large home. A buyer's agent's fee comes from splitting commission with selling agents. However, unlike a seller's agent, a buyer's agent works for you and will not disclose any information that might help the seller.[5]

Once you have found a home, the following types of mortgages should be considered.

An Adjustable-Rate Mortgages (ARM) is a long-term mortgage with short-term (usually annual) adjustments to the interest rate. It is common to start with an interest rate two percentage points below comparable fixed mortgage rates. If the prevailing rate on mortgages increases over time, so will the rate on the ARM. There is usually a high cap, which the rate cannot exceed. An ARM is almost always cheaper than a fixed mortgage in the short run, such as the first five years. After that, it will have to be re-evaluated to see if it is worth converting to a fixed mortgage. If lower monthly housing costs are needed in order to make ends meet, an ARM may be the correct choice. Also, if you only want to live in the house for the next five years or less, then an ARM is applicable. In some cases, the lender allows the ARM to be assumed by the new buyer.

If on the other hand, you feel comfortable with the current mortgage rate and monthly payment, you may want to lock in the rate with a fixed rate mortgage. If the idea of increasing rates and payments is distasteful, a fixed mortgage might be appropriate. As your income rises, you can allocate more towards retirement and other goals, or perhaps pay down the principal faster. There is a preferable way to accomplish this. What many doctors do is send to their lender an extra $100 or $200 each month, in addition to the scheduled payment. This requires the lender to recalculate your amortization schedule every time you make a payment. Some lenders are more equipped to do this than others. Still, others will only do this once per year on your anniversary date. You should never have to pay for such mortgage accelerator programs. A better way to keep track of your outstanding balance would be to pay down the exact principal amount due in the next or several monthly payments. You can do this easily by requesting an amortization schedule from the lender right from the beginning. If you have a thirty-year fixed mortgage, for example, you will have a schedule with payments numbered from 1 to 360. You could then submit your regular payment (let's say #1) and the principal amounts from payments numbers 2, 3, and 4. In this way you will be advancing yourself in the amortization schedule and you can at any time figure out your outstanding balance, remaining

[5] For more information, contact National Association of Exclusive Buyer's Agents, 800-986-2322, www.naeba.com; or American Homeowners Foundation, 800-489-7776, www.AmericanHomeowners.org.

term, and interest saved. You also make it easier for the lender as well. A free mortgage calculator may be downloaded from www.money99.com, for more precise calculations and various "what if" scenarios. Another site for salary calculations is www.homefair.com/cal/salcalc_res.html.

There are other types of mortgages. A hybrid mortgage starts out at a fixed rate for the first few years (from three to ten), then converts to an adjustable for the remaining term. In this way you can start out with a lower rate than a normal fixed, and you can count on this payment staying the same for a period where your income might be low. In later years, when your income rises, you can afford the mortgage rate to rise. A two-step mortgage is similar to a hybrid, in that, it starts out as a fixed with a lower than market rate. It then converts to a fixed with a higher than market rate. This would be advisable if you know you will move before the conversion, or you will be able to refinance because of the improvement to your income. A balloon mortgage starts off with a low fixed rate for an average of five years, and then the entire loan becomes due. Many large real estate deals are structured this way. If you are not able to pay the lump sum when due, you are expected to find another lender to refinance the loan. An assumable mortgage can be taken over from the previous owner if the lender is willing to transfer the old loan to you at the same, or different, interest rate. This may or may not be a bargain, depending on interest rates. Paper work and closing costs are reduced, and closing timeframes are usually quicker than with the other types of mortgages. Disadvantages include the fact that the seller is usually liable for the note, upon default, and therefore less willing to negotiate sale of the house for a lower price. Remember, even once you receive money from your mortgage lender, you will still need cash for various other negotiable items, such as earnest money, closing costs, an application fee, title search and title insurance, attorney's fees, appraisal fees, points, and loan origination fees.

Other more sophisticated mortgage types include biweekly mortgages, growing equity mortgages (GEMs), graduated payment mortgages (GPMs), FHA and Veteran's loans. The following Web sites are helpful in this regard, as they contain explanations of each, a real-time listing of rates and lenders, calculators, and other useful tools for traditional and sophisticated mortgages vehicles: www.hsh.com, www.homepath.com, www.bankrate.com, www.rate.net, www.iown.com, and www.kiplinger.com.

Generally, points and origination fees can be deducted in the first year on original mortgages, but not on refinancing. For refinancing, the deduction must be spread over the life of the mortgage. Real estate commissions on a home sale are not tax deductible.

■ **Example** A 30-year, $100,000 refinancing loan with 1 percent origination fee and one point. Total points are the equivalent of 2 percent, or $2,000. So, you may deduct $2,000/30 years = $66.67 each year as pre-paid interest. Often, points and fees can be added to the loan, but if you refinance again, you may deduct rather than amortize the remainder of the points you paid on the refinancing. If you have refinanced twice, but did not deduct the points from the first refinancing, you may file an amended tax return to recapture the deduction.

Private mortgage insurance (PMI) premiums range from about 0.5 percent of a home mortgage to about 1 percent. PMI can be avoided with a down payment of at least 20 percent. The insurance protects the lender, not you, should a default occur. When rising home values boost your equity, PMI can be dropped upon request. Similarly, most mortgages can be prepaid without penalty. If a penalty does exist, it is treated as interest and may be deducted in the year paid.

[A] Mortgage Refinancing Considerations

■ **Example** Now, let's assume that Dr. Jenninfer Sadowski has a 30-year, $100,000 mortgage, at 10 percent, and her monthly mortgage payment is $878. She refinances the loan at 7.5 percent with a new monthly payment of $700. Her monthly savings is not $178, as one might initially assume, since no consideration has been made for after-tax consequences. In order to calculate this amount, she must multiple her tax bracket (28%) by the pre-tax savings amount of $178, and then subtract, to arrive at the accurate, tax adjusted amount:

$178
−50 ($178 x .28)
$128 less per month

[B] Mortgage Payback Ratio

Prepaying principal on your mortgage is not advisable if you do not have an emergency fund available. If you have, then it might make good sense to pay extra toward the principal on your mortgage. With the bull market of the past decade, some authorities opine, however, that extra funds might earn a better rate of return if invested elsewhere. Another rule of thumb is that you should only spend 28 percent of your gross monthly income on your mortgage payment, PMI, real estate, school tax, and homeowners insurance. This is a test that lenders use to determine how large a mortgage you would qualify for. A lender considers your other consumer debt payments such as your car, student loan, and credit card payments. Your total debt should not exceed 36 percent of your gross monthly income. This could be higher if you have an excellent credit history or you are making a large down payment. For peak financial health, only buy a home that you like and can comfortably afford. Also, stay away from mortgage insurance to cover the cost of your outstanding balance. It is too costly, and you can get a better deal using a term or universal life insurance policy.

Consider the following example if you want to refinance your existing mortgage.

Mortgage Refinancing: OK if the new rate is 1 to 2 percent less than the old rate.
Payback Period (months): cost to refinance/savings per month
Cost of $1 deductible interest: $1 (1-Marginal Tax Bracket)

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Current mortgage:	$100,000 @ 10% for 30 Yrs =	$877.57 / month
New mortgage:	$100,000 @ 7% for 30 Yrs =	$665.30 / month
Difference		***$212.27 / month***

Given:

1 point—origination fee	= $1,000
1 point—discount fee	= $1,000
Title Insurance	= 500
Recording Fee	= 400
Total costs	**$3,200 / $212.27 = 15 months**

Generally, a payback period less than 24 months is recommended. In this case, if you stay in the house longer than 15 months, you would recoup the costs of refinancing and benefit from the lower rate.

Remember, that since it is not likely that your income will dramatically increase over time as with physicians of the past, a lender may not approve you for a larger mortgage than you can qualify. Moreover, the more money you allocate toward housing, the less you are going to allocate toward other important goals like investing or retirement.

[C] Reverse Mortgages

A reverse mortgage gives medical professionals several options for withdrawing equity from their homes.

1. Line of credit option allows you to decide the timing and amount of withdrawals.
2. Tenure option involves equal monthly payments for as long as the home is occupied as a principal residence.
3. Modified tenure option is a mixture of loan payments and an available line of credit. Reverse mortgages may be ideal for the medical professionals who own their own homes "free and clear," since payments are considered a "return of principal" and not taxable income. They can be prepaid at any time. Moreover, you do not give up any of the benefits or responsibilities of home ownership with a reverse mortgage, but upon death, your heirs must pay the balance of the mortgage, normally with proceeds from sale of the house.

[D] Renting

Most medical professionals should probably not spend more than 30 percent of take-home pay for rent on a personal apartment. Advantages of renting include freedom and flexibility, more square footage for the money, less concern about property values, and more liquidity for other financial needs or desires.

According to *Career Magazine,* there are several Web sites to link apartment rentals, real estate companies and other resources, at www.careermag.com/relocate/.[6] Another site is amcic.com/relocation to find information on demographics, schools, crime reports, and realtors. Additionally, the firm 4Relo.com[7] compares Web sites and the information they provide on renting and relocation home issues. Be sure to get replacement cost coverage renter's insurance, rather than the older cash value type insurance policy.

[E] Automobiles

Buying an expensive automobile got a little less costly in 2001 because the luxury excise tax was reduced to 4 percent from 5 percent. Additionally, the threshold was raised to $38,000, from $36,000. Moreover, the tax is being gradually phased out and will continue to drop one percentage point through 2002, after which it is scheduled to expire.

Generally, medical professionals should try to avoid luxury cars and prudently not spend more than 10 to 15 percent of gross income on the cost of a car, including gas, insurance, and maintenance, regardless of whether it is new or pre-owned. Be aware that some new cars depreciate 10 to 20 percent the moment they are driven off the lot, so resist the urge to buy new. Never finance for more than four years, sell your old car yourself, and make your car last at least seven years. Some insurance companies will give you a reduced rate for cars equipped with a driver side airbag or anti-lock brakes, as well as for doctors who live less than ten miles from the office.

■ **Example** If Dr. Sue Kosmicky, a dermatologist, makes $80,000, her car allowance should not be more than $8,000, using the 10 percent gross income rule of thumb. So, if insurance is $1,200 annually, she can afford to make $6,800 in car payments per year. Adding $1,200 for gas and $800 for repairs reduces this amount to $4,800 per year, or $400 per month.

Leasing a car may have several advantages, such as convenient maintenance, low down and monthly payments, no resale responsibility, and tax savings since you pay sales tax on the lease portion rather than the purchase price of the car.[8] It might also be worthwhile if the after-tax borrowing cost of a home equity loan is less than the lease financing rate.

There are two types of leases: open and closed ended. In the former type, if the car is worth more than the set price upon expiration of the lease, you are responsible for the underage or coverage. In the more advantageous latter type, the responsibility of the value of the car is shifted to the leasing company. Other tips on car leasing include:

[6] Career Magazine, 4775 Walnut Street, Suite 2-A, Boulder, CO 80301, or see www.careermag.com.
[7] www.4relo.com/.
[8] IRC § 917.

- Inform the lessor how you want the auto equipped; do not accept unwanted options.
- Obtain all delivery and other charges in advance, including down payment and security.
- Know all deposit, registration fees, interest rates, residual value, rebates, and all taxes (sales, personal property, use, and gross receipt).
- Know the capitalized cost (selling price) of the car.
- Know annual mileage limits, usually 15-18,000 miles, and all excess use charges.
- Avoid maintenance and service contracts, and arrange for your own insurance.
- Understand that terms, such as money factor, or interest factor, may be used instead of the term interest rate. In this case, simply multiple the rate by 24 for an estimate of the true interest rate involved.
- Read the contract and understand all penalties, especially for premature or late termination, purchase or return terms, and consequences of theft.
- Check the lease terms through an independent company, such as First National Lease Systems.

