Retirement Edition

ParsecFinancial
WEALTH MANAGEMENT

Note from the CEO

Richard Manske, CFP®
Chief Executive Officer

Of all the financial goals we are asked for our help in achieving, retirement is the most common. The financial media drones on and on about what investors need to do and to be thinking about. The top 5 lists abound, itemizing the do's and don'ts of retirement planning. As I reflect on my twenty years of retirement planning, I realize that most rules of thumb do not work well. The best planning is rooted in sound cash flow management. Each investor, retired or otherwise, needs to have a cash flow budget. A good cash flow statement tells us a lot about the reasonableness of retirement goals. How much we spend and save is the linchpin to any successful retirement plan.

Financial planners and advisors often over simplify two areas of retirement planning: longevity risk and lifestyle expenses. Because longevity risk (the risk of running out of money before running out of breath) weighs so heavy on the advisor psyche, we plan for longer than average life expectancies. Planning until age 95, or in some cases 100, helps clients and advisors dispel much of the longevity risk issue. It may cut the wings of client spending along the way by planning for a horizon that is not statistically likely.

The other retirement planning assumption we often see oversimplified is what our client's lifestyle expenses are. In my experience, the expected retirement expenses ebb and flow over the lives of our retirees. Often, newer retirees find themselves spending more in retirement because they have the time necessary for travel, hobbies, and newfound opportunities to spend. In the middle to late retirement, spending may slow. Houses sometimes get downsized, travel may lessen, cars might be driven less, and the trappings of consumerism lose some of their appeal as some retirees spend less time accumulating possessions and may instead feel a calling towards simplification.

Parsec Financial employs modern financial planning software that can help clients plan dynamically. We can help assist with looking at different variables. Uneven spending can be factored into the retirement plan projection. Considerations with life expectancy can also be toggled to help determine optimal spending and portfolio allocations. Retirement planning is one of the most interesting things we get to do as advisors. We learn our client's varying sentiments about the variables we utilize for spending and expectancy.

We should all remember why it is that we are investing and stay focused on these life goals and aspirations. We realize that the lives we lead now and in the future need to be sustained by well-reasoned asset allocations and appropriate spending for a long and healthy life. For our oldest clients whose time frame is not as long, we can begin the discussion of how their money will outlive them and what is the best way for that legacy to help the people and causes that are most dear to them. Whether you are already an experienced retiree or a young investor, having a solid retirement plan is a core part of feeling financially secure.

Retirement Edition

Columns

Features

Three-Part Look at Financial Issues in Retirement:

We are now accepting 2018 *Parsec Prize* applications. The deadline to apply is December 31, 2017.

We hope you encourage eligible organizations to apply. For more information, please visit our website at: parsecfinancial.com/parsec-prize.

Jim's Crystal Ball

Some Great News on Income

One of the most frustrating aspects of the U.S. economy over the past 16 years has been the persistent failure of real median household income to rise above the record of $58,665 set in 1999. Note that "real" in economic parlance means adjusted for inflation. The median of any distribution is the point at which half the observations (thousands in this case) are above and half are below.

These data come from the Census Bureau once a year in the Income and Poverty in the United States report. The report for 2016 was released on September 12 and it showed that our long wait was over.

As Chart 1 shows, we saw a new record in 2016 when real median household income was $59,039. That was up 3.2 percent from 2015, which itself rose by 5.2 percent from 2014. Those two healthy increases were enough to finally set a record in 2016, up 0.6 percent from the $58,665 of 1999.

