



WANT TO ACHIEVE FINANCIAL FREEDOM?



Follow these four tips suitable for any optometrist.

BY AARON NEUFELD, OD

As optometrists, we possess a wealth of knowledge on everything eye-related, but how do we become good stewards of the revenue we earn providing exemplary eye care? Truth be told, most optometrists would say they do not have a wealth of investing knowledge. This article aims to change that by sharing four helpful tips that have guided me and many other optometrists in achieving financial freedom.

WHAT IS FINANCIAL FREEDOM?

Before we get into the tips, let's agree on what it means to achieve financial freedom. Simply put, it means having enough money and/or assets to live comfortably without needing to work.

That is, while your residual income pays the bills, you can focus on what matters most to you, whether that means spending time with family, traveling the world, or continuing to serve your patients in the best manner possible.

With disciplined investing practices, financial freedom can come much earlier than your enrollment in Medicare, despite what conventional wisdom might tell you. Consider the following four recommendations and you'll be on your way.

TIP NO. 1: START EARLY, COMPOUND INTEREST

Einstein famously said, "Compound interest is the eighth wonder of the world. He who understands it, earns it;

he who doesn't, pays it." Compound interest is the most important factor when looking at your investing horizon. Simply putting a small amount of cash away in investments over a long-time trajectory can make a big difference depending on when you start saving.

Let's look at an example of three hypothetical investors' strategies to better understand this: The smart investor, the late investor, and the hard investor (see Table). For the purpose of this exercise, we will assume a typical 7% interest market rate of return, where the shaded dark area indicates the years in which \$200 per month was saved.

The smart investor saves \$200 per month from 25 to 35 years of age, then stops all contributions. The late investor saves \$200 per month from 35 to 45 years of age, then stops all contributions. The hard investor saves \$200 per month from 35 to 65 years of age, then stops all contributions.

By the time each investor retires at 65 years of age, we see a few surprising results (Figure):

- By simply investing earlier, the smart investor has double the amount of funds compared with the late investor (\$402,707 vs \$199,992).
- The hard investor started saving later, and despite trying to catch up, still has \$39,702.54 less than



TABLE. Savings of the Smart, Late, and Hard Investors

AGE (YEARS)	SMART INVESTOR	LATE INVESTOR	HARD INVESTOR
20			
25	\$14,369.15		
30	\$34,759.27		
35	\$49,324.10	\$14,369.15	\$14,369.15
40	\$69,991.88	\$34,759.27	\$34,759.27
45	\$99,319.87	\$49,324.10	\$63,693.25
50	\$140,936.87	\$69,991.88	\$104,751.14
55	\$199,992.23	\$99,319.87	\$163,013.10
60	\$283,792.96	\$140,936.87	\$245,688.00
65	\$402,707.86	\$199,992.23	\$363,005.32

the smart investor (\$363,005 vs \$402,707).

- In addition, the hard investor put in more time than the smart investor (30 years vs 10 years), and thus more money.

The moral of this story is: The sooner you start saving, the quicker you will see the power of compound interest.

TIP NO. 2: TRUST IN THE INDEX FUND

The purpose of an index fund is to mirror the performance of a market index, such as the popular Standard & Poor's 500 (S&P 500), a service

that tracks the 500 largest publicly traded companies in the United States. Other indices, such as the Total Stock Market Index, track the entire US stock market, consisting of 3,550 companies.

Index funds are run by computer algorithms programmed to automatically track the market's dips and peaks. Computerized robots don't demand the salary of a Wall Street hedge manager, so they are significantly cheaper (or even zero cost, in the case of services, such as Fidelity); thus, those savings are passed along to you. Statistics show that investors pay nearly nine-times more in fees for actively managed mutual funds,

which charge an average of 0.78% per year, while the average index fund's cost is only 0.09%.

This is a stark contrast to the investment objective of actively managed mutual funds, which try to "beat the market's return" by outperforming the S&P 500 index. But for such mutual funds to be successful, you would need to hire a fund manager to pick and choose your investments. The cost of this management, in addition to the trading costs, administration, marketing, and other fees will essentially come out of your net investments return. For this reason, most actively managed mutual funds will greatly underperform compared with the S&P 500 index over many years, after accounting for fees and the cost of the funds, thus making index funds a superior option for nearly all investors.

TIP NO. 3: KEEP IT SIMPLE AND ALLOCATE PROPERLY

Determining the right asset allocation can be the most crucial—and most stressful—decision an investor makes for their retirement and other taxable investment accounts. Many investors spend a lot of unnecessary time on this step. However, whether your asset allocation is simple or complex, it can still serve you well.

So, what should you do? In short: Keep it simple. Believe it or not, the most successful investor may have a portfolio comprising only three to five funds. Each investor's choice varies, as it is influenced by individual personality and risk tolerance. (The higher your risk tolerance, the more stocks should dominate your portfolio.)

Here's a scenario: If you have \$500,000 invested entirely in stocks and the market plummets by 50% (resembling the 2008–2009 crash), could you bear that \$250,000 loss and wait 4 to 5 years for recovery? If this gives you pause, consider a heavier bond allocation.

