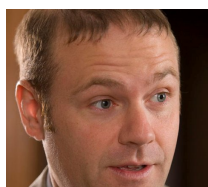


# Parsec Financial

## Third Quarter 2009 Newsletter

### Generational Planning



Rick Manske, CFP®

MANAGING PARTNER

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#### Special Points of Interest

- Check your beneficiary designation
- Parsec prize winners are AB Tech Foundation and Asheville Chamber of Commerce
- Don't forget to sign up for the e-newsletter at: [news@parsecfinancial.com](mailto:news@parsecfinancial.com)

It is important to realize that the most often overlooked estate planning item is the basic beneficiary designation form. All IRAs, Roth IRAs, section 457 plans, 401(k) plans, Profit Sharing plans, annuities, and other retirement accounts have beneficiary forms. Upon the death of the account holder these simple forms govern the disposition of the decedent's retirement portfolio assets. Completing the beneficiary forms with the most up-to-date information is imperative. Furthermore, life insurance benefits are distributed in the same manner. Beneficiary forms from your financial intermediary can be updated at any time. Your bank, insurance company or broker-dealer will request that you declare a primary beneficiary, and possibly contingent beneficiaries. The primary beneficiary will receive the asset if they are living (unless they process a qualified disclaimer); the contingent beneficiary will receive the asset if the primary is not alive.

Over a long career there can be hundreds of thousands of dollars, and in some cases, millions, accumulated in retirement plans. Oftentimes, a person's entire estate will be comprised of retirement accounts, home equity and

life insurance proceeds, most of which will pass to family and friends via the beneficiary designation. Naming individuals and not your general estate as beneficiary gives your family or friends the best opportunity to consider the most favorable tax treatment on the portfolio after you are gone. To be a good steward of the resources that you have accumulated, you should leave retirement assets to heirs in the most tax-advantaged and simplest way possible.

Sometimes an individual's circumstances require the use of a trust as IRA beneficiary. Other times it is advantageous to leave a retirement account to a charity. These more unique beneficiary situations require very careful planning that takes into consideration relatively complicated tax and legal issues that are too involved for this article to address. Please consult with your attorney and financial advisor.

Review your beneficiary designations on all retirement accounts, insurance policies and annuities to be sure assets pass to others in the manner you desire. For accounts we manage, feel free to contact Parsec Financial to review or make changes to your beneficiary information.

## Dr. Jim Smith's Economic Commentary



Dr. James F. Smith  
CHIEF ECONOMIST

### Growth for Now, But Then What?

Since September 1, nearly all the economic news about the U.S. economy, and even much of it about the global economy, has been quite positive. That's a relief as it is always more fun for me to be able to report good news.

For example, one of the best leading indicators of economic activity is the Purchasing Managers Index (PMI). It is released on the first business day of every month and has been around since 1931 except for five years during World War II. Levels of the index above 50.0 percent mean that the manufacturing sector of the economy is expanding, while readings of 41.2 percent or more mean that real GDP is rising.

Their September 1 release (at [www.ism.ws](http://www.ism.ws)) reported the August 2009 PMI was 52.9 percent. That was the first time the index had risen in eighteen months and was the highest it had been since September 2004.

If that level of the index were to last for a year, it would be consistent with real GDP growth of 3.7 percent on a year-over-year basis. We would all celebrate if that turned out to be the actual result.

On September 12, The Wall Street Journal ([www.wsj.com](http://www.wsj.com)) released the forecasts of its panelists for the next eighteen months. For the second month in a row, all 51 of us who responded had positive real GDP growth for the third quarter of 2009. The range was from 0.5 percent to 4.5 percent (seasonally adjusted annual rate).

The average was 3.0 percent. To show you how the forecasters have changed their minds over time, that average was 1.6 percent when they first asked us to provide the number back in November 2008. From there it fell steadily to 0.4 percent in both March and April

2009. It was only 0.9 percent in July 2009, but leapt to 2.4 percent in August and now to 3.0 percent in the survey conducted September 4-8.

My recent forecast was 4.0 percent, up slightly from my long-standing expectation of 3.6 percent. It's quite gratifying to see nearly all the other panelists move toward what was a few months ago viewed as my "too optimistic" (if not "crazily optimistic") forecast that the recession is over and we are embarked on a healthy recovery to be followed by a long expansion.