A rough rule of thumb to determine whether to buy or lease involves multiplying all the payments required by the number of months you will have to pay, and add the down payment to yield the total amount of the purchase. Then, multiply the lease payment by the number of months, and add required up front costs, as well as residual value (end of lease buyout cost), to determine the total amount to lease. Compare the two figures to determine the most economical deal. Typically, a cash deal is less expensive in the long run, providing a higher after-tax rate of return is not available, as an alternate investment, for the funds.

Perhaps the worse reason to lease a car is to drive one that you could not otherwise afford to drive. This is because most low monthly payments are only composed of two portions: interest on the note and the prorated cost of auto depreciation. No money is applied to ownership of the vehicle. Finally, do not buy "gap" insurance to cover the difference between what your auto insurer would pay if your car was totaled, and what you would owe the leasing firm. It's usually too expensive and the risk is minimal.[9]

[F] Weddings for Medical Professionals

The average wedding costs about $20,000, in Y2001, segmented in the following manner, and medical professionals often spend much more.

[9] When you need to shop for a new or used car, or lease, the following resources are helpful: Auto Price Line: 900-999-2277 and Consumer Reports: 900-446-0500. Also try www.carport.msn.com,

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Reception:	$7, 635
Rings	4,060
Photography	1,311
Bride's Dress	896
Music	830
Bridesmaids' dresses	790
Flowers	756
Rehearsal dinner	698
Men's formalwear	449
Other	1,752
Totals:	*$20,000*

However, if wedding spending is cut in half, on just the top three items, the $6,500 might be better invested for the future, than consumed in the present, and if it earns about 10 percent, at a 28 percent MTB, the following will occur:

Year	Balance	Return	Taxes	Year End Balance
1	$6,500	650	221	6,929
20	21,892	744	744	23,337
40	78,603	7,860	2,672	83,791

Therefore, consider the following question. Do you want a big wedding party for your family and friends, or an earlier retirement for yourself?[10]

[G] Paying the Bills

According to a Gallup poll study[11] for Visa card last year, married or not, American consumers preferred paying for some of the above bills, as well as their miscellaneous unsecured debt, in the following manner.

- 37% Checks and paper records
- 31% Electronically and without paper.
- 23% Checks and personal accounting software
- 5% Combination of the above
- 4% Face to face

www.edmunds.com, www.intellichoice.com, www.autosite.com, www.leasesource.com, www.autobytel.com, and www.autoweb.com.

[10] The following Web sites will assist in providing information to make this decision: www.theknot.com; www.rachel.itgo.com, or www.weddingsabout.com/home/weddings/msub29.htm.

[11] Gallup, Alec: Cumulative Index. Princeton, NJ: Gallup Press, 1999. See www.gallup.com.

[H] Personal Financial Ratios

The economic platitude of the past, such as don't spend more than 15 to 20 percent of your net salary on food, or 5 to 10 percent on medical care, among others, have given rise to the more individualized personal financial ratio concept. Personal ratios, like business ratios, represent benchmarks to compare such parameters as debt, income growth, and net worth.

According to Edward McCarthy, MIB, CFP™, a personal financial expert from Warwick, Rhode Island, the following represent useful ratios for the medical professional.

- Basic Liquidity Ratio = liquid assets/average monthly expenses. Should be 4-6 months, or even longer, in the case of a medical professional employed by a financially insecure HMO.
- Debt to Assets Ratio = total debt/total assets. A percentage which is high initially, and should decrease with age as the medical professional approaches a debt-free existence.
- Debt to Gross Income Ratio = annual debt repayments/annual gross income. A percentage representing the adequacy of current income for existing debt repayments. Medical professionals should try to keep this below 25 to 30%.
- Debt Service Ratio = annual debt repayment/annual take-home pay. Medical professionals should try to keep this ratio below about 40%, or have difficulty paying down debt.
- Investment Assets to Net Worth Ratio = investment assets/net worth. This ratio should increase over time, as retirement for the medical professional approaches.
- Savings to Income Ratio = savings/annual income. This ratio should also increase over time, especially as major obligations are retired.
- Real Growth Ratio = (income this year − income last year)/(income last year − inflation rate). It is desirable for the medical professional to keep this ratio growing faster than the core rate of inflation.
- Growth of Net Worth Ratio = (net worth this year − net worth last year)/net worth last year − inflation rate. Again, this ratio should stay ahead of inflation.[12]

By calculating these ratios, perhaps on an annual basis, the medical professional can spot problems, correct them, and continue progressing toward stated financial goals.

[I] Current Rate of Return

Another important concept to understand is the current rate of return (CRR). According to this principle, the current rate of a taxable return must be evaluated in

[12] McCarthy, E.: The Fast Forward MBA in Financial Planning. New York: John Wiley & Sons, 1999.

reference to a similar nontaxable rate of return. This allows you to focus on your portfolio's real (after-tax return), rather than its nominal, or stated return. Since most medical professionals own a combination of both vehicles, it is important to calculate the average rate of return (ARR), as demonstrated in the following matrix. Usually, this will result in the assumption of more risk, for the possibility of great return.

CURRENT RATE OF RETURN MATRIX (MTB = 28%)*

(Not Currently Taxed)					
Asset	**Amount**	**Avg. Return**	**(×)**	**% Total**	**Weighted Est. ROR%**
IRA	$ 8,200	9.0%		6.81	.61
IRA	$ 8,200	9.0%		6.81	.61
401-k	$102,000	6.5%		84.70	5.51
Insurance Cash Value	2,000	2.0%		1.66	.03
Sub-Total	*$120,400*			*100%*	*6.77%*
(Currently Taxed)					
Asset	**Amount**	**Avg. Return**	**(×)**	**% Total**	**Weighted Est. ROR%**
Checking	$ 9,500	3.0%		31.32	.94
CD	10,000	8.0%		32.97	2.64
XYZ	8,406	5.0%		27.71	1.39
Widget	2,425	3.2%		8.00	.26
Sub-Total	*30,331*			*100%*	*5.22*
			×	*(1-MTB)*	*x.72*
				After Tax	***3.76%***

(Entire Portfolio)			
Not Currently Taxed	$120,400	6.77 × 79.87	5.408
Currently Taxed	30,331	3.76 × 20.13	.752
Total	*$150,731*		
		After Tax ROR	**6.16%**

To compare after tax yields, with taxable yields, use the following formulas: Tax equivalent yield = yield/(1 − MTB), while taxable yield X (1 − tax rate) = tax exempt yield.

■ **Example** If the yield on a tax-exempt municipal bond was 6% and you are in a 28% tax bracket; the equivalent taxable yield (ETY), is 8.3%, calculated in the following manner: 06/1.00 − .28 = .083, or, 8.3% ETY. This means that you would need a taxable instrument paying almost 9 % to equal the 6 percent tax exempt bond.

[J] Personal Budgeting Rules

Budgeting is probably one of the greatest tools in building wealth. However, it is also one of the greatest weaknesses among physicians who tend to live a certain lifestyle. This includes living in an exclusive neighborhood, driving an expensive car, wearing imported suits and a fine watch, all of which do not lend themselves to expense budgeting. Only one in ten medical professionals have a personal budget. Fear, or a lack of knowledge, is a major cause of procrastination. The following guidelines will assist in this microeconomic endeavor.

1. Set reasonable goals and estimate annual income. Do not keep large amounts of cash at home, or in the office. Deposit it in a money market account for safety and interest.
2. Do not pay bills early, do not have more taxes withheld from your salary than you owe, and develop spending estimates and budget fixed expenses first. Fixed expenses are usually contractual and may include housing, utilities, food, telephone, Social Security, medical, debt repayment, homeowner's or renter's insurance, auto, life and disability insurance, and maintenance, etc.
3. Make variable expenses a priority. Variable expenses are not usually contractual, and may include clothing, education, recreational, travel, vacation, gas, entertainment, gifts, furnishings, savings, investments, etc.
4. Trim variable expenses by 10 to 15 percent, and fixed expenses, when possible. Ultimately, all fixed expenses get paid and become variable in the long run.
5. Use carve-out or set-asides for big ticket items and differentiate "wants from needs."
6. Know the difference between saving and investing. Savers tend to avert risk and investors understand risk and takes steps to mitigate it.
7. Determine shortfalls or excesses with the budget period.
8. Track actual expenses.
9. Calculate both income and expenses as a percentage of the total, and determine if there is a better way to allocate resources. Then, review the budget on a monthly basis to determine if there is a variance. Determine if the variance was avoidable, unavoidable, or a result of inaccurate assumptions, and take needed corrective action.

[K] Zero-Based Budget

A zero-based budget means you start with the absolute essential expenses and then add expenses from there until you run out of money. This is an extremely effective, yet rigorous, exercise for most medical professionals and can be used personally or at the office. Your first personal financial item should be retirement plan contribu-

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tions, then your mortgage and other debt payments, and then other required fixed expenses. From the office perspective, the first budget item should be salary expenses for both you and your staff.

Operating assets and other big ticket items come next, followed by the more significant items on your net income statement. Some doctors even review their P&L statements quarterly, line by line, in an effort to reduce expenses. Then you add discretionary personal or business expenses that you have some control over. Do you run out of money before you reach the end of the month, quarter, or year? Then you better cut back on entertainment at home or that fancy new, but unproven piece of office or medical equipment. This sounds Draconian until you remind yourself that your choice is either (1) entertainment now but no money later or (2) living a simpler lifestyle now as you invest so you're able to enjoy yourself at retirement. When you were a young doctor, it may have been a difficult trade-off. But at midlife, you're staring ultimate retirement in the face.

§ 13.05 Use and Abuse of Credit

Our greatest glory is not in never falling, but in rising every time we fall.

—Confucius

The horror stories involving credit card debt, and credit reporting, are well known. In this age of managed care, understanding the rules of the personal credit and credit card use is vital for all medical professionals.

[A] Pre-Approved Credit Cards

The offer a new doctor gets from a credit card company, with pre-approval for a low interest rate, is a classic case of reading the fine print. Many times, pre-approval simply means that you are on the mailing list bought from a consumer reporting agency, based upon your current credit score. However, the credit card agreement almost inevitably gives the issuer the right to not approve your application based upon their investigation. In other words, they have not yet purchased your credit report when you get the pre-approved mailing. Since the rate of return for direct mail is somewhere around 1 percent, it would be a waste of their money to purchase and review the credit reports of everyone on a particular mailing list. After you respond, they purchase a credit report and then decide whether or not to issue credit to you.

[B] Medical Employers and Credit Reports

What makes you qualify for credit? Certainly, medical professionals are no longer as desirable as they were only a decade ago, as all financial institutions now look at occupational growth potential. HMOs, hospitals and other employers will also often run a credit

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report on prospective medical employees, since legal limits to the type of questions that can be asked have been curtailed. This is a valuable tool, since many believe that how you manage your personal finances may say something about your ability to handle job responsibilities. For example, if you live a lifestyle you cannot afford, you may not be objective in a tough medical utilization review decision-making role. This may sound harsh, but financial personality profiling is on the rise. Thus, don't be surprised if your next job application contains an authorization for credit reports and a background check.

[C] Compiling Credit Reports

Your credit report is a data image of your payment history. It contains personal information, such as your social security number, date of birth, current and previous addresses, and financial payment information. Some credit reports also include your past or current employers.

Credit bureaus are information gatherers. Banks, mortgage lenders, credit card companies, and anyone else who is considering extending credit are information hunters. Credit reporting agencies sell credit reports. The three best known are Experion (formerly TRW Information Systems Inc.),[13] Trans Union Corporation,[14] and Equifax.[15] You may order a credit report from one of these agencies for about $10, and some states provide two free reports per year. If you live in Georgia, Maryland, Massachusetts, or Vermont, the reports are free. Be sure to indicate your desire for an individual or joint account report.