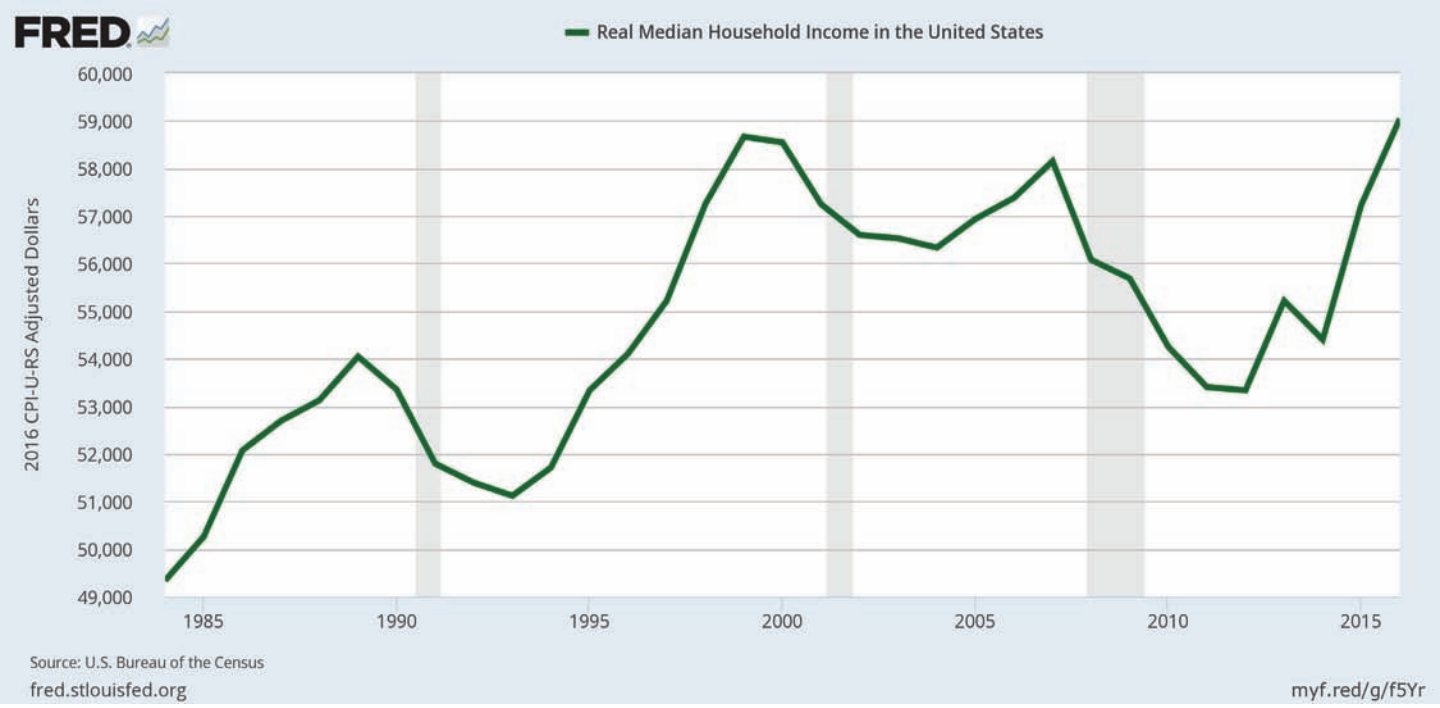


Chart 1

The Census Bureau said that we should be careful in how we interpret these new data as there have been changes over the years in how they calculate certain types of income. The Economic Policy Institute then reviewed the data. They concluded that real median household income in 2016 was still 1.5 percent below 2007. To show that this is truly a "distinction without a difference," we just have to look at the newer data provided by Sentier Research whose principals used to produce those data at the Census Bureau.

Their last report (for now, at least) showed a new record of $59,345 in May 2017. Those results are shown on Chart 2. That means we will see an undisputed new record when the Census Bureau releases their 2017 data in September 2018.

The record level of income is good news for the U.S. economy. Consumers have the wherewithal to keep moving real GDP upward for some time to come. That will keep employment setting new records as well.

We should see many more economic records for the U.S. throughout the rest of 2017 and all of 2018. That will be a most happy development for all of us.

