

# THE JD INVESTOR

A MONEY AND FINANCE BLOG FOR LAWYERS



# INVESTING FOR LAWYERS

## WHAT YOU NEED TO KNOW



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*Timothy Corriero (represented under the tradename "Juris Wealth") is an Investment Advisor Representative of Gemmer Asset Management LLC ("GAM"), an investment adviser registered with the Securities and Exchange Commission that maintains its principal place of business located in Walnut Creek, California. For additional information, please refer to Gemmer's ADV Part 2A Brochure or Form CRS.*

## Contents

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|  |    |
|--|----|
| Introduction: Lawyers are different.....   | 3  |
| Illustration: A wealth accumulation window .....   | 3  |
| Part 1: The single most important factor in investing .....  | 5  |
| Figure: Investment returns vs. investor returns, in percentage terms (Jan 93 to Dec 22) .....      | 6  |
| Figure: Investment returns vs. investor returns, in dollar terms (Jan 93 to Dec 22) .....          | 7  |
| Part 2: What does investment risk mean? .....  | 8  |
| Table: “Risky” stocks vs. “lower risk” bonds .....   | 10 |
| Part 3. Can you beat the market?.....  | 11 |
| Figure: Don’t try to outguess the market .....   | 12 |
| Figure: Factor-based investing to generate returns higher than the market overall .....            | 13 |
| Part 4. What should you invest in?.....  | 14 |
| Illustration: A world of investment opportunities: percent of world stock markets as of 2018 ..... | 14 |
| Part 5. Do you know how to minimize your tax burden? .....   | 16 |
| Part 6. How will you manage the “what-ifs” in life? .....  | 17 |
| Part 7. What’s your number? And how will you get there?.....                                       | 18 |
| Illustration: Getting to \$5 million+ in 20 years .....  | 19 |
| Part 8. Should you work with an advisor? .....   | 20 |
| Now what? .....  | 21 |
| Disclosures .....  | 22 |

## Introduction: Lawyers are different.

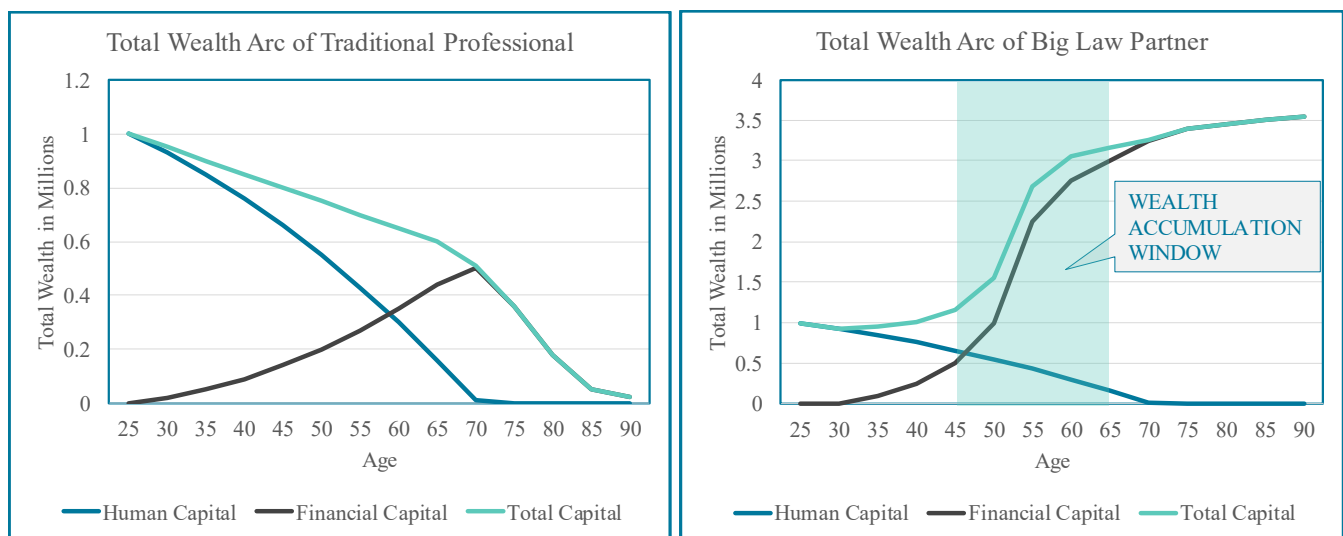
As a lawyer, your financial situation likely differs from many others in the working world, including other professionals.

Your years of schooling came at a significant cost. Many lawyers come out of school with debt of well over \$100,000. And even if you avoided substantial student loan debt or have completed repayment, those three years of schooling came at a significant opportunity cost in foregone income.

On the other hand, lawyers also have the benefit of significant earnings potential over the course of their career. The highest paid partners in the largest firms in the U.S. earn several million dollars a year.

Yet earnings over a career, however large, are *finite*. This is particularly true for attorneys, who generate an income based on their human capital: meaning their income is a direct function of the hours worked. And at some point, we all run out of those hours. For that reason, it's critical to recognize, and take full advantage of, any "wealth accumulation window" that you may find yourself in. This is a period of time in which your income is substantially greater than your current run-rate expenses, creating a surplus cash flow. If managed correctly, this surplus income may be converted into wealth over time. By saving diligently and investing correctly, many lawyers can retire with real wealth to fund a comfortable retirement. A conceptual illustration of this dynamic is shown below.

### Illustration: A wealth accumulation window



In my experience, however, those who take advantage of this window are in the minority.

There are many senior law firm partners who have lived a lifestyle equal to their means. Their expenses crept up over the course of a working lifetime, matching their rising income. Private school tuitions for the children, expensive vacations, and little spending discipline have brought many attorneys, in their 60s to 70s, to a point where they face a significant reduction of income, limited retirement savings, and no real ability to recover from the failure to take advantage of the opportunity presented to them over their career.

You've worked too hard to end up in that place.

You owe it to yourself, and to your family, to ensure that you are optimizing your finances and creating sufficient wealth so that at some point in your life, you are no longer totally dependent on your ability to generate income based on hours worked.

As the founder of Juris Wealth, I work with attorneys across the country and have become intimately familiar with the range of wealth trajectories that characterize many legal careers, and the unique challenges that come with this.