[D] Reading Credit Reports

When you read your credit report, ensure the accuracy of information and write down any errors, or circle them on the report. Among the most common mistakes are loans and credit repair not being updated. For example, medical and professional school loans are notorious for being mishandled. This is because of ever-changing deferment rules. If your loan payments are due to start nine months after graduation, and you entered medical school after taking a year off, look out. You will have made three payments and then be able to further withhold payments while you remain a student. The confusion arises when your payments stop. With most loans, a missed payment is a late payment. This halting of payments, perfectly legitimate for students, can be misinterpreted to mean late payments and possible default. As a medical professional, you should strongly consider purchasing your credit report and looking carefully at your loan payment history.

[13] www.experion.com, or 888-397-3742.
[14] www.transunion.com, or 800-916-8800.
[15] www.equifax.com, or 800-685-1111.

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[E] Credit Rating and Scoring

The category in which a credit agency classifies you is based upon payment history. Recently, credit reporting agencies have shifted away from ratings to a system known as credit scoring. Your score is determined by proprietary formulas that are based on your credit history, the higher the better. The practical benefits of this scoring system are numerous. First, medical professionals do not need to be experts at deciphering credit reports since the same scoring system is used by many different companies. For example, Equifax created and sells "Beacon Score," which is utilized in mortgage approvals. Fair Issacs is another company that offers a popular scoring system for the retail sector.

[F] Correcting Credit Report Errors

A credit bureau is not the place to get an item fixed on your credit report. Rather, you must take it up directly with the credit issuer. In any case, a late payment noted on a credit report by a durable medical equipment vendor, for example, has to be addressed directly with that merchant. The DME merchant then has 30 days to acknowledge your complaint and respond to you. In the meantime, you do not have to pay for the disputed items. Most credit errors cannot be reported or kept on your credit report for more than seven years. For legitimate late payments, you should contact the credit grantor and negotiate to take one of the following steps. Be tenacious, and either remove the late payment or write a letter explaining that the problem has been resolved and you now are a good credit risk again. This letter is a powerful tool and should be saved with other permanent financial records. The industry term for it is a letter of correction.

[G] Credit Repair Services

Credit repair services are oversold, and their claims tend to be exaggerated. They do not have an inside track to the consumer reporting agencies. Good credit repair services are experienced in communicating with creditors and can help with legitimate repairs. They cannot restore your credit rating or your good name. However, realize that with some time and effort you can accomplish the same results yourself.

[H] Debt Ratios and Credit

The debt to income ratio is a formula used by most lenders and is represented as take home pay divided by your monthly debt. For example, let's say that ABC Bank has issued you a VISA card with a $1,500 limit. You use the card, and one day get a letter stating that your credit limit has been increased. The new higher limit is considered "available credit." Then, XYZ bank sends you a MasterCard. Your credit

limit is $2000, and all you have to do is call their toll free number to activate it. You wisely determine that you do not need the card and don't activate it. Unfortunately, the $2000 is still considered available credit and may be held against you. Now, when you apply for a loan, the loan issuer will run a credit report on you. It will add up your total credit card limits, whether they are active or not. This is your available credit. If your available credit is considered too high, you will not be approved for your loan, or approval will cost a higher interest rate. Taking it one step further, the potential creditor will add your total available credit and figure out the minimum monthly payment. This number is used against you as follows.

Let's suppose that, as a new internist for an HMO, you are earning $8000 per month. You apply for an auto loan. A typical debt to income ratio is 35-40 percent. On the generous side, 40 percent of $8000 is $3200. In other words, your total monthly debt payment must be $3200, or less, to have your loan approved. Unfortunately, your newly raised credit limit and nonused cards could cost you an additional $600 per month, if they were maximized out. Your current monthly payments are $2600. Your new car payment is $450. The total is $3050. Your loan should be approved, but by including the extra $600, you realize that this is money you still could potentially be required to pay every month. Your monthly obligations are considered to be $3200. Add in car payment of $450 and the total is $3650. Total debt to income ratio is 45 percent. No loan extended.

[I] Denied Credit

If you are denied credit, your have the right to obtain a credit report free from the agency that denied you. Your request must be made in writing and within sixty days. Consumer credit is governed by the Fair Credit Reporting Act (FCRA). The regulations are issued by and enforced by the Federal Trade Commission. Certain states offer consumers additional rights. Credit reporting agencies are referred to as a "consumer reporting agency." Here is how it is meant to function.

You apply for a credit card. The credit card issuer purchases a credit report from one of the credit reporting agencies. The credit report is referenced by your social security number. The report lists your name and current address and confirms your social security number. Then, it lists your current and past credit and payment history. All late payments are recorded. The information is coded to reflect number of days a payment is late.

[J] High Interest Rates

Late payments do not mean that you are paying the monthly minimum and paying interest. Rather, they reflect when a minimum payment has not been made. Recently, some credit card issuers have offered skip payment plans. This is a marketing ploy to have interest accrue. If you do take advantage of this option, it does not constitute

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a late payment. Also, liability for stolen credit cards is usually limited to $50, per card. Some cards offer a $0 level, and others can enforce a much higher amount than $50. So, you must always read the fine print in your credit card agreements. For the technophilic medical professional, many Internet shopping sites offer a 100 percent safety net. Their policy is that if any unauthorized charge is made using your credit card information, you will not be responsible for the charges.

[K] Debit Cards

Unlike credit cards, debit cards deduct the amount of purchase directly from your checking or other account. There is no grace period or "float" on them, and the safeguards against loss or theft aren't as strict as with conventional credit cards.

[L] Assumed Identify Scam

Assumed identity is a rising crime, particularly targeting healthcare professionals. The problem occurs when someone learns of your social security number. They can then purchase your credit report and learn all about your credit history, apply for a credit or debit card(s), and run up extravagant bills. They commit these dastardly deeds by assuming your identity. Since social security numbers serve as a de facto national identification card, this brand of thief can wreak real havoc, since it is difficult to convince a credit card company that a card issued in your name is not really your own.

[M] Disposable Credit Cards

Disposable credit cards are the newest innovation to help reduce fraud and assumed identity scams on e-commerce based websites. As with traditional credit cards, these cards are numbered, but used only once. Then, electronically they are erased so that there is nothing left in the merchant's database for hackers to steal. Currently, disposable credit cards are available from American Express, Discover, and MBNA America in Wilmington, Delaware. Unfortunately, they can be inconvenient since use is not possible on one-click shopping sites like Amazon.com, where permanent card numbers must be stored.

[N] Brokerage Firms

Banks and S&Ls are for borrowers and savers, brokerage firms are for investors. Brokerage firms can be either full-service or discount houses. The former maintains research departments and issues a constant stream of information to its stockbrokers (commissioned sales people) to pass along to you, the medical professional. All this

comes at a price, of course. On the other hand, if you have your own ability to make some investing decisions, save money and use a discount house.[16] The newest machination is on-line electronic trading, via computer and the Internet, where individual trades can be made for as little as $6 to 8, versus $200 to 300 for the same trade from a full-service broker, or $35 to 50 from a discounter. Examples include Ameritrade Holding, Charles Schwab, DLJdirect, E-Loan, TD Waterhouse Securities, and Wit Capital.

However, somewhere between the full-service retail broker, and on-line trading is a new hybrid company, such as The Financial Commerce Network (TFCN).[17] Begun in September 1999, TFCN defines itself as an on-line prime brokerage aggregator of high net worth individuals, medical professionals and institutions, for which it charges about $500 per year. As a potential accredited investor of TFCN, however, be sure you are able to meet the $200,000 per year annual income requirement, have a liquid net worth of more than $1 million, and are able to pony up a $500,000 minimum investment. Unlike, firms such as E*TRADE and Ameritrade, which are in a growth mode, TFCN is in a service mode, as clients are assigned a “personal relationship manager” available either by telephone or e-mail. The combination of delivering prime brokerage services, but doing so as an on-line non-broker-dealer, seems to set TFCN apart for the technologically astute medical professional.

Regardless of choice, make sure your brokerage house is federally insured by the Securities Investor Protection Corporation (SIPC) for accounts up to $500,000 on assets in stocks, bonds, or mutual funds, and with a $100,000 limit in cash. Be aware that this protection is not a safeguard against fraud or bad decision making on your part; and you will have to sign an arbitration agreement prior to the commencement of trading.

[O] Reorganization and Bankruptcy

The medical professional should be familiar with the two kinds of bankruptcy. They are liquidation and re-organization. In the United States, the first bankruptcy laws date back to the early 1800s. Today’s law is the Bankruptcy Act, which was enacted by Congress in 1978. Chapter 7 involves liquidation bankruptcy. Chapters 11 and 13 involve reorganizations, which require a repayment plan.

As a physician, if you file for a Chapter 7 bankruptcy, you are requesting that the court eliminate your debt. You must disclose all that you own and all the income you earn. The court then assigns a trustee. The trustee has the authority to take control of any non-exempt property you purchased prior to the filing. You keep control of property you claim to be exempt. What assets you claim to be exempt are scrutinized by the trustee. The reason for this is because the trustee has the ability to sell all non-exempt property in order to satisfy any unsecured creditors, if not fully, at least

[16] For example, see www.marketwatch.com, www.multex.com, and www.TheStreet.com.
[17] See www.tfcn.com.

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partially. You can, however, keep any property you purchase after filing for bankruptcy. Examples of exempt property are clothing, personal effects, household goods, and some or all of the equity in your home or car. When the bankruptcy case is closed, you are discharged of most, or all, of your debt. You can choose to have some debt non-canceled, in which case, you would keep the property, and make payments under a new loan agreement.

Chapter 13 bankruptcy follows the same administrative procedure and paperwork. You still need to claim your assets, debts and income. However, you also must provide a loan repayment plan that fits into your budget. You are allowed to pay your reasonable living and office expenses. If there is any surplus, that amount is surrendered to the trustee who in turn pays your creditors. If at the end of a three-year period all debts are not fully repaid, they are usually forgiven. One type of debt that is usually not forgiven is federal income taxes. The IRS will, however, stop accruing interest on the outstanding balance. Chapter 7 and 13 will also not discharge alimony or child support, debts stemming from accidental infliction of personal injury or death, DWI-related debt, and criminal fines.

There are a few differences between using a Consumer Credit Counseling Service (CCCS) and Chapter 13 bankruptcy. Under Chapter 13 there are filing and attorney's fees. CCCS may have a small fee, which is sometimes waived. Creditors are stopped from proceeding with collection actions if you miss a monthly payment under Chapter 13. The CCCS plan does not provide this protection. After three years your debts are wiped out under Chapter 13. The CCCS plan requires that your debts remain until paid in full.

Chapter 11 bankruptcy applies to healthcare professionals with unusually high debts. Typically, businesses undergoing reorganization that want to remain in business would opt for Chapter 11. It is also available to individual doctors with debt in excess of Chapter 13 limits ($269,250 of unsecured debt and/or $807,750 of secured debt), or substantial non-exempt property such as real estate. The debtor would remain in control of the assets, so in effect, the debtor becomes the trustee. Therefore, the debtor has the power to reject creditor claims with no penalty, extend the time for repayment, and even reduce the debt owed the creditor.

Chapter 11 may sound like a windfall for debtor doctors, but it does not come without great cost. It can take an extremely long time, averaging between several months and several years. The filing fee is $830 and professional fees generally start at $10,000 for a legal retainer, but can run to tens of thousands. Before the court confirms Chapter 11, the doctor debtor must provide a Plan of Reorganization. This requires a tremendous effort in pre-bankruptcy planning. Many Chapter 11 physician bankruptcies turn into Chapter 7 bankruptcies.

Also, be aware that all bankruptcy may be soon less inviting to debt-burdened doctors and consumers. A new U.S. Senate approved bill will push more people into debt repayment plans, rather than letting them erase their debts with the above machinations. As enacted, the bill would:

- Limit repeat bankruptcy filings;
- Require credit counseling before filing for bankruptcy, with some exceptions;

- Place child support payments first in line, ahead of credit card debts and other obligations.

§ 13.06 Basic Financial Planning Concepts

Most principles of personal financial planning evolve from the following concepts.

