

Financial Risk: An Alternative Biblical Perspective

Robert Brooks
The University of Alabama

Challenging the secular perception that the Bible has nothing useful to offer on modern financial risk-taking, Dr. Brooks suggests that the Bible does presents a case for taking financial risk and offers several options for mortgage payments plus retirement savings.

Financial risk has captured the attention of many over the years. The objective of this paper is to challenge both the secular perception that the Bible has nothing useful to offer modern financial risk-taking, as well as challenge the modern Christian financial counseling community's perceived extreme level of risk aversion.

The focus here is on personal financial management and the use of mortgage debt. Mortgage debt is used primarily for illustrative purposes, although the focus is on risk aversion in general. While a change in tax law (e.g., a flat tax where mortgage debt is not deductible) may influence the specifics here, it will not change the general focus.

Typically, the secular view is to borrow heavily, taking advantage of the tax deductibility of mortgage interest, whereas the Christian financial counseling community's view, typically, is to quickly pay off mortgage debt.

Consider the following two different viewpoints—the first from a member of the professional investment management community and the second from the Christian financial advising community.

Peter Bernstein recently traced risk-taking throughout history, with some attention given to his perception of the role of the Christian church. He states:

As long as people sensed that they had no control over their futures, chance explained the entire outcome of risk taking. But that view vanished abruptly with the arrival of Christianity. Now random chance was out; God's will was in. "Thy will be done" became the dominant paradigm for determining the future and explaining the past. As a consequence, scientific research was crushed (8).

Clearly, Bernstein's view is that Christianity offers nothing in the way of understanding appropriate

financial risk-taking. He asserts that mankind eventually shed this burden through enlightenment:

But even the Church, calling on the highest authority of them all, could not stifle human curiosity. The authority of religion ultimately crumbled before the endless search for a better life on earth (8).

On the other hand, the Christian financial advising community has long recognized the value of biblical principles in modern financial management. For example, Howard Dayton states:

The Bible has the answers to the financial problems of the sophisticated twentieth century. The eternal principles of Scripture are practical in any culture and in any century (125).

Larry Burkett, a widely followed Christian financial advisor, further emphasizes the importance of understanding God's will for personal money management:

I sincerely believe that once Christians have been educated in God's plan for their finances, they will find a freedom they have never known before (*Your Finances* 13).

Ron Blue emphasizes the fundamental difference between the Christian and the secular community:

Ultimately, financial planning is the predetermined use of financial resources in order to accomplish certain goals and objectives. The difference in financial planning between the Christian and the non-Christian is the source of the goals and objectives (19).

However, the Christian financial community appears to exhibit a high level of risk aversion. Recent books with titles such as *Debt-Free Living* and *The Coming Economic Earthquake* support this assertion. Two principle issues are addressed here. First, has the Christian financial advising community analyzed the economic consequences of being highly risk averse? Second, is a high level of risk aversion supported biblically? The choice appears to be either 1) debt is bad and religion is good or 2) religion is bad and debt is good. The objective here is to demonstrate that there is an alternative viewpoint—appropriately used debt is good and religion is good.

Economic Consequences of Being Highly Risk Averse

One way to illustrate the economic outcome of being highly risk averse is to build on an example offered by Burkett in *The Coming Economic Earthquake* (214). Two plans are offered based on a \$100,000, 30-year, 10 percent mortgage and the ability to save an additional \$100 per month for retirement in 30 years. (It is important to emphasize that one's own location in the life cycle and one's vocation highly influence the economic strategies given here. Our assumption is for someone in a stable profession with 30 years until retirement.)

Plan A assumes the additional \$100 is deposited monthly in a

savings account at 6 percent. As Table 1 illustrates, after 30 years the house is paid off and the investor has \$101,051 in the bank.¹ The preferable plan B places the additional \$100 payment on the mortgage to pay it off early and then after the mortgage is paid, both the mortgage payment and the additional \$100 is deposited at 6 percent, yielding \$177,901 in the bank.