With that context, in the subsequent sections of this white paper, I provide guidance for several financial planning and investing topics that lawyers should have a firm understanding of. I have offered my opinion (often a strong opinion) on each of these topics, hoping that all attorneys make the most of the money that they have worked so hard to make.

Tim Corriero, J.D., CFP ©, founder of Juris Wealth, LLC

## Part 1: The single most important factor in investing

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Do you know what it is? It's probably not what you think. It's not what the markets do, and it's not what funds you're invested in.

It's *you*, and what *you* do. As one of my favorite authors, Nick Murray,<sup>1</sup> says:

***90% of investing involves managing yourself, not your money.***

Yet the focus of many investors is often on things of marginal importance relative to the impact of their own behavior.

For example, an investor developing and implementing a portfolio may be focused on whether to invest in individual stocks, or invest through actively managed funds, or to simply buy passive index funds. Important considerations.

Yet this same investor may – at the same time – decide to not max out their 401(k) contribution this year because they are buying that new car (maybe a Tesla?). They work hard, so of course they should enjoy the fruit of their own labor, right?

Yet the relative advantage (or disadvantage) of choosing individual stocks vs. actively managed vs. passive index funds (the area of focus of the investor) is *vanishingly small* relative to the enormous financial impact of skipping a year of 401(k) contributions. This investor is the proverbial passenger on the Titanic, who is focused on rearranging the deck chairs as it's going down. It's a focus on something that is dwarfed in importance by other factors.

But in contrast to the passenger on the Titanic who had no control over whether the ship went down or not, *you do*. In fact, you have total control of whether you're going to ram into that iceberg, or steer deftly around.

Is this being a hyperbolic?

No. It is impossible to overemphasize the impact of an investor's own behavior on their ultimate financial success.

For example, take the impact of foregoing contributions to a 401(k) for just one year. Doing so early in your career may reduce the projected value of your investments in retirement by *well over half a million dollars*. That's not a typo. If your 401(k) contribution at age 25 would be \$22,500, and if this were 100% invested in stocks, generating a 9% compound annual return, at age 65 that investment would be worth \$706,712.

And that's just missing one year of 401(k) contributions. Different behavior-based investing mistakes, such as changing your investment allocation in the face of different market conditions (i.e., market-timing) can easily result in *multi-million-dollar differences* in portfolio values over time.<sup>2</sup>

In practice, the mistake I see most investors make is to pull out of the market either in a bear market, or because they fear stocks are expensive and are poised for a correction. This is market timing and does not work. Not only does it not work, but it also destroys a tremendous amount of wealth over time. Just look at

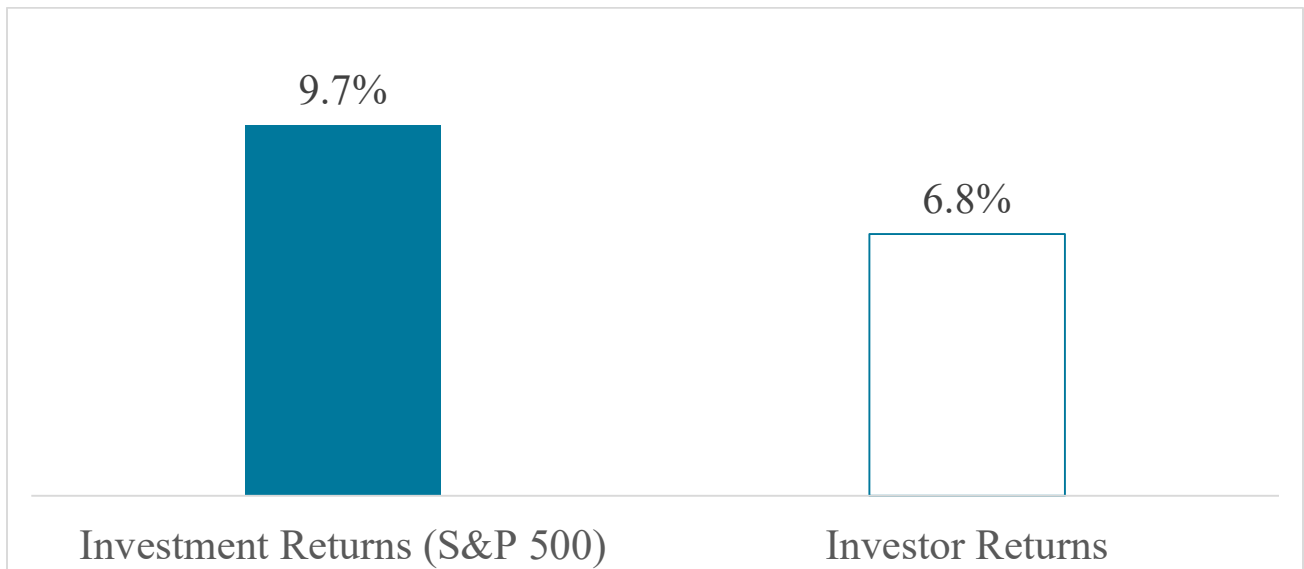
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<sup>1</sup> Nick is the author of several excellent books on investing (and on financial advising), including *Simple Wealth*, *Inevitable Wealth*, which is phenomenal, though unfortunately out of print. You might find a copy on eBay.

<sup>2</sup> This shouldn't be hard to believe. If the difference in investing vs. not investing just \$22,500 in one year can result in a \$700,000+ swing in portfolio values in retirement, how much larger of a mistake is it when an investor might move even larger sums of money (\$100,000? \$500,000?) in and out of the market, earning *compounding* suboptimal returns as a result.

the 20-year annualized return of the S&P 500 vs. what the average S&P 500 investor generated over that same time period.

