CFM UPDATE

SPRING 2007

THE QUARTERLY NEWSLETTER OF CARTER FINANCIAL MANAGEMENT AND CARTER ADVISORY SERVICES

SHOULD YOU CONSIDER A HEALTH SAVINGS ACCOUNT?

By Dru Fenimore, Guest Column

Dru Fenimore

Are you interested in decreasing the annual cost of health insurance premiums? Do you consider yourself a healthy person who increasingly pays more in medical insurance premiums every year?

Although these are rhetorical questions, who *doesn't* want to save money, especially in insurance premiums? Thanks to a provision in the 2003 Medical Drug, Improvement and Modernization Act, a new tool called the Health Savings Account (HSA) was introduced to enable us to take back control of rising medical costs.

HSAs are special, individually owned accounts that allow tax-free contributions to be used to pay current and future medical expenses. The owner of an HSA account contributes an annual amount (subject to a maximum) toward this account, so that when common medical expenses arise, the HSA account money funds the cost.

Accompanying any HSA is the HDHP, or the high deductible health plan, which must be in place before an HSA can exist. An HDHP represents a different philosophy of health care; with an HSA/HDHP combination, people pay a low "just in case" cost if they should have a major illness – in other words, a similar situation to a catastrophic health plan.

HSAs can be used for routine expenditures, such out-of-pocket costs for deductibles, co-pays, prescription drugs, over-the-counter medicines, and even long-term care insurance premiums and premiums paid during unemployment. The premise is that individuals managing their own care will make better decisions and shop around for the best value.

For individuals and businesses, the greatest selling point of high-deductible insurance is the low monthly premium. For example, a young, healthy, single person might pay only $50 per month for a plan with a $5,100 maximum annual out-of-pocket cost compared to what he or she might pay, such as $250 per month or more, for a plan with a very low deductible. As a result, the difference between the low and high deductible insurance premiums ($200 per month) could be contributed toward the HSA to fund future medical costs.

Pros and Cons of HSAs

As in any other healthcare plan or insurance vehicle, there are pros and cons for consideration. Here are a few for review.

Pros:

- HSA account earnings are not taxable.
- Money not spent stays in the account and earns interest, giving individuals in good health fallback funds for later expenses.
- Others can contribute to the funding of your HSA.
- Employees may take their HSAs from one job to another with no penalties.
- People age 65 and older may withdraw money from their HSAs for any purpose without penalty (though the money withdrawn does become taxable if not used for a qualified medical expense).

continued on page 4

DOES IT PAY TO PREPAY YOUR MORTGAGE?

By JoAnne B. Galbraith, CFP®

JoAnne Galbraith, CFP®

Owning your home free and clear can contribute to a sense of security and comfort, but is paying off your mortgage a good financial decision? As with many decisions based on economics, the answer turns out to be: "It depends." Let's explore the factors you should consider in deciding whether to prepay your mortgage.

Prepayment Penalties

First, check to see if your mortgage loan has a prepayment penalty. Most mortgage loans don't contain a prepayment penalty clause, but you'll need to read the fine print to find out if your loan does.

Higher-rate Consumer Debt

If you have any consumer debt, you should consider paying off these loans first, especially if they carry higher interest rates than your home mortgage. The interest on a home mortgage is tax deductible, while the interest on credit card or personal debt is not.

Adequate Emergency Reserves

Before prepaying your home mortgage, make sure you have adequate reserves set aside for emergencies. In a situation where cash is needed

continued on page 5

PRESIDENT'S LETTER SPRING 2007

Bill E. Carter, CFP®, ChFC, CLU

The investment marketplace got a little interesting for a while in the first quarter when the volatility we thought we would see actually happened. Even though we did not see a 10 percent correction in the market, we did see a 2 percent correction in a single day – which was long overdue.

