Robert P. Olympia
Elizabeth Barrall Werley
Jeffrey S. Lubin
Kahyun Yoon-Flannery
Editors

An Emergency Physician's Path

What to Expect After an Emergency Medicine Residency

Springer

Editors
Robert P. Olympia
Emergency Medicine
Penn State Milton S. Hershey
Medical Center
Hershey, PA, USA

Elizabeth Barrall Werley
Emergency Medicine
Penn State Milton S. Hershey
Medical Center
Hershey, PA, USA

Jeffrey S. Lubin
Emergency Medicine
Penn State Milton S. Hershey
Medical Center
Hershey, PA, USA

Kahyun Yoon-Flannery
MD Anderson Cancer Center at Cooper
Cooper Medical School of Rowan
University
Camden, NJ, USA

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Chapter 101
Retirement Planning

Laura H. Mattia and Robert W. Wolford

Many of us consider retirement the ultimate goal of a career. Whatever the motivation (escape stress\burnout, spend time with family, try something new, etc.), it is important to define your expectations in retirement. What excites you about retirement? Everyone's retirement looks different and what excites one person does not excite another. A thoughtful retirement plan includes financial modeling, but, more importantly, it requires you to think about what your postretirement life will look like. This chapter discusses the financial considerations of retirement planning. Chapter 102 will discuss the nonmoney factors to consider in planning an outstanding retirement.

Several steps are required to plan your postretirement financial life:

Step 1. Estimate Your Required Annual Income

The best place to start planning for retirement is to create a vision of what life after emergency medicine looks like. Only then can you determine if you have enough income and resources to successfully achieve your vision.

Your income requirements will depend upon your lifestyle expectation and your goals. To estimate your lifestyle expenses, start with your current budget for expenses (housing\rent, car, food and groceries, utilities, cell phone, insurance, medical, gym and club memberships, taxes, hobbies, etc.). From there, you can determine how your spending will change. Paying off a mortgage and eliminating work-related costs will decrease your expenses. Today's active retirees often have increased expenses due to travel, new hobbies, etc., and these additional

L. H. Mattia
Atlas Fiduciary Financial, LLC, Sarasota, FL, USA
e-mail: Lauram@atlasfiduciary.com

R. W. Wolford (✉)
Department of Emergency Medicine, University of Illinois College of Medicine at Peoria, Peoria, IL, USA

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expenditures must be planned for. Many preretirees overlook important necessities such as health care (not all covered by Medicare), home maintenance, and car maintenance\replacement.

Future inflation is often overlooked. If a retiree has a fixed retirement income beginning at age 65 and inflation is 3% (the average inflation rate over the past 100 years), the retiree has a loss of purchasing power of 26% in 10 years, 45% in 20 years, and 59% in 30 years. This risk must be factored into your analysis.

Step 2. Estimate How Long You Will Live in Retirement

Knowing your estimated life expectancy and planned retirement age, you can calculate the number of years your money must last. Identifying the age most emergency physicians retire is challenging. A Korean study reported that emergency physicians more than other medical doctors are likely to retire early [1]. In addition, a survey of retired emergency physicians found that 40% retired earlier than they planned [2]. The individual physician must consider the consequence of early retirement on life expectancy and the need for additional savings.

In 2019, men in the United States aged 65 can expect to live 18.2 more years on average, and women aged 65 years can expect to live, on average, 20.8. The IRS estimates life expectancy around age 90 to protect against the risk of outliving retirement money. When estimating your life expectancy, factor in your family history and personal health condition. You may want to assume you will live to 100 or more to be conservative. Retirement life expectancy is the time beginning at retirement and extending until death. Proper planning will protect you from outliving your assets, the number one fear of retirees.

Step 3. Identify Your Retirement Income Sources

After estimating annual expenses and the number of years you will need it, the next is to identify potential income sources. Over the past 30 years, major changes in how individual retirees finance their retirement have occurred. As the future of Social Security becomes more uncertain and pension plans disappear, personal savings must account for a larger share of retirement income.

Some retirees plan to receive income from continued employment. The assumption is that if they do not have enough money to retire when the time comes, they will just keep working. Unfortunately, this may not be feasible due to health issues or unfavorable job conditions.

Social Security

Social Security is a source of guaranteed income to help you meet living expenses. Social Security represents a large financial asset. For example, if you receive $40,000 per year from Social Security, this would be equivalent to $1,000,000 in assets, assuming you follow the widely discussed 4% withdrawal rule. About half of all Americans file for Social Security when they first become eligible for benefits, at age 62. Choosing the best time to claim your benefit is not easy as the system is complex and there are a lot of misconceptions about Social Security.