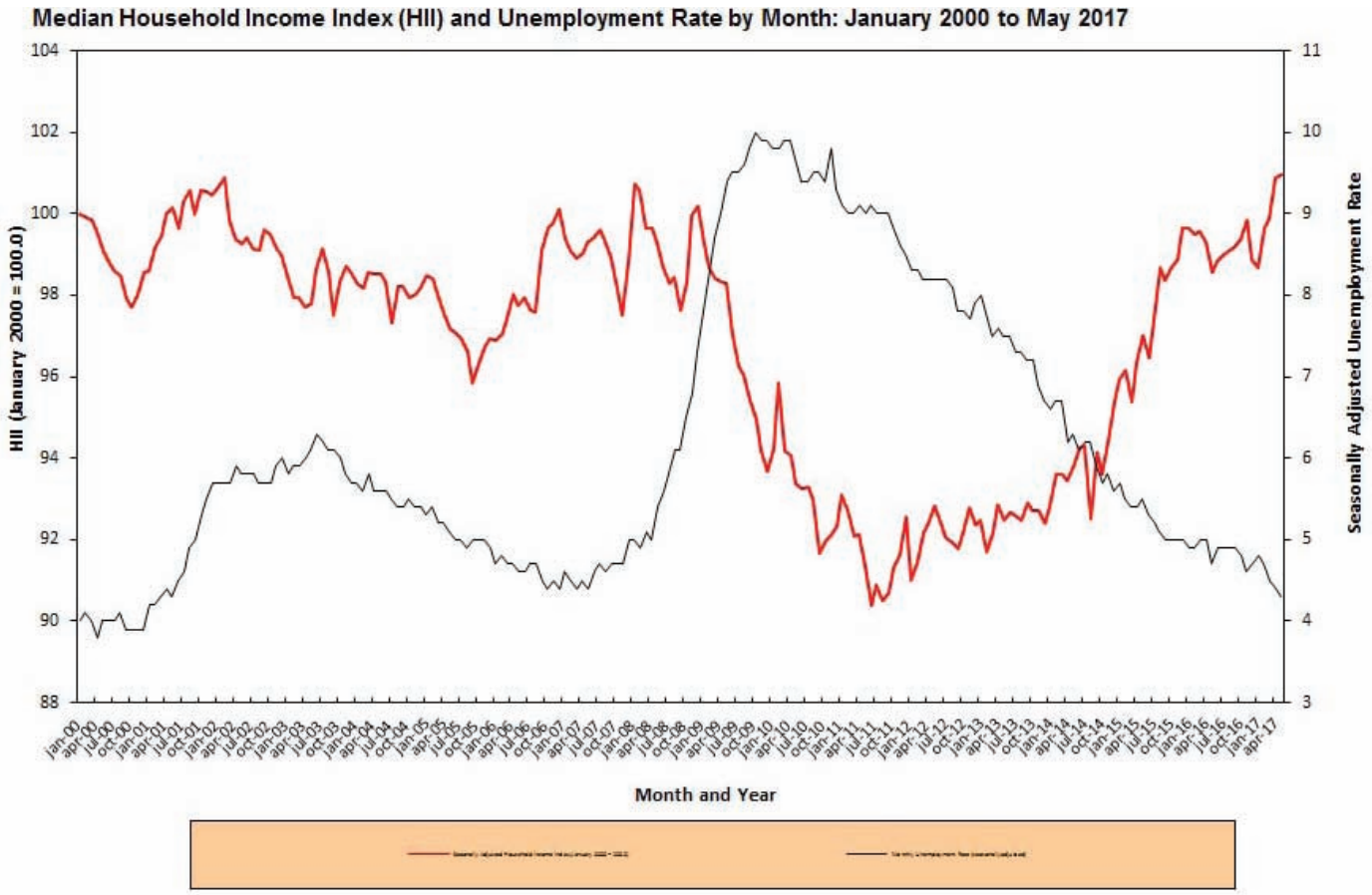


Chart 2

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**®

I am about twenty-something years away from retirement, but I am already starting to think about how I want to spend my twilight years. Rising life expectancies, a changing retirement plan landscape, and new priorities as we age suggest that getting intentional about our ideal retirement – ahead of time – might result in a more fulfilling experience after leaving the workforce. While we never know what life has in store for us, pondering some key questions and even experimenting with a mini "faux-tirement" can help us clarify how to design our best after-work lives.

Before embarking on a short-term sabbatical and certainly ahead of your actual retirement, I recommend reflecting on a few important questions. Logistics are a big deal and can contribute to or detract from your happiness after leaving the working world. Consider where you would like to live in retirement. Do you get more energy from solo activities, or is spending time with family a high priority? If family means sons and daughters and their families, would your children welcome closer proximity, or have they given you hints that a little distance might be a good thing? You may want to live right next door to your daughter. If she is not happy with the arrangement, you may come to regret your decision to move.