To understand the significance associated with this correction, you have to understand that there were 910 trading days in the Dow Jones *without* a 2 percent drop. Birinyi and Associates, a stock market research firm, says that the 910-day record goes all the way back to 1900, and was the longest period of time without a 2 percent one-day drop since May 1970. It's interesting to note that during that entire 910-day run, you rarely saw positive views in the press about the U.S. stock market.

The volatility was not to last for long; the market has already stabilized or began to move upward; the market's low point in March was down 5.8 percent from its February high, but as I write this letter during the middle of April, the market is showing even more strength. It will be interesting to see whether the Dow Jones has closed over 13,000 by the time you receive this letter.

The main areas to keep focused on are the same ones that I discussed in the last newsletter – oil prices, interest rates/inflation and the impact of the slowdown in the housing market.

As I have said many times, there are many factors and conditions affecting the markets – and *anything* can happen. As a result, we'll just have to see how 2007 plays out. In light of the fact that everything with the economy is pretty much the same as it has been for several months, I would like to devote this letter to discussing an issue that is important to all of us: "fiscal policy," or what is more commonly referred to as "tax policy."

As the Democrats gain more power, one of the common themes I see throughout the Democratic Party in the written press, television and radio, is the idea of increasing taxes. One reason to increase taxes is to fund new programs, while a second rationale is supposedly to cut the deficit. The third reason is to create a more level playing field as to who is paying the taxes. This last issue is at the heart of the debate: the alternative minimum tax (AMT).

I would like to devote this letter to discussing an issue that is important to all of us: "fiscal policy," or what is more commonly referred to as "tax policy."

The AMT was implemented in the 1980s to ensure that the very wealthy would have to pay *some* taxes. You may remember that this period was a time of tax shelters when the AMT did just what it was supposed to do by affecting only the very high income earners. Today, however, the times have changed. The AMT now affects large numbers of the middle class, a number that is growing each year.

For the last several years, there was much talk in Washington about changing the AMT, and yet, it raises an incredible amount of revenue. The question, then, is where does the money come from to replace the taxes lost to any changes in the AMT rules?

The answer for some is relatively apparent. The burden of making up lost revenues should rest on the shoulders of high income earners. There is still much debate about this, but I think the odds of the income tax brackets increasing on those who make high incomes are pretty good.

Let me be clear. Clients who have read this newsletter for years know that I don't take sides for Democrats or Republicans in this President's Letter. Instead, I simply try to relay to you what the impact of policy may be by either group on your personal finances.

If there is a Democratic president or even if the Democrats win both the House and Senate, another area I think will be changed very quickly would be to increase the capital gains tax from 15 percent to at least 20 percent, if not higher. In light of that, I think there are actions that you may want to consider in your personal planning.

First, if you have a highly concentrated position that has a large gain in any asset, be it real estate or the market, you may want to consider selling that asset and re-establishing a new cost basis. Keep in mind that a 15 percent tax is the best I think we will see for probably for the next 20 to 30 years. Everything runs in cycles, including tax policy, and the policy enacted since Reagan was elected in 1982 was to decrease taxes. I strongly believe that we are about to enter a period of increasing taxes, and once that starts, I think it is going to continue for some time.

Second, if taxes are increased, we need to consider the impact it will have on the economy, and what impact the economy will have on your investments. Historically, most tax increases were bad for the economy. Consumers have less money to spend, and that affects corporate earnings. In addition, corporate income taxes may also be increased. When that happens, you have lower earnings and lower returns in the markets. There will still be some sectors in some areas that will do well regardless of the situation, and there will probably even be some areas that will be favored by new tax policy. However, the whole area of tax reform is something that we follow closely and will continue to monitor for the long term. There is little doubt in my mind that a change in tax policy will require changes in your investment portfolio.

One way to counter the negative effects of a tax policy on stocks and bonds would be to move a higher percentage of your portfolio to alternative investments. We began adding alternative investments in our clients' portfolios in late 1999. Since then, we have continued to increase and further diversify our allocation to alternative investments. The reason for this is that most alternative investments have a low correlation to traditional stocks and bonds. We believed that that was important years ago, and I believe it is even more important today. So, keep your eyes on Washington and keep your eyes on tax policy. More important, keep your eyes on your checkbook!

