THINKING OUTSIDE THE STOCKS (AND BONDS)

Investors who diversify their portfolios into nontraded assets can mitigate their risk of loss.

BY JASON M. O'DELL, MS, CWM, AND ANDREW TAYLOR, CFP

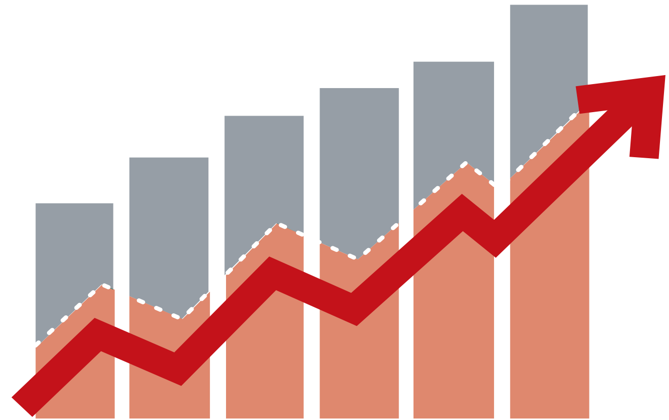
Most investors have concerns about the global economy. We are almost a decade removed from the 2008 financial crisis and have witnessed the S&P 500 Index appreciate by nearly 200% since then. Interest rates remain low by historical standards, and the threat of increasing rates presents the potential for bonds returns to disappoint investors interested in reducing equity exposure.

Central banks and governments throughout the globe have implemented an array of measures to stimulate growth in their respective domestic economies. US financial markets have responded favorably to the multiyear trend of government spending. However, the days of artificial stimulus from the US Federal Reserve Board (the Fed) appear to be coming to an end. In 2014, the Fed announced the end of its long-running bond purchase program, and in 2015 a branch of the Fed, the Federal Open Markets Committee, raised short-term interest rates for the first time in nearly a decade. Many economists anticipate that the Fed will announce a series of increases to the federal funds rate—the rate at which banks and other institutions lend money to one another on an overnight basis—in 2017, after a single rate hike each in 2015 and 2016. Removing the market's safety net may amplify the volatility of equities and force the US economy to stand on its own.

Investors with a desire to reduce risk face a dilemma. An environment of rising interest rates typically does not favor traditional bond investments, as bond prices and interest rates have an inverse relationship. It is crucial that well-informed investors adjust their investment behavior accordingly. This group includes, of course, retina specialists.

INVESTMENT THEORY FOR PHYSICIANS

Savvy physician-investors understand that portfolio diversification is a key consideration in reducing some of the risk of loss. Historically, in volatile markets, mitigation of loss has been not a luxury but a necessity. Many educated investors who assumed that they were adequately diversified still lost nearly half the value of their portfolio in the crash of 2008 and 2009. How did this happen? Even though many investors were diversified within the stock market, with holdings in various sectors, they still fell victim to market risk. In other words, the entire market came crashing down, and so did all investors within the market.



Affluent individuals should approach investing with the goal of diversifying risk through noncorrelated assets, allowing their funds to compound over time by achieving positive returns net of taxes and inflation with reduced volatility. This is not to suggest that opportunities should be ignored. Rather, this strategy simply states that risk must be properly managed and allocated.

Generally speaking, this strategy is suitable for physicians of all ages for different reasons, and young retina doctors should consider how this investment philosophy will look at different stages of their careers. With proper savings and risk management, a young physician has no need to participate in speculative investments. Consistent after-tax returns and proper planning will be sufficient to allow a young physician to retire comfortably and maintain an appropriate standard of living. The greatest asset of a physician who has been in a stable practice for 10 or 15 years is the ability to generate future earnings. A higher risk tolerance

is appropriate for a doctor in this demographic because income earned will be significant enough to live comfortably during this portion of his or her career. An established physician who is less than 10 years from retirement has likely accumulated significant assets and will need to limit the range of possible outcomes for his or her established wealth.

DIVERSIFICATION

Diversification need not be limited to securities such as traditional stock and bond investments or bank deposits. Proper diversification includes investment in multiple classes rather than within a single class (such as securities or real estate), particularly in the volatile markets that return periodically throughout an individual's lifetime. A balance of domestic and foreign securities, real estate, small businesses, commodities, and other alternative investments may prove to be much less volatile overall than holding the majority of investments in real estate and securities, a habit of many physician-investors.

Most doctors who contact our team are either affluent and want to fine-tune their planning or are becoming increasingly involved in their financial planning and want to know the secrets of the more financially successful. Subsequently, many of our physician clients have taken a more active interest in surgery centers, medical office buildings, and other health care–related real estate. This strategy contradicts the concept of diversification because it makes a disproportionate amount of capital dependent upon the success of a single industry. One strategy of portfolio diversification for doctors is to avoid all health care–related investments, as many physicians are already invested heavily in health care.

THE TIME IS NOW

There has never been a better time to focus on investment risk management. For physician-investors seeking to diversify traditional stock and bond portfolios and reduce portfolio volatility, nontraded investments can be attractive alternatives. Please contact us to see if alternative investments or other planning strategies might possibly reduce your investment risk. ■

Jason M. O'Dell, MS, CWM

- principal, OJM Group; author, *For Doctors Only: A Guide to Working Less & Building More*
- 1-877-656-4362; odell@ojmgroup.com

Andrew Taylor, CFP

- wealth advisor, OJM Group
- 1-877-656-4362

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