Money Basics Edition

ParsecFinancial
WEALTH MANAGEMENT

Note from the CEO

Richard Manske, CFP®
Chief Executive Officer

Many of the important financial planning concepts are multi-generational. The time value of money ensures that strategies are best optimized over long time frames. Young investors enjoy this advantage, but many of them are unaware of the opportunity. It is up to grandparents, parents, aunts, uncles, and experienced adults to impart their wisdom to the younger generation.

Participating in an employer's 401(k) program or, if that is unavailable, funding an IRA or Roth IRA are simple financial planning concepts to enact; however, we often see young people not taking advantage of this opportunity.

With this version of our newsletter, we share strategies for setting a successful foundation. If you know someone who may benefit from reading it, please share! And, of course, no matter your age or stage in life, you can benefit from these strategies.

It is an honor and great duty you impart to us. Thank you for the opportunity to work with you. We take the responsibility very seriously and strive to do our best. We look forward to a prosperous 2017.

Money Basics Edition

Columns

Features

Jim's Crystal Ball

How Fast Can the U.S. Grow?

While we will never fully understand how Donald Trump accomplished his surprising victory in the 2016 election, my hunch is that a big part of the story is that a great many people were very frustrated with the extremely slow pace of economic growth in recent years. **Chart 1** shows the year-over-year percentage change in real GDP from 1930 to 2015. The "flattening" of real growth at around 2.1 percent a year since the end of the recession in June 2009 is quite evident.

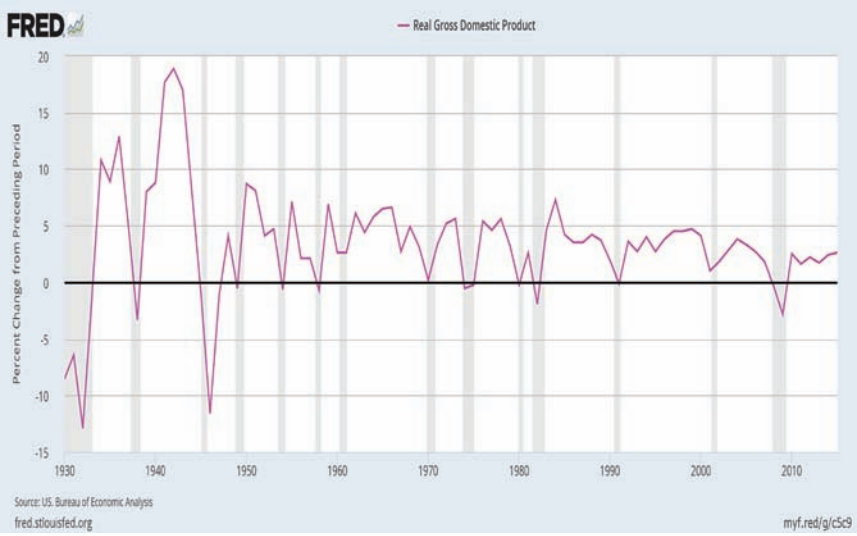


Chart 1

John Lonski, the chief economist for Moody's, has pointed out that real GDP growth averaged only 1.3 percent a year from 2006 through 2015. Since the advent of comparable GDP data in 1929, the only slower growth decade was 1929 through 1938, which encompassed both the "Great Depression" of August 1929 to March 1933 (43 months) and the 13-month recession that ran from May 1937 to June 1938. That decade averaged real GDP growth of only 1.0 percent a year.

For the entire 1929 through 2015 period, real GDP growth has averaged 3.1 percent a year. As the graph shows, there has been enormous variation around that average. The two biggest declines in real GDP were 12.9 percent in 1932 and 11.6 percent in 1946.

By far the largest increases came during World War II. The peak was the increase of 18.9 percent in 1942. That was preceded by a 17.7 percent rise in 1941 and followed by a 17.0 percent jump in 1943.

