Money Basics Edition

ParsecFinancial
WEALTH MANAGEMENT

Note from the CEO

Richard Manske, CFP®
Chief Executive Officer

This edition of our newsletter centers on young investors and the financial basics they need to climb their wall of financial challenges and reach independent wealth. Getting the financial infrastructure set up correctly and making financial planning a process in life is a commitment that can be life changing.

It is important to make a plan and stick to it. Grit and determination can get you a long way towards independent wealth. If you find yourself more experienced on these matters, please take the time to share with the other people in your life. It is surprising to learn so few people have these important conversations with their children and grand-children.

Achieving life's goals is the most pressing motivation that young investors have. The trajectory towards one's financial goals can be made difficult by just a few bad decisions. I talk more about that subject in my article, *Keeping Up with the Joneses*. By prioritizing correctly, a young investor can develop the habits and cash flow to have a great life without compromising their retirement futures.

We at Parsec are here to help every generation in achieving goals. Please let us know how we can help you on the path to a sound financial future.

Money Basics Edition

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Features

Jim's Crystal Ball

The U.S. Economy is Steadily Gaining Momentum

In a very rare event, the U.S. economy is actually exhibiting growing strength after an unusually long period of economic expansion. This expansion started in June 2009 and has now lasted longer than all but two of the 34 expansions since the December 1854 start of business cycle dating. The organization responsible for defining business cycles in the U.S. is the National Bureau of Economic Research (NBER). The current expansion will move into second place in April 2018, passing the 106-month long one that ran from February 1961 to December 1969, and will become the longest expansion ever in July 2019, moving past the ten-year (120 months) one of March 1991 to March 2001. Almost all economic forecasters expect that to happen.

As **Chart 1** shows, real GDP has set new record highs every quarter this year. According to the Bureau of Economic Analysis (BEA) release of November 29, real GDP was running at a seasonally adjusted annual rate of $17.2 trillion in the third quarter of 2017. We will get the first look at the fourth quarter when the BEA issues its "Advance" estimate on January 26, 2018.

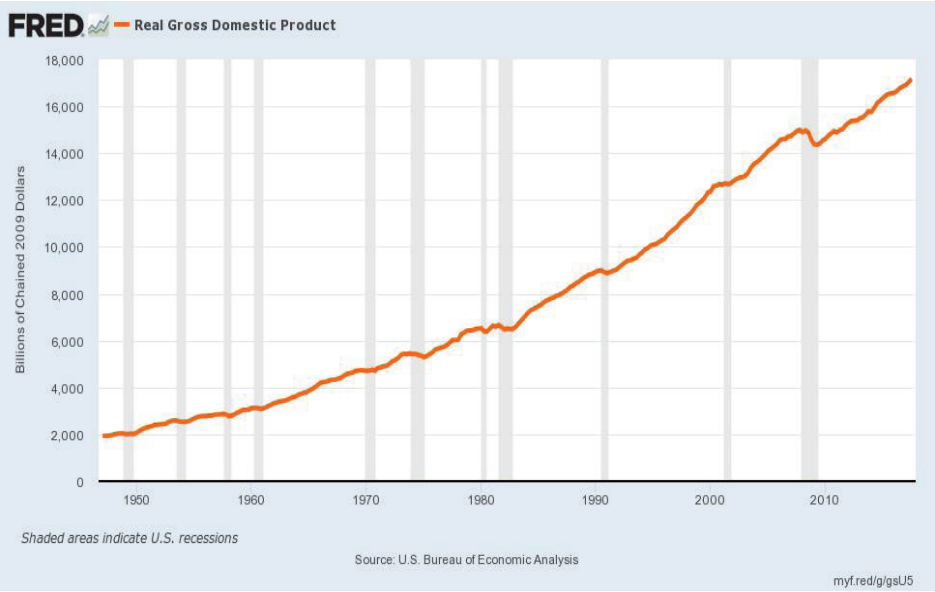

Chart 1

Both the second and third quarters of 2017 showed real GDP growth above 3.0 percent. It was 3.1 percent in the second quarter compared to the first and 3.3 percent in the third quarter compared to the second. Those are the first two consecutive quarters of real GDP growth above 3.0 percent since the second and third quarters of 2014.