Two other panelists (Bruce Kasman of JP Morgan Chase and Brian Wesbury of First Trust Advisors) also had 4.0 percent for the third quarter. Dick Berner of Morgan Stanley was the top at 4.5 percent, followed by Susan Sterne of Economic Analysis Associates at 4.3 percent.

Professor J. Dewey Daane of Vanderbilt University, who was a member of the Board of Governors of the Federal Reserve System from November 9, 1963 to March 8, 1974, is the pessimist at 0.5 percent real GDP growth. He's also the only panelist with a negative number for the fourth quarter of 2008. At -1.0 percent.

The average for the fourth quarter is 2.5 percent. That's also the highest since we started forecasting that quarter in November 2008.

My forecast for the fourth quarter is 3.5. That's the same as three other forecasters (Paul Ashworth of Capital Economics, Dean Makin of Barclays Capital and Mark Neilson of Macro Econ Global Advisors (not to be confused with Macroeconomic Advisers, an entirely different firm)). It's also below five others. The top is my good friend, Gene Huang, the chief economist for FedEx in Memphis at 4.9 percent. Three others were at 4.0 percent and one at 3.8 percent.

For the full year 2010 on a fourth quarter-over-fourth quarter basis, the consensus (average) is for real GDP

growth of 2.8 percent. My forecast of 3.3 percent is not much higher than that. The range includes one negative number of -1.3 percent (Mike Cosgrove of Econclast).

Two people (Tracy Herrick of The Private Bank and Dana Johnson of Comerica Bank) top the group with real GDP growth of 4.6 percent. Brian Wesbury is close behind at 4.5 percent.

Clearly the optimists are very much in the majority. Recent data have given credibility to our views.

On September 15 the Census Bureau gave us the best news on retail sales we've seen in a long time ([www.census.gov/retail](http://www.census.gov/retail)). Total retail and food services sales were \$351.4 billion on a seasonally adjusted basis in August. That was up 2.7 percent from July but down 5.3 percent from a year earlier. It was the highest total since the \$355.0 billion of October 2008.

Even a straight line from August through December would mean large increases on a year-over-year basis for November and December. That would bring smiles to the faces of retailers across the country.

Automobile sales, which were given a big push by the "Cash for Clunkers" program, helped to push total retail sales up, but since that program is now finished, that would not be good news for future retail sales totals. However, as it turns out, retail sales in other categories actually helped lead the way.

Two categories of retail sales were above year-earlier levels in August. Those were "Health and Personal Care Stores" (think drug stores), up 2.9 percent from August 2008 and 3.0 percent for the first eight months of 2009 and "Food Services and Drinking Places," which were up 0.7 percent from August 2008 and 1.1 percent for the first eight months of 2009.

Some especially good news came from the Board of Governors of the Federal Reserve System on September 17 in their quarterly Z.1 "Flow of Funds" report ([federalreserve.gov/releases/z1/default.htm](http://federalreserve.gov/releases/z1/default.htm)). They told us that the net worth of consumers improved from March 31 to June 30, 2009. The total value of our assets rose from \$65.2 trillion to \$67.2 trillion.

The biggest increases were in the value of our equity holdings. The value of corporate stocks owned by consumers went up from \$5.2 trillion to \$6.3 trillion, a gain of 21.7 percent. Our holdings of mutual fund shares rose from \$3.3 to \$3.7 trillion, a gain of 14.9 percent while at the same time, the value of equity in noncorporate business (farms and small businesses) fell from \$7.3 trillion to \$7.0 trillion or 3.7 percent. Most of that was due to a drop in the value of nonfarm non-residential real estate.

The value of real estate owned by households rose (yep, you read it right, it went up) from \$17.9 trillion to \$18.3 trillion, a gain of 1.8 percent. Our unborrowed home equity rose from \$7.5 trillion to \$7.9 trillion and represented 43.1 percent of the value of household real estate.