To avoid errors and get the greatest benefits, it is important to understand how the system works. Americans who have worked for 40 quarters are eligible for benefits as early as age 62, but they could get larger monthly checks by waiting. When you should claim depends on your situation. For every year you wait to claim beyond full retirement age, until age 70, your benefits will increase by 8% (not including the compounding of cost-of-living adjustments). After 70, there are no additional increases, so this is the longest you should wait to claim. How long you should wait after 62 to claim benefits depends on numerous factors, including your health. Coordinating with your spouse to determine the best time to claim your mutual benefits has an impact on your combined benefits while you are both alive and on those of the surviving spouse after one of you dies. Surviving spouses are eligible for benefits beginning at age 60 and disabled spouses at 50, but they can only receive one benefit, so it pays to optimize at least one of your benefits. Divorced people can claim on their ex-spouses' accounts if they were married for at least 10 years. This is only an advantage if your ex-spouse's account would provide greater benefits than your own. Making this claim will not limit the benefits your ex draws. They can still get their full benefit as if you had not made this claim.

Making the right Social Security choices requires investing some time and effort to understand the rules and how they apply to your situation. Visit the Social Security Administration (SSA) website (https://www.ssa.gov), and create your account. With your account established, you ensure you are receiving accurate credit for your annual income, use the site's benefit calculator, claim your benefit, and decrease the ability of others to commit fraud by stealing your identity and claiming your benefits.

Personal Savings Play a Large Role in Retirement

In the past, Social Security and pension plans were depended on to fund an individual's retirement. Unfortunately, this is no longer the case. Personal savings play a central role in funding retirement income needs, and while individuals preparing for retirement recognize this need, many are unable to save enough.

The move from defined benefit plans (i.e., pensions) where the employer takes the risk to 401(k) and 403 (b) plans requires individuals to make their own decisions about how to allocate assets to generate income in retirement. It is essential to take full advantage of employer-provided benefits or retirement contribution-matching programs, if available.

Personal savings available for retirement income consist of the following three categories:

- Brokerage and Bank Accounts—Taxable Accounts.

  These savings are not tax sheltered, so all capital gains and income are realized in real time.

- Traditional Retirement Accounts.

  Investment retirement accounts (IRAs) and defined contribution (DC) plans are the most common retirement accounts. At age 72, you must begin taking distributions from all traditional retirement accounts in the form of required minimum distributions (RMDs).
- Roth Retirement Accounts.

  While there is no tax benefit when you contribute to a Roth account, your earnings grow tax-free, and you can withdraw from them tax-free. Roth accounts are not subject to required minimum distributions (RMDs), but the ability to make contributions to them is limited by your income (check https://www.irs.gov, as this changes annually).

The Distribution Stage

The change from accumulating wealth (preretirement) to the distribution\spending (retirement) phase is often jarring. As a retiree, you must approach your investments differently than how you did as a 40-year-old when you were accumulating wealth. Nearly 60% of emergency physicians are concerned about their financial preparation for retirement [2]. Historically, retirement strategies focused on de-risking and capital preservation. Moving to cash and laddering fixed income is one way to minimize market risk. In recent years, it has become clear that a longevity strategy may be more appropriate, as the retiree's primary risk may now be outliving their money. A longevity strategy calls for a disciplined approach to maintain some equity exposure to keep pace with inflation and taxes and adding some alternative exposure to mitigate the increased risk. With a broad mix of investments, you have a higher probability of weathering any future economic environment and achieving greater security.

An Investment Strategy Will Improve your Chance of Success

One of the most important determinants of success in investing is preparing and sticking to a strategy. For years, successful investors and experienced investment committees have used a documented strategy for managing critical investment decisions. Although you may consider yourself a disciplined and savvy investor, empirical evidence demonstrates that most investors make decisions based upon emotion and often make bad decisions as they attempt to chase yield. Studies have shown consistently that while mutual funds quote excellent long-term track records, the actual performance for average investors is lower because they tend to make buy and sell decisions at the wrong time. Markets by their nature go up and down, never in a straight line. While some investors may be able to overcome behavioral risk,

having the discipline to not sell at the worst times, volatility can cause actual losses and result in less money over time. Negative compounding results in lower actual returns and also creates havoc when taking distributions.

Volatility risk and *behavioral risk* are two risks inherent to investing. A third risk, *sequence risk,* is exclusive to retirees due to cash withdrawal needs. With cash inflows, it is better to experience bad returns first as you buy more shares at a lower price, enhancing the effect of compounding. This is the basic tenet of dollar-cost averaging during the accumulation phase. When taking distributions, the opposite is true. Good returns up front help to preserve and grow assets; bad returns up front eat away at your principal, and you can never get it back. Volatile market returns impact your portfolio differently depending upon whether you are in the accumulation or distribution phase which is another reason to maintain a low-volatility portfolio.

Adhering to an investment strategy helps avoid these pitfalls by removing emotions from investment decisions and minimizing risk. The investor's objective is to create a predetermined plan, prior to any investment decisions, so that during the market's move up or down, the preplanned strategy will invoke smarter and timelier decisions void of emotion. There is a simple approach to developing your investment strategy:

1. Determine your risk tolerance

   Some people are risk-takers and others avoid risk. Risk can be a combination of volatility and liquidity. Be honest and do not overthink this. There are various questionnaires available that can help you determine your level of risk tolerance. The success of an investment plan will be determined by one's ability to invest in a portfolio with a suitable amount of risk.

