THE EDITOR'S CORNER

Funding for Retirement

Retirement is the subject of this month's Management & Marketing column. The article addresses a concern that faces all of us: If you live long enough, you will retire. There are not many 80-year-old orthodontists, but an increasing number of retirees are reaching that age.

Orthodontists generally earn high incomes for many years in practice, and thus should be capable of funding a comfortable retirement. Still, it takes a certain amount of discipline and planning to accumulate a fund large enough to continue to support the lifestyle to which one has become accustomed.

The big retirement questions are how long and how much, and how to invest to satisfy the first two. Immediately there is a problem. Nobody knows how long he or she will survive. Actuarial tables are of limited use. Like group norms, they tell you little about the individual. The tables do tell us that women live longer than men—perhaps six years longer on the average, according to a report from the Max Planck Institute. This means that for an orthodontist still married at the time of retirement, the size of the fund must be predicated on the remaining years of the female spouse—the female orthodontist or the wife of a male orthodontist. For any particular couple, however, we are still in unknown and unknowable territory. Catch-22 is that some of us will live to be 100, and we don't know who. Catch-23 is that if we don't know who might live that long, we don't know how much of a retirement fund will be adequate.

The belt-and-suspenders solution to this dilemma is to accumulate a fund large enough that, at the time of retirement, it can be invested in government securities with a guaranteed annual return that equals the amount needed to maintain a chosen lifestyle. Whatever the size of the retirement fund, it would be dangerous to leave the money at risk after retirement in any form of investment that can decline in value.

Catch-24 is that not everyone can put aside enough money for enough years, or maintain adequate value in the fund at the time of retirement. For those who have accumulated a fund that is substantial, but not large enough to withstand annual withdrawals indefinitely at the desired level, it may be possible for an accountant or actuary to work out how to make up for the shortfall in annual yield, with annual reductions in the principal amount, and still have the fund last for the longest conceivable lifetime. For those who do not come close to accumulating a retirement fund adequate to support continuation of a chosen lifestyle, there could be a late-inning rally through sale of the practice and, if necessary, one's home real estate. If that is still not enough, a scaling down of one's lifestyle will be necessary.

The question of what to invest in is also a great unknown. You will only know how well you did when all is said and done. Accumulation of a retirement fund depends on advance planning—perhaps the postponement of some immediate gratifications in favor of early and regular contributions to the fund. If one starts early enough, it may minimize the temptation to take on too much risk and may allow the fund to be completely protected from risk when it reaches an adequate level. The luckiest orthodontist I ever knew carried the idea of diversification to the *n*th degree. He invested in everything—stocks, bonds, real estate, oil, gas, stamps, coins, gemstones. It happened to be at a time when the economy was booming, and he made money on everything. Luck may play a role in every aspect of our lives, but should not be depended upon in investment planning.

The smartest orthodontist I ever knew with regard to investments was an outstanding clinician who, upon retirement, became a highly successful bond broker. He invested his money only in AAA-rated, insured, in-state tax-free municipal bonds. He set up a 10-year ladder of these bonds so that he always had bonds maturing, from which he could invest the proceeds in new bonds with the farthest-reaching maturities in his ladder. This had the virtue of averaging out available yields, so that he didn't have to buy soon-to-be-called bonds at a premium. New money and the yields from his current bonds were also invested at the farthest possible maturity on his ladder. Interestingly, the smartest non-orthodontist I knew had an identical investment strategy.

Why this method works so well is revealed in the formula that converts a tax-free yield to its taxed equivalent:

Tax-free yield/(1 – tax bracket) =
Taxed equivalent

As an example, here is the taxable equivalent yield of a 5% tax-free bond for an investor in the 35% tax bracket:

$.05/(1 - .35) = 7.69\%$

Not only is this a good way to minimize risk, but it also requires a smaller retirement fund to achieve a yield equal to that of a considerably larger fund of taxable investments.

While a qualified retirement plan is an excellent vehicle for building wealth because of the pyramiding effect of tax deferral, it is not a suitable place for tax-free bonds, which would be taxed upon withdrawal from the plan. It is highly suitable for investments such as stocks and mutual funds.

With sensible planning and minimization of risk, any orthodontist should be able to enjoy a happy retirement.

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