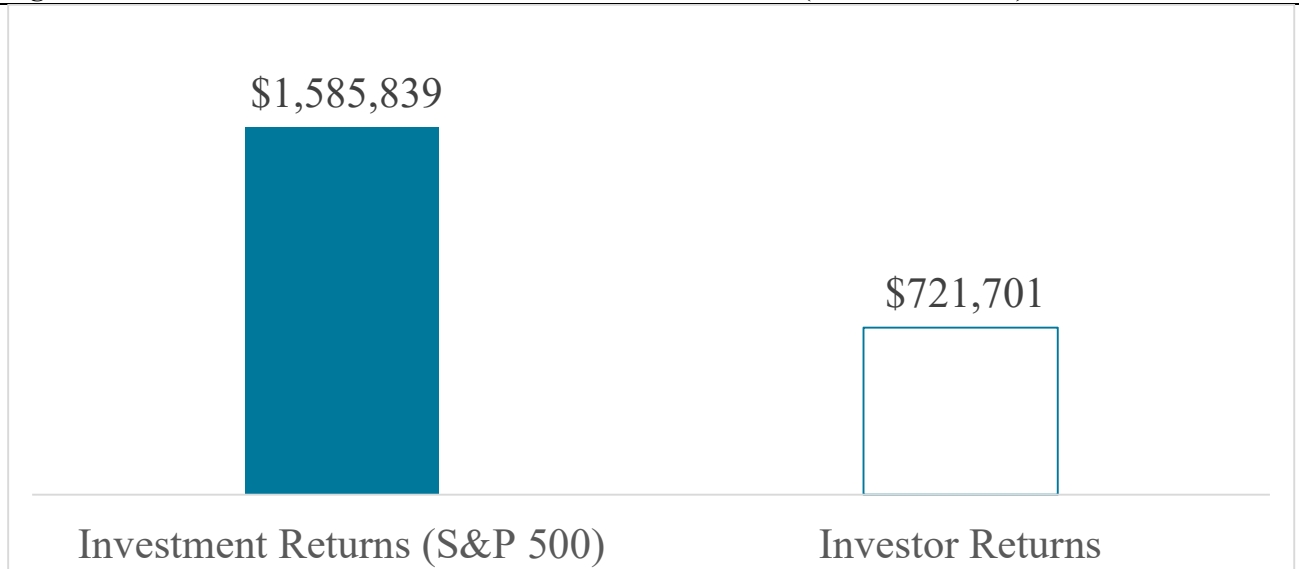
**Figure: Investment returns vs. investor returns, in percentage terms (Jan 93 to Dec 22) <sup>3</sup>**



If this does not seem like a big difference, let's look at what these relative returns would have resulted in – dollar wise – if you started with a \$10,000 investment.

<sup>3</sup> Average Equity Investor as determined by Dalbar. Study source: Dalbar QAIB 2023 study, Morningstar, Inc. Past performance does not guarantee future results. The S&P 500 Index is an unmanaged float-adjusted market capitalization-weighted index that is generally considered representative of the U.S. stock market. Other indexes may be more appropriate to benchmark your investments against. It is not possible to invest directly in an index. Data is provided for illustrative purposes only it does not represent actual performance of any client portfolio or account and it should not be interpreted as an indication of such performance.

**Figure: Investment returns vs. investor returns, in dollar terms (Jan 93 to Dec 22) <sup>4</sup>**



Managing *you* doesn't have to be complicated. It can be as simple as adhering to the following basic elements of a well-constructed financial plan: save early, save consistently, minimize costs, minimize taxes, and don't vary your investment strategy in the face of market movements. While this is ultimately simple stuff in theory, for many investors, it's not easy in practice.

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<sup>4</sup> See footnote 3.

## Part 2: What does investment risk mean?

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After your own behavior, the second most important determinant of a portfolio's results over time is how much investment risk you take, which usually is understood to mean the relative allocation to "riskier" growth assets (e.g., stocks and REITs) versus "lower risk" assets (e.g., bonds and cash).

"Riskier" and "lower risk" are in quotes here, because while this is how the word "risk" is used in the investment context, I believe it is highly misleading.

It is so misleading, in fact, that I think it gets things exactly backward.

What are generally known as "low risk" investments may, in fact, be better considered "high risk" (and vice versa) when we define the word "risk" in a manner that is most directly relevant to us. That is, risk as appropriately measured for investors saving and investing money for retirement and other truly long-term goals.

Here's why: in finance jargon, it is a truism that stocks are "riskier" than bonds. But "risk" here has a technical meaning. Specifically, it refers to *volatility*, as measured by standard deviation. This is the measure of the investment outcomes that are more (less) variable around an average.

For example, a projected return for a bond may be 4% with a standard deviation that informs us that, in the vast majority of cases, the ultimate realized return is very likely to be within a tight range around that 4%, perhaps between 3% and 5%. That's low volatility. And therefore "less risky."

In contrast, stocks may have a higher expected return – perhaps 8% – but with those higher expected returns comes a larger dispersion around that average. Perhaps 0% to 16%.<sup>5</sup> This larger distribution of possible returns is what people mean when they say stocks are riskier than bonds.

Yet here's the critical fact of this math that is not explained to you and that illustrates why these facts can be interpreted in a way that is backward: those standard deviation measurements reflect *short-term* volatility. And for our most important financial goal – retirement – we're focused on the *long term*. And when I say long term, I mean the *very long term*.

Even if you're 62 years old and on the verge of retirement, are you planning on spending all your money in the next few years? No way. Even at that age, your money will almost certainly have to last decades to come. If you're in your 30s or 40s, your investment horizon may be half a century or more.

If we're trying to save and grow our money for the very long term, shouldn't we use a definition of risk that is relevant to what we're doing? What if we define risk as running out of money and falling short of our target goals for wealth over time?

Well, just as "standard deviation" is a mathematical assessment of "risk," which informs us of the volatility of returns in the short term, what does the math tell us about the returns of stocks and bonds in the long-term? Here the math is incredibly clear.

**Over a long enough time horizon, stocks create wealth far in excess of bonds.**

And it hasn't even been close.

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<sup>5</sup> This is what people mean when they say that risk and return are inextricably linked. Under finance theory, the higher the expected return, the higher amount of risk (standard volatility) around that return.



For example, let's assume your great-grandparents had \$1,000 to invest on January 1, 1926.<sup>6</sup> And that they could choose between the "safe" investment of short-term U.S. government debt ("T-Bills") or "risky" investment of U.S. stocks. How would such investments have performed over the almost 100 years since then?

As of the end of 2022, the "safe" investment in T-Bills would have grown into \$160,824 and the "risky" investment in stocks would have turned into \$42,289,923.<sup>7</sup>

Let that sink in.