2. Decide on goals, objectives, and strategies.

   Establish investment-performance goals with appropriate benchmarks to monitor results. What is the target rate of return? What are the sources and measurements of risk? How long do you require your savings to last? How much income needs to be withdrawn from the portfolio?

3. Decide on your strategy for managing volatility risk.

   Maximizing return without regard for volatility risk is a major contributor to the failure of most individual investors. All investors want maximum return with the least amount of risk, but how one manages volatility risk will determine success. Most institutional investors adopt a strategy based on science and modern portfolio theory. The "efficient portfolio" relies on blending together different investments, specifically for the purpose of controlling volatility.

   The goal is to preserve your assets and to grow those assets responsibly. The best way to accomplish this goal is to build a diversified portfolio with multiple asset classes. While it may be possible to "outperform" by making a concentrated bet on an attractive investment, to do so entails a level of risk that may be unnecessary. Appropriate asset allocation should enable an investor to achieve attractive compound asset growth in the good years while providing acceptable downside protection during the bad years.

4. Set guidelines for asset classes.

   The investment strategy should provide guidelines to select asset classes. The more specific you are within each class, the better. For example, you may decide to use the following asset classes in your portfolio: large-cap domestic stock, small-cap domestic stock, mid-cap domestic stock, international stock, domestic bonds, international bonds, real estate, convertible securities, natural resource funds, and alternative investments. For each asset class, you should compile a list of all your constraints. For example, you might determine that you will never invest more than 35% in domestic bonds; that you will only invest in individual bonds – never bond funds, that they should be investment grade – AAA bonds; and that you will not hold more than 5% in any issuance. Also, determine what asset classes you will avoid, for example, limited partnerships, junk bonds (average quality BBB and below), aggressive mutual funds, and hedge funds, due to the additional risks associated with these investments.
5. Implement an asset allocation policy.

   Based on the first four steps, you can create an asset allocation – setting up a portfolio that has multiple asset classes. The allocation must consider the need for cash flow, growth, and safety. Studies have shown that 90% of an investor's success comes from asset allocation decisions, not from security selection or timing. This step involves analyzing each new asset in terms of how it will impact the overall portfolio and determining the optimum amount to include.

   The goal of asset allocation is to find asset classes that have a low correlation to each other to reduce volatility while targeting a specific return. Correlation measures the way asset classes move in relation to each other. The ideal mix is chosen with asset classes that move in opposite directions under different economic environments so that combined the overall portfolio is more stable making it easier to withdraw income and less prone to sequential and behavioral risk.
6. Rebalancing

   This might be the most crucial step. Your strategy should clearly delineate how often you are going to monitor performance and when you are going to rebalance. This component is the discipline that most investors lack. The ability to harvest gains as investments are going up and at the same time invest in asset classes when they are out of favor is the greatest tool the investment strategy can offer. Not many investors were savvy enough to sell equity as it grew in 2019, 2020, and 2021 and buy alternative assets, but those who had a strategy may have been some of the few who did and benefited in 2022 when equity plummeted.
7. How to withdraw Your income to maximize efficiency

   Once you have successfully reduced volatility and you are rebalancing on a regular basis, you can withdraw cash generated from dividends, coupons, maturing bonds, and security appreciation captured during the rebalancing process. You should maintain a minimum cash cushion of at least 6 months in addition to your emergency savings.

   The order you withdraw your funds can depend on numerous factors. Usually, it makes sense to withdraw from your taxable account to allow the money in your retirement accounts to grow tax deferred as long as possible. However, if

you are older, have a sizeable portfolio, and have low tax basis investments, it might make sense to leave them for an inheritance or charitable gift. Taking withdrawals from a traditional IRA or 401(k) will create a tax liability in the form of ordinary income. You also lose the opportunity to grow your investments tax deferred, but once you turn 72 you are required to begin taking required minimum distributions (RMDs). If you have a sizeable traditional IRA, it might make more sense to begin spreading the tax burden over a longer period but with careful consideration of your marginal tax bracket and Medicare part B and part D premium bracket (known as IRMAA) in each year. Since Roth IRAs are never subject to RMD, it is ideal to let that money continue to grow tax deferred. Your heirs will benefit from the preferential tax treatment if they should inherit your assets in this form. Usually, you will want to use the Roth funds last unless there are specific tax reasons to use them sooner.

Conclusion

The decision to retire is a major life transition requiring deep thought and considerations which are unique for every person. Typically, the average investor's success is not based on choosing the "best" investment but on decisions regarding upfront planning, an investment strategy, and diversification. You would not go on a trip somewhere new without a map (or these days a navigation system). The same should be true as you evaluate your options to navigate the unknown territory of retirement and the capital markets. It might be worth having a professional, independent fee-only, CFP to help you plan. A reliable source to find this type of independent advisor who will sign a fiduciary oath while working with you is NAPFA.org. If you decide to do it yourself, consider conducting further research on the material presented in this chapter to ensure a successful retirement.

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