In closing, I want to urge you to attend an upcoming series on a wide variety of issues on eldercare. One trend that I have no doubt about is the aging of America. While eldercare is nothing new, as the Baby Boomers continue to age, the exponential growth of the elderly in America is going to present a whole new set of challenges. The purpose of this series on eldercare is to provide information so our clients can be prepared for what will not only be the golden years, but at some point will be some of the more challenging years many of us will face. The first seminar, presented by Jessica Therivel, LMSW, "Long-term Healthcare Planning: How to Address the Elephant in the Room," will be held on June 12 at the Westin Galleria. More information on this is included below.

I hope you will join us for this extremely informative series of seminars – and I hope you will learn valuable information you can begin applying to you and your loved ones today.

Bill Carter

Bill E. Carter, CFP®, ChFC, CLU
President

CARTER EDUCATIONAL SERIES

Long-term Healthcare Planning: How to Address the Elephant in the Room

Presented by Jessica Therivel, LMSW

Jessica Therivel is a Dallas-based social worker/consultant with extensive experience in caring for and counseling the elderly; gerontology care; and individual counseling, family counseling and bereavement counseling. She developed a nationally distributed instruction course for dealing with vision loss in the elderly, and is a speaker at multiple gerontology conferences and workshops. This will be the first of a two-part series.

Join us for this great opportunity to learn and be prepared in caring for our loved ones.

Reservations may be made by visiting *www.cascfm.com*. Or, call Rebecca Kim at (214) 363-4200.

Date: Tuesday, June 12, 2007

Time: 6:30 p.m. light snacks
7:00 p.m. - 8:00 p.m. formal presentation

Location: Westin Galleria (LBJ Freeway and the North Dallas Pkwy) Galleria Ballroom 3/Level 3

MAKE YOUR RESERVATIONS TODAY!

FINANCIAL TRENDS	**3/31/06**	**6/30/06**	**9/29/06**	**12/29/06**	**3/30/07**
Dow Jones Industrial	11,109.32	11,150.22	11,679.07	12,463.15	12,354.35
NASDAQ	2,339.79	2,172.09	2,258.43	2,415.29	2,421.64
NAREIT Composite	174.39	170.52	183.14	198.02	200.47
Russell 2000	765.14	724.67	725.59	787.66	800.71
MSCI-EAFE	1,827.65	1,822.88	1,885.26	2,074.48	2,147.51
Prime Rate	7.75%	8.25%	8.25%	8.25%	8.25%
Gold	582.00	613.50	599.25	635.20	663.20
10-Year U.S. Treasury	4.85%	5.34%	4.63%	4.71%	4.65%
30-Year U.S. Treasury	4.89%	5.19%	4.77%	4.82%	4.85%
1-Year Certificate of Deposit	4.00%*	4.25%*	4.55%*	4.40%*	4.50%*

*Past performance may not be indicative of future results. Source of Information: Issues of the Investment Book and The Wall Street Journal. *Bank of Texas rate*

"Health Savings Account" continued from page 1

- Catch-up contributions are allowed if you have not reached your maximum contribution levels. Individuals 55 and older who are covered by an HDHP can make additional catch-up contributions each year until they enroll in Medicare. In 2007, the catch up contribution maximum amount is $800; in 2008, the max is $900, and in 2010, the amount will be $1,000, which will be the cap going forward.

Cons:
- HSAs are only available when they are combined with qualified high-deductible insurance plans.
- People under age 65 will be taxed and charged a penalty fee of 10 percent for withdrawing money for non-medical use.
- Routine doctor visit co-pays and prescription plans are not covered under HDHPs until your deductible has been met. If your HSA is not funded, this could mean initial out of pocket expenses.