Investing in "risky" stocks over the last 96 years versus the "safest" bonds would result in 263 *times greater return*.

Note too that this time period includes *all* the bear markets you've heard of, including the 1929 stock market crash, where equities declined by more than 80%, pushing that \$1,000 investment *well below* \$500 in value as of the end of that first decade. It includes the bear market of 2001 where equities lost 44%. It includes the Great Recession of the late 2000s where stocks lost 50% of their value.

So which asset is the "riskier" one again?

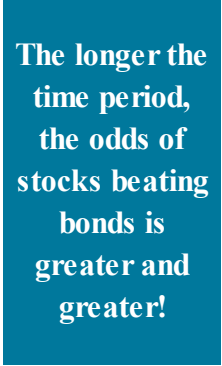
The point is so clearly illustrated over very long time periods of time. But we don't have to look at a century. We can look at periods even as short as 10, 20 or 30 years. i.e., the time period that is most relevant to *your* long-term savings and investment plan, as shown in the table below:

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<sup>6</sup> Remember, this is just on the eve of the next great stock market crash, right?

<sup>7</sup> Source: Bloomberg, Gemmer Asset Management calculations.

**Table: “Risky” stocks vs. “lower risk” bonds <sup>8</sup>**

| Periods of time in which stocks outperformed bonds (1926 - 2022)                      |   |
|---|---|
| <b>1 year periods</b> ..... <b>65%</b><br><i>(1926, 1927, etc.)</i>                   |  |
| <b>10 year periods</b> ..... <b>83%</b><br><i>(1926 to 1936, 1927 to 1937, etc.)</i>  |   |
| <b>20 year periods</b> ..... <b>99%</b><br><i>(1926 to 1946, 1927 to 1947, etc.)</i>  |   |
| <b>30 year periods</b> ..... <b>100%</b><br><i>(1926 to 1956, 1927 to 1957, etc.)</i> |   |

Even with lower returns, there are good reasons to hold bonds, even a lot of bonds, in a long-term portfolio.

For example, if you have enough investments to fund your expenses for the rest of your life, perhaps you should have all your money in bonds. As the saying goes, “if you’ve won the game, stop playing.” And you can stop playing by parking your money in the safest possible asset: short-term federal government bonds, which yield a very low return but are 100% safe.

A more likely reason for the average investor to hold some bonds (and not 100% stocks) is to simply reduce the volatility of your portfolio over time. If your savings rate is high enough, you may be able to achieve your financial goals with a portfolio of, say, 60% stocks and 40% bonds. You will be sacrificing returns, but what you get instead is a “calmer” ride on the journey towards your goals.

<sup>8</sup> Source: Bloomberg, Gemmer Asset Management calculations. Stocks represented by S&P 500 Index. Bonds represented by 5-Year treasury notes. Returns calculated for each asset over the reference periods shown (1 year, 10 years, 20 years and 30 years) and the resulting percentages of the results in which one asset class cumulative performance was greater than the other.

### Part 3. Can you beat the market?

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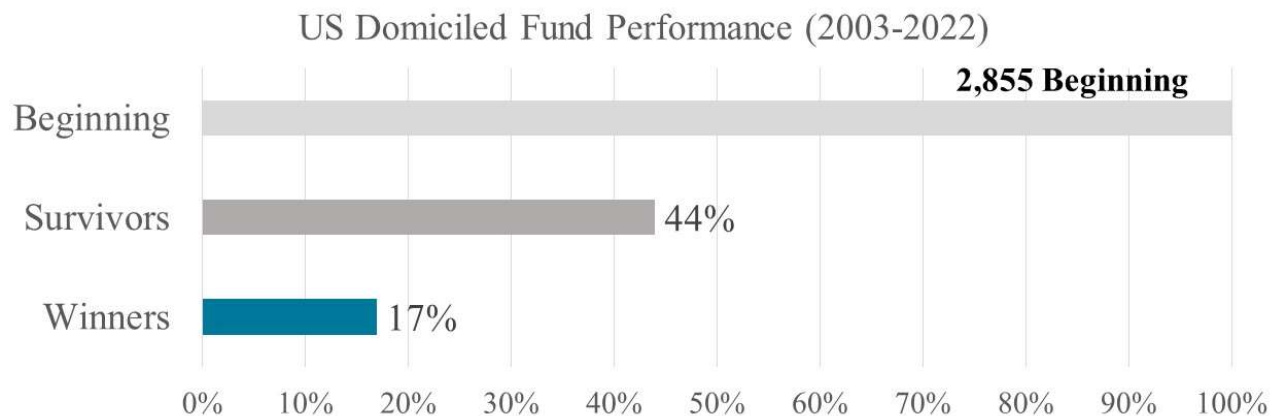
Traditionally, the investment strategies pursued to do better than the market has been to either (a) be an active investor and/or (b) a market timer. Meaning that you invest in individual stocks and bonds (an active investor) and/or invest in different sectors or geographies at different times (a market timer) in order to do better than the market overall.

Unfortunately, the evidence is incontrovertible: over the long-term, trying either approach is almost certainly doomed to failure. Over the long term, active management has consistently been shown to generate lower returns than a purely passive approach would, as reflected in the benchmark indices that active managers are compared against.<sup>9</sup>

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<sup>9</sup> There are many reasons for this, but in brief here are two: if you're in a taxable account, the tax deck is stacked against you if you buy and sell a stock within a year. Your gain is taxed the same as ordinary income, not at the much lower long-term capital gains rate. For those in the highest marginal tax bracket, this means *well more than 40%* of your gains for such trades go to the government. Hold your stocks for a year or more, and your taxes can be half that. Further, consider trading costs, which are effectively another "tax" on your money. The more you trade, the more trading costs you incur, the more your money goes to someone else. It's a losing proposition all around.

**Figure: Don't try to outguess the market**<sup>10</sup>



If this is true for professional investment managers, it's undoubtedly true for the non-professional investor (i.e., you) as well. Sure, in the short term, any one of us may get lucky and invest in the right stock and or get into or out of the market at the right time in order to do far better than the market overall. But just because even the proverbial blind squirrel stumbles across an acorn now and then does not mean that it's a valid investment approach for an investment portfolio being constructed for decades to come.