[A] Marketability and Liquidity

Marketability and liquidity are two concepts that are interrelated but often confused by the medical professional. Marketability deals with the speed at which an asset can be turned into cash. *Liquidity,* on the other hand, deals with an asset that can be turned to cash without a significant loss of value. A physician's practice may be good investment, but is it not particularly marketable or liquid. A common stock traded on the New York Stock Exchange can be easily sold for its quoted fair market value.

[B] The Time Value of Money

To the young physician starting a career, the time value of money is not a primary concern. It involves spending dollars in the future compared with spending today. Paying off high student loans while earning a relatively low salary leaves barely enough for present personal consumption. In the past, the rationale to spend today, forsaking the future, was not only a function of necessity but stemmed from the probability that future income would grow appreciably higher. Today, this is no longer a given for medical professionals.

In the simplest terms, a dollar today is worth more than a dollar tomorrow. The supply and demand for a dollar today to be paid back in the future is what determines interest rates. This calls for an understanding of the concepts of present and future value.

Present value is what you have today. So a dollar is a worth a dollar. Future value is what that dollar will grow to when compounded at a given interest rate. If you started with 100 dollars and earned 10 percent for five years, you would end up with 161 dollars.

Year	Paying Amount of	Interest Factor	Ending Amount	Interest (annual)
1	$100	1.10	$110.00	$10.00
2	110	1.10	121.00	11.00
3	121	1.10	133.10	12.10
4	133.10	1.10	146.41	13.31
5	146.41	1.10	161.05	14.64
				$61.05

Whenever you do not have a financial calculator, such as a Hewlett-Packard 12-C, Texas Instruments BA III plus, or, computer spreadsheet handy, you can figure future value with this formula.

$$FV = PV\ (1 + i)^n$$

FV is future value and PV is present value. The periodic interest rate is represented by the i. The number of periods being compounded is the n. The n means to the power of some number. In the example above, the equation would appear as follows:

$$FV = \$100(1+.1)^2$$

$$FV = \$100(1.21)$$

$$FV = \$121$$

Likewise, the formula for present value is: $PV = \text{amount} / (1 + i)^n$.

Other time value of money concepts, easily determined with a calculator, or interest table include the future value of multiple (equal) cash flows (ordinary annuity); conversion to an annuity due; the present value of multiple (equal) cash flows (ordinary annuity); and the conversion to an annuity due.[18]

Lump Sum Interest Table

(Future values of $1.00 lump sum invested at beginning of year one at various annual interest rates)

Year	5%	6%	7%	8%	9%	10%	11%	12%
1	1.05	1.06	1.07	1.08	1.09	1.10	1.11	1.12
2	1.10	1.12	1.14	1.17	1.19	1.21	1.23	1.25
3	1.16	1.19	1.23	1.26	1.30	1.33	1.37	1.40
4	1.22	1.26	1.31	1.36	1.41	1.46	1.52	1.57
5	1.28	1.34	1.40	1.47	1.54	1.61	1.69	1.76
6	1.34	1.42	1.50	1.59	1.68	1.77	1.87	1.97
7	1.41	1.50	1.61	1.71	1.83	1.95	2.08	2.21
8	1.48	1.59	1.72	1.85	1.99	2.14	2.30	2.48
9	1.55	1.69	1.84	2.00	2.17	2.36	2.56	2.77
10	1.63	1.79	1.97	2.16	2.37	2.59	2.84	3.11
11	1.71	1.90	2.10	2.33	2.58	2.85	3.15	3.48
12	1.80	2.01	2.25	2.52	2.81	3.14	3.50	3.90
13	1.89	2.13	2.41	2.72	3.07	3.45	3.88	4.36
14	1.98	2.26	2.58	2.94	3.34	3.80	4.31	4.89
15	2.08	2.40	2.76	3.17	3.64	4.18	4.78	5.47
16	2.18	2.54	2.95	3.43	3.97	4.59	5.31	6.13

[18] Note that when cash flow occurs at the beginning of a period, it is called an annuity due. When it occurs at the end of a period, it is called an ordinary annuity.

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Lump Sum Interest Table (Continued)

(Future values of $1.00 lump sum invested at beginning of year one at various annual interest rates)

Year	5%	6%	7%	8%	9%	10%	11%	12%
17	2.29	2.69	3.16	3.70	4.33	5.05	5.90	6.87
18	2.41	2.85	3.38	4.00	4.72	5.56	6.54	7.69
19	2.53	3.03	3.62	4.32	5.14	6.12	7.26	8.61
20	2.65	3.21	3.87	4.66	5.60	6.73	8.06	9.65
21	2.79	3.40	4.14	5.03	6.11	7.40	8.95	10.80
22	2.93	3.60	4.43	5.44	6.66	8.14	9.93	12.10
23	3.07	3.82	4.74	5.87	7.26	8.95	11.03	13.55
24	3.23	4.05	5.07	6.34	7.91	9.85	12.24	15.18
25	3.39	4.29	5.43	6.85	8.62	10.83	13.59	17.00
30	4.32	5.74	7.61	10.06	13.27	17.45	22.89	29.96
35	5.52	7.69	10.68	14.79	20.41	28.10	38.57	52.80
40	7.04	10.29	14.97	21.72	31.41	45.26	65.00	93.05
45	8.99	13.76	21.00	31.92	48.33	72.89	109.53	163.99
50	11.47	18.42	29.46	46.90	74.36	117.39	184.56	289.00

Per Period Interest Table

(Future values of $1.00 invested annually at beginning of each year at various annual interest rates)

Year	5%	6%	7%	8%	9%	10%	11%	12%
1	1.05	1.06	1.07	1.08	1.09	1.10	1.11	1.12
2	2.15	2.18	2.21	2.25	2.28	2.31	2.34	2.37
3	3.31	3.37	3.44	3.51	3.57	3.64	3.71	3.78
4	4.53	4.64	4.75	4.87	4.98	5.11	5.23	5.35
5	5.80	5.98	6.15	6.34	6.52	6.72	6.91	7.12
6	7.14	7.39	7.65	7.92	8.20	8.49	8.78	9.09
7	8.55	8.90	9.26	9.64	10.03	10.44	10.86	11.23
8	10.03	10.49	10.98	11.49	12.02	12.58	13.16	13.78
9	11.58	12.18	12.82	13.49	14.19	14.40	15.72	16.55
10	13.21	13.97	14.78	15.65	16.56	17.53	18.56	19.65
11	14.92	15.87	16.89	17.98	19.14	20.38	21.71	21.13
12	16.71	17.88	19.14	20.50	21.95	23.52	25.21	27.03
13	18.60	20.02	21.55	23.21	25.02	26.98	29.09	31.39
14	20.58	22.28	24.13	26.15	28.36	30.77	33.41	36.28
15	22.66	24.67	26.89	29.32	32.00	34.95	38.19	41.75
16	24.84	27.21	29.84	32.75	35.97	39.54	43.50	47.88
17	27.13	29.91	33.00	36.45	40.30	44.60	49.40	54.75
18	29.54	32.76	36.38	40.45	45.02	50.16	55.94	62.44
19	32.07	35.79	40.00	44.76	50.16	56.28	63.20	71.05

Per Period Interest Table (Continued)
(Future values of $1.00 invested annually at beginning of each year at various annual interest rates)

Year	5%	6%	7%	8%	9%	10%	11%	12%
20	34.72	38.99	43.87	49.42	55.76	63.00	71.27	80.70
21	37.51	42.39	48.01	54.46	61.87	70.40	80.21	91.50
22	40.43	46.00	52.44	59.89	68.53	78.54	90.15	103.60
23	43.50	49.82	57.18	65.76	75.79	87.50	101.17	117.16
24	46.73	53.86	62.25	72.11	83.70	97.35	113.41	132.33
25	50.11	58.16	67.68	78.95	92.32	108.18	127.00	149.33
30	69.76	83.80	101.07	122.35	148.58	180.94	220.91	270.29
35	94.84	118.12	147.91	186.10	235.12	298.13	379.16	483.46
40	126.84	164.05	213.61	279.78	368.29	486.85	645.83	859.14
45	167.69	225.51	305.75	417.43	573.19	790.80	1095.17	1521.22
50	219.82	307.76	434.99	619.67	888.44	1280.30	1852.34	2688.02

[C] Securities Regulation

The Securities and Exchange Commission (SEC) is the federal agency that administers the federal securities laws. The Securities Act of 1933 was a response to securities fraud during the Depression. The regulations had two basic objectives. First, it was designed to prevent fraud as it pertained to initial public offerings (IPO). The 1933 Securities Act also required strict disclosure in a registration of all material information of new securities before they can be sold or even offered for sale to the public.

The 1934 Securities Exchange Act concerns itself to the secondary distribution of securities. All public companies must be registered with the SEC. The Act made it illegal to use the mails or any instrument of interstate commerce to purchase or sell any security. According to Section 2(1) of the 1933 Securities Act, a security can be defined as any:

> Note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, reorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option or privilege on any security or, in general, any interest or instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for receipt for, guarantee of, or warrant or right to subscribe to any purchase, any of the foregoing.

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[D] Open Ended Mutual Fund Primer

An open ended mutual fund is an investment vehicle that pools funds on behalf of its investors, to achieve the economies of scale and professional management not otherwise obtainable by the individual investor. It accepts new investors and allows sales at its net asset value (NAV), which is the pro rata share of the fund's market value. There are currently more than 10,000 mutual funds, as reported by CDA/Wisenberger, the leading provider of mutual fund information services to financial professionals. The following general criteria may be used to helped select a domestic fund:

1. Review the fund's track record back to 1973, check its fees and read the prospectus.
2. Look for risk-adjusted performance relative to the appropriate index benchmark.
3. Look for a fund with a system, analytical, or team approach, so it is not managed by a single individual, who can err, become promoted or fired, or be hired away by a competing fund.

For example, James Craig left his post as manager of the Janus fund on January 1, 2000, and turned control over to Blaine Rollins, a Janus stablemate. What shareholders might worry about going forward is if Rollins can't match Craig's gains, the same unfair comparison that dogged Peter Lynch's successor at Fidelity Magellan Fund.

4. What is the chance that past performance can be replicated in the future?

The controversy about fund fees is often confusing to the medical profession. Load (commission based) funds are not necessarily bad, and no-load (non-commission based) funds are not necessarily good. In fact, one might even argue that there is no such thing as a no-load (expense) fund, since all have fees associated with them, disguised under various terms. These include management fees, advisory fees, 12b-1 fees, redemption fees, low load fees, diminishing (vanishing) loads, operating expenses, marketing, sales and advertising fees, etc. As a general rule, the aggregate fee for a mutual fund should probably not exceed about 1 percent for a domestic bond fund, 1.5 percent for a domestic stock fund, 2 percent for an international fund, and about 2.5 percent for an emerging market fund. Furthermore, most funds offer a choice of three asset classes.

Class A is a front-loaded fund that offers break points for volume discounts The more money invested, the lower the load. It is not wise to invest in a front-load fund if you plan to cash out within a couple of years. For a true long-term investor, however, it might be smarter to use Class A funds, since your costs are spread out over the number of year you hold the fund.

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Class B fund, or back-end load, shares have an exit fee associated with them that usually diminishes after seven years. They typically have higher annual fees than Class A shares, but are reduced after the seventh year surrender penalty has elapsed.

Class C fund, or level load, shares do not have an initial sales charge, but may have higher 12b-1 fees, on a deferred basis, as well as a deferred sales charge depending on the date of redemption.

According to Kay R. Shirley, Ph.D., CFP™, an advisor in Atlanta, all mutual funds have a load, that is either paid as an upfront fee (Class A), surrender penalty (Class B), or a fee deducted each year (Class C) to reimburse the company, whether load or not. "There is absolutely, unequivocally, no mutual fund in existence that has zero operating expenses."[19] Furthermore, no-load funds unfortunately become an excuse not to pay a professional for advice, and instead, often advance the coffers of the fund company itself. So, since you are going to have to pay something either way, be it salary, hourly fee, percentage or commission, you might as well pay a professional advisor, rather than a company with a toll-free telephone line.