Our liabilities declined slightly from \$14.20 trillion to \$14.07 trillion. That was the lowest level in three years. Consequently, our net worth rose from \$51.1 trillion to \$53.1 trillion. That's the highest since the third quarter of 2008 and was 487.4 percent of disposable personal income.

This is all wonderful news and, except for the rise in the value of equities, completely unexpected. It's always nice to get a positive surprise, especially after so many bad ones.

More good news came from the Fed on September 16 when they told us industrial production in August grew by 0.8 percent from July on top of a 1.0 percent monthly gain in July ([federalreserve.gov/releases/g17/](http://federalreserve.gov/releases/g17/)). That moved the index to 97.4 (2002=100), the highest since March. It was still 10.7 percent below August 2009.

Indeed, there has been such a preponderance of good news lately that some (overly giddy) analysts have begun to talk of a "sweet spot" for the economy. By this they appear to mean a period of economic growth with little, if any, inflation.

That strikes me as a pretty silly definition. A few years ago (2003 to mid-2007) we talked about a "Goldilocks" economy that was growing "not too fast, not too slow,

but just right,” which seems justified in hindsight.

However, the current situation with very high levels of unemployment, very high levels of debt in relation to income, tight credit and extremely low levels of capacity utilization hardly seems like a “sweet spot” to me. The truly horrible levels of the actual and predicted deficits of the federal government make it really unlikely we’re in anything like a “sweet spot.”

The deficit for fiscal 2009, which ended on September 30, was the highest ever recorded. It was nearly four times the previous record of \$459 billion set just one year earlier. It was the largest share of GDP of any year since 1944.

The Congressional Budget Office (CBO) on August 25 released its annual summer “Update” on The Budget and Economic Outlook ([cbo.gov](http://cbo.gov)). They raised their estimates of the deficit over the next ten years by \$2.7 trillion from their March estimates to a total of \$8.0 trillion.

They pointed out that federal government spending last fiscal year rose by 24 percent, the biggest increase since the Korean War year of 1952. They also said that federal government revenues fell by 17 percent, the biggest percentage drop since 1932.

Congress will be forced to actually cut spending rather than just slowing the rate of increase as they usually do. This will be very difficult and extremely unpopular, but it can’t be avoided. They will either have to go to a flat tax or raise the tax rates in the current system quite high. That will also be unpopular.

The CBO shows that Medicare and Medicaid are the biggest parts of the problem, followed by Social Security. These three programs were about 9 percent of GDP in 2008. Under current law, the CBO expects them to rise to about 12 percent of GDP in 2019 and 19 percent by 2035.

That would either require levels of taxation never before seen in the U.S. or huge cuts in spending. No one knows what will happen, but we all know the current situation cannot go on much longer.

The good news is that historically Congress has acted whenever there is a clear understanding that a budget crisis looms. A good example was their action in response to the 1983 Greenspan Commission on Social Security Reform. They enacted most of the report’s recommendations in 1983 and solved the short-term funding problems of the system.

No one knows what Congress will do about the current problems. However, they will have to take major actions within the next two years.

The short-term concern (or at least we hope it is short-term) that most people have is about the employment situation. Nationally, some 6,929,000 net nonfarm payroll jobs disappeared from the peak in December 2007, when the recession began, to August 2009.

It could easily take until 2013 to create that many net new jobs. That concerns most people not just because of the human misery of those households affected directly, but from the macroeconomic viewpoint of how consumers can keep spending if they don’t have growing incomes.

There were some small signs of hope in the September 18 Bureau of Labor Statistics report, “Regional and State Employment and Unemployment-August 2009” ([bls.gov](http://bls.gov)). While 42 states and the District of Columbia followed the national trend of declining nonfarm payroll jobs, eight states posted increases from July.

North Carolina, which had lost 268,800 such jobs on a seasonally adjusted basis from February 2008 to July 2009, regained a net 7,000 of them in August to lead the nation. In second place was Montana with a gain of 5,100 jobs followed by West Virginia with an increase of 2,800 jobs. The other states with net job gains in August were Arkansas, Nebraska, New Hampshire, New Jersey and South Dakota.

Should these states turn out to be the bellwethers for a quick return to employment growth across the land, there would be rejoicing in many quarters. There is some evidence that could happen though I am still dubious.