Unfortunately, Burkett's analysis ignores two critical aspects of retirement planning—taxes and risk.²

With today's tax structure, investors are able to deduct mortgage interest expense from taxes, implying a lower after-tax cost of debt. Also, it is easy to

Table 1. Various Retirement Plans With \$100,000, 30-year, 10% Mortgage

Tax Rate	Plan A	Plan B	Plan A'	Plan B'	Plan C
0%	\$101,051	\$177,901	\$101,051	\$177,901	\$205,013
10%			\$182,597	\$229,009	\$378,512
20%			\$266,950	\$280,116	\$557,705
30%			\$355,313	\$330,621	\$745,034
40%			\$449,691	\$381,729	\$944,566
50%			\$553,693	\$432,836	\$1,163,623

Plan A: No taxes; 6% earnings on retirement fund; do not prepay mortgage

Plan B: No taxes; 6% earnings on retirement fund; prepay mortgage

Plan A': Taxes; 6% earnings on retirement fund; do not prepay mortgage

Plan B': Taxes; 6% earnings on retirement fund; prepay mortgage

Plan C: Taxes; 9.5% earnings on retirement fund; do not prepay mortgage

invest retirement funds on a pre-tax basis as well as deferring tax liabilities for income and capital gains. Hence, the true after-tax cost of a mortgage is (R_{AT})

$$R_{AT} = R_{BT} (1-T)$$

where the before-tax cost of the mortgage is denoted as R_{BT} and the marginal tax rate is denoted as T . We ignore the timing difference between when interest is paid (monthly) and when the tax deduction is claimed (annually). Hence a 10 percent mortgage with a 30 percent tax rate implies an after-tax cost of the mortgage of 7 percent, derived from $10\% (1-0.3)$.

The benefit of investing with pre-tax dollars is expressed as ($\$Pre\text{-Tax}$)

$$\$Pre\text{-Tax} = \$After\text{-Tax} / (1-T)$$

where $\$After\text{-Tax}$ denotes the amount in after-tax dollars. Hence a \$100 investment in after-tax dollars and a 30 percent tax bracket implies a pre-tax investment of \$142.86, derived from $\$100/(1-0.3)$. Thus, the ability to invest on a pre-tax basis implies the ability to invest an additional \$42.86 per month.

Plan A' and plan B' illustrate adjusting plans A and B to

recognize these tax benefits. For a tax rate of 30 percent, we have \$330,621 in the bank for plan B' and \$355,313 in the bank for plan A'. Comparing plans A' and B', we see that one's tax rate determines which strategy is preferable. Clearly, taxes play an important role in the decision to pay off a mortgage.³

One critical issue involves the nature and level of risk aversion. Obviously, there are tremendous advantages to paying off one's house. There is a higher level of security as well as the flexibility to quickly move if needed (for example, going on an extended mission trip). If there is another systemic financial shock, such as the crash of 1929, one would appreciate not having the added burden of a mortgage payment. However, owning your own house would probably not be helpful in a revolution (just ask someone from Cuba). Thus, of all the possible systemic events that could occur, having one's house paid off helps in some and does not help in others. Moving from the unlikely events to the more likely, assuming a 10 percent mortgage and a 6 percent investment implies an extremely high level of risk aversion for a 30-year investment horizon. That is, accepting a 6 percent rate

when your mortgage costs you 10 percent implies an extremely low risk investment such as a bank savings account.

Consider the following alternate riskier strategy—Plan C. Use the additional \$100 to invest in a mutual fund that buys mortgages (such as the GNMA Fund offered by The Vanguard Group). Due to default insurance, servicing fees, and portfolio management costs, these funds will earn approximately 1/2 percent less than prevailing mortgage rates. As Table 1 illustrates, plan C yields \$745,034 in the mutual fund. It is important to note that the period-to-period performance of the mutual fund will vary and the assumed 9 1/2 percent rate is a long-run average.