If the fourth quarter comes in at 3.0 percent or better, which is my forecast and that of a few other optimistic economists, it would be the first run of three such strong quarters since the fourth quarter of 2004. The new Tax Cut and Jobs Act of 2017

should boost growth in 2018 and 2019 and beyond.

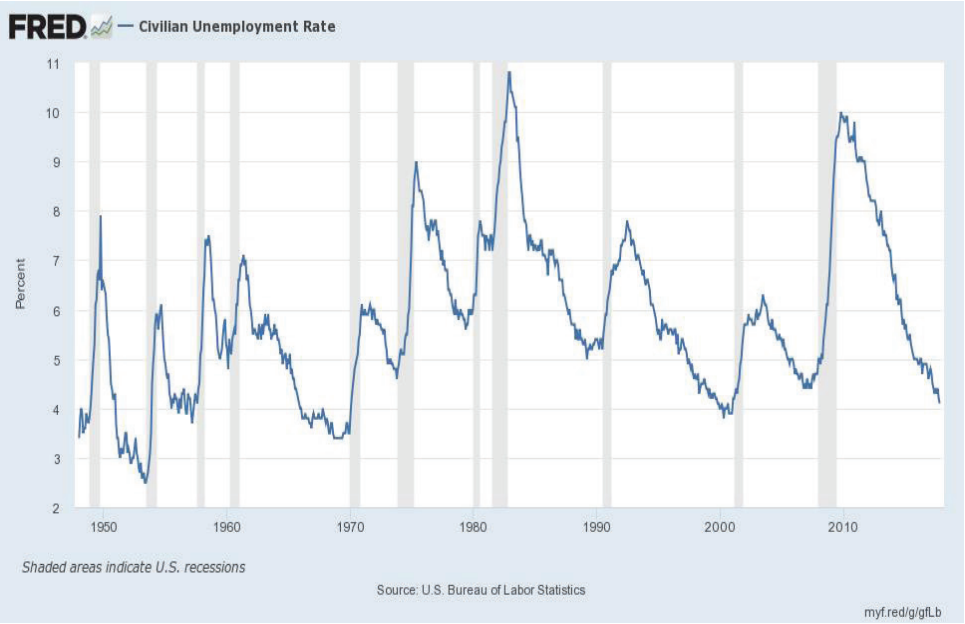

Chart 2

Not very surprisingly, these high and rising levels of real GDP are supported by record levels of both total civilian employment and nonfarm payroll employment. The growth in total civilian employment is driving the unemployment rate down to lows rarely seen in the last 40 years.

Chart 2 shows that we are now very close to the 3.9 percent national seasonally adjusted unemployment rate of October, November and December of 2000. If we go even lower than that, which seems very likely, we'll be back to levels not seen since 1969.

Record employment is leading to record levels of both disposable personal income and personal consumption expenditures. On November 30, the BEA reported that real disposable personal income was running at a record seasonally adjusted annual rate of $12.8 trillion in October.

Real personal consumption expenditures (PCE) were running at a record $12.0 trillion in October at a seasonally adjusted annual rate. This suggests we will have another excellent Christmas shopping season in 2017. That will gladden the hearts of retailers all over the country.

The only important economic variables that are far from new records are industrial production in manufacturing and housing starts. Total industrial production has set new record highs, but manufacturing is still about five percent below its 2007 peaks.

The total number of private housing starts peaked at a seasonally adjusted annual rate of 2,273,000 units in January 2006. That was still below the record of 2,494,000 units in January 1972. It will be a very long time before we break that record.

For single-family homes, the record was set in January 2006 with 1,823,000 units at a seasonally adjusted annual rate. That is more than double the 877,000 level of October 2017.

The U.S. and global economies are definitely on a roll. There are fewer countries in recession today than at any other time since 1973. You should expect good economic news throughout 2018 and beyond. That will be fun to experience.

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, CFP®

Now that the holidays are behind us, many of us are refocused on improving our health and fitness habits in the New Year. While this is an admirable and important goal that brings several long-term benefits, many Americans often neglect an equally impactful goal – becoming financially fit!