Likewise, are you interested in moving to a different town, city, state, or country? In many instances, relocating becomes an option in retirement when you are no longer tied to a job. Perhaps you dream of moving to the beach, the mountains, or even Costa Rica? While the allure of an exotic locale can be appealing, there are many factors to consider ahead of time. An important one is cost-of-living. Prices can vary widely from one town to the next, significantly affecting how long your money will last you. If you are worried retirement savings could be tight, a move to a lower-cost town or country might be worth considering.

While money and the landscape are important, don't underestimate the power of social connections. A new bungalow on the beach might sound dreamy now, but the reality of meeting new friends from scratch could be harder than you imagine. Moving to another country comes with even more complications. Costs-of-living may be much lower in some cases, but higher taxes and travel expenses could offset lower-cost living. Let's not forget the challenges of adjusting to a new culture. Considering the myriad of pros and cons that come with relocating, you may want to do some seriously soul-searching as well as in-depth research before any big move.

In addition to where you would like to live, consider how. Do you want to cruise the country in a new RV or travel the world in luxury? Are you a homebody who wants to stay put? The answer can have a big impact on other financial decisions. For example, selling your home might be the right decision if you plan to travel extensively or

live abroad. Other questions should be considered, though, such as what type of housing market is it? If home prices continue to rise, will you be able to afford a new home upon your return? Do you need the liquidity from your home to fund your travel expenses? These are just a few questions to consider, but what's most important is thinking through how these choices will affect your long-term retirement income.

Outside of logistical considerations – of which there are many more than the above – what are your personal interests or hobbies? Maybe you look forward to dedicating more time to volunteer work or playing golf. Perhaps you want to use your newfound time to simply explore what you're interested in. Either way, starting to think about how you will spend the majority of your time in retirement and whether or not your current living accommodations and/or location will support your endeavors can set the stage for a successful post-work life experience.

On that note, retirement experts are increasingly recommending a trial run, if you can swing it. Call it a sabbatical or a "faux-tirement." Taking one can provide "on-the-ground intel" on what to expect during the real thing. For example, one retirement planning guru observed that she enjoyed balanced days best during her "faux-tirement" – ones in which she had a fun or leisurely activity planned and also accomplished a few items on her to-do list. This same professional realized how much she missed her work "family" and recognized that, in retirement, she might need to develop a new social network to fill this void.

Other insights you might gain from trial-running your retirement include seeing how your spending patterns change, discovering which activities energize or deplete you, and what's missing or not. Many companies are now offering employees extended vacation times or sabbaticals. These can be the perfect testing ground to start designing your ideal retirement. Happy planning!

Carrie Tallman is the Director of Research. She is a CFA charterholder as well as a CERTIFIED FINANCIAL PLANNER™ practitioner.

New SEC Guidance

Harli Palme

Within the last year, the Securities and Exchange Commission (SEC) released guidance on how Registered Investment Advisors (that's Parsec) can assist clients in transferring money between accounts. The single intention of these regulations is to protect client funds from fraud. Protecting client assets has always been a primary concern of ours. With these new regulations we have refined our money movement policies.

What will change?

A first-party transfer occurs when money moves between accounts owned by the same person. Clients will be required to sign off on every first-party transfer. This includes one-time requests and the set-up of recurring instructions. A Parsec employee will verbally verify the instructions with the client.

A third-party transfer occurs when the money movement results in a change of ownership. This could be a client sending money to family member, or moving money from an individual account to a joint account with a spouse. All third-party transfers require the client signature, as well as a verbal confirmation. Additionally, due to SEC regulations, we do not accept standing letters of authorization on third-party transfers that permit Parsec employees to alter the timing or amount of recurring distributions without the client signature.