The appropriate issue is whether \$745,034 is sufficiently above \$355,313 (Plan A': less risk) or \$330,621 (Plan B': less risk and pay off early) to warrant taking 10.75 additional years⁴ to pay off one's house as well as taking the additional risks above bank accounts. The additional risks, including manager risk, tax risk, and market risk, are very real. Manager risk refers to the possibility that the mutual fund manager may not purchase the right securities, may take too

much risk, or may steal from the fund. This risk can be minimized by investing in a mutual fund with a long, credible history. Tax risk refers to the possibility that Congress may adversely change the tax laws, such as disallowing the deductibility of mortgage interest. Market risk refers to the possibility of adverse movements in mortgage-backed securities within the mutual fund. Most of the market risk with plan C has been hedged. For example, if inflation erupts and rates rise, the value of the mutual fund will fall, but the value of the house will rise. If interest rates fall resulting in under-performance of the mutual fund in the long-run due to prepayments and other factors, then one could also refinance the house at a lower rate.

Hence, no matter which direction interest rates move, you have created a natural hedge between the mutual fund and your mortgage. From Table 1, it is clear that one's tax bracket is a major factor driving the results under the alternate plans. These results are also sensitive to the level of mortgage rates, but the general pattern remains. Also important in this analysis is the stability of one's income. If your income is unstable, there is additional merit to paying off

your house. Finally, it is possible to even outperform plan C with riskier bond and equity funds. However, riskier investments carry with them the possibility of greater losses.

This analysis naturally leads to the next issue as to the biblical perspective on taking financial risk.

The Bible and Risk Aversion

For Christians, the Bible is a trustworthy guidebook for life. The Bible offers a worldview in which there are many absolutes—God exists, the atoning death, burial and resurrection of Jesus Christ, a heaven for followers of Jesus Christ and a hell for the unbelievers, and so forth. Hence,

*...put your hope in God
(which is certain) and
not in your wealth
(which is uncertain).*

there are doctrines and principles that are absolutely certain. Upon these certainties, the Christian is equipped to face the uncertainties of life. For example, Paul instructs Timothy concerning the wealthy in his congregation:

Command those who are rich in this present world not to be

arrogant nor to put their hope in wealth, which is so uncertain, but to put their hope in God, who richly provides us with everything for our enjoyment (1 Timothy 6:17).

That is, put your hope in God (which is certain) and not in your wealth (which is uncertain). The biblical teaching is that the Christian should serve God and not money (see Luke 16:13).

The Christian financial advising community's high level of risk aversion seems to stem from two trains of thought.

First, the Bible highly recommends (commands?) one to keep out of debt. For example, Paul exhorts, "Let no debt remain outstanding, except the continuing debt to love one another, for he who loves his fellowman has fulfilled the law" (Romans 13:8). In the original Greek, a double negative meaning emphatic is used.⁵

Μηδενι μηδεν οφειλετε
To no one nothing owe ye

Other related references include Deuteronomy 15:6 and 28:12. Most Christian financial advisors do not interpret the Bible as expressly prohibiting debt, but rather that one should be extremely cautious when debts

are incurred. One interesting interpretation here is to observe that "debt" in the U.S. is fundamentally a different type of legal contract than debt when the Bible was recorded. One could argue that debt contracts in the U.S. have been influenced by biblical concepts. For example, mortgage contracts contain absolutely no liens on an individual or his family members. That is, you cannot be jailed for becoming disabled, losing your job, and failing to pay your mortgage.

Second, most Christian financial advisors use economic arguments to convince their audiences that using debt does not make sense, for example, e.g., Burkett (*Coming Economic* 4) upon which the analysis of Table 1 was based. Our objective here is to address this second train of thought. Obviously, if one believes that the Bible expressly prohibits debt, then no amount of economic rationale should matter. God does expect His children to pay their bills:

The wicked borrow and do not repay, but the righteous give generously . . . (Psalm 37:21). The implication here is clearly that if the righteous have borrowed, they should make every effort to repay. Thus,

serving God rather than money does not mean that one should neglect the stewardship of financial resources. One can put his hope in God and still aggressively manage financial resources. This concept is illustrated by the following proverb:

The horse is made ready for the day of battle, but victory rests with the LORD (Proverbs 21:31).