In fact, stop and consider for a moment just where does the money come from in a no-load fund, to support telephone operators, build skyscrapers and office buildings, and pay managers salaries? Regardless, performance, not price, is the ultimate goal for any successful investor.

The following are not recommendations, but rather represent lists of the best, worst, largest, specialized and most diversified mutual funds of 1999-2000, beginning with the best.

1999—10 Best Performing Mutual Funds

Fund Name	**Total Return (capital gains & dividends)**
Nich-App Inst. Global Technology	493.70%
Warb-Pincus JP Smco Ad.	329.70
MAS Small Cap Growth Inst.	313.90
Van Wagoner Emerging Growth	291.20
Nevis fund	285.50
Monument Internet A	273.10
Warb Pincus Inst. Japan Growth	269.60
Driehaus Asia Pacific Growth	265.00
Vertex Contrafund	261.40
Amerindo Technology A	250.60

Source: USA Today: 1/5/2000

[19] Shirley, Kay: Live Long and Profit. Chicago: Dearborn Trade Press, 1997.

The following is a list of the ten worst performing mutual funds for 1999.

1999—10 Worst Performing Mutual Funds

Fund Name	Total Return (capital gains & dividends)
Profunds Ultra-Short OTC Svc	−80.60
Pauze Tombstone B	−73.50
Potomac OTC/short	−56.80
Rydex Arktos Inv	−54.30
Hudson Investors funds	−35.40
American Heritage	−31.60
Profunds Ultra Bear	−31.20
Fidelity Select Medical	−29.60
Comstock Capital Value B	−28.20
Fidelity Select Environmental	−25.80

Source: USA Today: 1/5/2000

The following is a list of the 15 largest stock funds, ranked by size for 1999.

1999—15 Largest Stock Funds (ranked by size)

Mutual Fund	Total Return (capital gains & dividends)
Fidelity Magellan	24.10%
Vanguard 500 Index	21.10
Washington Mutual Investors	1.20
Investment Company of America	16.60
Fidelity Growth & Income	10.40
Fidelity Contrafund	25.00
Janus Fund	47.10
American Century Ultra	41.50
Janus Twenty	64.90
EuroPacific Growth	57.00
Vanguard Windsor II	(5.80)
New Perspective Fund	40.20
Janus World Wide	64.40
Fidelity Blue Chip	24.30
Vanguard Wellington	4.40

Source: USA Today: 1/5/2000

The following is a list of ten major specialized mutual fund sectors, with returns, for 1999.

1999—10 Specialized Funds (type of Lipper index)

Sector Type	Total Return (capital gains & dividends)
Balanced	8.70%
Emerging Market	70.80
European Region	24.40
Financial services	(1.00)
Gold	3.60
Health/Biotechnology	17.40
International	40.80
Pacific Rim	92.50
Science & Technology	134.80
Utilities	15.80

Source: USA Today: 1/5/2000

The following is a list of 12 major diversified fund returns, for 1999.

1999—12 Diversified Funds

Objective	Total Return (capital gains & dividends)
Large cap core	22.40%
Large cap growth	38.10
Large cap value	11.20
Mid cap core	38.30
Mid cap growth	72.60
Mid cap value	9.70
Small cap core	28.30
Small cap growth	62.60
Small cap value	6.30
Specialty Diversified	(6.80)
S&P funds	20.20
Equity Income	3.30

Source: USA Today: 1/5/2000

Moreover, recall that past performance is not indicative of future performance, as the past decade on Wall Street is reviewed through its indexes, in the chart below.

The Decade on Wall Street (1990-2000)

How major indexes fared, as measured by annual percentage change.

Year	Dow Industrial	S&P 500	Nasdaq Composite	Russell 2000
1999	25.2%	19.50	85.60	19.60
1998	16.1	26.7	39.6	(−) 3.5
1997	22.6	31.0	21.6	20.5
1996	26.0	20.3	22.7	14.8
1995	33.5	34.1	39.9	26.2
1994	2.1	(−)1.5	(−) 3.2	(−) 3.2
1993	13.7	7.1	14.8	17.0
1992	4.2	4.5	15.5	16.4
1991	20.3	26.3	56.8	43.7
1990	(−)4.9	(−)6.6	(−)17.8	(−)21.5

Source: USA Today: 1/5/2000

[E] Taking a Toll in 2001 and 2002

By comparison to the bull market of the past decade, the bear market of 2001 was tough on even the biggest mutual funds in the industry, and early 2002 continued the debacle. The chart below lists approximately how the ten largest funds fared, listed in order of size, with the largest listed first, by mid-year.

Y2001 Mutual Funds

Fund Name	Total (+ Gain or − Loss)
Fidelity Magellan	−23%
Vanguard 500 Index	−21%
Investment Company of America	−5%
Washington Mutual Investors	+8%
Fidelity Growth & Income	−13%
Fidelity Contrafund	−22%
Growth Fund of America	−20%
Janus Fund	−35%
PIMCO Total Return	+13%
Amer. EuroPacific	−27%

Source: AJC 4/01/2001

[F] Mutual Fund Liquidations

When a mutual fund goes out of business or liquidates its holdings, the management company sends you a check for the value of your account, on the last day of operations, usually at a loss to you. In Y2000-2001, 11 funds were liquidated in the small

cap group, 8 in the growth and income category, and 23 in pure growth funds. Some of the biggest funds to liquidate in 2000-2001 were WPG US Large Stock Funds, Munder Value Fund, PIMCO Small Cap Growth Fund I, Standish Fund Fixed Income II, Smith Barney Retirement 2000, and both the Invesco Pacific Basic and Latin America funds. To avoid this hurtful possibility, steer clear of new offerings, funds devoted to extremely narrow niches, like the Tombstone Fund, or those in operation for only a short period of time.

There are also fewer no-load funds available in 2002, as Invesco and Credit Suisse withdrew their offerings in favor of advisor mediated transactions. This may be not only prescient for the industry but advantageous for individual physician investors.

Also, be aware that according to experts, some mutual funds may not give shareholders a fair shake when it comes to full disclosure about industry tactics. Information the astute medical professional should demand from their mutual fund companies, include:

1. Manager compensation (based on asset growth, pre-tax or after tax returns, performance, or some other meters?);
2. Tax efficiency and tax policies (since tax efficiency does not necessarily indicate the size of your future tax burdens, knowledge of the fund's tax policy is vital information to possess);
3. Portfolio holdings (providing information on individual companies that is less than six months old, would allow medical professional investors to better diversify holdings and avoid redundant funds);
4. Tax basis accounting (telling investors not only their average cost per share, but also showing what a fund has done based on the timing and amount of its purchases, rather than just calendar year results, as is now done);
5. Record of proxy issues (particularly the issues that affect health care investors).

According to Charles A. Jaffe, a financial columnist for the *Boston Globe,* the following participants of the mutual fund industry may have exhibited behavior that was down right disingenuous to its investors in 1999-2000.[20] Therefore, as always, consider the caveat "buyer beware."

- Technology star manager and "wunderkind" Ryan Jacob was allowed to start his own mutual fund company with his Uncle Len, as a "disinterested director." This ruling contradicted the SEC's previous hype on the importance of independent directors for all mutual funds. The fund was down more than 75 percent in Y2001.
- Eric Ryback, of the Lindner Family, fired nearly every individual fund director and appointed himself as co-director in each case. The only manager not dismissed was Ryback himself. Since a common denominator in the poor perfor-

[20] See www.boston.com/globe/columns/jaffe.

mance of the funds was Ryback, perhaps it might have occurred to the consulting company that made the recommendation to fire Ryback himself?

- The Monument Funds made a limited-time offering to encourage the jump into its fund, from a rival, the Internet Fund. Unfortunately, the waived sales charges were a pittance compared to the extraordinary capital gains taxes due by investors of the Internet Fund.
- Money Magazine listing it best 100 funds in the June, 1999 edition, and then in a list two months later, included fund recommendations that didn't make the cut in the June article.
- The Kaufmann Funds have a high expense ratio, a history of suspect advertising, and have given its investors a large capital gains distribution for the year.
- Donald Yacktman obfuscated the poor performance of his funds, down 21 percent in 1999, by talking about its good performance since inception in 1992, when he and his board of directors were about the only investors.
- Alliance Capital created three new board of director slots for directors previously voted out by investors. So much for democracy.

The French have a saying about the potential deception of such shenanigans, *"Plus ça change, plus c'est la meme chose."* The more things change, the more they remain the same.

Other sources of mutual fund information, that all investors deserve to have, are included in the list below:

No-Load Mutual Fund Investor
Sheldon Jacobs

Kiplinger's Mutual Funds
1729 H Street
Washington, DC 20006

Moneyletters Mutual Fund Advisor
819 North Charles Street
Baltimore, MD 21201

Handbook of No load Fund Investors
PO Box # 318
Irvington-on-Hudson, NY 10533

Morningstar Mutual Funds
225 West Wacker Drive
Chicago, Illinois 60608
800-735-0700
www.morningstar.net

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Value Line Mutual Fund Survey
220 E. 42nd Street
New York, NY 10017
800-535-8760
www.valueline.com

[G] Free Edgar

Corporate 10-K reports, filed annually with the SEC, are available at: www.freeEdgar.com, as well as from www.edgar-online.com, and: www.sec-gov.com. These databases will tell you fascinating tidbits about company financial statements, investments, executive perks and other corporate shenanigans, before you invest money in them. For example, Apple Computer nearly halved its finished goods inventory to $16 million, from $30 million, in the last quarter of Y 2000, while it took a charge of $90 million so it could buy CEO, Steve Jobs, an airplane.

[H] Valid Idea

The next time you are tempted to buy a stock touted by a so-called expert, view this Web site to look into his or her media record: www.validea.com.

Institutional Mutual Fund and Equity Vehicles

Most medical professionals do not have the knowledge or resources to manage a significant portfolio of load, or no load, mutual funds. Asset allocation, portfolio structure, fees, and style drift are important concerns. One company, SEI Investments (610-672-2112), mitigates these matters with the unique approach of managing multiple specialist managers, through a continuous portfolio quality management process. This "manager of the managers" concept, according to Christian Shomber, CFA, CEBS, is ideally suited for healthcare professionals. Of course, institutional money management of this type is available only through professional financial advisors, working intensely with high net worth individuals (cshomber@seic.com).

A similar concept, using individual equities, has been is streamlined by Manning & Napier, according to Edgar J. Beaudreault, Jr., vice president of the Investment Advantage Corporation (800-316-9623), of Rochester, New York.

[I] Investment Index Alternatives

More than $250 billion dollars was poured into the mutual fund industry in 1999.[21] This has led to competition from alternative investment indexes, such as Spiders, Diamonds, Qubes, and WEBS.

[21] www.indexfunds.com

1. *Spiders.* A Spider (Standard & Poor's Depository Receipt) is an investment trust that acts, and trades, like a stock. When you buy shares in the spider, you are buying an interest in all the companies, included in the S&P 500, at once. Unlike a mutual fund, spiders have full liquidity throughout the day, rather than only at the end of the market day, and at whatever their price is at 4 P.M. Therefore, spiders are attractive to short-term traders, since they can be bought cheaply, and one can buy them on margin, or sell them short, at will. Spiders are also tax efficient, but are terrible for dollar cost averaging because there is a sales commission associated with each transaction. Mutual funds are better in this regard. Spiders have an annual expense ratio of about .18.
2. *Midcap Spiders.* A spiderlike trust that tracks the S&P Midcap 400 index, ticker symbol MDY.
3. *Diamonds.* A spiderlike trust that tracks the Dow 30, ticker symbol DIA.

4 *Qubes.* Another trust that tracks the technology-laden NASDAQ 100, ticker symbol QQQ.

5. *World Equity Benchmark Shares.* Track the stocks of 17 countries and nine industrial sectors tracked by Standard & Poor's. Ticker symbol is WEBS.