Since the end of World War II, the biggest increases in real GDP were 8.7 percent in 1950, 8.1 percent in 1951 and 7.3 percent in 1984. Only two years since 2000 have exceeded 3.0 percent growth. We had a 3.8 percent rise in 2004 and 3.3 percent in 2005. The last year above 4.0 percent growth was 2000 at 4.1 percent. The growth rate of any capitalist, free-market economy is composed of three variables: the growth of the labor force, the growth in

hours worked per worker and changes in labor productivity (output per hour). **Chart 2** shows the annual percentage change in the civilian labor force.

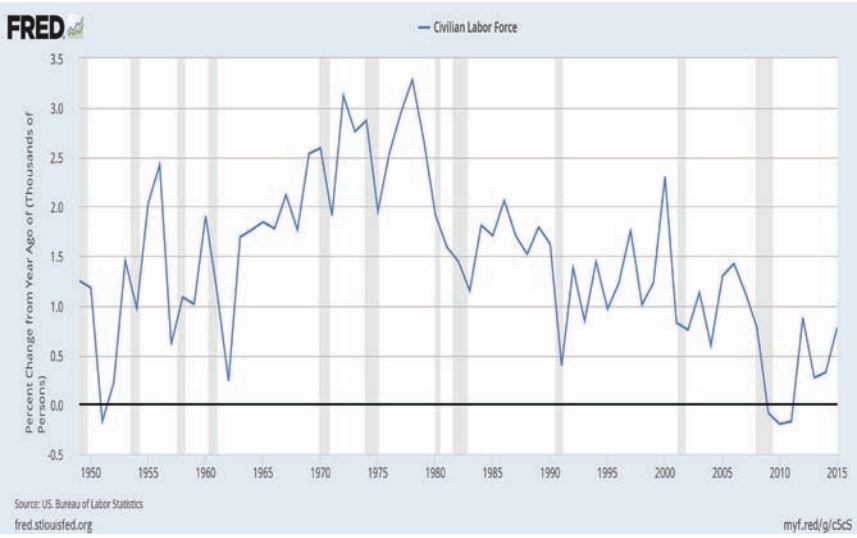


Chart 2

Note how high it was in the 1970s and 1980s and how low it has been in the last few years. It was negative, meaning the labor force actually shrank, in 2009, 2010 and 2011. It was 0.8 percent in 2015. Most analysts attribute the bulk of the rapid growth in the 1970s and 1980s to the entry of members of the baby boom generation (those born from 1946 through 1964) into the labor force. Conversely, the pattern since 2008 is generally credited to the baby boom retirees.

Average hours worked have trended up by 0.1 percent a year for over a hundred years. No one knows why this is so, but we will assume that will continue. Thus the sum of the first two factors is a relatively puny 0.9 percent a year. (That's 0.8 percent in growth in the labor force +0.1 percent for growth in hours worked.)

There are only two ways to boost civilian labor force growth over the next ten years. One is to raise the labor force participation rate. As **Chart 3** shows, that rate has declined dramatically over the last decade.