So how should you invest? The right answer, unquestionably, is some form of low-cost passive-type of investing. For many, this means buying and holding index funds that own every security in their underlying benchmark indexes. Yet for many professional investors (me included), this means taking a "factor-based" approach to investing, which utilizes some of the same strategies employed by index funds, but which invests more heavily in stocks exhibiting characteristics which have been academically proven to achieve even higher risk-adjusted returns than pure indexing. Specifically, the academic research has been most compelling and robust around the stocks with the following characteristics (referred to as "factors") performing better over time:

- Small company stocks have done better than large company stocks;
- Value stocks have done better than growth stocks; and
- Profitable company stocks have done better than unprofitable company stocks.

<sup>10</sup> Source: Dimensional Fund Advisors. The sample includes funds at the beginning of the 20-year period ending December 31, 2022. Each fund is evaluated relative to its primary prospectus benchmark. Survivors are funds that had returns for every month in the sample period. Winners are funds that survived and outperformed their benchmark over the period. Where the full series of primary prospectus benchmark returns is unavailable, non-Dimensional funds are instead evaluated relative to their Morningstar category index. Data Sample: The sample includes US-domiciled, USD-denominated open-end and exchange-traded funds (ETFs) in the following Morningstar categories. Non-Dimensional fund data provided by Morningstar. Dimensional fund data is provided by the fund accountant. Dimensional funds or subadvised funds whose access is or previously was limited to certain investors are excluded. Index funds, load-waived funds, and funds of funds are excluded from the industry sample. Morningstar Categories (Equity): Equity fund sample includes the following Morningstar historical categories: Diversified Emerging Markets, Europe Stock, Foreign Large Blend, Foreign Large Growth, Foreign Large Value, Foreign Small/Mid Blend, Foreign Small/Mid Growth, Foreign Small/Mid Value, Global Real Estate, Japan Stock, Large Blend, Large Growth, Large Value, Mid-Cap Blend, Mid-Cap Growth, Mid-Cap Value, Miscellaneous Region, Pacific/Asia ex-Japan Stock, Real Estate, Small Blend, Small Growth, Small Value, Global Large-Stock Blend, Global Large-Stock Growth, Global Large-Stock Value, and Global Small/Mid Stock. Morningstar Categories (Fixed Income): Fixed income fund sample includes the following Morningstar historical categories: Corporate Bond, High Yield Bond, Inflation-Protected Bond, Intermediate Core Bond, Intermediate Core-Plus Bond, Long-Term Bond, Intermediate Government, Long Government, Muni California Intermediate, Muni California Long, Muni Massachusetts, Muni Minnesota, Muni National Intermediate, Muni National Long, Muni National Short, Muni New Jersey, Muni New York Intermediate, Muni New York Long, Muni Ohio, Muni Pennsylvania, Muni Single State Intermediate, Muni Single State Long, Muni Single State Short, Muni Target Maturity, Short Government, Short-Term Bond, Ultrashort Bond, Global Bond, and Global Bond-USD Hedged. Index Data Sources: Index data provided by Bloomberg, MSCI, Russell, FTSE Fixed Income LLC, and S&P Dow Jones Indices LLC. Bloomberg data provided by Bloomberg. MSCI data © MSCI 2023, all rights reserved. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. FTSE fixed income indices © 2023 FTSE Fixed Income LLC. All rights reserved. S&P data © 2023 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved. Indices are not available for direct investment. Their performance does not reflect the expenses associated with management of an actual portfolio. US-domiciled mutual funds and US-domiciled ETFs are not generally available for distribution outside the US. There is no guarantee investment strategies will be successful. Past performance is no guarantee of future results.

Putting specific numbers on these “factor premia”, we see the following returns over long periods of time:

**Figure: Factor-based investing to generate returns higher than the market overall <sup>11</sup>**

|  | Returns           |                        | Annualized<br>Outperformance |
|--|-------------------|------------------------|------------------------------|
|  | <u>Small</u>      | vs <u>Large</u>        |                              |
| Small company stocks outperformed large ('28-'22).....             | 11.84%            | 9.85%                  | 1.99%                        |
|  | <u>Value</u>      | vs <u>Growth</u>       |                              |
| Value stocks outperformed growth ('28-'22).....                    | 12.52%            | 9.28%                  | 3.25%                        |
|  | <u>Profitable</u> | vs <u>Unprofitable</u> |                              |
| Profitable company stocks outperformed unprofitable ('64-'22)..... | 11.51%            | 7.72%                  | 3.79%                        |

Source: Dimensional Fund Advisors

These “factor premia” are most robust over long periods of time, and an investment strategy designed to benefit from this expected outperformance should be truly long-term. One way of implementing such a strategy is by investing in Dimensional Fund Advisors (DFA) funds. DFA was founded by students of Eugene Fama, the Nobel Prize recipient and University of Chicago economist, and is based on Fama’s research, and uses sophisticated trading strategies.

<sup>11</sup> Source: Dimensional Fund Advisors. All returns are in USD. Premiums are calculated as the difference in annualized returns between the two indices described over the period shown. MSCI indices are gross div. For US stocks, indices are used as follows. Small Cap minus Large Cap: Dimensional US Small Cap Index minus the S&P 500 Index. Value minus Growth: Fama/French US Value Research Index minus the Fama/French US Growth Research Index. High Prof minus Low Prof: Dimensional US High Profitability Index minus the Dimensional US Low Profitability Index. Profitability is measured as operating income before depreciation and amortization minus interest expense, scaled by book. Indices are not available for direct investment. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment. Past performance is no guarantee of future results. Actual returns may be lower.