One of the best indicators of employment growth one quarter ahead comes from the monthly surveys of small business owners conducted by the National Federation of Independent Business ([nfib.com/portals/0/pdf/sbet/SBET200909.pdf](http://nfib.com/portals/0/pdf/sbet/SBET200909.pdf)). Their data project an unemployment rate of 9.2 percent for the fourth quarter.

Given that August was 9.7 percent on a seasonally adjusted basis, that could imply very strong employment gains from now through December. No other forecast looks like this, but it would spark very good economic growth if it were to come true or be even close to the mark.

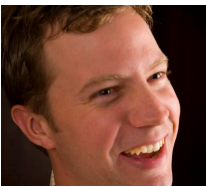
The forecasters in The Wall Street Journal survey see a 10.0 percent unemployment rate in December 2009,

falling only to 9.8 percent in June 2010 and 9.3 percent in December 2010. The range for this December is from 9.1 percent (from two of us who follow the NFIB data) to 10.4 percent.

This year will see real GDP fall by 2.4 percent on a year-over-year basis, which would be the biggest drop since the 10.9 percent fall of 1946. The only remotely comparable year since was the 1.9 percent drop in 1982.

We should see real GDP grow by 3.2 percent in 2010 if employment and incomes grow enough to support consumer spending. Since that's 70.0 percent of GDP, we really need consumers to be able to stay in the game.

## Has the Market Really Gone Too Far?



Michael Zeimer, CFP®

PARTNER

There are very few market observers (including myself) who are not somewhat surprised with the strength of the market recovery from the intraday low of 667 set on March 6<sup>th</sup> of this year. With it becoming a forgone conclusion that the worst recession since the 1930s is over, and with the S&P 500 now up 60% since its March lows, it appears that the skeptic's predictions for a "severe correction" or "W" shaped recovery get louder and louder. Although it is widely believed that many of these pleas are simply "market timers" looking for an opportunity to invest into this recovery at more attractive prices, there does appear to be some valuation concerns with the S&P trading at 1057 (as of October the 7th's market close).

Most analysts predict that the S&P 500 will have earnings of approximately \$60.00 a share for the calendar year of 2008. By taking \$60 a share in earnings and dividing it into the October 7 market price of 1057, we obtain a price to earnings (P/E) ratio

of approximately 18. With the historical average P/E of 15, that would lead many to think the S&P 500 is "overvalued." However, many forget that the market is "forward looking" and is not concerned with where we have been but where we are going. By using the 2008 earnings estimate, we are assuming that Q1, Q2 and Q3 of 2010 are going to be similar as Q1, Q2 and Q3 of 2009. This assumption is most likely incorrect.

Another factor to consider regarding P/E ratios is that historically high inflationary periods have tended to coincide with lower P/E ratios. Considering that inflation is currently very low, we could deduce that a higher P/E ratio would be reasonable for the market at this time.

In recessionary times, companies focus on reducing costs, shedding employees and reducing inventories. Due to these actions, we have seen productivity continue to rise throughout the recession. This makes it reasonable to believe that companies are currently operating on an extremely lean basis and that any improvement in the economy will flow directly to a company's bottom line (and greatly improve earnings). Forward-looking earnings could be 25-35% higher

than the past four quarters. If we assume that earnings grow 25-35% then the market's forward looking P/E is 14 to 13 respectively. Although these multiples are not overly "cheap," they are below the market average, which could indicate an additional 7-15% appreciation from the present levels over the next year. If you add a 2-3% dividend yield, one could expect a decent total return even from current levels.

This is why when we choose individual equities, we focus on companies that are industry leaders, have strong revenue growth and are priced below their peers. We believe this strategy will allow investors to participate in market growth and not get caught trying to time the markets' short-term swings.

## Parsec Prize

The third and fourth quarter Parsec Prize is awarded to AB Tech Foundation and the Asheville Chamber of Commerce in the amount of \$14,000 each. We are pleased to support the AB Tech Foundation in their efforts to provide quality educational programs to

their students and staff. We are also proud to support the Asheville Chamber of Commerce in their endeavor to advance the causes for economic vitality in our community. Thanks to each of these wonderful organizations for their hard work!

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