

# **5 Indisputable Truths about Money**

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Will I have enough to retire? Can we afford to renovate the kitchen or go on that special vacation? What is the best way to invest my money? What will educating my kids cost and how will I pay for it? How can I save on my taxes? They're killing me.

These are typical questions that are on the minds of many people today. They are important questions; finding ways to understand, manage and grow your money is the cornerstone of financial success.

Understanding these fundamentals is not as hard as you imagine.

Complicated, as the financial picture may seem, there is an easy way to become a more educated consumer. Consider these five areas; addressing them all, will put you on the road to financial freedom.

- Five Choices to Make with Your Money
- Four Factors That Will Effect Your Net Worth
- Three Ways to Accumulate Money with Respect to Taxes
- Two Places You can Invest Your Money
- One Way to Ensure Financial Freedom

## **Five Choices To Make with Your Money**

**Spend,** We all know spending. First, there is the cost of living (mortgage, rent food, utilities, car insurance, etc.). These are immediate expenses. Next, we generally spend money on non-appreciating things like automobile, furniture and vacations. We tend to operate on a principal of '*tiered liquidity*'. That is, we spend the money over a prolonged period of time: we pay for a mortgage on our house for over 30 years; the new car may take about 5 years to pay, furniture perhaps a year.

**Give,** For the majority of people, the costs of raising and educating children are the most common form of giving. This may be construed as an investment, but that is something that will be reserved for a later discussion. Other kinds of giving are monies that are donated or gifted through charitable contributions, to the family, or through structured estate planning.

**Gamble,** When we think of gambling we usually think of a casino; betting on sports, cars and horses. Frequent and consistent lottery playing is another form of gambling. Aggressive speculation in the stock market is also gambling and **NOT** to be confused with investing.

**Save,** Savings, is money that will ultimately be spent; it is not to be confused with investing. We save for items that we want, or need to purchase in the near future, that costs more money than we currently have in our pockets, or checking accounts. Savings should never put our money at risk. Money allocated for savings, needs to be, in a safe, and easily accessible place: a bank savings account or CD. Savings can become an investment by default, if for example, you decide to buy a house or car you were saving for, but it is best to allocate money for both savings and investments.

**Invest,** With money that is leftover after spending and saving many people will invest. In reality, putting aside money for investment should be the first choice, not the last. The most common places to invest are in your own business, direct investments in securities (stocks and bonds), commodities or retirement funds.

## **Four Factors That Will Effect Your Net Worth**

**Income**, Income is every form, in which we take money, starting, with what we earn. It may include an inheritance, a gift insurance, a court legal settlement, or of course, money from investments.

**Time**, has tremendous impact. Those who start saving and investing, early in life, will end up with more than someone who starts later. The sooner you begin, the more time and money has to work for you.

**% of Income You Invest, Save or Spend**, invest more, spend less. That formula is your "recipe for success." The percentage of income you spend, or invest, becomes different with age. Typically, a 25-45 year old, is spending more on a home, a new car, and furniture. Years ago, a 65 year old may have more discretionary spending (vacations, for example), but generally they are spending less.

**Method of Investment**, When you invest, there are three things that will impact the return:

- **Timing (2%)**

Most people have the misconception that when you invest (timing) is the most important factor in the return that you receive. Over the long run, it is the least important. Short-term timing may appear, to be very important, however, over an extended period of time, it does not matter. If Mary puts her money into the stock market, on the best day of the year, every year, for 20 years, and Sally puts money in on the worst day for the same 20 years, the difference in the final amount that each will have, is very small.

- **Investment Selection (6%)**

Because all investors have access to the same, wide array of basic investment choices, the playing field is level. With a few rare exceptions, this vast array of funds, will perform, much the same, over time. The fund company you choose to invest with, matters very little. The caveat to this, is the personal investment you make in your own business. Creating a successful business may outperform all other investments, but certainly has it's risks!

- **Asset Allocation (92%)**

How you allocate your money is the major variable, whether you profit, or lose money over time. Compare Mary who invested 99K of her 100K in Microsoft in 1985 and the remaining 1K in a money market fund, with Sally who did just the opposite. The difference in how you allocate your money, between stocks and bonds, or equity and debt may make all the difference in the world.

### **Three Ways to Accumulate Money with Respect to Taxes**

There are really only three choices for individuals: pay taxes now, later or never. Making wise tax choices NOW, if financially smart and can have significant impact on your current and future income. Here are the key features of these three options:

#### **1099 – Now**

- Direct investment (not qualified as in a retirement plan), for example, stocks, bonds or own business.
- May be capital gains taxes
- Pay taxes as you earn your money
- Current tax bracket is known
- No amount of limitations
- No qualification: no proof of income levels or net worth necessary

#### **1099 – Later**

- investment through a corporate or private retirement plan or tax deferred annuity
- Taxed later at an unknown tax bracket
- Amount of limitations and income qualifications may apply
- May be tax deductible

#### **1099 – Never**

- Current Roth IRA's, some municipal bonds, growth in the cash value of life insurance
- Must qualify, based on income
- Limitations may apply
- Cash may be borrowed tax free\*
- Income tax-free death benefit\*

#### **Note: only applies to cash value of life insurance**

While capital gains laws have varied tremendously over the years, the current laws dictate, short-term capital gains (1099-Now) or long-term capital gains (1099-Later) are dependent on the length of time they are held. If your capital gains are short-term, you pay taxes now: if they are long-term you pay later.

## Only Two Places You Can Invest Your Money

Regardless of the name, there are only two categories of investments:

- ***Stocks (Equity) = “You Own It”***  
Stocks are synonymous with equity. When you buy, or invest in stocks, stock funds, real estate commodities, or your own company, you are buying a share of something. You have some percentage of ownership. Success or failure is based on how that asset performs.
- ***Bonds (Debt) = “You Loan It”***  
Bonds on the other hand, are synonymous with debt. When you purchase bonds you are loaning money to that equity, be it government or municipality, a corporation, bank (yes, bank accounts are the equivalent of loaning money to a bank), family member or private individual. Even the mortgage or owner finance, on your own business, is a debt.

Historically, stocks have significantly outperformed bonds extended periods of time. On average, stocks have doubled in value, every seven years. Bonds, historically, have taken over fifteen years to double. It pays to know your “Rule of 72”, or how often money doubles.

## Only One Strategy to Ensure Financial Freedom

Spend less than you make. Many people spend as much or more than they make: the start up costs for a new home, car, furniture and education are high. Sometimes there is a need to bridge gaps for various expenses, such as education for children, or an early retirement, that require more spending for a short period of time. Whether it is income during your working years, or the return on investments in your retirement, **the only way to accumulate money is to spend less than you earn.**

Understanding these indisputable truths is important and will help you think through financial choices that you make daily. That said, getting the guidance and expertise of a qualified financial planner is even better! These truths represent only a fraction of the knowledge necessary to make many complicated investment decisions.

**For more information and assistance contact:**

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