How to Make this Easier

Parsec advisors and client service specialists will assist clients with the necessary paperwork to move money between accounts, but while there is a paper form to do just about anything you want, the safest and fastest way to transfer money is electronically. In most cases, your client service specialist can initiate a wire transfer online and walk you through the process to approve it electronically. If you have a login and password to your custodian website (Schwab, Fidelity, TD Ameritrade, etc.), it's often as easy as clicking a few buttons on your phone. Of course, you may log into your custodian web site and request a transfer directly with your custodian anytime you like. If you're transferring a large sum, however, it's a good idea to notify your advisor or client service specialist so they know what to expect. If you do not have access to your accounts online through your custodian, your client service specialist can assist you with obtaining that access.

Harli Palme is the Chief Compliance Officer and Chief Operating Officer. She is a CFA charterholder as well as a CERTIFIED FINANCIAL PLANNER™ practitioner.

Strong People are Harder to Kill

Sarah DerGarabedian

In a prior newsletter article, I addressed the positive health effects of continuing to work during retirement – particularly for mental health. What about physical health in retirement? If we have helped you prepare financially for a long retirement, you'll want to ensure that you can enjoy it to the fullest.

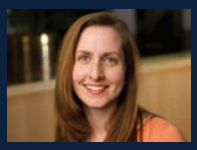
To build and maintain some level of physical fitness, you should include activities that will target cardiovascular conditioning, strength training, balance, and flexibility. Yoga is great for balance and flexibility (and strength, to some degree). Jogging, rowing, swimming, cycling, and hiking are all good forms of cardiovascular conditioning. One key area that many people (especially women) overlook is strength training – lifting heavy things.

I have always enjoyed yoga and hiking, but I only recently began incorporating strength training into my daily routine. It's made a huge difference in my quality of life! I love the fact that I can help my husband move heavy furniture and lift ramps to save kitties trapped under docks at high tide (true story), as well as place landscaping bricks in the yard, carry heavy bags, and load kayaks on the truck. A large part of the reason I continue to include strength training in my workouts is to ward off the deleterious effects of aging, for what good is saving for retirement if you can't enjoy it?

Like investing, all forms of exercise involve some amount of risk, and strength training is no exception. Consultation with a professional is recommended, particularly if this is new to you. We are fortunate to live in an area that places a high value on recreation and fitness, so there are plenty of options to suit every personality and budget.

I personally enjoy working out with a small group of friends, which turns something that could be viewed as a chore into something fun and social. As noted in my previous article, a strong social network is crucial for a healthy and fulfilling retirement.

So get out there, grab some friends and use your muscles!



Sarah DerGarabedian is the Director of Portfolio Management. She is a CFA charterholder.

Basic Retirement Math

Michael Bruder

Is there a rule for calculating how much money you need in retirement? Well, it depends on the author of the article! Have you ever wondered how that author can tell YOU what the rule is for YOU if the author doesn't even know YOU or anything about YOUR financial situation? There is not a one-size-fits-all approach, and it's never too early to begin thinking and planning for a financially sound retirement. Why not start now?

Later in this edition, my colleagues, Bill Hansen and Michael Baughman, provide an in-depth look at income and spending in retirement. I would like to offer a quick "back of the envelope" look at basic retirement math.

Let's begin by discussing your personal situation. The first thing to determine is how much annual income do/will you have? Income sources could be social security; employer pensions and severance packages; home equity; savings and investment accounts; an inheritance; or a part-time job. Taking account of these sources of income should give you a quantifiable idea of the annual income you will or currently receive in retirement.

The next item is a bit trickier: How much do you spend monthly, or will you need to spend monthly in retirement? Prepare an accurate and honest picture of your monthly spending habits to determine if current spending will be sustainable in retirement. My colleague, Michael Baughman, explores how to calculate retirement expenses in his article. I encourage you to read it for helpful tips.

Now, you've calculated your monthly income versus your monthly expenses. If you have a surplus, good for you! If you have a deficit, you'll need to determine how to fund that deficit.

Calculate the monthly deficit and annualize it. Determine the total amount of your liquid investable assets along with the types of accounts- qualified (tax deferred) and non-qualified (not tax deferred). Dividing the annual deficit into the total liquid assets gives you the number of years your investable assets would support your spending deficit not considering any growth.

