



# Horton Financial Services, LLC

Insights about financial choices

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## Financial Choices <sup>TM</sup>

### Lead Story:

Recently one of my clients told me that she just didn't know how she was going to get through this life with things so difficult to manage, particularly finances.

The truth is that she is a lot better off than most of us. Her perception of her circumstances is different than my view of her situation.

That being of little consolation to one so determined to be miserable, I suggested she cling to "hope," because that will instill in her an optimistic view of things that will see her through periods of despair. No sooner than I had made that suggestion, she began speaking in positive terms.

Hoping for better things to come seems to open doors that may have been there all along, but we have never seen them. It generates a euphoric anticipation of life.

## Enduring Hope

We, as a people, are already "rich" by global standards, and are fortunate indeed to be living in the United States of America. Our forefathers had little more than "hope" to drive them to build a great nation.

"Hope" is just as powerful today as it was then. The hope of better things to come, a better life, indeed, improved finances, keeps those things in our sights to improve our aim. "Hope" is a very underestimated emotion, in my opinion.

It is difficult to become negative while clinging to "hope". Psychologists tell us that negative thoughts bring about more negativity in us, not only in our thoughts, but in our actions as well. One begets another, and so it goes.



Raymond C. Horton, Sr.

The study of human dynamics teaches us that a positive event will break a negative cycle, but if the negative cycle is a compounded one that is made up of many negative events, it can take numerous positive events to turn it around. It starts with "hope".

## The Bush Boom

Interest rates continue to remain low. The federal income tax cuts are beginning to manifest in greater investment by business and industry. Earnings are starting to grow. Recent growth in Gross Domestic Product is reported to be slightly above 3%. With positive momentum, we might end the year with more economic growth than originally thought by the Presidential Economic Advisors.

If that is true, then we may see something akin to an economic boom in 2004. No,

nothing like what we saw in the mid to late nineties, but in relationship to where we have been during the last three years, a 5% or 6% growth would indeed seem like a "boom", especially if interest rates hover anywhere near their present altitude.

I expect interest rates to climb once again as the economy grows, but within reasonable proportion. For your solace, I can tell you that the one thing that all the economists from every corner of the Nation will agree upon is that they will all disagree.

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### Points of Interest.....

- "Hope" is an underestimated emotion.
- Economists will agree to disagree.
- Be careful with use of credit cards.
- Wise use of capital is a challenge.
- One out of eight will suffer a long term disability prior to normal retirement age.
- Focused upon doing the right thing.
- "Compound Interest" should be one of the wonders of the world.

Editor's forecasting...\*

The S&P 500 Index broke 1,000 by Labor Day as forecast in the August issue.

We are now expecting the Dow to break 10,000 by the end of the year.

\*Not to be relied upon.

## Credit Cards—



The use of credit can be a very valuable tool when used appropriately. Therein lies the problem with credit. It is often misused.

Credit is best used for convenience and record keeping, and should probably not be used when it is simply because there are no available funds to pay for the merchandise or service being purchased.

This is particularly true for one's personal use of credit. In a business environment, credit is simply another form of short term financing, and if one's credit history is good, business credit can cost anywhere from 0% to 18%.

Personal credit can generally range from 6% to 22%, and the average is currently around 14% on credit cards. This is true even with the prime lending rate at its lowest in forty years.

A \$10,000 balance at 14% interest, with you paying \$120 each month, will cost you \$27,074.21 in interest and take 25 years and 9 months to pay off. Who wants to live like that?

If a person comes into a windfall of \$50,000, should he pay off a 6% mortgage, a 14% credit card, or invest the money? The answer may be clear to you, but this kind of question often comes up, and the best economic choice isn't always what most people will do.

Even though one might earn 7% in a relatively safe investment, or even 10% in his or her business, or eliminate the high interest credit cards, the psychological reasons often outweigh the economic reasons. Some people simply want the house paid off regardless....wrong economic decision. Pay off the plastic!