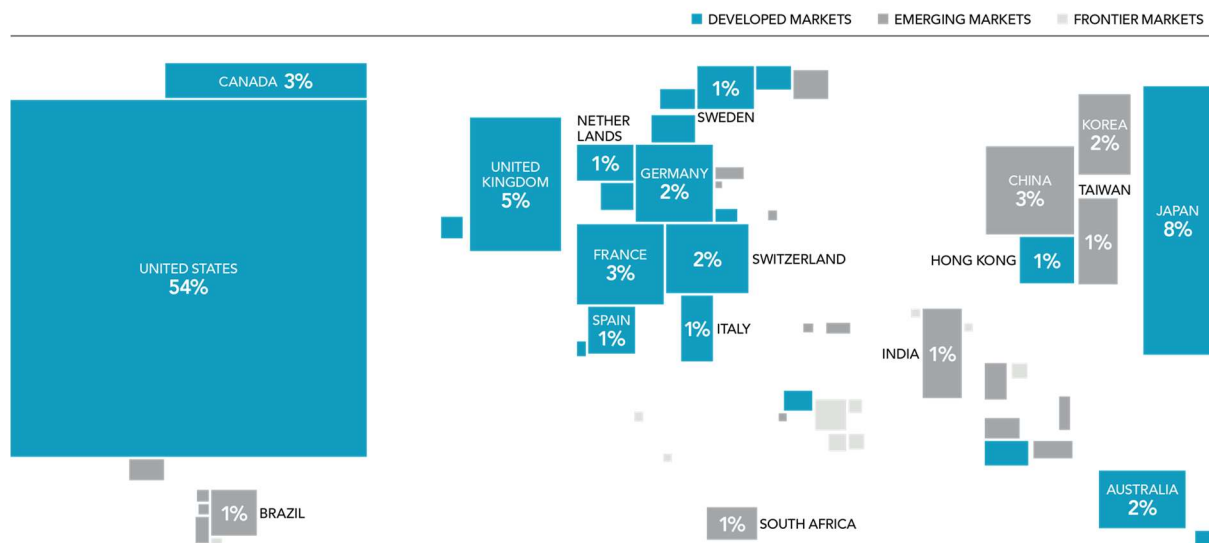
## Part 4. What should you invest in?

Do you know broadly what types of stocks and bonds you should invest in and why? Said another way, do you have a view as to what the “buckets” are that you would invest in and in what proportion?

The primary components of your financial asset portfolio should undoubtedly include a combination of (a) U.S. stocks; (b) ex-U.S. stocks; (c) U.S. bonds; (d) ex-U.S. bonds. Some believe that separate allocations to (e) REITs and (f) inflation-indexed bonds are also merited.

As to how you should divide your investments among these buckets, you might reasonably allocate between 50% and 65% of each of your equity and bond exposures to U.S. companies and the remainder to ex-U.S. companies.<sup>12</sup> We do this for the benefit of diversification and the fact that only slightly more than half of the value of the world’s cumulative stock markets are represented by the U.S., as shown in the illustration below.

### Illustration: A world of investment opportunities: percent of world stock markets as of 2018<sup>13</sup>



What about financial assets and investments that are not in the buckets outlined above? The investment world is very large, and there are certainly things not included in the standard “stocks and bonds” bucket above. For example, you could invest in currencies (including cybercurrencies), commodities, private equity, venture capital, hedge funds, etc. It’s beyond the scope of this paper to provide a detailed analysis of why many of

<sup>12</sup> For ex-U.S. exposure, if you want to dig down into the next level of specificity, you might invest 80% of your money in what is most often referred to as the “Developed Markets” (primarily most of Europe, Australia, New Zealand, and Japan), and the remaining 20% to the “Emerging Markets” (primarily Brazil, Russia, India, and China).

<sup>13</sup> Information provided by Dimensional Fund Advisors LP. Market cap data is free-float adjusted and meets minimum liquidity and listing requirements. Dimensional makes case-by-case determinations about the suitability of investing in each emerging market, making considerations that include local market accessibility, government stability, and property rights before making investments. China A-shares that are available for foreign investors through the Hong Kong Stock Connect program are included in China. 30% foreign ownership limit and 25% inclusion factor are applied to China A-shares. Many nations not displayed. Totals may not equal 100% due to rounding. For educational purposes; should not be used as investment advice. Data provided by Bloomberg. Diversification neither assures a profit nor guarantees against loss in a declining market.

these categories are *not* appropriate investments for the majority of my clients, but I'll share two brief reasons here:

The first is that many of these assets represent objects of *speculation* rather than *investment*. Making an *investment* means you have a disciplined and well-informed reason for putting money at risk and for the return expectations based on that risk. It's a bit like farming: lots of hard work, sowing seeds, weeding, cultivating the crop over time, with the reasonable expectation of a bountiful harvest at the end of the season since planted and cultivated seeds + rain = harvestable crop.

In contrast, *speculation* is more like "taking a flyer" in the hopes of some substantial return without a well-grounded rationale that couples the risk you take with the returns you expect. Buying Bitcoin? Speculation. Buying a low-cost index fund meant to be held for 20 years+? That's investing.

Within this framework, investing in currencies and commodities, as a good example, are speculative in nature. Sure, there are sophisticated and informed investors who *invest* in currency and commodities, but these assets lack the inherent productivity and profitability that comes with investing in companies through stocks and bonds. Most non-professional investors lack the necessary knowledge and informed perspective to make them appropriate *investments*. Take currencies, for example. It's a zero-sum game: you're making a bet that a particular currency (or currencies) is mispriced relative to another currency and that the market will ultimately reflect the appropriate value. It's like a seesaw, you only win when someone else loses. The only winners, really, are the intermediaries – like the investment banks – that facilitate the trades.

The second reason I'd suggest that some of these assets have no place in an investment portfolio isn't because they're speculative. Private Equity and Venture Capital, for example, can be legitimate investments for the very large and very sophisticated investor. But for the average person, there are several reasons why they're just not suitable. For example, they have very substantial minimum investment sizes (often \$250,000+, if not \$1 million+), have very high fees (often much higher than 1% annually, plus a share of the profits), and introduce a number of new risks to a portfolio that wouldn't exist otherwise, such as vintage risk.<sup>14</sup>

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<sup>14</sup> Vintage risk arises from the fact there is an "investment period" and a "liquidation period" in these types of funds, which is often 7 to 15 years in duration. This means much of your return can be dominated by overall market valuations in those two time periods, which would impact all assets in the class you're investing. Buying office buildings around 2000 and planning to sell them in 2010? Good luck generating an attractive return, as 2000 was an expensive time for commercial real estate, while 2010 was a time of real turmoil in the sector. It's not that your manager didn't do a good job. It's just that 2000-2010 was a "bad vintage."

