38: Pre-Financial Independence

Full Episode Transcript

With Your Host

Bonnie Koo, MD

Welcome to The Wealthy Mom MD Podcast, a podcast for women physicians who want to learn how to live a wealthy life. In this podcast you will learn how to make money work for you, how you can have more of it and learn the tools to empower you to live a life on purpose. Get ready to up-level your money and your life. I'm your host, Dr. Bonnie Koo.

Welcome to episode 38. So in episode 37, I talked about doing a year-end reflection and specifically I said at the end that it's so important to understand where you are so you can kind of figure out where to go next.

And so today, I want to talk about specifically about how to figure out when you can actually not just retire, but to start cutting back. One of the things I hear over and over again from other women physicians is that most of us don't want to quit medicine, but we would all love to work just a little less and go part-time.

And I find that people don't quite see that they actually can cut back a lot sooner than they think. Now, when people think about retirement, they usually think about the stock market in terms of their 401Ks, their Roth IRAs, et cetera.

And most of us think about our retirement accounts as having this or rather we need to reach this magical number, this financial independence number before we can "retire." And so just to give you a preview and to make sure we're all on the same page, this financial independence number is a number where once you have it, you can stop working completely and just work off your retirement money.

And that is based traditionally on something called the 4% rule. And so what is the 4% rule? Basically a rule saying that for every million dollars you have saved and invested, that will give you $40,000 a year. Now, just recently, I read that they actually think it could be more like 5% and possibly even higher, like 6%, meaning that one million dollars would actually be $50,000 or even $60,000.

What this rule basically says is that this is the amount of money you can withdraw out of your account and you'll likely not run out of money by the time you die. Because that would suck basically to retire and then run out before you die. And so the goal is to not run out of money in retirement. This makes sense, right?

But this 4% rule recently now might be the 5% rule, which is just extra money for everyone. So many of us live by this in terms of well, my number is this. And so I will tell you that for a long time, I would say my number is five million dollars because to me that meant $200,000 a year of income.

Now, this is before taxes obviously, depending on whether this is pre-tax or post-tax money. But for simplicity's sake, that was a number that I had picked. So I think a lot of us kind of live life with this number and we're thinking, okay, once I get this number, then I can retire. But we forget that it's not black and white, it's not all or none.

Meaning you don't have to wait until you get to that number, let's just use five million as an example, to "retire" or do something else. You actually can do it a lot sooner before you reach five million.

Now, in terms of compound interest, it's not linear. Most of the growth can be almost exponential, depending on where you are on the curve. And so like I said earlier, one of the things I hear all the time from other women physicians is they would love to cut back a little bit, but many people feel like they can't because of money.

And so I recently actually had a few clients where they were in this same exact situation and after running their numbers, I was actually able to show them pretty quickly that they can in fact go part-time. And actually I think one of them was technically in a place where they could just quit completely and be fine, which is kind of crazy if you're thinking you can't even retire or cut back at all.

And so it's so important to know what your numbers are and what they mean. And so I think the better number to focus on is not the financial independence number but something that I call the pre-financial independence number or the pre-FI, or pre FI.

And this number is simply the number that you reach, which is before your FI number, where you can actually go part-time and just have a lot more flexibility without affecting your future retirement number goals. So how does that work?

Well, the reason why this works and why this is a thing is because even if you don't add any additional money to your investments, compound interest is still working its magic. Your money's still going to grow even if you don't put money into it.

And usually what happens when people cut back is they don't stop contributing to their retirement. They just contribute less because they're making less. And so one scenario that I think is worth spending time figuring out is at what point were you able to go part time and then what does that part time look like?

Meaning are you going to just cut back a day, and does that mean that you just contribute less to your retirement, but you still have plenty to fund your existing spending? Vacations, et cetera. Or does it mean that you just cover current expenses and no longer contribute to your retirement?

And there's everything in between. You might be like, okay, I'm going to make enough to contribute to or rather to spend on and to live my life, and I'm just going to do enough to get the match, or maybe I'll just do enough to fund a Roth IRA. So you can kind of play with this, and this is how you calculate it.

Because most of us are kind of - we can kind of figure out how to get to our magical number, like five million dollars, how long it's going to take. They're based on what we currently contribute every year. And so the pre-FI, there's no - at least I haven't found a particular calculator for this, so it takes some trial and error.

And so you want to open up your favorite compound interest calculator. I'll link in the show notes to one that I use. It's very simple. It's called the Moneychimp compound interest calculator. And all these calculators are very similar.

You have to put in your current principal and what that means is what you currently have. So I'm going to use the example - you might hear me typing. I'm going to put in $500,000. And then it's going to ask what is your annual addition, how many years to grow, and what is the interest rate.

And for Moneychimp, it also asks when do you want to make the additions. Is it going to be at the beginning of the year or at the end of the year? This affects things slightly. And so if my current principal is $500,000 and let's say my ultimate goal is to have let's use three million dollars, which using the 4% rule means $120,000 or with the 5% rule, it's more like $150,000 a year.

And so let's say I currently am able to put away $25,000 a year and let's say that right now, I'm thinking I would have to work for 20 more years and then the interest rate - this is where I find a lot of people put in a really low number. They're so conservative.