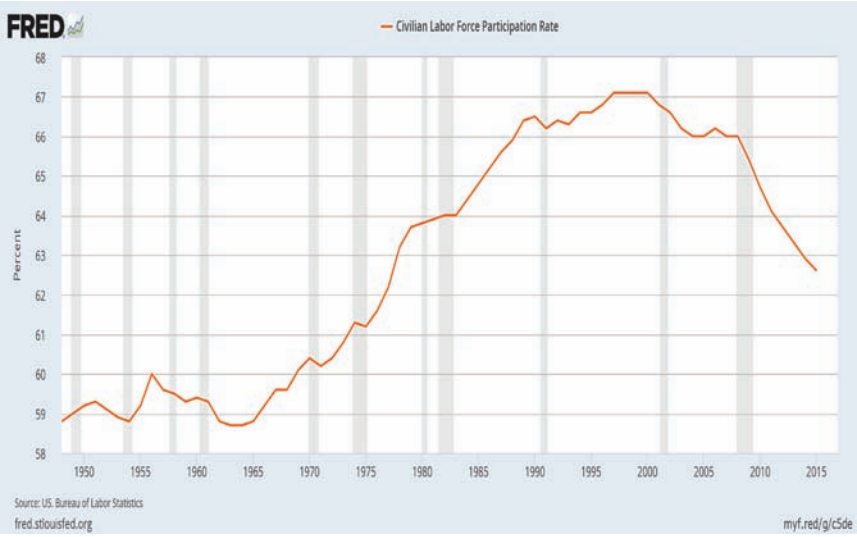


Chart 3

The labor force participation rate is simply the number of civilians age 16 and over who either are employed or would like to be employed as a share of the total civilian population in that age range. At 62.6 percent in 2015, it was lower than any year since the 62.2 percent in 1977. It was 62.7 percent in November.

Each one percentage point increase in the participation rate would add 2.5 million people to the labor force. The problem, of course, is that no one has the slightest idea of how to raise the desire of the 95 million people who are not currently in the labor force to go out and look for a job. Of course, the majority of those people are happily retired and will never return to work, but some are in younger age groups.

The other way to increase the labor force is to increase immigration. It seems highly unlikely that we will see any initiatives to do that, no matter how beneficial it would be to economic growth, from the Trump administration. On the obverse side of that argument, Dr. Angela Merkel, the Chancellor of Germany, very publicly stated that in addition to humanitarian concerns, she wanted to admit a million Syrian refugees to Germany in order to boost their labor force, which would have declined without a boom in immigration.

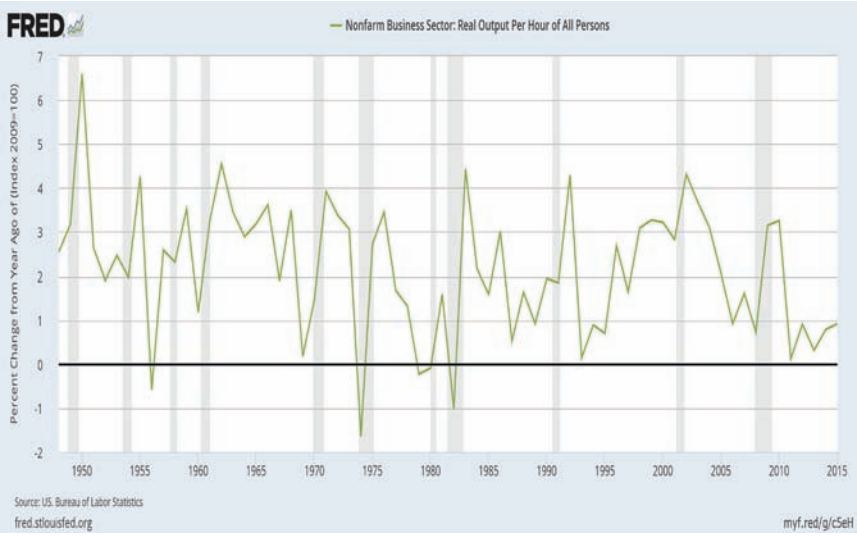


Chart 4

The final variable in determining the growth rate of a nation is labor productivity. **Chart 4** shows the annual percentage change in this critically important variable since 1948.

You can clearly see the abysmal pattern since 2011. We haven't even hit 1.0 percent since 2010. For the year ended in the third quarter of 2016, labor productivity growth was 0.0 percent, as the Bureau of Labor Statistics reported on December 6.

All this suggests it will be very hard for the US economy to return to real GDP growth of 3.5 percent a year or more on a sustainable basis as many analysts and Trump supporters expect. To do so will require huge increases in productivity, which would be helped by a big cut in the corporate income tax. Lowered personal income tax rates might help boost the labor force participation rate, too.

Another boost could come from regulatory reform. The best current estimates of the "deadweight loss" from the excess of regulatory costs over benefits is about $2.3 trillion a year or about 12 percent of nominal GDP. If that could be significantly reduced and those expenditures put to productive uses, real GDP could grow a lot faster.