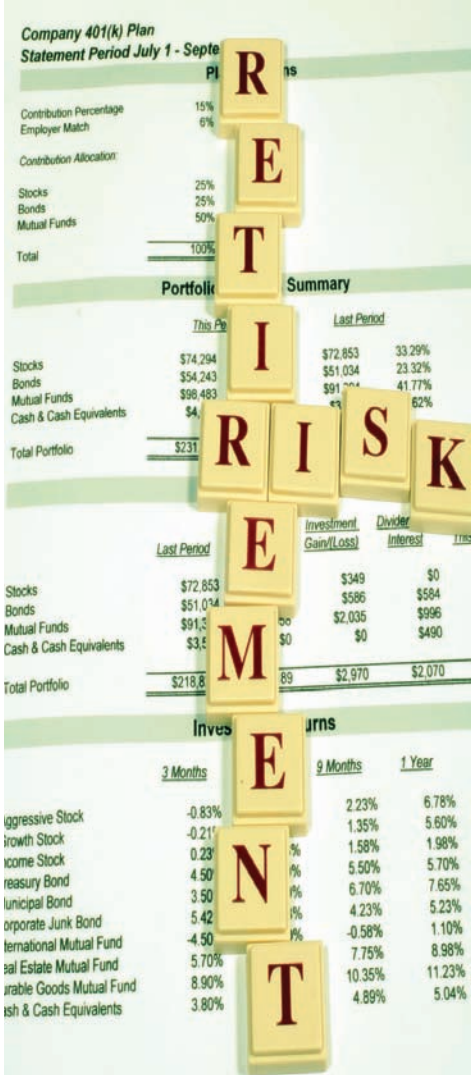
At Parsec, we plan for you to live to age 95; so should you. Again, if you have a surplus, good for you! If you have a deficit, let's work together to determine the required annual rate of return on your liquid investable assets to prevent it. Or, you can decrease your monthly spending to achieve the desired result.

Basic retirement math isn't rocket science. It simply requires an honest look at your income versus your spending and how to adequately plan to shore up any deficiencies. Your Parsec financial advisor is prepared to assist you in this process. Just ask!

Michael Bruder is a Senior Financial Advisor. He has earned the Certified Trust and Financial Advisor (CTFA) designation from the Institute of Certified Bankers. He is also a CERTIFIED FINANCIAL PLANNER™ practitioner.

Retirement Income: A Closer Look

Bill Hansen



Earned income stops for everyone at some point, and people then need to navigate the transition from saving for retirement to how to spend from their investment portfolio.

From a financial planning standpoint, we generally encourage clients to be debt-free in retirement so that when their earned income stops so do their debt payments. Exceptions may be made for situations with reasonable levels of debt at extremely low interest rates or for loans with short remaining terms.

In retirement, clients generally have a mix of stocks, bonds and cash in their investment portfolios, plus a small allocation to alternative investment in many cases. It is important to select an asset allocation that suits your individual situation and risk tolerance and to stick with that mix of assets through various market conditions. We counsel our clients to avoid market timing, or large shifts in and out of the stock market based on the mood of the day.

Bonds, or fixed income, provide a limited amount of current income and serve as a source of retirement spending when stock prices are lower, historically about 3 out of every 10 years. However, you never know when these negative years will come. Currently, we are in the 9th consecutive year of positive returns, which is unusual. Interest income on a bond portfolio will increase gradually along with the overall level of interest rates. This occurs as individual bonds (or bonds within a bond mutual fund) mature and are reinvested at higher rates. But the increase in interest rates usually comes in tandem with inflation, or an overall increase in prices. By its very nature, we do not expect capital appreciation in a bond portfolio.

Since there is typically some level of inflation in the economy, retirees need to have some investments that provide rising income over time in order to preserve their purchasing power and offset the effects of inflation over time. For that we focus on stocks, particularly those that pay dividends.

Modern financial theory holds that the value of any investment is the sum of the present value of its future cash flows. This logic applies whether the investment is a publicly traded stock, a piece of commercial real estate or a hot dog stand. With a dividend-paying stock, you are getting a return on your initial investment each quarter rather than relying purely on future earnings growth to make a profit. While short-term volatility can be considerable, over longer time periods stock prices historically follow rising earnings and dividends.