HSA Tax Savings

Reduction in Federal Income Tax from HSA Contributions in 2006

Illustrative Examples

HSA Contribution	Income $20,000	$40,000	$60,000	$80,000	$100,000	$120,000
	Single Taxpayer					
$500	75	75	125	125	140	140
$1,000	150	150	250	250	280	280
$1,500	225	225	375	375	420	420
$2,000	300	300	500	500	560	560
$2,500	375	375	625	625	700	700
$2,700 1/	405	405	675	675	756	756
	Head of Household with 1 Dependent Child					
$1,000	100	150	250	300	260	260
$2,000	200	300	455	600	520	520
$3,000	300	450	605	900	780	780
$4,000	400	600	755	1,200	1,040	1,040
$5,000	500	750	905	1,500	1,300	1,300
$5,450 1/	545	817	973	1,613	1,417	1,417
	Married Couple with No Dependents					
$1,000	100	150	150	150	250	260
$2,000	200	300	300	300	500	520
$3,000	300	450	450	450	750	780
$4,000	310	600	600	600	1,000	1,040
$5,000	310	750	750	750	1,250	1,300
$5,450 1/	310	817	817	817	1,362	1,417
	Married Couple with 2 Dependent Children					
$1,000	0	150	150	150	260	310
$2,000	0	270	300	300	520	620
$3,000	0	370	450	450	780	930
$4,000	0	470	600	600	1,040	1,240
$5,000	0	570	750	750	1,300	1,550
$5,450 1/	0	615	817	817	1,417	1,667

1/ Maximum contribution generally allowable.

Note: Assumes: all income is from wages and salaries; taxpayers use the larger of the standard deduction or itemized deductions of 18 percent of income before HSA contributions; and heads of household and married couples with children have dependents eligible for the child tax credit and the earned income tax credit. HSA contribution may not exceed the health plan deductible. Assumes that the Alternative Minimum Tax (AMT) exemptions will be $45,000 for married taxpayers filing jointly and $33,750 for single and head of household taxpayers.

Contribution Levels for HSAs
For 2007, the maximum annual HSA contribution for an eligible individual with self-only coverage is $2,850. For any individual, the maximum contribution is the lesser of the indexed amount or the HDHP's deductible. For family coverage, the maximum HSA contribution is $5,650. Catch up contributions for individuals age 55 or older are increased by statute to $800 for 2007. In addition, both the HSA contribution and catch-up contribution apply pro rata based on the number of months of the year a taxpayer is an eligible individual.

There are new amounts for out-of-pocket spending on HSA-compatible HDHPs. The maximum annual out-of-pocket amounts for HDHP self-coverage increases to $5,500 and the maximum annual out-of-pocket amount for HDHP family coverage is twice that, or $11,000. For 2007, the minimum deductible for HDHPs increases to $1,100 for self-only coverage and $2,200 for family coverage.

With 73 percent of Americans incurring less than $500 per year in annual medical expenses, many of us are probably carrying more health insurance than we need. If this sounds like you, maybe you should get involved in managing your health and see if an HSA might be right for you. Of course, as with any major financial decision, you should consult your insurance agent or financial advisor before making a long-term decision about your insurance needs.

Dru Fenimore is an agent in the Life & Health Department of Upshaw Insurance Agency, Inc., a Texas-based firm with offices in Dallas, Amarillo and Borger. Contact Dru at 214/343-8184 or druf@upshaw-insurance.com. ■

"Does it Pay to Prepay your Mortgage" continued from page 1

quickly, such as a health crisis or job loss, you'll want a source of readily available funds instead of home equity.

Retirement Savings Status
If you are still in the process of building a retirement nest egg, you may use excess cash to take full advantage of 401(k), traditional and Roth IRA contributions before prepaying your mortgage. If you are already retired, it's probably not a good idea to withdraw money from a retirement plan to prepay your mortgage.