Medical studies are clear that stress plays a significant role in our health and happiness. Engaging in regular exercise, eating better, and participating in stress-reducing activities go a long way to improve our overall well being. You may be doing all the right things from an exercise and diet perspective. If your financial situation is unstable, unknown, or deteriorating, you may be cancelling-out many of the positive benefits derived from a healthy lifestyle.

Multiple surveys over several decades all confirm that money continues to be the number one stressor among Americans. As a result, when your financial life is in disarray, it can have long-term negative consequences on your health – both physical and emotional.

What does being "financially fit" mean? How do you get started? Achieving financial fitness will vary from one person to the next. In general, when you have a strong handle on your money situation and it feels more supportive than stressful, it's safe to say that you've reached a financially fit state.

Having a handle on your money means knowing what your income and expenses are and if you're able to save on a monthly basis. It also involves knowing your net worth – what is the value of your assets (car, house, cash balances, retirement savings, etc.) and your debts (student loans, car loans, credit card balances, mortgage, etc.), and what the difference is between the two. Ideally, you want to have a positive net worth in which you own more in assets than you owe in debt.

For those of you just starting out, it's normal to have a negative net worth. As you earn more money through work, save diligently, and invest prudently, your assets versus your debts should grow over time.

In addition to tracking and knowing your spending patterns and net worth, there are a few other critical items to consider. Establishing an emergency fund can make a huge difference in your ability to weather unexpected financial turbulence. An emergency fund is simply a savings account with enough money to cover your discretionary spending for three to six months. If your car breaks down or you have an unforeseen medical event, having a cash cushion will help you keep your "financial" head above water.

Likewise, acquiring adequate insurance can help avert financial catastrophe, often for pennies on the dollar. Review disability and term life insurance policies to meet this need.

Understanding and working to improve your financial situation and establishing some important safety nets are the first pieces of the puzzle. Now, it's time to look at part two of what it means to be financially fit. Although more subjective, understanding your emotional relationship with money is as important as having a handle on your cash flows and net worth. Someone may have significant wealth and cash inflows that cover his/her expenses ten-fold, but he/she may still feel stressed-out financially. In this example, although a person's basic money situation is extremely strong, financial stress tied to constant worry can offset any benefits derived from a healthy money situation.

Bringing awareness to your relationship with money can help address the second factor in a financially fit life: money feels supportive as opposed to a stressor. Often, our financial stress is not about money but related to deeper fears or beliefs we're unaware we hold. A mindfulness practice can help in this regard as well as talking with a friend or a trusted colleague who has a healthier relationship with money. What does your friend believe about money that you don't? What do you tell yourself about your finances that creates stress? Are your beliefs helpful – i.e. will they actually improve your financial situation – or, are they harmful? Journaling about your beliefs and asking these types of questions can also help.

Now that we've examined what it means to be financially fit and how to get there, it's important to establish habits that keep you on track. As with a physical fitness program that requires regular workouts and healthy eating, staying financially fit includes regularly monitoring your cash flows, tracking your net worth, maintaining an adequate emergency fund and insurance, and questioning any unhelpful thoughts, beliefs, or habits that could derail your progress. When you make time for these important activities, it not only helps secure your financial future but lowers your stress levels in the process.

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Buying vs. Renting

Melissa Stamatiades

Many Americans believe that home ownership is part of the American Dream. You may find yourself asking, "Is it time to buy a home?" Owning your home is considered an investment. As we know, there are positives and negatives to certain types of investments. Let's explore them in this article.

In North Carolina, the median cost to own a home is 49% higher than the median cost to rent.

Source: 2015 American Community Survey data from the U.S. Census Bureau.

Some of the benefits of purchasing a house may include the long-term investment potential; the ability to lock in your monthly housing expense (rent could escalate over time; mortgages tend to be fixed); the pride of home ownership; and control over the decision to move.

Negatives of ownership could include maintenance (interior, exterior, and landscaping); large unexpected expenses (roofs leak, HVACs fail, and water heaters quit); larger upfront costs (closing costs and down payments); and potentially larger monthly mortgage payments than what would be paid in rent.

Renting can have its benefits too. They may include lower monthly expenses; the ability to relocate more easily; and lower maintenance responsibilities. In some cases, rent could be lower than combined mortgage payments and related home expenses, which may give you the increased ability to fund an investment account and thus diversify your wealth. Unfortunately, when you rent, you lack control. You could be asked to move at the end of your lease, and your rent could continue to escalate. Also, any improvements are not investments.