Several firms have also developed "interval funds," which are a hybrid that can buy heavily into private placements and make venture capital investments.

[J] Individual Companies

In lieu of mutual funds, a portfolio of individual companies may be constructed, with or without professional assistance. The following is the most recent list of the 10 most admired domestic firms (2001–2002), according to a study by Clark, Martire & Bartolomeo.[22]

1. General Electric
2. Southwest Airlines
3. Wal-Mart Stores
4. Microsoft
5. Berkshire Hathaway
6. The Home Depot
7. Johnson & Johnson
8. FedEx
9. Citigroup
10. Intel

[22] For a complete list, go to www.fortune.com.

[K] DRIP Programs

For those with very limited funds who wish to avoid, or complement, mutual funds or investment indexes by investing in individual stocks; the small investor medical professional might consider various dividend reinvestment plans (DRIPs) to purchases shares cheaply and easily. Consider on-line brokerages at www.netstock.com or www.buyandhold.com. These companies will allow you to invest as little as $20 per month in equities. If you invest $20, and select a stock that sells for $10, you'll get about 2 shares, minus a tiny commission. If you select a company that sells for $60, you'll receive a third of a share. In this manner, virtually any healthcare professional can afford to automatically invest, and re-invest, $25-50 per month in the stock market. Since not all companies offer dividends, or DRIP programs, another potential advantage of these two companies is the fact that they also allow the purchase of non-DRIP companies, such as Microsoft, Apple Computer, Oracle, and Yahoo!

A Standard & Poor's stock guide for 2001-2002, with a wealth of information on more than 8,000 securities, is available by calling (404) 526-5668.

[L] Risk Tolerance and Aversion

One of the key elements in individual equity, debt, or mutual fund selection, in all the disciplines of financial planning, is personal risk tolerance. Risk involves the standard deviation, or degree of fluctuation in the market value of a security. All security investments can be classified as conservative, moderate, or aggressive. A conservative risk tolerance generally tends to seek lower returns in exchange for low price volatility. A moderate risk tolerance accepts some price volatility in exchange for a higher rate of return. It follows that an aggressive risk tolerance will pursue the highest return possible, despite large fluctuations in price volatility.

Risk tolerance depends on several factors. The more years the physician has to invest, the more risk possible. Also, a stable marriage, good health, and successful practice bode well for more risk, than if unsettled. Younger investors accept more risk, older ones less risk. If an adequate emergency fund is in place, the less likely will be the potential need to rely on an investment portfolio to cover short-term cash needs. The size of the portfolio and the nature of other investments can indicate the suitability of riskier investments.

The amount of this emergency fund has been the topic of much debate among financial advisors. Historically, a three to six month cash horde was suggested. Now, with the increased uncertainty brought about by managed care, cash reserves of six to twelve months, or more, may be in order to mitigate such adverse occurrences as accepting a less lucrative managed care contract; being deselected from a healthcare plan, being terminated as an employed healthcare professional; or, collapse of an integrated IPA, etc. If this sounds like a lot of cash held in an interest bearing account, consider establishing a ready line of credit to accomplish the same thing,

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or a second mortgage to tap the equity in your home. Just be sure you don't lose your house. In this way, all available assets can be invested with a long-term perspective.

To test your own risk tolerance, ask yourself the following questions and determine if you strongly agree, are neutral or disagree.

RISK TOLERANCE SURVEY FOR PHYSICIANS	
1. I am not dependent on current income from investments.	SA ....N ....D
2. Outpacing inflation is more important than capital preservation or current investment income.	SA ....N ....D
3. I am a physician-executive and feel in control of my practice.	SA ....N ....D
4. I am employed by a hospital, HMO, MCO, etc.	SA ....N ....D
5. I am willing to accept fluctuating values when investing for the long-term.	SA ....N ....D
6. To obtain above-average returns, I am willing to accept above-average volatility.	SA ....N ....D
7. Would you include high yield bonds in your portfolio?	SA ....N ....D
8. Do you include international funds in your asset allocation?	SA ....N ....D
9. How much of your existing portfolio would you feel comfortable repositioning to reach your goals?	SA ....N ....D
10. My office costs are increasing and my income is decreasing	SA ....N ....D
11. I am young and intelligent enough to re-educate and re-engineer my medical profession for the new system of managed care, or begin another profession and a new career.	SA ....N ....D

[M] Gender Risk Tolerance Differences?

Although not specific to physicians, a study of 401k plans by Watson Wyatt Worldwide found that women investors may do better than men, for the following reasons:

- Women are not necessarily risk averse.
- Women gravitate to less volatile companies.

Yet economist Leslie Papke, of Michigan State University, found no differences in the 401k investment styles of men and women age 55 and up. This was also echoed

by high wage-earning women professionals, studied by Deloitte & Touche, as well as working women, studied by the Employee Benefit Research Institute.[23]

[N] Personal Lifestyle

Additional risk determinations can be estimated from the following personal lifestyle matrix.

PERSONAL LIFE CYCLE MATRIX

	Earnings	Assets	Savings	Debt
Accumulation Phase:	rising	small	low	high
Preservation Phase:	high	rising	increased	low
Dissipation Phase:	lower	little	lower	none

[O] Preparing a Net Worth and Net Income Statement

The key to starting the financial planning process is determining your current financial position. A statement of net worth includes all your assets and liabilities, at a specific point in time, whether owned by you or provided by your practice. This is similar to a corporate balance sheet, except that a balance sheet shows assets at their original cost. Your net worth statement shows assets at their fair market value.[24]

Below is a sample net worth statement for you to get started with your financial planning process. Because this part of the process is the basis of so many others, we separate the ownership of assets. This provides you with the backdrop for estate or retirement planning.

Net Worth Statement, Drs. David and Hope Smith, as of July 20, 2000

Assets	Your Name	Spouse's Name	Joint Name
Bank Accounts:			
Checking	________	________	________
Savings	________	________	________
Savings Bond	________	________	________
Money Market Funds	________	________	________
CDs	________	________	________
Credit Union Account	________	________	________
Stocks	________	________	________
Bonds	________	________	________
Mutual Funds	________	________	________

[23] www.women.com/money.
[24] "Getting Financially Organized" is a free booklet from Citibank 800-669-2635.

Assets	Your Name	Spouse's Name	Joint Name
Life Insurance (Cash Value)	________	________	________
Residence (Current Value)	________	________	________
Other Real Estate	________	________	________
Practice Interest	________	________	________
Other Business Interest	________	________	________
Receivables	________	________	________
Trusts	________	________	________
Tax Shelters	________	________	________
Personal Property:			
Jewelry	________	________	________
Autos	________	________	________
Furnishings	________	________	________
Collectibles:			
Antiques	________	________	________
Fine Art	________	________	________
Precious Metals	________	________	________
Retitement Plan Accounts:			
Pension/Profit Sharing Plan	________	________	________
Annuities	________	________	________
IRAs	________	________	________
Stock Option Plans	________	________	________
Saving & Incentive Plans	________	________	________
401k Plans	________	________	________
Deferred Compensation	________	________	________
Total Assets	$________	$________	$________
Liabilities			
Mortgages	________	________	________
Notes	________	________	________
Personal Loans	________	________	________
Business Loans	________	________	________
Credit Card Balances	________	________	________
Auto Loans/Lease	________	________	________
Total Liabilities	$________	$________	$________
Net Worth (Assets Less Liabilities)	$________	$________	$________

[P] Cash Flow Planning

Since almost all areas of financial planning are controlled by cash flow, it is important to construct a cash flow net income, or profit and loss statement, that is accurate and believable. The success of your plan rides on your implementation of financial strategies that arise from the foundation of your cash flow statement. If you don't

believe the numbers, you will not implement the strategies, thereby allowing your plan to fail.

For example, your retirement plan may depend on your being able to save a periodic amount of your surplus income. Your surplus income is determined by your net income (income after taxes and less your expenses), which comes directly from your cash flow statement. You will not save what you do not believe exists, that is, surplus income. Also, your targeted retirement income is a function of your current standard of living, adjusted for inflation and anticipated lifestyle changes. Your standard of living is a function of your cash flow statement. Your target must be believable to be achievable.

Cash flow planning also affects how medical professionals provide for their children's college education. The added cost of saving for future education must be balanced against saving for retirement. Or if education is to be paid out of current income, how will it affect cash flow? As another example, an accurate cash flow plan affects investment decisions, risk management programs, income tax planning, survivorship planning, and long-term care planning. Moreover, cash flow planning also relates to estate planning by determining the most efficient transfer of wealth to heirs. When planning for lifetime gifts, the medical professional must consider the potential loss of income from assets transferred. Finally, when life insurance is applicable, you must determine the added expense during life in order to provide the liquidity necessary to pay estate taxes at death.

[Q] A Lifestyle Plan

A cash flow plan covers a specific period of time, and is the most difficult financial statement to construct because many doctors perceive it to be a tool for setting up a budget. Most doctors do not live a disciplined spending lifestyle, and the thought of a budget is viewed as a possible compromise to their lifestyle. It is not designed to be a budgeting tool, although it certainly can be. A cash flow plan is designed to provide comfort when there is surplus income, which can be diverted for other planning needs. If there is no surplus income, perhaps a budget is in order to generate the funds needed? For example, if retirement savings are treated as just another periodic bill, you are more likely to succeed.

A comprehensive cash flow statement, or lifestyle budget outline, begins with an analysis of your operating checkbook and a review of various source documents, such as your tax return, credit card statements, pay stubs, and insurance policies. A typical statement will show all cash transactions that occur within one year. It is helpful to establish a monthly equivalent to all items of income and expense, but for the purposes of getting started, items of income and expense may be noted by the frequency you are accustomed to receiving or spending them.

Cash Flow Statement, Drs. David and Hope Smith, from 01/01/2002 to 12/31/2002

Cash Receipts or Inflows	Monthly Account	Quarterly Amount	Annual Amount
Income from practice	$______	$______	$______
Income from employment	______	______	______
Pensions/Annuities	______	______	______
Interest	______	______	______
Dividends	______	______	______
Net Rentals	______	______	______
Equipment Leases	______	______	______
Miscellaneous	______	______	______
Total Inflows	$______	$______	$______
Cash Disbursements or Outflows			
Housing:			
Mortgage payment/rent	$______	$______	$______
Real estate tax	______	______	______
Home improvements	______	______	______
Utilities	______	______	______
Maintenance/Repairs	______	______	______
Home Insurance	______	______	______
Food (Home)	______	______	______
Lunches (away from home)	______	______	______
Clothing	______	______	______
Transportation:			
Finance/Lease payment	______	______	______
Gas/Oil/Maintenance	______	______	______
Auto Replacement fund	______	______	______
License/registration	______	______	______
Insurance	______	______	______
Education	______	______	______
Insurance:			
Disability	______	______	______
Liability	______	______	______
Malpractice	______	______	______
Life	______	______	______
Health	______	______	______
Umbrella	______	______	______
Long-term Care	______	______	______
Other	______	______	______
Miscellaneous:			
Reimbursed business expenses	______	______	______
Medical expenses	______	______	______
Alimony	______	______	______