Still, the bottom line is that demographic factors will make it very hard for US real GDP growth to return to its 3.1 percent a year long-term average, much less 3.5 percent or more. Good policies could make that happen, but it is definitely not a sure thing.

Jim Smith is the Chief Economist. He has been an Adjunct Professor at Kenan-Flagler Business School at UNC Chapel Hill since 1988.

Mental Wealth Corner

Carrie Tallman, CFA

Now that the holidays are behind us and most of us either over-spent, over-ate, or both, it might be time to consider a money cleanse! A juice or soup cleanse may sound more appealing, but a money cleanse can provide important financial insights as you chart a course for the new year and beyond.

So, what is a money cleanse? While it's an admittedly unscientific concept, I see it as an opportunity to trim back on excess spending, gain new awareness around your money pain points, clear out old, unhelpful money patterns, and ultimately uncover new, more helpful money strategies.

If you're up for the challenge, I recommend committing to at least a month of money cleansing. You'll also want to choose a way to track your spending. Budgeting tools like eMoney or an Excel spreadsheet work great. Consider pairing up with a friend or your spouse. Cleanse buddies can help us stay on track and often provide invaluable feedback when the going gets tough. Finally, plan to keep a journal for the duration. While a cleanse buddy is great for support and encouragement, this is your journey. Tracking your own progress and setbacks will help you uncover new money insights and may even change the way you relate to money.

Where to begin? Here's a sample of steps you can use as a template for your own money cleanse:

Step 1: Set your money cleanse intention. Example: Reduce unnecessary spending and start a savings plan!

Step 2: Set aside at least an hour before you start your cleanse and make a list of all your non-discretionary expenses (rent, food, utilities, etc.) and amounts. Include all your discretionary spending (restaurants, music, movies, etc.) and amounts. Calculate the total for each category. Notice if your discretionary expenses ("wants") exceed your non-discretionary expenses ("needs").

Step 3: Commit to spending only on non-discretionary items for one month, plus select one discretionary item splurge. A cleanse is different from a budget, so there's no need to target a savings goal (yet). The point is to significantly reduce or, ideally, eliminate discretionary spending.

Step 4: Select one day towards the end of each week in which you'll track your spending with your chosen budget-tracking tool and journal about your experience over the last seven days. Reflect on the following questions: What did you find most difficult? What was easy? What did you miss the most? What were you surprised by? How did that feel and how did you deal with these restrictions? Write about what mattered, where you got stuck, and what you learned.

Step 5: Check-in with your money cleanse buddy as needed for support and encouragement.

Step 6: At the end of the money cleanse, use your budgeting tool to determine what items or experiences you spent money on and in what amount. Were you able to stick to the cleanse? How much extra money did you have at the end of the month? Were any of your discretionary expenses surprisingly easy to give up? Were any difficult to let go?

Step 7: Summarize your findings and set a goal for the

upcoming year. For example, you could target a monthly and an annual savings goal. After one to three months of the cleanse, you would have a jumpstart on savings and clarity on which expenses you can reduce and which "wants" you just can't live without.

Get creative, push your limits, learn, and above all, take back control of your finances. While most cleanses are about detoxing from unhealthy food, a money cleanse is more about uncovering and detaching from unhealthy habits. When we get complacent with our spending habits, we're more likely to overspend and start to believe we need certain luxuries or other non-essential items. This can lead us to live beyond our means in order to support a lifestyle that may not be serving us. I'm all for the little comforts in life as long as they arise from thoughtful and conscious choice. A money cleanse can bring new awareness and intention to how and why we spend. Doing so takes control away from our unquestioned and unhelpful money habits and puts us back in the driver's seat of our financial lives – where we belong. Happy cleansing!

Carrie Tallman is the Director of Research. She is a CFA charterholder.