Typically, to use income, savings and investments to best advantage while managing debt would be to pay off higher interest debt rather than invest in a lower earning asset.

In short, be careful with the use of credit, especially credit cards! Misuse can follow you to your grave.

## Utilization of Capital

Capital resources for business are not always easy to acquire. A frequently used source may be a "line of credit". With a line of credit, one simply draws down whatever amount is needed for capital expenditures.

Typically, one would pay interest and principal on the amount of capital used. Today's interest rates for a commercial or personal line of credit are typically lower than in years past, and sometimes you can set it up on an interest only basis for a set period of time, with principal payments optional.

Companies of all sizes live and die misusing capital. It's a management challenge.

Anticipation of the need for said capital is an essential determination for management to make on target. Many business owners are guilty of not planning ahead quite far enough, even though all the indicators may be there to tell them that in six months they need to establish a line of credit, or expand an existing one.

Financial forecasting is a specialized skill that enables managers to more accurately assess the need and timing of such capital requirements. Most managers today are taught these skills. Some, on the other hand, simply have an instinct for it that is integrated within their own management persona.

A business may establish a line of credit at 5%, knowing they are earning 15% selling widgets after costs of goods sold. If they are paying federal income tax at 34% and state tax at 6%, their net return on capital is 6%. The business will continue to do this until things adversely change, whether it be sales, cost of goods, tax law, or any other element factoring into the process, such as competition.

Capital is a powerful tool, and only a tool. It isn't character, integrity, love or devotion. Only the human element represent these traits. Capital doesn't care. It has no emotion, but it does inspire and motivate the human aspect of its use.



## 412(i) Plans

Some tax solutions are often referred to by their location in the U.S. Tax Code, and so it is with 412 (i) plans.

This is a fully insured "Defined Benefit" Pension plan. It works particularly well for companies and employers with fewer than ten employees with owners over 50 years of age.

It allows potentially huge tax deductions based upon an inordinately large pension contribution that does not follow the same rules and limitations as those for "Defined Contribution" plans.

In the 412(i) or Defined Benefit plan, the law doesn't care how much you put in so long as it does not

violate the maximum you can take out as retirement income. Where one might be able to contribute \$40,000 in other Qualified Plans, this plan might allow one to put in three, four, or five times that amount, resulting in an equal tax deduction.

The real beauty of this is that a corporate owner/employee, or a professional, can legally take money out of the business for their personal benefit and take a tax deduction for so doing. He or she might be able to accumulate over \$1,000,000 in this manner in as few as five to ten years.

Check with us to see if this is the right type plan for you!

## The Thing That Makes It All Possible

It is sometimes easy to take things for granted, including ourselves. Think with me for a moment about your lifestyle. You probably have a nice home in a good neighborhood that you have chosen for yourself and your family. As most Americans, you may have a mortgage on that home. Most of us pay that mortgage note monthly with income derived from our livelihood, how we earn a living.

You probably own one or more vehicles that you bought with income from the same source. The school tuition probably comes from the same source too, unless your family is fortunate enough to have earned scholarships. How about the food you eat and the clothing you wear? All the goods and services you purchase to keep the family running are likewise paid from your earnings.

Question? What would happen if the earnings stopped? What if you became disabled and couldn't work to make the income that has been paying

for everything your family needs. From where would the money come?

Remember the children's story about the goose and the golden egg? Using this analogy, you are the goose, the one that produces the golden egg. We do not hesitate to insure the golden eggs, but what about the goose?

According to the Department of Housing & Urban Development, "one out of 18 mortgages is not being paid due to a disability of the mortgage holder". The Home Health Agency of the Federal Government tells us that 48% of all mortgage foreclosures are due to the disability of the mortgage holder.

One of every eight Americans each year will suffer a long term disability lasting more than 90 days, according to the same source. For a male age 40, the risk of long term disability is 2.9 times greater than the risk of death in the current year.

