Investing the Proceeds from Your Practice Sale

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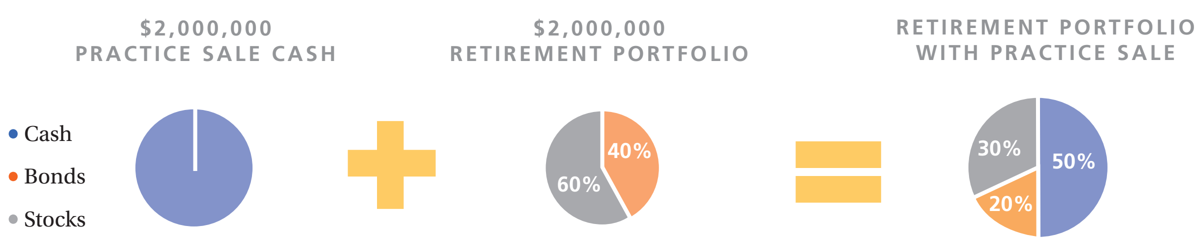
Over the past ten months, dentists we work with have sold their practices and deposited over $20 million from their practice sales for our firm to manage. For the typical dentist we work with, this doubles the size of their retirement portfolio. It is our job to determine how to best fund their lifestyle costs and grow their nest egg. So, how should we invest the $20 million? And perhaps, more importantly, when should we invest the $20 million?

While this could be an article unto itself, we have found that the best place to invest a retired dentist's nest egg is in the stock market. There are many alternatives, but stocks have the liquidity we require to adapt to the future, as well as the best prospect to outpace inflation. However, it is not a question of if the stock market will crash during your retirement, it is a question of when, so, while we feel stocks are the best place for the $20 million, is now the time to buy?

Many Canadians accumulate their retirement savings gradually, paycheque-by-paycheque, over the many years of their careers. That reality lends itself to a natural cadence for timing an investment, a systematic purchasing strategy. Deposits are made gradually through time, with no single deposit being large relative to the size of the portfolio itself. Unlucky timing occurs with some deposits, good timing occurs with others. Ultimately, over time, the good and bad average-out to an acceptable average.

Our dentist clients, who sold their practices as mentioned above, face a different reality. The payouts from their practice sales are roughly equivalent to the value of their existing portfolios. Assume for discussion purposes that each dentist was in a typical balanced retirement portfolio of 40% bonds and 60% stocks. After the practice sale, cash is deposited into his/her investment account, so the originally balanced portfolio instantly becomes a portfolio of 50% cash, 20% bonds and 30% stocks. With no systematic purchasing plan naturally appearing for this lump sum deposit, the average dentist is forced to make the short-term decision of when to invest the fruits of their life's work; and what will happen if the day they choose to invest is an unlucky day?

To return the portfolio to its long-term strategy of 40% bonds and 60% stocks, the average dentist depositing practice sale proceeds at our firm would need to double the amount invested in stocks. If they had purchased that $1.2 million of stocks at the beginning of September 2008, they could have been worth only $998,500 30 days later. Not investing at the beginning of September 2011 (three years later) would have meant missing out on growing the portfolio to $1,331,000 during the subsequent 30 days. What options do we have to help us make this short-term decision?



	HISTORICAL RESULTS AFTER AN IMMEDIATE INVESTMENT OF $2,000,000				
	1 Month	1 Year	5 Years	10 Years	15 Years
Average Result	$2,011,210	$2,139,199	$2,762,167	$3,563,875	$4,288,980
Best Result	$2,140,467	$2,592,632	$4,337,515	$6,009,273	$6,012,984
Worst Result	$1,799,627	$1,441,525	$1,657,360	$1,692,942	$2,961,924
# of Periods Observed	366	355	307	247	187
% of Positive Observations	66%	83%	89%	95%	100%

1. Accept the risk of choosing an unlucky day and immediately invest it all today.
2. Wait for a market low to happen first, accepting the risk that inflation erodes the value of your cash in the meantime and that markets could continue to rise while you wait.
3. Invest the cash gradually and minimize the risk of both unlucky timing and inflation.
4. Other methods not addressed in this article.

Searching History for Guidance

The US stock market is one of the most studied markets in history, frequently symbolized by the S&P 500 index. That index is composed of 500 of the largest US businesses. We examined what historically would have happened to our clients' practice proceeds if they had immediately purchased a portfolio containing $800,000 bonds and $1.2 million in S&P 500 stocks at the beginning of the month. We then tested the outcome for every month from January 1, 1988 to July 1, 2018. The results are in the chart above.

Guideline #1: *Savings not needed for over five years should be invested immediately in the portfolio strategy, accepting the risk that you might be wrong in the short run.*

As you can see in the chart, on average and no matter the holding period, we would have grown the portfolio savings if we immediately invested the cash.

Guideline #2: *Savings needed within five years should be invested systematically over a 12-month period to reduce the risk of picking an unlucky day.*

We observed a reduction in the likelihood of a positive portfolio result as the investment period shortened. We considered what would happen if our clients purchased the same portfolio over 12 months, rather than immediately as in our original scenario above. This systematic buying strategy improved the portfolio's performance in the worst market conditions over these shorter periods.

Your practice sale proceeds force you to make a short-term decision of when to invest the cash that most others can inherently avoid. This is because of the size and timing of when the cash is available to the retirement portfolio. Modern finance supports investing the cash immediately, and our review of history suggests this would have been the correct decision on average, especially for periods longer than ten years. For shorter periods, a systematic purchasing strategy could have minimized the portfolio damage during the worst performing markets in history. Other tools not reviewed in this article are available to guide mid-term investment periods, such as technical analysis, fundamental analysis and macro-economic indicators.

Using each of these tools gives us the best chance of making both the right long- and short-term decisions with your practice sale proceeds.

Feedback can be sent to info@mcnultygroup.ca

Mark is President of McNulty Group, a firm responsible for $350 million of Ontario dentists' retirement savings. In addition to multiple television and radio appearances, Mark is the author of The Transition Coach 2.0 – A Canadian Dentists's Guide to a Perfect Retirement, and his new book The $6Million Dentist. In 2017 Mark was chosen as The Canadian Financial Advisor of the Year at the Wealth Professional Awards. For more information please visit www.mcnultygroup.ca