The current dividend yield on the S&P 500 index is about 1.9%. We believe that dividends help put a floor under the value of an individual stock, because you are receiving an ongoing stream of cash flow from the time that you make your investment.

Total return is comprised of two components: income and price appreciation. Since 1926, the income component of total return has represented about 40% of the overall return of the stock market and has always been positive (by definition, the income component can't be negative). However, the variability of the income return has been much lower than that of the appreciation component. Over that same period, the annual standard deviation or volatility of the income component was 1.6% versus 19.2% for the price or capital appreciation component.

By focusing on those companies that we believe are likely to have consistent dividend growth over time,

particularly for those of our clients who are retired and spending from their portfolios, we are setting up a condition where there is less uncertainty about a significant component of their overall return.

Growth stocks, which pay lower or no dividends, must earn their total return exclusively from a change in price. All else equal, a company that does not pay a dividend must have a higher expected growth rate than a dividend-paying stock to command the same valuation.

We believe it is important to consider both the level and sustainability of dividends. The S&P 500 currently has a dividend payout ratio of about 50%. This means that for every $1.00 in earnings, companies are paying an average of about $0.50 in dividends. Significant levels of debt or off-balance sheet obligations like underfunded pension plans or post-retirement health care benefits may restrict a company's ability to pay dividends in the future, since these are competing claims on the company's cash flow. When evaluating individual stocks for inclusion in client portfolios, our Research Committee considers the current dividend yield, the company's historical track record of dividend increases, and the dividend payout ratio. A high dividend payout ratio of 75% or more may indicate that the dividend is at risk of being cut in the future. An unusually high dividend yield is also a sign that the dividend may not be sustainable. If something seems too good to be true, it usually is. At the same time, there are many well-known companies that have increased their dividends every year for 25, 35, 50 or even 60 consecutive years. You may already own some of these companies, especially if you are a Parsec client. We want to focus on companies with sustainable and increasing dividends to provide a source of retirement spending.

The traditional theory taught in universities and graduate schools worldwide used to be that the lower the dividend payout ratio, the higher the earnings growth rate in subsequent periods. More recent studies have demonstrated exactly the opposite, that is, higher dividend payouts actually resulted in higher future earnings growth. This relationship was shown to hold true across a number of different countries and time periods. If this continues to hold true, it would be a double win for investors, since they would capture both a higher current dividend as well as higher future earnings growth by investing in dividend-paying stocks.

Why not buy all dividend-paying stocks? Different clients with different investment objectives may have different levels of dividend-paying stocks. A retiree who is spending from their portfolio, in addition to likely having an allocation to fixed income (bonds), may have more dividend-paying stocks than a younger client in the accumulation phase. As we review client portfolios for potential improvements, increasing portfolio income is one factor that we consider.

Also, a cornerstone to our investment philosophy is broad diversification among growth and value companies, small, medium and large companies and international companies. We never know what the future holds, so we want to have a mix of assets that will perform well under a variety of market conditions. If we focused exclusively on dividend-paying stocks, we would be forced to underweight sectors of the economy like technology that we believe have attractive future growth prospects.

For client portfolios that include individual stocks, we start by focusing on high quality companies with the potential for rising earnings and dividends. We then combine 30-40 such companies into a well-diversified portfolio. Regardless of what happens in the stock market over the next year, your portfolio income should be higher each subsequent year. The management teams of high quality companies with long track records of dividend increases are very reluctant to cut their dividends. Even in a recessionary environment, more companies should increase their dividends than maintain or cut them.

We encourage our clients to focus on this concept of rising portfolio income to meet their investment goals and help provide peace of mind during the inevitable corrections and bear markets that we will all experience at some point.

Bill Hansen is the President and Chief Investment Officer. He is a CFA charterholder.

Retirement Spending: A Closer Look

Michael Baughman

Planning for spending in retirement presents a complex challenge. Will you spend more or less in retirement than when you were working? You may spend more on travel and hobbies but not as much on clothes, commuting, or child care. Healthcare costs increase over time, but how should you plan for that? What about long-term care? As my colleague, Michael Bruder, stated in his article, each person's situation is unique.