At age 35, one has a 50/50 chance of being unable to work for more than three months before turning age 65, according to the Society of Actuaries, as quoted by Money Magazine in April of 2000.

The case for insuring one's ability to earn an income is well documented by the eight major insurers of disability insurance. Unlike life insurance that is based upon life expectancy from mortality tables, disability is based upon morbidity tables.

Fewer than ten years ago there were more than one hundred such insurers. Most of them were driven out of the business of underwriting for disability insurance. Many afflictions that once would have normally killed someone, now only renders them disabled. The resulting flood of disability claims put the insurers out of business.

Insurers tell us that most people are willing to pay up to 2% of their income for this type of protection.



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***Meeting Financial Challenges Every Day!***

WE are on the web.  
Visit us at [www.  
HortonFinancial.com](http://www.HortonFinancial.com)

## About Our Practice

For almost forty years, I have been helping people solve financial problems. The slogan of Horton Financial Services is ***"Meeting Financial Challenges Every Day!"***

Our firm is paid for distributing insurance and investment products, but the nature of our business is planning, working with each client, one at a time, to help them achieve certain financial objectives.

We have never focused upon our personal income, but upon doing the right thing for the client, always considering the income a by-product of our service.

We have impacted over 2,000 lives in a positive way over the years, and continue to grow our business one client at a time, typically upon referral from existing satisfied clients and contract holders.

Our pledge to you is that we will always strive to do the right thing for you, and to merit your continued trust and confidence.

## Compound Interest

Most persons do not really understand how compound interest works. Throwing tax issues into the mix make it even more a mystery. It may have been Albert Einstein who said, "compound interest should be considered one of the official wonders of the world." I am sure it was he who also said "taxation is the most difficult subject for me to understand."

So, if we are in awe over either of these subjects, we are in good company. If Albert Einstein was bewildered by them, why should we feel differently?

Compound interest is interest that is added to the principal amount, which earns interest again, etc. Tax deferral or tax-free growth of a principal sum and its compounding interest adds one's marginal income tax rate to the compounding, resulting in interest earnings on what would have been taxes paid.

Look at the total after-tax growth of \$10,000 deposited at 6% for a twenty year period of time under three different scenarios with a 27% marginal income tax rate. Results:

<u>SIMPLE</u>	<u>COMPOUND</u>	<u>+TAX-FREE</u>
\$22,000	\$33,102	\$45,685

So, why would one do anything other than "tax-free" investments? It might be that he or she could earn considerably more than 6% over time. The market has roughly doubled that figure over the last twenty years. But, close-to-the-vest is considered best for some persons.

If not "tax-free", why not "tax-deferred"? This is a little more difficult question to argue. It all washes down to how much risk one is willing to assume to reach the expected target, anywhere from zero to 100%. Usually, somewhere in the mix of things the answer will emerge.

If you were a contestant on the show "Who Wants to Be A Millionaire?", and you were down to one lifeline, the 50/50 one, and you were at the \$250,000 question, and you just didn't know the answer, would you be willing to guess the answer, knowing that you had an equal chance of being either right or wrong? If you were right, you would have \$250,000 (or possibly more if you went on farther into the game), or you would lose down to \$32,000. How much risk are you willing to assume?

When you select a bank Certificate of Deposit rate of 2%, you are assuming almost no principal risk, but you will pay your

marginal tax rate on its earnings. If inflation is 2%, you have lost 27/100ths on your investment in purchasing power (27% marginal tax rate).

It is good to be able to know about interest rates and risk. Start with the most elementary components and dwell there. Those principles never change, even though everything else does.

Be like the immigrant junk man, who after forty years of success, explained that he bought scrap for one dollar and sold it for three dollars, and was happy with making 2%. :) )

Sources include:

- Wall Street Journal
- Fox Financial News
- The Shreveport Times
- Dow Jones
- National Assn of Insurance & Financial Advisors
- American Health Insurance Association
- The National Underwriter