6 Tips for Managing Risk in Your Retirement Accounts

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This is the second of six articles to be written for the ACG Update in 2011 based on the six themes in the Physicians Financial Navigator™, a proven wealth management system for physicians.

For many physicians, their practice 401(k) or hospital 403(b) plan is their primary or only source of retirement savings. As assets in these plans grow, it becomes increasingly more important to understand how to preserve and protect what you accumulate. If the investment markets dip significantly, it is natural to be concerned that a lifetime of practice can be threatened. Following are six points to help you maintain perspective.

Don’t stop

Continue to make contributions to your retirement accounts. Our economy goes up and down, but the fact remains that practically all of us will retire from the work force at some point in our lives. Even if you plan to practice for as long as you are competent, there will come a point where you can’t work any longer.

Recognize that Social Security is simply not going to provide any sort of meaningful equivalent to a career spent practicing medicine. Your financial independence is up to you. You should regularly review your goals and objectives; to validate the amount you are saving as well as the level of risk you are comfortable taking.

Beware of emotions

It is common for people to have an emotional reaction to the market’s ups and downs. The chart below shows how investors’ emotions change as markets move through their normal cycles.

Studies have documented how individual investors, and even professionals, chase performance. When markets are doing well, investors get less concerned about risk and put their money to work in investments that have been doing well recently. Too often that means investing while looking through a rearview mirror. It is important to maintain a clinical approach to money management, investing in down markets and rebalancing in rising markets.

Understand your risk tolerance

Investing is about finding a balance between our desire for high rates of return with the dread and pain that comes from losing our hard-earned money. Determining the level of risk you’re comfortable with will allow you to maintain the discipline to invest consistently.

It is important to understand your own tolerance for risk and how that relates to your long term goals. If you can accomplish all of your financial goals with minimal growth of your money, then you do not need to take much risk. For most physicians, there is some level of risk that must be taken to achieve growth that will outpace inflation over a long term. It is also important to understand that reaching a retirement age does not mean you are finished investing. Someone who steps out of active practice at age 65 could easily need to continue beating inflation for another thirty years!

Rebalance consistently

The pace and focus of medicine can make it challenging to understand and make decisions about managing your retirement assets. Often, physicians will establish an investment portfolio when they start a new position and then forget about the way the money is invested over time. It is important to understand the impact of changing economies on your retirement portfolio.

A consistent strategy of review and reallocation can enhance returns, reduce risk and maintain confidence.

In the graph below, consider the effect that an annual rebalancing strategy had on the risk and return of a portfolio over a long period of time.

The red bars represent a portfolio that was never rebalanced. The orange bars show what happened when the portfolio was rebalanced annually. On the left-hand side is courtesy of Shayne Ruffing, CLU, ChFC, AEP®, who is the creator of the Confident Transition Plan™ for medical residents, the Physician Disability Income Analyzer™ and the Physician’s Financial Navigator™. Thomas W. Ostrosky is an experienced wealth manager, guiding his physician clients in the complexities of asset preservation, estate planning and life insurance.

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side of the chart are bars showing risk levels. In this case, risk refers to how volatile the account value was. The rebalanced portfolio was less volatile.

Rebalancing requires effort on your part. If you are not comfortable making these decisions on your own, a professional financial advisor can guide you in making appropriate decisions, based on your objectives.

Understand your plan
If you are in private practice, you are likely involved in any major decision involving your retirement plan. If you work for a hospital, you may find that your investment options, plan sponsor and other important considerations change often, based on an investment or benefits committee recommendation. In addition to maintaining your investment allocation, you should regularly review how your plan is structured. Has the matching formula changed? Are there any new options to increase contributions? Are you fully funding the profit sharing or deferred compensation plans, in addition to the regular 401(k) or 403(b), if available? Do you understand the three phases of tax treatment and which two of them you can take advantage of?

Remember that retirement funds are for retirement
Technically, there are provisions for making early withdrawals from your retirement plans. However, they are rarely advantageous. Early withdrawals have tax penalties in many cases and can significantly impact your future financial security. Consider that a dollar withdrawn today is like taking two dollars away from your future self.

Planning for retirement is not easy. The practice of medicine requires a lifetime of intense focus in a singular area and often does not leave room for understanding the complexities of investing. A professional advisor should be able to help you articulate your goals, understand your options and develop a coordinated plan to realize your objectives.