How can you decide what is best for you? A few questions to ask are:

1. ***Will you be in the home at least three years?*** Three years is the common guideline as the "break even" for recovering the closing costs associated with a home purchase. If you answered no or maybe, you should strongly consider renting.

2. ***What is your financial situation now and a reasonable expectation for the future? Do you have enough in your savings to pay for an unexpected large repair?*** Trees fall, roofs leak, water heaters fail, and HVAC reach the end of their useful lives. If you do not currently have enough saved for both a down payment and the unexpected repair bill, you should consider renting.

3. ***Do you want to be a homeowner?*** In addition to being responsible for the interior maintenance and exterior maintenance, you are responsible for landscaping. You might enjoy the occasional time spent gardening, but are you prepared to mow the grass in summer heat? Gardening could be fun, but weeding and edging might not be.

Ultimately, either choice has its benefits. Spend time thinking through both your financial situation and your life and career plans for the next five years. If you would like help with the decision, please contact your advisor.

Melissa Stamatiades is a portfolio manager in the Asheville office.

The Basics of Health Savings Accounts (HSAs)

Jessie Goodwin

A Health Savings Account (HSA) may be a great way to plan for health-related expenses, increase retirement savings, and reduce taxes. Understanding the rules for an HSA account and talking with your advisor can help you to determine if an HSA is right for you. Let's review the basics before you start your conversation.

The tax-advantaged treatment of an HSA allows taxpayers to reduce their adjusted gross income with this above-the-line deduction. This means you receive the tax benefit regardless of whether or not you itemize deductions. Also, employers can make contributions to an HSA on behalf of an employee. These contributions are not subject to income tax. Funds in an HSA can be used for qualified medical expenses. Any contributions that are not used for qualified expenses in the year of contribution remain in the account for future use.

To make contributions, you cannot be eligible to be claimed as a dependent on someone else's income tax return, and your health insurance must be a High Deductible Health Plan (HDHP). You cannot have any other health insurance or be enrolled in Medicare. There are a few exceptions to the "no other health insurance rule." The best way to determine if you qualify for an HSA is to consult your financial advisor, insurance provider, and/or tax professional.

While employers sometimes coordinate opening and funding an HSA for their employees, it is not required. If you qualify for an HSA, and your employer does not offer it as a benefit, you can still open one and fund it.

There are no income limits for making contributions, which makes an HSA ideal for those who do not qualify to fully benefit from other tax-advantaged accounts such as Individual Retirement Accounts (IRAs) or Roth IRAs.

Like IRAs and Roth IRAs, HSA contributions must be made by the tax filing deadline for the year. For example, 2017 contributions can be made until April 17, 2018. The contribution limits are $3,450 for individuals and $6,900 for families. This limit includes your contributions and any made on your behalf.

Distributions from the account are tax free if spent on qualified medical expenses. The list of qualified expenses is long and may include items such as preventative care, doctor visits, hospital stays, dental care, vision exams, acupuncture, and prescription medicine. The IRS website contains a complete list of qualified medical expenses.

Many HSA providers will issue a debit card for the account, making it easy to pay for your qualified expenses as they arise. Distributions spent on non-qualified expenses may incur a penalty if taken prior to age 65.

If you accumulate funds in your HSA and you no longer need them for health care expenses after age 65, those funds may be distributed without penalty. They will, however, be subject to income tax, similar to an IRA distribution.

Flexibility to either spend from or build up savings in a Health Savings Account is an advantage. If you are eligible to contribute to an HSA, you and your financial advisor should discuss it.

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Keeping Up with the Joneses

Rick Manske

Believing that happiness is somehow linked to something we can buy is a concept that is probably the biggest culprit to the challenge to save. Sadly, it is common that folks are in a position where they cannot fully fund their goals. Many of us can be our own worst enemy when it comes to saving money.

Studies have shown that once our most basic needs are covered, our happiness does not grow as we accumulate more. Therefore, people that are spending to attain possessions they feel they need are not on a path to sustainable happiness; worse yet, those behaviors can cause anxiety that comes with an uncertain financial future.