Of course, one can be too greedy and wildly speculative, resulting in terrible losses:

The plans of the diligent lead to profit as surely as haste leads to poverty (Proverbs 21:5).

He who works his land will have abundant food, but the one who chases fantasies will have his fill of poverty. A faithful man will be richly blessed, but one eager to get rich will not go unpunished (Proverbs 28:19-20).

If one is to be "made ready" or prepared financially, are there any prohibitions to financial risk-taking in the Bible? One of Jesus' parables provides some insights.

Three men were given some money (talents) to manage while the master was away:

The man who had received the five talents went at once and put his money to work and gained five more. So also, the one with the two talents gained two more. But the man who had received the one talent went off, dug a hole in the ground and hid his master's money (Matthew 25:16-18). . . .[To the man with ten talents] His master replied, "Well done, good and faithful servant! You have been faithful with a few things; I will put you in charge of many things. Come and share your master's happiness!" (Matthew 25:21). . . .[To the man with one talent] His master replied, "You wicked, lazy servant! So you knew that I harvest where I have not sown and gather where I have not scattered seed? Well then, you should have put my money on deposit with the bankers, so that when I returned I would have received it back with interest" (Matthew 25:26-27).

Although the context is the coming kingdom of heaven, it is clear that the master rewarded those who "put his money to work" and *doubled* the investment. Although the duration of the investment is

unknown, it is clear financial risks were taken on behalf of his master. Jesus appears to be exhorting to at least earn bank interest. Bank deposits at that time had no FDIC insurance and were fairly risky propositions. Jesus clearly did not reprimand the other two for their risk taking.

Interestingly, the Bible does offer some practical wisdom for managing financial risks:

Cast your bread upon the waters, for after many days you will find it again. Give portions to seven, yes to eight, for you do not know what disaster may come upon the land. . . . Whoever watches the wind will not plant; whoever looks at the clouds will not reap. . . . Sow your seed in the morning, and at evening let not your hands be idle, for you do not know which will succeed, whether this or that, or whether both will do equally well (Ecclesiastes 11:1-6).

Clearly, when taking financial risks one should diversify in at least seven or eight asset classes (stocks, bonds, and so forth), and it requires courage. We are advised to put forth considerable effort. However, the Bible does not prohibit taking calculated financial risks.

Summary

The objective of this paper was to challenge the secularist view that the "Church" offers nothing in the way of understanding financial risk, as well as to challenge the Christian financial advising community to reconsider its high level of risk aversion. Although evidence of imprudent financial risk-taking abounds, there are compelling reasons to carefully assess one's level of aversion to financial risks.

ENDNOTES

¹ Although the numbers reported here are slightly different from Burkett, they are fairly close. Burkett's Plan B appears to have an extra \$100 invested at the starting date and the full mortgage payment (rather than the required partial) appears to be made for the last payment.

² Burkett and others do a very good job of warning people of the various pitfalls related to misuse of debt.

³ It should be noted that all three plans, A', B', and C will be subject to income tax when the money is taken out of the retirement plan. Currently, there are ways to minimize the tax liability when the money is withdrawn.

⁴ By prepaying at a rate of \$100 per month you shorten the life of the mortgage by 10.75 years.

⁵ See *Today's Parallel Greek-English New Testament* (Richmond, VA: The Iversen-Norman Associates, 1976), page 454.

REFERENCES

Bernstein, Peter. "Risk as a History of Ideas," *Financial Analysts Journal* (Jan.-Feb 1995): 7-12.

Blue, Ron. *Master Your Money*. Nashville: Thomas Nelson, Inc., 1986.

Burkett, Larry. *The Coming Economic Earthquake*. Chicago: Moody Press, 1991.

Burkett, Larry. *Your Finances in Changing Times*. Chicago: Moody Press, Inc., 1975

Dayton, Howard L. *Your Money: Frustration or Freedom*. Wheaton: Tyndale House Publishers, Inc., 1971

The Holy Bible, New International Version. Grand Rapid: Zondervan Bible Publishers, 1984.

JBIB