Parsec Financial

Second Quarter 2008 Newsletter

Financial Advice and Planning

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NORTH CAROLINA GIFT AND ESTATE TAX

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The North Carolina Gift Tax

Many clients are surprised to learn that North Carolina has its own separate gift tax rules. Interestingly, North Carolina is one of only four states having a state gift tax independent from the Federal gift tax rules. North Carolinians are initially granted the annual gift exclusion amount in keeping with the Federal gift exclusion amount, currently $12,000. This amount can be transferred by individuals annually to as many other individuals as one chooses without any gift tax being due either to North Carolina or the Federal government.

However, when a North Carolinian chooses to make a gift beyond the $12,000 annual exclusion to another individual, the North Carolina gift tax comes into effect. Each individual is entitled to a total lifetime (not annual) exemption of $100,000 to be deducted from gifts, but only on gifts made to Class A donees. Class A donees are made up of lineal issue, lineal ancestors, adopted children or step-children of the donor. Once the donor has utilized the $100,000 in gifting, no further exemption in North Carolina is allowed and gift tax will be due on additional gifts exceeding the annual exclusion amount. Also, if gifts beyond the annual exclusion amount are made to more than one donee in any calendar year, the $100,000 exemption amount must be apportioned among the donees, relative to the amount each donee receives in proportion to the total amount of all the gifts made in that calendar year.

Please note that no $100,000 North Carolina gift tax exemption is allowed for Class B beneficiaries, consisting of brothers, sisters, descendants of brothers and sisters, or an uncle or aunt by blood. Class C beneficiaries are donees of any relationship other than those mentioned in Class A or B, and also do not receive the $100,000 North Carolina gift tax exemption.

For gifts exceeding the $12,000 annual exclusion amount, the donor is responsible for filing a North Carolina gift tax return and for either payment of the gift tax or election of use of the $100,000 exemption amount, if the gift was given to a Class A beneficiary. The North Carolina gift tax rates vary between the various classes of beneficiaries. For example, Class A beneficiary tax rates range from 1% for gifts of $10,000 above the $100,000 exemption to 12% for gifts of $3,000,000 above the $100,000 exemption. Tax rates for gifts made to Class B beneficiaries range from 4% on the first $5000 to 16% on gifts over $3,000,000. Tax rates for gifts made to Class C beneficiaries range from 8% on the first $10,000 to 17% on gifts exceeding $2,500,000.

The North Carolina Estate Tax

The state of North Carolina in 2008 maintains an applicable estate tax exemption equal to the federal amount of $2,000,000. Under North Carolina law, an estate that is not subject to the federal estate tax is not subject to State estate tax.

The North Carolina estate tax is structured to pick up the federal estate tax credit for state death taxes. This means that North Carolina will receive its estate tax revenue from a piece of what is paid by the taxpayer to the federal government. However, unlike the federal system, North Carolina did not adopt the state tax credit phase out or termination. For decedents dying on or after January 1, 2005, the North Carolina estate tax will continue to be equal to the state death tax credit for estates as it existed prior to 2002.

Dr. Jim Smith's Economic Commentary

RECESSION, SCHMECESSION—GET OUT AND GO SHOPPING!

Dr. James F. Smith,

Chief Economist

The magazine, newspaper, radio and television pundits seem to miss no opportunity to scare you to bits about the state of the economy. Wonderful evidence that this is working was in a front-page report in *USA Today* on March 18.

A full 76 percent of consumers polled said they thought the U.S. was in a recession. This was a huge contrast to the 22 percent who thought the economy was continuing to expand. This was the greatest portion of consumers to report they thought the economy was in dire shape since September 1992, which helps to explain why Governor Clinton won the election that November.

However, it doesn't mean the consumers were right. In fact, at the time consumers were reporting that the economy was in recession we were already 18 months into the longest (exactly 10 years) expansion in our history. Clearly, consumer perceptions did not square with economic reality then, and they are probably off now, too.

Even more frightening, the survey revealed that 59 percent of consumers said it was likely the U.S. economy might slip into a recession lasting several years. A gargantuan 79 percent of those polled said they were worried about this possibility. So, in case you are one of those 79 percent, let me tell you now: I can assure you that there is minimal chance that the U.S. is entering or will ever see another depression, which is what we call recessions that last for several years.

Subsequent surveys released by both the Conference Board and the University of Michigan have shown consumers becoming even more pessimistic. For example, the Index of Consumer Sentiment for May, which was released by the University of Michigan on May 30, showed that consumers were more pessimistic than at any other time since June 1980. That was the last full month of a short (six month), but deep recession exacerbated by President Carter's use of the Credit Control Act of 1969 to scare consumers away from using credit. Over 90 percent of the respondents in May's Michigan survey said they were worried about the economy because of the recent reports in the media.

The Great Depression began in August 1929 and ended in March 1933. After those 43 months, real GDP was down by 33 percent and the unemployment rate was 25 percent. Prices had fallen 27.2 percent.

The Great Depression was caused by monumental policy mistakes that are unlikely to be repeated (it is possible that policymakers learn things—especially if the pain is big enough). The worst was committed by the Federal Reserve System, which simply did not understand either the gravity of the situation or the fact that when banks fail in a system with no deposit insurance (the FDIC was not created until 1933), then the money supply shrinks. They took no offsetting actions and allowed the money supply to shrink by one-third, which led directly to falling prices (deflation) and shrinking GDP.

The other major political blunder was the imposition of the Smoot-Hawley Tariff in 1930. This raised the average tariff on imported goods to 49.8 percent, the highest in U.S. history. The rest of the world retaliated with their own tariffs and world trade declined by two-thirds during that period.