It is true that spending money triggers the brain to release some positive feelings, but such moments of satisfaction post purchase are not long lasting. Other dopamine releases can be found in alternate pursuits. Exercise, enjoying life's simple pleasures, spending time with those we love, or doing what we love can invoke the same feelings and a more genuine happiness. Finding happiness this way is much better than in consumerism, which has the capacity to sap us of one our biggest desires, financial security.

Most people do not start with a lot of accumulated wealth when they are young. As a result, getting to where they want to go in life is the most pressing motivation that young investors have. The trajectory towards one's financial goals can be made difficult by just a few bad decisions. By prioritizing correctly, a young investor can develop the habits and cash flow to have a great life without compromising their retirement futures. I submit these two examples: the decision of where you live and what you drive. Those two decisions can cast many people on a disappointing wealth accumulation trajectory.

Buying a home is a goal most young people have. As a result, there is enormous emphasis put on the marketing of houses and the stigma of success that where one lives can bestow. I see many people, young and old, laboring hard

and sacrificing retirement and education savings because of the decision to live in a certain size home or a home in a certain desirable location that comes with too great a financial commitment. This harmful cash flow decision is made worse by the fact that housing has negative carrying costs: taxes, insurance, maintenance, and repairs. The larger the house, the higher the carrying costs. Also, consider the added expenses associated with furnishing and heating/cooling a larger home.

The magnitude of the financial decision is best witnessed when you look at a typical monthly budget. If an investor is trying to save more, they will be hard pressed to find many categories in a typical budget where they can cut expenses by $200-1,000+ per month, but scaling your home purchase correctly certainly can be.

The second decision that hobbles the ability to save for future goals is found in what kind of vehicle a person drives. Buying used cars and committing to a ten-year holding period does come with higher maintenance expenses and a bit of jealousy when a new car passes your older version. But, this wise decision enables the old car driver to have many years where there is no car payment and/or lease payment. In most budgets, it is difficult to find cuts. Having another $300-700 per month for investing is hard to find by cutting food expense.

The basics of a successful financial plan start with prudent cash flow investing. If you want to pre-determine your financial future, it starts with making wise decisions about some of big discretionary expenditures. Get those correct, and you should be able to maximize your work-sponsored retirement plan, develop adequate emergency funds and begin a Roth IRA. Get those wrong, and it is hard to cut enough trips to Starbucks to really save enough that it will matter anyways.

Let us help you with your financial plan. Your advisor is happy to design a financial plan that will assist you in achieving your goals.

Rick Manske is the Chief Executive Officer. He is a CERTIFIED FINANCIAL PLANNER™ practitioner.

Understanding Financial Aid Eligibility

Harli Palme

If you have children who are heading to college in the future, you have likely wondered about your chances of qualifying for financial aid. There are a few terms you should be familiar with when navigating this process. The Cost of Attendance (COA) is the cost for the student to attend a specific college in a given year. The Expected Family Contribution (EFC) is how much money the student's family is expected to pay for college, no matter where they attend. The difference in the COA and EFC is the financial need. This is the gap students try to fill through financial aid, whether that comes from grants, scholarships, or loans that must be repaid.

While it's true that the higher your income and the greater your assets, the less likely you are to qualify for need-based aid, there are other factors that affect eligibility. The more children you have in college at a time and the more expensive the school is they are attending, the greater your chance of qualifying for some aid. Also, unsubsidized loans are not need-based and are available to all students (these are loans where the interest begins accruing immediately.) Therefore any student who is seeking aid in any form should apply.

The main student financial aid application is the Free Application for Federal Student Aid (FAFSA). The FAFSA calculates the student's Expected Family Contribution to determine how much a family can afford to spend on education. Many colleges today use other financial aid applications in addition to the FAFSA, and each one is different in how it assesses need. This article addresses in general terms how the FAFSA assesses need. Before making any changes to your financial situation to improve your chances of receiving financial aid, please consult with your financial advisor.

Income and Assets

When it comes to applying for aid, only a portion of assets and income are includable in the EFC calculation.

	Parents	Student
Assets	5.64%	20%
Income	22-47%, depending on size of family	50%
Exempted Income Allowance	$18,300 to $38,880, depending on size of family	$6,570

As you can see, assets and income that belong to the student reduce financial aid to a greater degree than assets and income that belong to the parent.