Income Taxes
Now comes the tricky part; you'll want to consult your tax advisor. We all know that interest on a home mortgage is tax deductible, but you will need to make sure you are actually *benefiting* from the deduction. If your total itemized deductions are less than the standard deduction, or if your itemized deductions are being phased out because your income is too high, you may not be fully benefiting from the mortgage interest deduction. As a result, the inability to fully benefit from the tax deduction may make paying off the mortgage more attractive.

Investment Alternatives
By prepaying your mortgage with excess cash, you are basically guaranteeing yourself a rate of return equal to the interest rate on your loan. However, if you have a low interest rate mortgage and are willing, instead, to invest your excess cash elsewhere, you may be able to earn a higher return on your investments than you are paying on your mortgage. What's more, investment capital gains and most dividends are taxed at a maximum rate of 15 percent, while the mortgage interest deduction saves taxes at your marginal tax rate, which can be as high as 35 percent. This means you may be able to come out ahead, even if you earn a lower return on your investments than your mortgage interest rate. If you are considering investing your excess cash instead of prepaying your mortgage, you must remember that investing carries risks and that investment returns are not guaranteed.

If you are considering investing your excess cash instead of prepaying your mortgage, you must remember that investing carries risks and that investment returns are not guaranteed.

Determine Your Alternatives
In the end, the decision to prepay may be ruled by emotions. For some, the idea of being debt free is just too appealing, regardless of the economics. For others, a compromise might work. Instead of paying off the loan entirely, you could ramp up your payments to eliminate the debt by a certain date, such as, for example, when you plan to retire. Ask your financial advisor to help you calculate how much extra you will need to pay each month to be debt free by your target date.

JoAnne B. Galbraith, CFP®, is a financial planning analyst with Carter Advisory Services. Contact her at jgalbraith@cascfm.com. ■

CFM HIGHLIGHTS

- We would like to welcome the following additions to CFM:
  - Anjee Reed – Executive Assistant for Bob Berg
  - Pam Dorman – Receptionist
- Brandon Ratzlaff was accepted to the MBA Program at The Neely School of Business at TCU. He will also take the CFP exam in July.
- Bill Carter, Jerry Mallonee and Tom McIntire attended the Raymond James National Conference in San Diego, March 11-16.
- Bill Carter attended a Foundation for Financial Planning meeting in San Francisco, April 10-12.
- Carter Financial Management held its semi-annual Charity Day on April 18 at the Dallas Area Habitat for Humanity.
- Bill Carter was guest speaker at the Bosque County Muster in Meridian, Texas, on April 21.
- Tom McIntire attended the Hines REIT due diligence meeting in Houston, April 24-25.
- Bill Carter and Tom McIntire attended the FPA Retreat for advanced planners in Galveston, May 5-8.
- Bill Carter will attend a Capstone meeting in Little Rock, May 13-15; a Private Enterprise Research Center meeting in College Station on June 1; the 12th Man Advisory Board meeting in San Antonio, June 21-22; and the Morningstar Investment Conference in Chicago, June 27-29.
- Bill Carter will be a keynote speaker at the Illinois Financial Forum 2007 on June 4, alongside Bob Veres and Susan Bradley. ■

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RJFS DEADLINES

Cutoffs:

Trades/Mutual Funds	3:00 CST
No Load Mutual Funds – Buys:	1:00 CST
No Load Mutual Funds – Sells:	2:30 CST
Nuveen Munis	10:00 CST
Government Bonds	4:00 CST
Wires-From Customer Accts.	12:30 CST

CFM MISSION STATEMENT:

Our mission is to become our client's trusted advisor by providing superior financial planning services that enable our clients to define and achieve their financial and life goals.

REMINDER: If you are making out a check for your Raymond James account, please note we can only accept checks **payable to Raymond James** or **Raymond James & Associates**. We **cannot** accept checks payable to *Carter Financial Management* or *Raymond James Financial Services*. Thank you for your cooperation.