

ParsecFinancial

Second Quarter 2007 Newsletter

Financial Advice and Planning

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Special Points of Interest

- ◆ Has the recession of 2007 already begun?
- ◆ Parsec welcomes 6 new employees!
- ◆ Second quarter Parsec Prize awarded to North Carolina Arboretum

Estate Planning is an area that needs addressing but is often neglected because of the myriad of personal challenges it presents: facing our demise, deciding whom to benefit with our assets and to what amount, understanding the estate tax laws and how they impact our situation, etc. Although we don't purport to have simple answers, we do understand this important field and can help you design an efficient strategy specific to your needs.

How you hold title to your assets is the most important concept of estate planning because assets pass by "operation of law." For example, an asset held solely in one name will pass as directed by your will and through the probate process. Real estate is often held as Joint Tenant with Right of Survivorship and will pass to the surviving joint tenant without passing through probate. Assets with beneficiary designation (IRAs, life insurance policies, 401-ks, etc.) will pass according to the listed beneficiary outside of probate. Therefore, it is prudent to review all of your assets to determine how title is held, especially accounts with beneficiary designations, to ensure they are current with your intentions.

Once you determine how assets are titled, then your decision is how assets are to be distributed. Some clients organize a family meeting to openly solicit information and discuss reasoning behind distribution decisions. It may be uncomfortable, but it can serve to dispel

potential future family conflict.

Next, you may wonder whether a will or a trust is the appropriate vehicle for your plan. Though every person needs a will, not every plan needs a trust. Trusts are primarily designed to prevent unnecessary estate taxation, avoid probate and preserve family privacy. Currently and through 2008, estates of \$2,000,000 and under are exempt from federal estate tax. In 2009 the exemption increases to \$3,500,000 and in 2010 there is no federal estate tax. However, in 2011 the exemption drops back to \$1,000,000 unless tax law changes. Therefore, estates over \$2,000,000 can lower or prevent estate taxation with the proper use of marital bypass trust planning. This strategy allows husbands and wives to capture their current unified credit exemption and effectively pass \$4,000,000 free of federal estate tax.

Since estate planning is complex, comprehensive, and personal, we are unable to cover all the facets in this newsletter (we haven't even discussed other important considerations including Powers of Attorney, Living Wills, etc.). We encourage you to contact your advisor to seek assistance in navigating this vital topic.

Dr. Jim Smith's Economic Commentary

As those of you who have heard my commentary this year know, my call on the path of the U.S. economy has been for a short, mild recession that began on May 16 and should end on November 15. While it will be months before the seven members of the Business Cycle Dating Committee of the National Bureau of Economic Research (www.nber.org) decide to make a determination that a recession has begun, many economic signs point to that conclusion.

If you visit the NBER web site, you will discover it was November 26, 2001 before the committee decided a recession had begun on January 16 of that year. It was July 17, 2003 when they announced that the 2001 recession had ended on November 15, 2001. That meant it was over even before they told all of us that the recession had started.

The periods leading up to most recessions since World War II have rather similar patterns. In eight of the nine recessions after the end of the Treasury-Federal Reserve Accord in 1951, which released the Fed from the obligation to support U.S. government bonds at pegged prices, the Federal Open Market Committee (FOMC), the part of the Federal Reserve System that sets monetary policy for the U.S., controlled the growth of the money supply in a way that led the returns on short-term Treasuries such as 91-day bills to exceed the return on ten-year Treasury notes. This is an inverted yield curve.

The late Professor Rudiger Dornbusch of MIT once said that "No post-Korean War expansions in the U.S. have died of old age; they have been murdered by the FOMC." He was absolutely correct.

The reason is that an inverted yield curve causes people to postpone purchases for either business or personal purposes until either the prices of goods and services or the interest costs fall—or both. Indeed, throughout the entire 20th century, every time the Treasury yield curve inverted and stayed that way for four months or longer, a recession followed without exception. This has happened for 17 recessions. There were also four recessions that were not preceded by this signal (1937-1938, 1945, 1948-1949 and 1953-1954).

The next thing that usually happens is that residential

construction activity declines. This has been going on since the 34-year peak in housing starts was hit in January 2006.

The third event we usually see is a decline in car and truck sales. While one can attribute the collapse in heavy (Class 8) truck sales in 2007 to regulations that both reduce diesel engine emissions and fuel economy, there has also been a decline in the sales of cars and light trucks.

The fourth result is a decline in sales of other consumer durables such as appliances. This has also been going on for the first five months of 2007.

The fifth factor is a decline in capital spending by business firms. This is because they become wary of demand forecasts, at least in the domestic market. This, too, is happening.

The sixth factor is a flattening out of retail sales. While these rarely decline, given that "Shop 'til you drop and fall to the floor; rest a while and then shop some more" is the mantra of consumers in the U.S., retail sales for each of the first four months of 2007 have essentially been the same as December. Since personal consumption expenditures (PCE) account for a little over 70.0 percent of real GDP and retail sales account for about half of PCE, this is a worrisome sign.