## Part 5. Do you know how to minimize your tax burden?

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As many lawyers are in the highest marginal tax bracket, with an effective tax rate of 40% or more, tax management is critical. Here, there is some good news, and some bad news.

The bad news is that the federal and state governments, as incompetent as they may be in many things, are *very* good at taxation. While there are ways to invest to minimize your tax burden, there are no silver bullets. If you earn a lot of money, you're going to pay a lot in taxes.

Second, let's talk about whole life (or universal life) insurance policies. I mention them here because many lawyers are a common target for these financial products, which are often sold as a means to "tax diversify" your investments<sup>15</sup>, providing some amount of "tax-free" returns. These are enormously complex financial contracts which – in summary – combine an insurance product (which you need) and an investment (which you also need), but which when combined become quite bad when considered as either of those on a stand-alone basis.<sup>16</sup>

Now for the good news: there are a few things you can do to minimize (not eliminate) your tax burden. Some of the primary (but not only) ways to do this are as follows:

First, choose investment vehicles that are inherently more tax efficient versus the alternatives. An example is to invest in passive funds, which have low investment turnover versus actively managed funds, which trade a lot, and whose returns are far more likely to be characterized as short-term capital gains, which are taxed at the higher ordinary income rate.

Next, you should max out any ability you have to contribute to a tax-advantaged account, such as a 401(k) or an IRA. My clients generally max out their 401(k) contributions and are ineligible to contribute to a traditional or Roth IRA because they make too much money, but you should consider "back-door" Roth contributions IRA contributions<sup>17</sup> and utilize 529 plan college savings accounts<sup>18</sup>.

Finally, if you're still doing your own taxes, consider hiring a professional tax preparer. If you're a partner in a national law firm, your situation will be complex enough (K-1s, multi-state filings, etc.) that outsourcing tax preparation to a CPA is probably wise. Your accountant should work closely with you (and/or your financial advisor) to ensure that your investment and tax strategies are aligned.

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<sup>15</sup> Whatever that means.

<sup>16</sup> Have you ever seen those 1950s cars which are also designed to be a boat? Simply drive into the water and there's a motor on the back to get putter around a lake? Sounds like a great idea, but it ends up being very inefficient at both and has ended up an expensive curiosity which is "useful" to almost no one.

<sup>17</sup> There are no income limitations on non-deductible IRA contributions, but we advise them only for those eligible to convert non-deductible balances to a Roth without the conversion being taxable. Research the "Pro Rata Rule" for taxation of Roth conversions, or contact the authors.

<sup>18</sup> We recommend New York's 529 plan for those living in New York and Utah's 529 plan for all others. If you can, you should consider "super-funding" 529 accounts with a single contribution equal to five years' worth of gifts when the child is young.



## Part 6. How will you manage the “what-ifs” in life?

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As an attorney, you have been trained to understand and evaluate risks and how to minimize them for your clients. Are you doing the same for yourself and your family?

What if you lose your job? What if you get sick? What if you die and leave behind a spouse and children? What if you are sued?

Your financial goals should include not just making sure you’re saving enough for retirement, but just as importantly, that those you love are protected from these (fortunately) rare but potentially devastating financial risks. Doing so requires understanding and purchasing appropriate insurance products (or making sure these are provided to you through your work)<sup>19</sup>, and avoiding inappropriate ones.<sup>20</sup> It also requires having proper estate planning documents in place. You and your spouse/partner both need up-to-date wills, living wills, and durable powers of attorney for both health care and property. As you build wealth, you might also benefit from trusts and more complex strategies.

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<sup>19</sup> Primarily term life insurance, disability insurance, and umbrella insurance.

<sup>20</sup> You should avoid buying a whole life or universal life insurance contract.

## Part 7. What's your number? And how will you get there?

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Do you know what “your number” is? And just importantly, how to get there?

When can you retire? When will you have saved enough that you can have the flexibility to stop what you're doing right now and do something else? Whether that “something else” is to change jobs or simply to retire?

The “right” way to answer this question is to use financial planning software<sup>21</sup> to model your family's net worth from now until the end of your life, accounting for all expected inflows, outflows, investment returns, and tax rates.

There are limitations of such a model, given that so much is unknowable about the future. But it can still serve as a valuable framework for financial decision making and for understanding the most likely path forward.

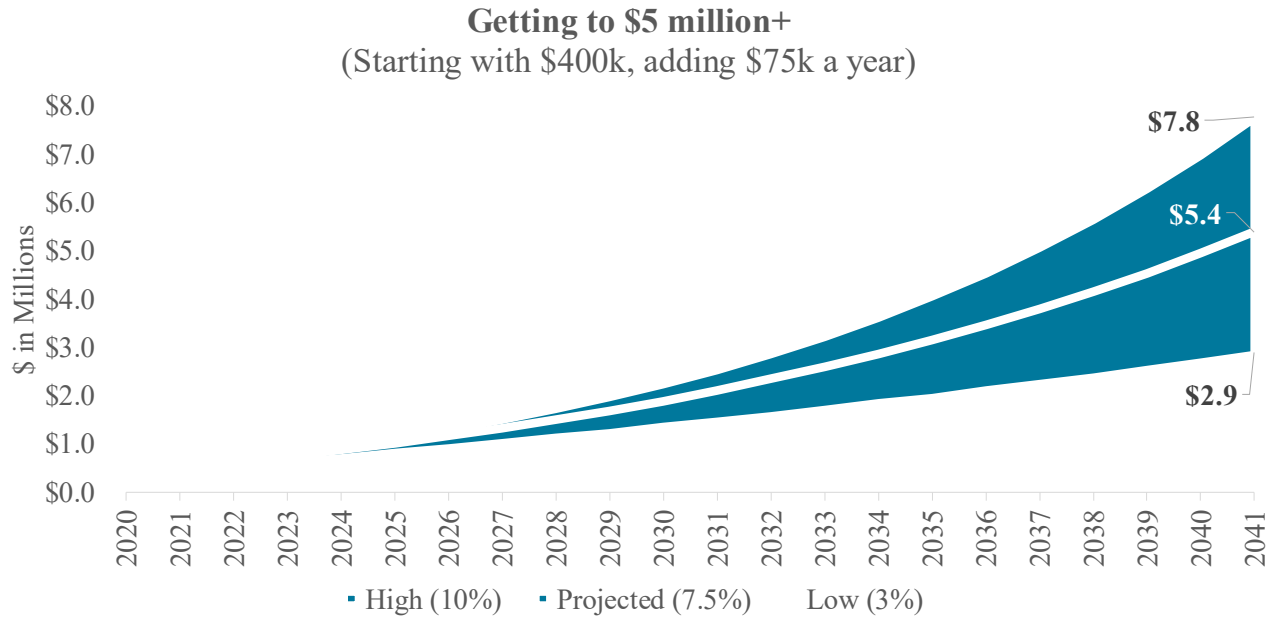
If that advice is unsatisfying, we reluctantly offer the following rule of thumb: multiply your desired annual pre-tax retirement expenses (in today's dollars) by 25 or 30. If you think you'll need \$200,000 a year in retirement for the rest of your life (growing that amount only by inflation), you'll want to have an investment portfolio of between \$5,000,000 and \$6,000,000 at the time you retire. That might be your number. This math holds true regardless of your age. Because it reflects a “safe withdrawal rate” of between 3.3% and 4% a year from a portfolio that is invested 60% in equities and 40% in bonds in perpetuity. In other words, that portfolio should continue to grow (or least remain static) net of your withdrawals, forever.