One long-standing approach to calculating expenses is to take some percentage of your pre-retirement income and reduce it by 20% - 30%. The thinking here is that income taxes will go down dramatically when you retire so you won't need as much income to maintain your current standard of living. Intuitively, this makes sense. However, what about future expenses in retirement? Do they go up, down, or stay the same?

What's a retiree or someone nearing retirement to do?

Step 1: Most financial planning software assumes that expenses go up each year with inflation in retirement. If your plan looks solid with this assumption, then you should plan on spending more during the first third of retirement. Some call this the "go-go" stage of retirement.

Step 2: Look at your financial plan with a more accurate assumption of real retirement expenses. As an alternate scenario, assume your real spending increases by only 1% or 2% per year and not the full inflation assumption. What does your plan look like now?

Step 3: Update your financial plan annually. If our projections are wrong, we'll see it well in advance and will have time to make adjustments.

My conclusion is that you should enjoy your life. Be thoughtful and realistic when planning for future expenses. You certainly do not want to outlive your money. But, don't defer those goals and dreams too long. As one 75-year-old client told me recently, "The golden years are not golden for all of us."

Cessation of work is not accompanied by cessation of expenses.
-Cato

I am reminded daily of how finite and unpredictable life is. As your financial advisor, we have the tools and experience to help you navigate this challenge. Please let us help you with your retirement planning needs.

Michael Baughman is a Senior Financial Advisor at our Tryon location. He is a CERTIFIED FINANCIAL PLANNER™ practitioner.

Moving in Retirement?

Melissa Stamatiades

Younger generations may associate retirement with downsizing and perhaps living in a retirement community with a weekly bridge game. Baby boomers (those born between 1946 and 1964), however, have much grander plans. According to a *Better Homes and Gardens* real estate survey, a majority of boomers do plan to move out of their current home, and 70% of them anticipate their retirement home will be their nicest.

Counting the days until the alarm clock goes in the trash? Whether you plan to wake up to a view of the countryside, golf course, or busy city street, proper planning is essential. Before choosing your home for those lazy days, you should stop to consider a few things. Relocating to a different state, neighborhood, or type of housing may present you with new and/or different expenses. If you have always loathed yard work and long to prop up your feet while someone else handles the landscaping, know that it comes at a cost. HOA fees vary widely and are often overlooked when determining a price point for home purchases. Cost estimates should include taxes (sales, property, and state income and estate), HOA/regime fees, insurance, maintenance, etc., to get the true cost of living in a new home.

Have you been searching for that perfect pied-à-terre in Manhattan? You will need to understand the difference between a condo and a co-op and the ongoing fees required by each. HINT: If you are looking at a co-op, find out if there is a ground lease in place.

If you're feeling nostalgic about family vacations of years past and want to encourage visits from your children and grandchildren, a beach house may be more your style. About a quarter of boomers plan to purchase a second/vacation home. Before you make the plunge, research what expenses are associated with the property. You might be surprised at the cost of flood insurance that comes with an ocean view. Repairs and maintenance can also run high due to strong winds and the sun's harsh rays. Additionally, certain big-ticket items (HVAC units, for example) may have a shorter lifespan due to the salty air.

In addition to planning for your near-term retirement, don't forget to plan for the future when your mobility, health, and interests could change. Transit options may not seem important now, but time stops for no one. Driving habits often change with age. Whether you stop driving at night or altogether, the ability to walk or take mass transit to a grocery store, medical facility, restaurant, or entertainment venue could vastly improve your quality of life.

Finally, remind yourself that visiting a place one week a year is very different from living there full-time. There is a reason you didn't choose to vacation in Chicago in February, after all. You may decide that a carefree retirement means renting when you travel, rather than owning and caring for a second residence.

Melissa Stamatiades is a portfolio manager in our Asheville office.

The holiday season is upon us! All Parsec locations will be closed on the following days:

Thursday, November 23 and Friday, November 24

Monday, December 25

Monday, January 1, 2018

We hope you and your family have a safe, happy holiday season and healthy, prosperous New Year.

ParsecFinancial
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