Also, be sure to reflect on when you will truly need the funds. For most of us, this will likely be at retirement. The majority of investments are considered

AT A GLANCE

- Compound interest is the most important factor to consider when looking at your investing horizon.
- It costs nearly nine-times more in fees to maintain actively managed mutual funds, for which financial professionals charge an average of 0.78% per year, compared with the average index fund's cost of only 0.09%.
- Determining the right asset allocation can be the most crucial, and often the most stressful, decision an investor makes for their retirement and other taxable investment accounts.

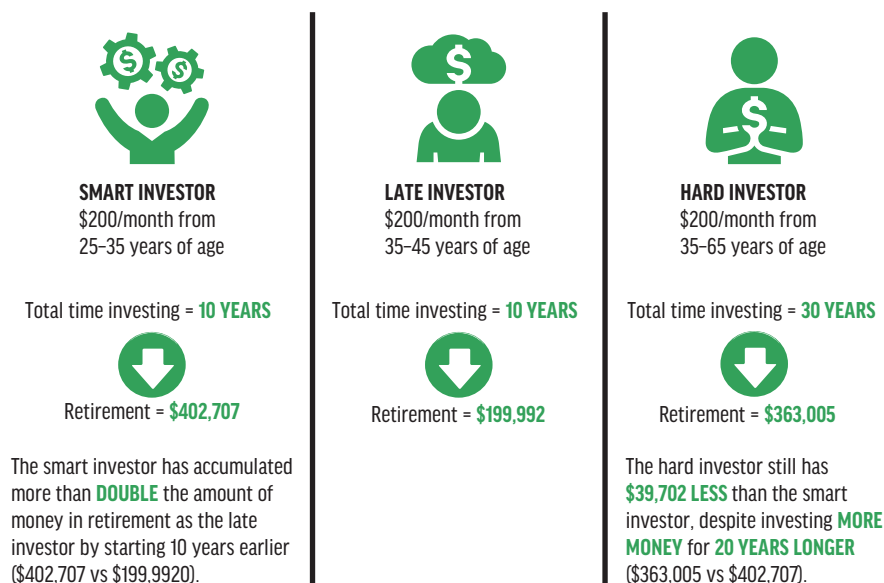


Figure. Although each type of investor saves the same amount of money per month, their final retirement funds differ depending on when they started saving and how long they saved. Note that the smart investor has the largest fund, despite only saving for 10 years simply because they started at 25 years of age.

long-term (ie, beyond 5 years); as such, a duration allows the market ample time for recovery. Remember, for many, it wasn't until 2012 that investors were able to recoup their losses from the 2008 debacle.

To determine the ideal stock-bond ratio, age can be instructive. A 30-year-old might lean toward a 90%-10% stock-bond ratio, while someone who has reached 60 years of age might prefer a 60%-40% split due to their impending retirement. (Stocks [and stock-focused index funds] hold more opportunity for gains, but also have more risk. On the flip side, bonds have slower growth with less inherent risk.)

For younger investors in their 20s or early 30s, even a 100% stock portfolio could be fitting. Although this approach would be high in risk, with a clear understanding and the right mindset, it can promise rewarding long-term returns.

TIP NO. 4: MAXIMIZE TAX-ADVANTAGED INVESTMENT VEHICLES

How exactly do these investments that we've been discussing actually take place? Well, there are a few key investment vehicles that provide ample

opportunity to grow your money with minimal interference from the government. Although there is no "one size fits all" investment vehicle when it comes to long-term investing, we have found that the approaches below have worked well for many optometrists.

401(k)

This option has a \$23,000 annual limit, although savers older than 50 years of age can contribute an additional \$7,500 in catchup contributions. If you are employed and are offered a match on your 401(k), make sure to take advantage of it! With a traditional 401(k), taxes are taken out when you withdraw the money in retirement, but not on the money that is contributed while saving.

Roth IRA

This option comes with a \$7,000 annual limit. Savers older than 50 years of age can contribute an additional \$1,000. Note that most optometrists will be over the modified adjusted gross income limit of \$161,000 if filing as single, and \$240,000 if filing married/jointly; however, a backdoor Roth IRA can be used to bypass these limits. (This column will take a more in-depth

look at backdoor Roth IRAs in a future issue of *Modern Optometry*.) Unlike a traditional 401(k), with a Roth IRA, you are contributing money that has already been taxed, so withdrawals in retirement are not taxed.

Health Savings Account

This option has a \$4,150 annual limit for self-only, and a \$8,300 limit for family coverage. Savers older than 55 years of age can contribute an additional \$1,000. If you have a high deductible medical plan, it makes sense to use a health savings account. Funds can be invested and are not subject to tax upon withdrawal.

Taxable Account

Unlike the three options above, when you invest in a taxable account, you contribute money that is already taxed into the account and are subject to capital gains taxes upon withdrawal. However, given the limits of each of the tax-shielded accounts, it would behoove you to contribute funds to a taxable account to further grow your wealth. The taxable account is a great option once all tax-efficient accounts are filled because it allows you to keep investing funds and further propel your journey to financial freedom.

PATIENCE IS A VIRTUE

The keys to successful investing lie in understanding that investing is a long-term process. If kept simple and consistent with proper use of tax advantages, this approach can yield commensurate results. Consider partnering with a financial advisor you trust to help you navigate this process. ■

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