Cash Receipts or Inflows	Monthly Account	Quarterly Amount	Annual Amount
Education	______	______	______
Child Support/Maintenance	______	______	______
Child Care	______	______	______
Parental Support	______	______	______
Discretionary:			
Charitable Contributions	______	______	______
Vacation & Travel	______	______	______
Vacation home expenses	______	______	______
Club dues (golf, tennis, health)	______	______	______
Restaurants	______	______	______
Entertainment (guests)	______	______	______
Entertainment (Self, theater, sports, movies)	______	______	______
Babysitting	______	______	______
Books, magazines, CDs	______	______	______
Gifts (holidays, wedding, birthdays)	______	______	______
Personal expenses (hair care, etc.)	______	______	______
Dry cleaning	______	______	______
Hobbies	______	______	______
Family pets	______	______	______
Liquor, cigarettes, cigars	______	______	______
Other	______	______	______
Wealth accumulation:			
SEP-IRA/IRA contributions	______	______	______
Qualified plan contributions	______	______	______
Salary deferrals	______	______	______
Mutual fund purchases	______	______	______
Systematic Savings	______	______	______
Investment Real Estate	______	______	______
Other Investments	______	______	______
Taxes:			
FICA/Medicare	______	______	______
Federal	______	______	______
State	______	______	______
Miscellaneous:			
Debt financing	______	______	______
Student Loans	______	______	______
Practice Development	______	______	______
Practice Buyout	______	______	______
Other	______	______	______
Total Disbursements	$______	$______	$______
Surplus (Deficit)	$______	$______	$______

[R] Common Cash Flow Mistakes

1. Preparing a cash flow budget is a planning tool, not a punishment. Keep the credit cards hidden until you've paid all prior credit card bills. If this means you must use some of your savings to pay off credit card debt, so be it. It is better to save the 19 percent finance charge than to earn 5 percent on your savings.
2. Don't live beyond your means. If that translates to your owning a late model American car, and not a new foreign sports car, your checkbook will thank you in the long run. But do not deny your spouse an occasional luxury, and agree on major purchases before making them.
3. Do not confuse your marginal tax rate with your average tax rate. The former is the highest tax rate on your last increment of income; while the latter is your total tax due, divided by your tax base. Obviously, your marginal rate is lower than your average rate.
4. Do not confuse a tax credit with a tax deduction. A credit is a dollar for dollar deduction from your income tax liability; while a deduction is only an equivalent of your marginal tax bracket (MTB). For example, in a 28 percent marginal tax bracket, a $1 credit, still equals one dollar. But, a one dollar deduction only equals 28 cents, although it can also reduce some state income taxes.
5. Refinancing consumer debt with a home equity loan will not only save you interest, but it will save you income taxes as well. Shop around for the lowest rate. Don't just use the bank you do business with.
6. Entertainment is a luxury, not a necessity. This is the first area to cut back on if you find yourself short at the end of a month.
7. Pay your estimated income taxes on time, and pay forth quarter state estimated taxes by December 31st. There is nothing worse than having to come up with a huge lump sum for taxes at the same time you have to fund your practice retirement plan.
8. Find a certified financial planner that both you and your spouse are comfortable with, since he or she will understand the risks and benefits of most personal economic opportunities. Some experts even suggest the best CFPs™ are those without a prior background relating to any of the specific disciplines of financial planning (i.e, insurance agent (CLU), investment advisor (RIA), accountant (CPA or EA) or stockbroker (registered representative) in order to achieve advice that is balanced across all areas of the financial continuum.

[S] What Should a Personal Financial Plan Include?

Financial planning can be accomplished on a comprehensive or modular basis, handling one issue at a time before moving on to the next. Unfortunately, of all available

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careers, medicine is probably one of the busiest, and precious little time is left for planning needs. Therefore, the assistance of a trusted and competent certified financial planner is suggested. The time devoted to the task is well worth it and has a long-term payoff.

Recall the story of the old man who spent a day watching his physician son treating HMO patients in the office. The doctor had been working at his usual feverish pace all morning, and although he was working hard, bitterly complained to his dad that he was not making as much money as he used to. Finally, the old man interrupted him and said, “Son, why don’t you just treat the sick patients?” The doctor-son looked annoyed at his father, and responded, “Dad, can’t you see, I don’t have time to treat just the sick ones.”

Therefore, once you have completed the cash flow and net worth statements, you are ready to draft your financial plan.

OUTLINE FOR A PROPERLY CONSTRUCTED FINANCIAL PLAN

- Written goals and objectives
- Consolidated financial statements
- Income tax planning
- Cash flow analysis
- Business entity structure
- Retirement planning
- Investment allocation
- College funding
- Pension or profit-sharing plans
- Non-qualified retirement plans
- Business buy-out agreement and funding
- Life insurance planning
- Disability insurance planning
- Risk management
- Medical insurance benefits
- Employee fringe benefits
- Estate planning
- Long-term care planning
- Implement, monitor and change, prn.

[T] Establishing Short- and Long-Term Goals and Objectives

The success of a financial plan depends on the clear identification of all goals and objectives. Each goal should be identified and quantified. The amount should be represented in today’s dollars, or at their present value. An assumed inflation rate will determine the future value assigned to those goals.

Short-term goals may be personal or practice related. For example, a personal short-term goal might be to the purchase of a summer home, a boat, college education

for your twelve-year-old daughter, or a major home improvement. Short-term goals involving your practice might be the purchase of a new piece of medical equipment requiring some minimum capital requirement. Another short-term goal might be to provide for insurance coverage to protect against malpractice claims.

The most common long-term goal in a financial plan is to retire comfortably. Once financial independence has been achieved, the next most common goal is estate and gift planning. Often, the financial planner provides great value by identifying, quantifying, and agreeing upon goals that previously were unconfirmed. Along with this discussion must be the agreement of certain financial assumptions. These assumptions impact upon the growth of your investment portfolio. In addition, it is also assumed that the income tax laws will change and a new analysis is required each year.

The following is a guide to help quantify and rank your financial goals. It is important to assign a time frame for accomplishing these goals.

Sample Financial Goals	Time Frame (In Years)
Pay off student loan	
Fund college education for my children	
Buy a home (principal residence)	
Buy a second home (vacation)	
Buy a rental property (office)	
Specific home improvements	
Other large purchase (car, boat, art)	
Buy a practice	
Buy another business	
Retirement (financial independence)	
. . . These may be separate goals	
Portfolio of investments to beat inflation	
Disability income protection	
Survivorship income protection	
Charitable fulfillment	
Estate planning (wills & trusts)	
Reduce estate taxes (other methods)	
Provide liquidity in estate	
Gifting	
Raise current income	
Take a dream vacation	
Other	
Get married	
Get divorced	
Have children	
Provide for aging parents	
Provide for long-term care	

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[1] General Financial Planning Specificity and Purpose

A financial plan must be both abstract and concrete in so far as its goals, amounts, and timeliness are concerned. Astute doctors use the following helpful hints and charts to establish both abstract and concrete goals and objectives.

Example of Abstract Doctor Financial Goals

What are your investment objectives?

Liquidity (instant cash availability)

Very Important				Not Important
1	2	3	4	5

Current income (monthly cash flow from investments)

Very Important				Not Important
1	2	3	4	5

Future income (maximize income in future periods)

Very Important				Not Important
1	2	3	4	5

Inflation protection (protection against loss of purchasing power)

Very Important				Not Important
1	2	3	4	5

Capital growth (real increase in value of assets)

Very Important				Not Important
1	2	3	4	5

Safety of principal (minimal risk of losing principal)

Very Important				Not Important
1	2	3	4	5

Diversification (to minimize risk by investing in a variety of asset classes)

Very Important				Not Important
1	2	3	4	5

Marketability (investments should be convertible to cash quickly)

Very Important				Not Important
1	2	3	4	5

Ease of practice management (relief from day-to-day investment decisions)

Very Important				Not Important
1	2	3	4	5

Example of Concrete Doctor Financial Goals

What are your specific financial goals? Within each time period, circle the level of importance of each goal. List any additional financial objectives you may have personally.

	Short-term (within the next year)		*Medium-term (within the next5 years)*		*Long-term (within the next 5–10 years)*		*Longest-term (10+ years)*	
Buy a house								
Estimated cost:	$							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Education expenses (self or children)								
Estimated cost:	$							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Debt reduction								
Current debt:	$							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Make home improvements								
Estimated cost:	$							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5

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	Short-term (within the next year)		*Medium-term (within the next5 years)*		*Long-term (within the next 5–10 years)*		*Longest-term (10+ years)*	
Buy a car								
How much:	$ ________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Make other large purchase (boat, plane, art, jewelry)								
Estimated cost:	$ ________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Take a vacation								
Estimated cost:	$ ________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Change profession or specialty								
Current salary:	$ ________							
Potential salary:	$ ________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Cover expenses with investment portfolio income								
Estimated cost:	$ ________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5

	Short-term (within the next year)		*Medium-term (within the next5 years)*		*Long-term (within the next 5–10 years)*		*Longest-term (10+ years)*	
Adequate retirement income								
Estimated cost:	$__________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Buy a vacation home								
Approx. cost:	$__________							
Maintenance:	$__________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Have children								
How many now?	$__________							
Planned:	$__________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Increase level of charitable giving								
Estimated current level:	$__________							
Estimated increase:	$__________							
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Take early retirement								
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5

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	Short-term (within the next year)		*Medium-term (within the next5 years)*		*Long-term (within the next 5–10 years)*		*Longest-term (10+ years)*	
Start a non-medical business								
What type? ______								
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Financial independence								
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5
Other Goals ______								
	Important	1	Important	1	Important	1	Important	1
		2		2		2		2
		3		3		3		3
		4		4		4		4
	Not Important	5	Not Important	5	Not Important	5	Not Important	5

[2] Tax-Planning Specificity and Purpose

Many doctors feel it is important to get a preliminary idea of their current tax burden prior to the end of the tax year. This allows for prudent financial accounting and tax planning to begin. The following simple spreadsheets are helpful in this regard.

Personal Sample: Income Tax Planning Worksheet

Name ______ Date ______

19 ____ 20 ____ 20 ____

Constructive receipt: (timing)	*1040 2003*	*1040 2002*	*1120 2001*	*1120 2000*
Sales				
Other income				

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Constructive receipt: (timing)	*1040 2003*	*1040 2002*	*1120 2001*	*1120 2000*
Operating expenses				
Shareholder's wages				
Compensation				
Itemized deductions				
Taxable income				
Tax				
Total tax				

Practice Sample: Income Tax Planning Worksheet

Name ______________________ Date ______________________

	19 ____	20 ____	20 ____
Gross Income			
Salaries			
Interest and dividends			
Net business income (SE taxable)			
Capital gains (net)			
Net passive activities			
Net nonpassive activities			
Other income or loss			
Total Gross Income			
Adjustments to Income			
IRA and Keogh contributions			
Other			
Total Adjustments			
Adjusted Gross Income			
Itemized Deductions*			
Medical (less 7.5% of AGI)			
Taxes			
Interest paid			
Charitable donations			
Miscellaneous deductions (less 2% of AGI)			
Other			
Total Itemized Deductions*			
Exemptions			
Taxable Income			
Income Tax			

*To be reduced by 3

[3] Risk Management and Insurance Specificity and Purpose

The next consideration for physician financial plan construction is risk management and insurance. A basic axiom is to insure all assets before assuming greater risk. Disability, death, liability, and property damage are all insurable risks that clients can easily accommodate.

Life Insurance Needs Analysis Worksheet

First, calcualte the approximate need for and amount of life insurance required, in the following simple manner. A more focused evaluation can be performed later with the help a financial advisor.

Cash needs:	**Dollar amount:**
Adjustment period for survivors	$________
Dependency period expenses	________
Educational expenses	________
Outstanding debt	________
Emergency fund	________
Special expenses	________
Charitable intentions or bequests	________
Income needs:	
Preretirement needs	________
Postretirement needs	________
Total needs (Cash needs + Income needs)	$________
Less: Assets and available resources to offset total client needs:	
Cash and cash equivalents:	
Money market accounts	$________
Savings accounts	________
Cash surrender values on others' life insurance policies	________
Invested assets:	
Investment	________
Retirement plans	________
Time deposit accounts	________
Life insurance:	
Individual	________
Group	________
Total assets (resources) available	$________
Total amount of life insurance needed (Needs—Assets)	$________

[U] Retirement Planning

Traditional financial planners believe that a medical professional will need 70 to 80 percent of pre-retirement income at retirement. On the contrary, the first five years of retirement usually result in spending higher than in pre-retirement years. The reason for this is that many newly retirees feel they have to make up for lost time. Traveling is increased. It costs more to go golfing on Maui during retirement than to buy a tunafish sandwich for lunch while you are working.