And so this obviously depends on how you are investing your money. That's not something I'm going to talk about in this episode. However, in my humble opinion, this is not advice, I recommend being aggressive. And that's only because even if you do retire, you're going to live for several more decades, and so there's really no reason to be super conservative, which I would consider anything more than 20% bonds.

We are personally invested in 90% stocks and 10% bonds. And so with an aggressive stock portfolio, you can use 10%. I had a client who was using 4% or 6%, which is super low. So obviously it depends on how you're investing it, but these clients were investing pretty aggressively. I think they were actually - some of them were 100% stocks.

And so 10% is actually something you can totally put in. So what I did right now is I put my current principal as $500,000. I'm making annual contributions of $25,000 a year and that could be your 401K and your Roth IRA. I put 20 more years to grow and I put 10%. And that came out to just under five million dollars.

Now, it depends what your goal is. Now, I just said let's try for three million dollars, so clearly, I don't have to work full-time for 20 years to reach three million dollars. So I guess first I need to play around with this a bit and see.

Okay, so when I change it to 15 years, then that would be just under three million dollars. Okay, so I could do that. I could keep working and humming along and working full-time, whatever I'm doing for another 15 more years and I'll get close to three million dollars.

Now, what if I cut back sooner than 15 years? How does that affect things? Remember I said the money keeps growing even if you don't put as much money. So now, this is where you have to do two calculations. You kind of have to do some trial and error.

So what I'm going to do is I do some calculations. I'm going to reduce the number from 15 years to a number before. So I'm going to do five and then 10. And then you got to take that future value and then put it in another calculation. So let me walk you through it step-by-step.

Okay, so what I currently have right now is I have $500,000, adding $25,000 a year, growing at 15 years at 10%. And that comes out to 2.96 million dollars. Now, I want to know how that's going to affect things if I cut back sooner, meaning that I'm going to basically not put as much money towards it.

So let's just try five years. Let's say current principal, $500,000, and annual addition, let's say I only do a Roth IRA, which for this year, the annual limit, contribution limit is $6000. So what I did is $500,000 principal, $6000 annual addition, five years to grow at 10%.

That gives me $845,000 and change. So what I do next is I actually open another window with the same compound interest calculator, and I copy and paste that $845,000 and I put it into a new calculation under current principal. So now the current principal is $845,000 and if you recall, I said I put five years, so now I'm going to put 10 years to grow, which gives me 2.3 million dollars.

So hopefully I haven't lost you, but what I basically did was decrease contributions and plugged it into the calculator to see where I would end up in 15 years. And so with less contributions, I get to 2.3 million versus close to three million if I was doing full contributions.

And so you might be thinking well, we don't get to our goal of three million dollars in 15 years. But you're also working less. And you know, one thing I heard, and this was actually at the White Coat Investor Conference, the first one actually where I remember one of the things Jim Dahle said is it's all about career longevity.

Because doctors are burning out so quickly right now and I think many of us would feel less burnt out if we just worked less. Obviously, there's other factors, but I know that's definitely one contributing factor is if we work less and had more time for ourselves.

And so he was saying how the goal is to figure out how to create a career that you love and can do for a long time. Because at the end of the day, most doctors or many doctors I should say went into medicine because they want to help people and because we love being doctors.

And a lot of us would have an easier time or would feel a lot more fulfilled if we just simply worked a little bit less. So how can you figure out, how can you carve out a way to do that and not affect your future finances? And one way is to simply work a little bit less, still contribute a little bit, still invest the money so that it's growing, versus trying to retire early.

I see a lot of doctors feverishly trying to get to this mysterious finish line where they can just quit medicine and I just think that's the wrong goal.

Because remember, in my earlier episode, The Retirement Myth, you're not going to be happier all of a sudden. We think we are, but it's extremely rare that you are because that's just changing the circumstance.

I hope I was clear in this process. I know it was probably a little confusing. But I think the big takeaway point here is don't fall into all or none thinking, thinking you have to work, work, work, put all this money away until you get to a magical amount, and then you can kind of hit the brakes or take a little break.

I always, always tell my clients only you can create the life that you want now. No one's going to do it for you. And if you want to have some more time, now is the time to do it. You can always work more later if you absolutely have to.

And I will say, at least I have found that once you've tasted what it's like to work a little bit less, you will do whatever it takes to protect that free time and it doesn't necessarily mean that you're going to have to get a side hustle, et cetera. But I think sometimes we forget that how resourceful we can be when push comes to shove.

And I think that's one of the beauties of being physicians is that we have so much flexibility about how our work lives can look like. I talked about earlier that you can try locums and you could do per diem work and there's just so many different ways to use our physician abilities to create income for us.

And it doesn't have to look like traditional working at a full-time practice or depending on your specialty. And so I hope this episode has given you something to think about. Maybe you'll run some calculations and re-run your numbers to see where you're actually at because like I said, unless you know where you are, this is like getting on the scale.

How much money do we have? Where are we going if we keep on this path? Do I want a different path? What would I need to do to get there? If you're in my Facebook group, Wealthy Mom Physicians, feel free to post there if you need some help with this calculation and I'll talk to you guys next week.

Hey, if you're a woman physician who is ready to practice medicine on your terms, then you've got to check out my program, Money for Women Physicians. It's part course and part coaching and 100% guaranteed to put more money in your pocket. Go to wealthmmommd.com/money to learn more.