Shouldering the Burden of Financial Responsibility

Sarah DerGarabedian

When you're the primary wage earner in your family, it can feel like you're carrying the weight of the world on your shoulders. The enormity of this responsibility can be paralyzing, causing the mind to race with worries: What if something happens to me? Have I prepared for the worst possible outcome? What more can I do to ensure that the people who depend on me will be OK if something happens to me?

To banish these worries, make sure you have addressed the following 5 areas:

Life Insurance

Hopefully you have some amount of life insurance in order to provide for your dependents should the worst come to pass. But do you have enough? Many companies provide life insurance as an employee benefit, but the standard amount will probably not be enough to replace your salary for an extended time. As a starting point, consider your current salary and how old your children are, so you can estimate how much financial support they will need and for how long. Beyond that, you may want to provide your spouse with your lost income until retirement age. Take these factors into consideration when determining the length of the term and amount of coverage you need.

Long-Term Disability Insurance

Many people do not realize the importance of this type of insurance. Think of it this way: If you become disabled and cannot perform the job that supports your family, how will you replace your income? What if your disability adds to the household expenses in the form of ongoing medical care? Now you've not only lost your earning power, but you've also become a liability to the family you once supported. Don't let that happen.

Estate Planning/Will

Often younger people who are still in the asset accumulation phase tend to put off drafting a will, despite its importance. It is especially imperative if you

Atlas through hard constraint upholds the wide heaven with unwearying head and arms.
--Hesiod

have young children, since it allows you to determine who will become their guardian if both you and your spouse are gone. Make sure your beneficiary designations are up-to-date for any IRAs, 401(k) plans, pension plans or life insurance policies. For more complex estate planning strategies you might want a trust – your financial advisor can help you figure out what you need to do to make sure your estate plan is sufficient.

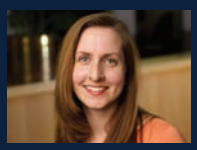
Retirement Savings

If the worst doesn't happen and you live to a ripe, old age, you need to be sure that you are saving money to provide for your golden years. As the primary earner, the bulk of this responsibility falls to you to contribute to your company's 401(k) or another retirement plan, but it is equally important to include your spouse in your retirement projections and contribute to a plan for him or her if you can. Again, your advisor can help you figure out how much you need to be putting aside and how to navigate the ever-complicated IRS rules and requirements for retirement savings.

Education Savings

Though not as imperative as the first four points, saving for your children's education expenses will relieve them of significant financial pressure when they are in school and will help them avoid taking on massive amounts of student loan debt. You can rest easier knowing that if you predecease your spouse and children, you won't be leaving them with an insurmountable tuition bill. As with retirement plans, there are several investment vehicles available to you for education savings. Work with your advisor to determine the best plan for you and your family.

Shouldering the burden of financial responsibility can make you feel like Atlas, but it needn't crush you. Proper planning and preparation will help put your mind at ease and allow you to live more fully in the present.



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The Costs of Waiting

Travis Boyer

Anyone can find an excuse to put off pushing money aside for retirement: It's too complex and I'm busy; I need money now since I just got out of school; I'll do it later...

The problems with delaying setting up your 401(k), however, are magnified even more if you are passing up the option to get an employer match. If you get a 5% match then the first 5% of your income that you set aside for your 401(k) essentially automatically receives a 100% return on investment. No investment option will ever offer an immediate and guaranteed return like the matching money offered by your employer.