In a 2000 study by Piper Jaffray,[25] half of the people surveyed age 35 to 54 plan to retire between 60 and 69, with the following activities expected after leaving the workforce.

ACTIVITY	MEN	WOMEN
Volunteer time	68%	80%
Recreational activities	73	61
Work (full or part time)	70	55
Travel	43	50
Start a business	21	13
Return to school	11	22

Therefore, it would be wise to allocate future income needs into periods. For example, the first five years of retirement as one period, then the next five as another period. Fortunately, your can construct the present value figures necessary to determine the appropriate savings today, by using the following table(s) with the indicated assumptions, or a financial calculator.

Estimated Retirement Income Worksheet	Example	Actual
1. Current Income (Level of Spending)	$190,000	______
2. Percentage of Pre-retirement Income needed For retirement (#1 times 80%)	152,000	______
3. Minus Social Security (assumes highest amount for 1999)	16,476	______
Subtotal	135,524	
4. Inflation Factor (from below assuming 25 years until retirement..	×2.67	______
Subtotal	361,849	______
5. Minus income from Pensions (if any)	0	______
6. Estimate of retirement income needed (Subtotal less #5)	361,849	______

[25] Piper Jaffray Survey 2000. See www.piperjaffrayventures.com.

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Estimated Retirement Income Worksheet	Example	Actual
7. Saving necessary to produce needed income (Multiply #6 by 15; assumes 4% inflation, 7% investment return, and a retirement of 20 years)	5,427,736	_______
8. Value of current assets (savings, investments, etc.)	350,000	_______
9. Future value (from Growth Factor below; assumes 25 years until retirement; × 5.43)	1,900,500	_______
10. Total amount you need to save (subtract #9 from #5)	3,527,236	_______
11. Annual amount you need to save (divide #10 by present value factor below; 63.25)	55,767	_______
Monthly amount you need to save (#11 divided by 12)	4,647	_______

Years Until Retirement	5	10	15	20	25	30	35
Inflation Factor (4%)	1.22	1.48	1.80	2.19	2.67	3.24	3.95
Growth Factor (7%)	1.40	1.97	2.76	3.87	5.43	7.61	10.68
Present Value Factor (7%)	5.75	13.82	25.13	41.00	63.25	94.46	138.24

[V] Estate Planning

Estate planning considerations were traditionally the last component of a comprehensive financial plan. For some doctors, estate taxes will decline, and about 2 percent of all taxpayers will be able to bequeath more to their heirs on a tax-free basis, up to $1 million starting next year under EGTRA-2001. The amount exempted from estate taxes rises to $1 million in 2002 and to $3.5 million by 2009. The estate tax will not expire completely until January 2010. After that, the estate tax repeal is scheduled to last only one year. Congress must then either repeal the tax by December 31, 2010, or the tax will revert to present-day rates. Some economists opine that this is a bookkeeping artifact designed to curb the cost of legislation. The law also gradually reduces the estate and gift tax rates to 45 percent, from 55 percent, by 2007.

Checklist for Determining Whether to Make a Wealth Transfer During Life or at Death

Possibilities	*Considerations*	*Choices*
1. Cost	Time-value of money considerations Lost opportunity costs from money expended during lifetime Possible gift taxes and GSTT	a. Outright lifetime gift; possible attorney and title transfer fees

Possibilities	*Considerations*	*Choices*
	Time-value of money considerations Lost opportunity costs from money expended during lifetime Possible gift taxes and GSTT	b. Establishment of inter vivos trust—attorney and title transfer fees for establishment and funding; possible attorney and accountant fees for maintenance
	Time-value of money considerations Lost opportunity costs from money expended during lifetime Possible gift taxes and GSTT	c. Lifetime establishment of custodial account; possible attorney and title transfer fees to establish
	Estate taxes at death Possible gift taxes and GSTT	d. Transfer at death by will substitute; possible attorney and title transfer fees before and after death
	Estate taxes and possible GSTT	e. Transfer at death by will; initial drafting fees and probate fees
2. Utilize features unique to gift tax		a. Gift splitting b. Annual exclusion c. Direct payment of medical and tuition expenses d. Transfers exempt from gift tax also exempt from GSTT
	Applies only if gift taxes are payable out-of-pocket	e. Gift tax is tax exclusive
3. Utilize features unique to estate tax	Not important for assets with little appreciation	a. Stepped-up basis for transfers at death versus carry-over basis for lifetime transfers b. State death tax credit allowed on federal estate tax return (Form 706); no similar credit for state gift taxes on federal gift tax return (Form 709)

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Possibilities	*Considerations*	*Choices*
		c. Credit for tax on transfers to a decedent within 10 years of death; no similar credit for gift tax
4. Need to achieve objectives immediately	Cost of implementation Possible gift, GSTT, and income tax liability	a. Desire to benefit the donee currently rather than in the future b. Desire to avoid probate (primary or ancillary); requires lifetime action c. Desire to achieve estate tax savings; optimal strategy often requires current action d. Desire to achieve estate tax savings; optimal strategy often requires current action

[W] Medical Practice Succession Planning

Although, not usually considered a component of a comprehensive financial plan for most laymen and financial planners, some thought must be given to succession planning when dealing with the successful physician business owner. Therefore, the following lists of considerations, both abstract and concrete, is helpful to review.

Physician Succession Questionnaire—Abstract Nonfinancial Issues

	Yes	*No*
1. Can the medical practice or business stay in the family?	____	____
2. Have I discussed family succession with my spouse and family members?	____	____
3. Is handing over the practice to my family an obligation or an opportunity?	____	____
4. Am I ready to let go of the practice or medical business?	____	____
5. How do I feel about the practice going on without me?	____	____
6. Will I be financially responsible for the practice if I am no longer running it?	____	____

7. Do I think anyone in my family is qualified to run the practice? ____ ____
8. Am I overlooking qualified family successsors because of gender, age, or other reasons? ____ ____
9. Do other family members like my choice of successor doctor? ____ ____
10. Would I be the best person to train my family to take over the practice? ____ ____
11. Can I let other family members make important practice business decisions, even if I don't agree with them? ____ ____
12. Can I accept that the practice will change over time? ____ ____
13. Am I withholding any information to make myself indispensable to the practice? ____ ____
14. Have I supported the decisions made by my family in front of other employees and patients? ____ ____
15. Have I set up a competent advisory team outside the practice? ____ ____
16. Do I have an adequate life outside the practice? ____ ____
17. Do I have adequate income for my retirement? ____ ____
18. Do I have a trusted medical business advisor? ____ ____
19. Is there someone to whom my family could turn for advice if I were incapacitated?

How to Assist in the Collection of Concrete Data for the Practice Valuation

Locate important corporate papers and place them in the hands of the attorney or at the company's offices.

	Yes	*No*
• Minute books and incorporation papers (certificate of incorporation and by-laws)	____	____
• Copies of partnership agreement, stock certificates, shareholder agreements	____	____
• List of shareholders or partners, officers, directors	____	____
• Copies of various contracts, such as supplier and/or sales contracts, property and equipment leases, employee agreements, labor/union contracts	____	____
• Organization chart, list of key employees, employee benefits	____	____
• Documents concerning major patents, trademarks, copyrights, product license/royalty agreements, etc.	____	____
• Three years of financial reports	____	____
• Interim financial statements for three years	____	____
• Corporate or partnership tax returns	____	____
• Cash flow projections, budgets, capital expenditure plans, order backlogs, historic budget vs. actual results for last five years	____	____

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Who is the best person to collect financial information?	____	____
• The company's controller	____	____
• VP of Finance	____	____
• Outside accountant	____	____
Information on the industry overall and the current economy. (This will often be collected by the appraiser, although the client may have insights that would be helpful.)	____	____
• Factors influencing the health industry, its history, participants, competitors, sales of businesses within the industry, position of the company within the industry	____	____
• Relevant economic conditions, expectations, factors affecting regional, national, and company's managed care industry positioning	____	____
• Prepare client for interview with appraiser.	____	____
• History of the practice, ownership, launching of new products, marketing programs, assessment of key personnel, general outlook for the business	____	____

The following 13 principles represent the fundamentals of good financial planning:

1. Spend less than you earn, and pay your debts on a timely basis. When possible pay down your credit cards in full, not just the minimum payment.
2. Cut your expenses because, without reducing expenditures, there is little to allocate to important long-term goals like retirement and college planning. Medical professionals can always cut discretionary expenses in the areas of travel and entertainment, clothing, cars, and other luxuries.
3. Pay yourself first each month for a systematic savings program. Capitalize on forgotten or automatic investment plans, and increase your rate of investing as you move forward. Do not wait until you get married to start saving and investing.
4. Cover all assets before assuming greater risk. Disability, death, liability, malpractice, property damage are all insurable risks which healthcare professionals can easily accommodate. If you have your own practice, obtain insurance from a quality insurance carrier. According to J. Norton Schlacter, ChFC, CLU, the following are useful resources:

   Term Life and Property-Casualty Insurance
   www.aig.com, or, 800-438-0446
   www.instaquote.com, or 888-223-2220
   www.masterquote.com, or 800-337-5433
   www.quotesmith.com, or 800-556-9393
   www.selectquote.com, or 800-343-1985
   www.consumerquoate.com, or 800-552-7283
   www.iquoate.com, or 800-972-1104
   www.insuremarket.com, or 800-695-0011

Cash Value Life Insurance Policies
www.veritas, or 800-555-4655
USAA 800-531-4440
Wholesale Insurance Network 800-808-5810

5. If possible, do not be the owner of your life insurance. Owning your insurance will increase your estate value and possibly your estate tax. Also, don't name minor children as beneficiaries of life insurance. Children need a trustee and custodian. If not named in the insurance contract, this could delay much-needed moneys.
6. When investing, seek first a return of principal, before your return on principal. But remember that no risk, equates to no reward. Maintain both liquidity and marketability in your investments for greatest flexibility. Always be aware of the eroding effects of inflation on any investment. Invest more aggressively for the long haul, and more conservatively for the short term.
7. Diversify your investment portfolio. Don't invest in a stock or mutual fund just because it had a great return last year. Consider the risks taken to achieve that rate of return? Do you already have similar investments such that an addition to that sector would reduce your diversification? Also, invest internationally, but try not to over diversify (or, di-worsify).

For example, suppose that young Dr. Joseph Fabisczak, a dentist, has a portfolio that consists of equal amounts of just two stocks, A and B, for a total of $10,000. If equity A suddenly drops in half, his portfolio sinks to $7,500, and falls about 25 percent just because of one stock's decline. At the other extreme, Dr. Dr. Martin Sadowski, a podiatrist, holds 25 stocks, with about $2,000 in each, for a total of $50,000. Each stock represents 4 percent of the portfolio's value. If one holding triples, it's now worth $6,000. But, even with its 200 percent surge, it will boost his portfolio only about 8 percent. If he had held only 10 stocks, in equal amounts, and one tripled, the portfolio would gain 20 percent: a big difference.

8. No financial vehicle is without cost; keep transactions to a minimum. Assume a low rate of return on investments for an added margin of safety.
9. Minimize income, gift, inheritance and estate taxes to the extent possible. Keep more of what you make with tax-favored investments, and turn top tax dollars into assets without undue risk.
10. Start a pension plan, profit-sharing plan, or other retirement plan. If you are an employed medical professional, contribute and maximize any contributions to your employer's existing plans.
11. Make sure your will and trusts are up to date, and drafted in your state of residence. Old wills should be revised. It would be complicated if your will had to be probated in a state other than where you live.

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12. Assuming that home equity will bail you out in retirement is a mistake. Homes are where medical professionals live, and love, not investments. Patience and discipline will win in financial planning.
13. Do not tie your personal esteem to money, and do not believe that because you are a good doctor, you can do it all. Seek professional advice, when needed. Remember, the best financial planning investment is education.