For the 2018-2019 FAFSA, a married couple with two children would have an income allowance of $25,040. This means that the first $25,040 of parental income does not affect student aid eligibility. Income over $25,040 is assessed at the applicable percentage. Earned income, dividends, capital gains, and retirement fund withdrawals all count as income for these calculations.

However several assets are exempt from the above calculations. Important examples of these are retirement account balances, home equity, cash value life insurance, and most personal property.

How 529 College Savings Plans Affect Eligibility

If a 529 plan is owned by custodial parent or the student, it is treated as a parental asset, meaning that 5.64% of the value is expected to be used to pay for education. The good news is that qualified withdrawals from these plans that go to pay for the student's education do not count as parental or student income.

If the 529 plan is owned by the non-custodial parent or another person, such as a grandparent, the balance in the plan does not count toward the EFC. Beware, however, because any funds withdrawn from the 529 plan to pay for the student's education are assessed as the student's income (50%).

Timing and Moving Money Around

The FAFSA requires "prior-prior year" tax return data. For example, the 2017-2018 FAFSA asks for income from the 2015 tax return. Delaying or avoiding some income may be a valid strategy, such as avoiding retirement plan distributions, not exercising stock options, or delaying capital gains in the assessment years. If a non-custodial parent or a grandparent has 529 funds earmarked for a student's education, they may consider using those funds to pay for the latter years of college to avoid the withdrawals being included in the student's income when they submit the FAFSA.

You may be tempted to move assets around to avoid having it includable in the FAFSA calculation. If you're going to spend down student assets, or move assets out of a child's name, or if you have cash for a large purchase (such as a home) or to pay off debt, do it prior to filling out the FAFSA.

You may be thinking of funding a retirement account to move cash off of your balance sheet and into a non-reportable asset. While saving for retirement is a worthy cause, it won't help you become more eligible for financial aid in the year you apply. The FAFSA requires that you add back those contributions to your income. Untaxed return of Roth contributions are assessed as income as well, even if used to pay for education.

These finer details are best discussed with your financial advisor or a financial aid professional. Most important is to understand the process and fill out the financial aid paperwork to begin with. Education is important. Good luck!

Harli Palme is a partner. She is a CFA charterholder as well as a CERTIFIED FINANCIAL PLANNER™ practitioner.

IRA Contribution Limits & Deadlines

Harli Palme

The deadline to make IRA contributions for tax year 2017 is Tuesday, April 18. The maximum contribution is $5,500 per individual ($6,500 if age 50 or over) or 100 percent of earned income, whichever is less.

There are income limits which determine whether you can deduct your Traditional IRA contribution or if you qualify to make a Roth contribution. The following table gives the phase-out range for the most common circumstances. Keep in mind that if neither you nor your spouse participates in a work-sponsored plan, you can deduct IRA contributions regardless of your income.

Do you qualify to deduct your Traditional IRA contribution?

If your income is less than the beginning of the phase-out range, you qualify. If your income is over the phase-out range, you do not. If your income falls inside the range, you partially qualify. Please see the table below for more information about the modified adjusted gross income phase-out stage:

Tax Filing Status	For Your 2017 Contributions	For Your 2018 Contributions
Single, participates in an employer-sponsored retirement plan	$62,000 – $72,000	$63,000 – $73,000
Married filing jointly, participates in an employer-sponsored retirement plan	$99,000 – $119,000	$101,000 – $121,000
Married filing jointly, your spouse participates in an employer-sponsored retirement plan, but you do not	$186,000 – $196,000	$189,000 – $199,000

Do you qualify to contribute to a Roth IRA?

The table below shows the modified adjusted gross income phase-out range for Roth IRAs:

Tax Filing Status	For Your 2017 Contributions	For Your 2018 Contributions
Single	$118,000-$133,000	$120,000-$135,000
Married filing jointly	$186,000-$196,000	$189,000-$199,000

If your filing status differs from those listed above, please contact your advisor, and he or she can help you determine whether you qualify.

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Life's most persistent and urgent question is,
'What are you doing for others?'
Martin Luther King Jr.

Parsec will be closed Monday, January 15, 2018
in observance of Martin Luther King Jr. Day.

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