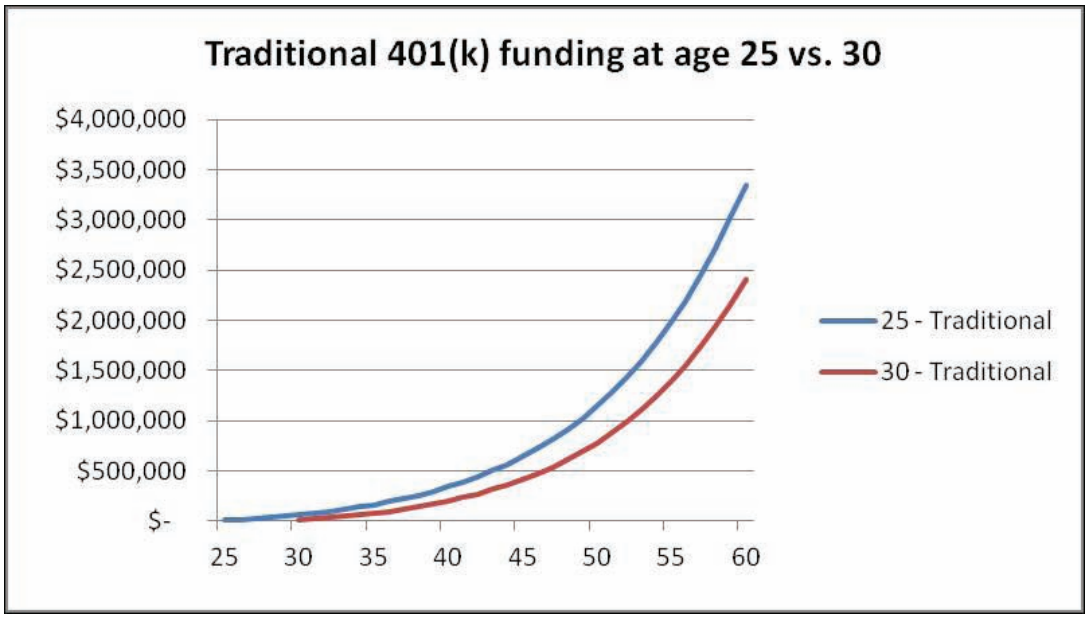
The main issue facing young professionals is that they are heavily indebted from school and thus can't pay down loans like they want to and still save for retirement. The rates on your student loans could be 7%, and your credit card rate could be 20%. If this is your excuse for not contributing to your 401(k) and you miss matching money, then your gap is still an 80% return between interest building up on your credit card and the missed investment opportunity in your 401(k). Continue to pay down debt; just don't miss this opportunity. Pay your debt down slower in this case.

If things are just tight and you aren't able to save 5% of your income, then the hard truth could be that you are living beyond your means. Even if you aren't offered a 401(k) match by your employer, you should still set aside 5% of your income into an IRA or Roth IRA with the goal of building your overall savings rates towards 15% of your income. If you are unable to meet these savings targets, then set a goal to adjust your lifestyle. Your current spending levels may not sustainable, and you are not setting yourself up to build wealth.

To hit this point home, I want to give examples of someone who begins contributing to their 401(k) at 25 compared to someone who starts at 30. Let's start with a few assumptions:

- You will retire when you are 60
- Current income at age 25 is $50,000
- You contribute 10% and receive a 5% match from your employer
- Your income grows annually at 4% (this is going to vary greatly among us)
- The compounded annual return on your 100% allocation to equity investments is 10% (Large US stocks have returned 10.1% as a compound annual return according to the *Ibbotson 2015 Yearbook*)

In this scenario, the person who got focused and set up their Traditional 401(k) at age 25 will have almost $950,000 more in their retirement account than the person who waited five years to get contributions rolling.



Hypothetical example. For illustrative purposes only and not indicative of any investment. Assumes 10% annual rate of return. Actual results will vary.

The scenario is presented above in a graph.

Remember, this assumes a steady, compounded investment return rate. Your investment returns will be volatile, but if these averages hold over the long run, then your ending balances should approach those represented above.

The ending balances in a traditional 401(k) based on the above assumptions is $3,351,093 for an investor starting contributions at age 25 compared to $2,406,115 for an investor starting contributions at age 30.

This massive difference is even larger when we account for those who also began additional savings outside of their 401(k) at age 25 compared to age 30.

These numbers are not inflation adjusted, meaning that these balances will be worth relatively less in 40 years compared to now. In the future, prices for all goods will be higher due to inflation. However, the difference in your account balance seen through investing early is still sizable and will result in a much more favorable retirement for those who got started early.

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