That dreadful law is still our basic tariff and every president from Franklin Roosevelt through and including George W. Bush has wrestled with Congress to get the authority to reduce its impacts.

The final blunder was raising taxes in a vain effort to balance the budget. In those days virtually all politicians had the quaint notion that it was immoral to run a budget deficit, except in time of war or a severe economic emergency, which they were quite slow to recognize.

It is highly unlikely that any of these blunders would be repeated. There are certainly politicians who would like to derail global trade, but they are unlikely to get very far with such counterproductive notions.

The Federal Reserve and other central banks around the world understand that their most important mission is to insure the safety and soundness of the financial system in their countries. That is why we have seen a wide variety of extraordinary actions since August 9, 2007.

We will see as many more of these as are necessary to restore confidence to financial markets. The central banks have essentially unlimited resources in the short run as they can create money in whatever amounts are needed. This is their role of being the Lender of Last Resort (LLR).

It is always critical for the LLR to step up in time to prevent a freefalling downward spiral, but they must also leave some uncertainty as to what they will do and when they will do it. This is the beauty of the Bear Stearns situation.

Bear Stearns was the fifth largest investment bank in the U.S. on March 14 with a book value of $80 a share and a market price of $30. They had a large amount of mortgage-backed securities that had become impossible to price because of all the financial turmoil.

On March 17, JP Morgan Chase and the Federal Reserve worked out an arrangement for the bank to buy Bear Stearns at $2 a share or $236 million. Bear Stearns headquarters building, which has no debt on it and is quite close to the headquarters of JP Morgan Chase, is worth $1.4 billion or $8 a share. The deal closed in late May at a revised $10 a share.

You can bet that all other leveraged firms have been carefully evaluating the quality of their credit lines. The Federal Reserve has succeeded in striking fear into the speculators while reassuring the rest of us that the financial system is sound.

Of course, they have also reduced their target for the Federal Funds rate to 2.00 percent. On September 18, 2007, that stood at 5.25 percent.

This monetary stimulus will add significantly to economic growth, but its strongest impacts won't show up until 2009 or 2010. Well before then, the FOMC will have to start raising rates to prevent inflation from becoming a problem then.

The first checks and direct deposits from the fiscal stimulus package started going out to the 130 million consumers receiving them on April 28. All of the $110 billion will be distributed by June 8. You had to file a tax return, even if you had no liability, in order to get your money.

This stimulus and the additional benefits for business investment will beef up the pace of the economy. The second half of the year will be much stronger than the first half.

The shortest recession we ever had was the six-month one from January to July, 1980. If the economy did indeed turn down in January and then did turn up in May, that simply isn't long enough to qualify as a recession. Furthermore, every long expansion since World War II has had at least one negative quarter in it. The first quarter posted positive real GDP growth, making the likelihood of a recession in 2008 even lower.

So ignore the bad news and remember that the economic fundamentals are strong globally. Through the first quarter of 2008 the U.S. economy grew in 96 out of 100 quarters. That means we're expanding the overwhelming majority of the time. If you'll just get out and go shopping, you can make your personal contribution to continued economic growth.

ADV Offer

Parsec's Form ADV, a disclosure document, describes services provided to our clients and is available upon request. If you would like a copy, please contact us.

Stock Market Outlook

EQUITY OWNERSHIP

Rick Manske, CFP®
Managing Partner

Thus far in 2008, we have seen a difficult economic backdrop. The faltering US housing market, a softening economy, high oil and food prices and financial sector shake down has led to upwards of $350 billion dollars of global banking write downs. Investing in such times, we are reminded of the importance of our continued focus of investing in durable, well-managed businesses. Our investment process centers squarely on the fundamentals of the businesses we own. Companies that maintain competitive advantages and durability of earnings are of increased importance. These uncertain times will create some excellent valuations in the short-term, and with the benefit of time this high-quality investment theme should remain remarkably resilient. Owning companies over the long-term indicates that we will experience rough conditions, so we assess each company's ability to withstand weak environments.

Global leaders constitute a large portion of our equity allocation. They possess an ability to raise capital in a weak economy and endure through to a recovery. They are geographically diverse and have access to growing emerging markets. The aging demographic is another theme that we favor. Governments, individuals and corporations are all ramping up spending towards healthcare. As people retire and live longer they will have an even greater need to invest for retirement. This trend is worldwide, with aging populations in Europe and Japan already ahead of the US. These themes should help to support our ideas in the healthcare and financial services sector.

Equities are ownership interests in businesses, and we believe that over the long-term stock prices will follow rising revenue, earnings and dividends. We try to avoid peaks in pessimism and optimism that can be very costly to long-term performance. As realists we attempt to keep reasonable expectations and make rational decisions. We feel that eventually home prices will stabilize, oil will correct and the financial system will recover, we just don't know exactly when. With careful research, buying high quality businesses at value prices will help get us through difficult market conditions. Whatever happens through the second half of the year, we remain committed to this discipline.

Parsec Prize

Parsec Financial has selected Quality Forward as the recipient of the second quarter Parsec Prize of 2008. Since 1974, Quality Forward has worked to enhance the environment and quality of life for the citizens of Asheville and Buncombe County through awareness building, community activities and community partnerships. Parsec selected Quality Forward for the work it does to make our region a cleaner and greener place to live. Quality Forward has earmarked the $17,000 from the Parsec Prize for several educational programs, including a new one that will teach school children the environmental impact of littering and the benefits of recycling.

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