Let's assume \$5 million is “your number” and that you are perhaps 40 years old with a few hundred thousand dollars in your firm's 401(k) plan. Is there a reasonable investment plan to get to \$5 million by the time you're 60? Yes, and it's illustrated below in the illustration. This is a very simple model, and it assumes away several complicating variables, but I believe it generally reflects the wealth-creation path that many of my clients are on. It assumes an initial investment portfolio of \$400,000 and an annual savings rate of \$75,000 a year for 20 years, for total investment contributions of \$1.9 million over your working life. At a 7.5% compound annual return, this should grow to be nearly \$5.4 million within 20 years. If you're fortunate enough to generate even stronger returns – say 10% per year – you'd have \$7.8 million. If \$75,000 a year strikes you as a lot of money, know that this amount includes all investment contributions, including those within 401(k) plans. For a working couple, maxing out contributions two 401(k) plans (the 2020 contribution limit is \$19,500 per person), and perhaps benefiting from additional profit-sharing plans or matching contributions, they may already be saving \$50,000 or more in such a manner.

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<sup>21</sup> We can say with confidence that the Excel model you built to answer this question is not comprehensive enough to be reliable.

**Illustration: Getting to \$5 million+ in 20 years <sup>22</sup>**



<sup>22</sup> Reflects projected wealth accumulation over time based on \$400,000 initial investment, and \$75,000 annual investments over 20 years, for cumulative contributions of \$1.9 million. Assuming a compound annual growth rate of 7.5%, this would generate a portfolio of \$5.4 million at the end of that period. A range of outcomes is shown, illustrating the result of a higher (10%) and lower (3%) compound return which may be interpreted as a more or less aggressive investment portfolio and / or a lower or higher actual market returns vs. expectations.

## Part 8. Should you work with an advisor?

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As providing financial advice and investment management is my business, I obviously have an economic self-interest in whether you decide to hire an advisor or not (specifically, in whether you might hire me). Yet wearing my fiduciary hat, here's the framework I'd use to answer that question.

Those who decide to forego working with an independent professional should, I believe, be able to answer "yes" to the following two questions: Are you sufficiently educated in the various topics relevant to developing and implementing a sound long-term financial plan? *And* is personal finance and investing something you enjoy doing, such that you would be willing and able to dedicate the necessary time and attention necessary to do this right?

A note of caution, however, on the first of the two questions above, which is the more critical one: please do not underestimate the complexity of what it means to be educated in this area. At a minimum, you should read a few good books on investing.<sup>23</sup> I do not believe that subscribing to *The Wall Street Journal* or *The Financial Times* and listening to Bob Brinker or Dave Ramsey is enough. There is simply too much on the line to be that casual about this topic. Being smart and generally familiar with the topics of finance and investments is not enough to be able to do this job right. If it were, then I wouldn't see so many smart lawyers throwing their money (a lot of money) away on whole or universal life policies.

If you can't truthfully answer "yes" to the two questions above, you should consider outsourcing this critical aspect of your financial life.

If you decide to work with a financial advisor, what should you look for?

First, it should be someone with the knowledge and experience to guide you on your investment journey. While not critical, evidence of this expertise through a Certified Financial Planner © designation is at least one measure of competency.<sup>24</sup>

Next, and far more importantly, that advisor should be a fiduciary: legally obligated to put your interests first.

I say this because there are many investment professionals out there who are not fiduciaries to their clients. They are most often held to a much weaker standard, requiring only that an investment be "suitable" for you, even if it's not necessarily the best thing for you. The best example I can give here is anyone who is selling you an insurance product or anyone who works for a broker-dealer who has an interest in you investing in their funds, because they make more money in doing so. Examples would be Raymond James, Merrill Lynch, Wells Fargo, etc. If you're working with an advisor who works for XYZ organization, and they want you to invest in XYZ mutual funds, be cautious and aware. It may be a good investment. But you can't be certain as to why it's being sold to you: because it's good for you – or good for them.

And if your financial advisor works for an insurance company, change advisors. They sell financial products. Their interests are not aligned with yours. Change advisors.

More generally, I think it's critical that an advisor and client be a good "fit": Does the advisor's services match the functions you want outsourced? Do you share investment philosophies? Does the advisor understand the needs of people in your stage of life and with your career arc? Does the advisor share your

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<sup>23</sup> I'm happy to recommend a few.

<sup>24</sup> And, yes, I have a Certified Financial Planner © designation.

academic background and work style?<sup>25</sup> Do you like this person? Can you envision working with him or her for a long time?

### **Now what?**

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After years of hard work toward your J.D., you're now a lawyer, making money. If you are going to manage your own money, please take every measure to ensure you're doing so correctly. We hope this paper provides a useful jumping-off point.

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<sup>25</sup> This item in particular is difficult for law firm partners. Becoming a financial advisor is a lot easier than becoming a successful law firm partner, and therefore the average advisor does not have the degree of business background and training as the people you work with every day. To benefit from the relationship, try to find one who does.

## Disclosures

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