The expectations component of the University of Michigan Index of Consumer Sentiment has been at levels below those seen in the last recessions for three months in a row. This suggests weak consumer spending ahead.

The final sign that we are in a recession is when employment drops. Total employment fell in April, but the nonfarm payroll numbers have not yet begun to decline. Keep watching for that.

When we get "final" numbers for real GDP growth in the first quarter of 2007 in late July, it is likely that the initially reported 1.3 percent at a seasonally adjusted annual rate will be revised down to 0.5 percent or so. With growth that weak, it doesn't take much to push the economy over the edge into recession.

High gasoline prices don't help either. They act like a

tax and prevent consumers from having money to spend on other things.

The good news is all economists know how to cure recessions. The FOMC cuts interest rates again and again until businesses and consumers respond with

greater purchasing activity.

The recession should end in November and set us up for a great Christmas shopping season. Then 2008 ought to be a strong year with 4.2 percent growth in real GDP.

Stock Market Outlook

The stock market as measured by the Standard and Poor's 500 Index has now regained its previous all-time highs. We should not place too much emphasis on the record as such milestones are merely novelty. However, we do want to take a moment to examine how the fallacy of market timing is best illustrated by the volatility that occurred over the last seven years. The last high in 2000 was marked by excessive greed; the low in October 2002 was ruled by fear and pessimism. Acting on these emotions would have led to disastrous results. Few investors skilled or otherwise could have timed the peak and valley correctly. The steady investor that held through the difficult conditions received 100% of the recovery. The next five years to the present was a period of first restored confidence and improving fundamentals followed by an increased appetite for dividends and balance sheet strength. The times were tough and we appreciate your having made it through it without selling out.

Many people ask us "What is the next big risk to the market?" There are several themes that may prove problematic for the market. Some of which include: the global war on terrorism, the funding schemes of our federal entitlement programs of social security and Medicare, the real estate slowdown and accompanying sub-

prime scare, global climate change, derivatives, etc. However, the market is very resilient with many favorable trends that act like a tailwind to a rising market. The stunning growth of worldwide capitalism, the retiring baby boomer demographic, fantastic technological progress and productivity gains remind us of the exciting things yet to come.

In past newsletters we have discussed the historical frequency of negative years in the stock market. We have also looked at the frequency of years that annual returns were in excess of 18%. You can imagine what the investor thought as he/she was taking profits after a nice run of 7% in the index and then, for highly unpredictable reasons, the market fantastically rallied towards one of those 18% years. Historically, nearly one in two years have been 18% or greater and approximately one in four years the market had a 25% or better return. Be prepared for the negative years that will invariably happen but do not miss the good years attempting to avoid an occasional negative. Work closely with your advisor to be sure you are positioned correctly for any intermediate term declines; this should help keep the majority of your portfolio invested in the stock market to capture the long-term trends.

Parsec Welcomes New Staff Members

Many of our clients have asked about our trust service offering. After much consideration, we have decided to embark upon an aggressive campaign to enhance this service offering to our clients. These changes are designed to help ensure that we are better positioned to serve our clients with solutions tailored to their individual needs. Parsec is excited to welcome and introduce to you the newest members of our staff. Please welcome Joe

Dillin, CTFA; Roger James, JD, CTFA; Riddik Lamm, JD; Sherry Wells, CTFA; and Vicki Oxner.

Also, we would like to give a warm welcome to Pam Wright, Client Service Specialist for Bart Boyer.

Business Continuity

We want to make you aware of our business continuity plans in case of an emergency. If a natural disaster or a fire disrupted our business services, your accounts, of course, would still be safe and secure at your broker/dealer (Schwab, Fidelity, TD Ameritrade, etc.) and you could contact them directly. In order to be prepared for emergencies, we would suggest that you become familiar with the contact information for your broker/dealer (find phone numbers on your statement). We would notify our clients of any disruption of business by a notice on our website (www.parsecfinancial.com) and a message on our telephone system.

We have developed plans that will permit us to continue to operate if there is a significant business disruption. We have taken steps to have a “mirrored” server installed at our Charlotte location and many of us could

relocate there in case of an emergency. The server is not online yet but should be ready in the next few months. We also have plans to set up a temporary location in Asheville at a local hotel and we have the capability to forward our phone calls to another location. The majority of our documents are retained in hard copy as well as electronic forms, and we keep a daily backup electronic copy stored at a secure location.

We have worked towards developing a “team” approach for our clients and you can be assured that if your advisor was away for an extended period of time that the secondary advisor – or other members of the team – would be familiar with your account and would provide the same level of service. This is also an integral part of business continuity.

Parsec Prize

Parsec recently awarded the second quarter “Parsec Prize” of \$14,000 to the North Carolina Arboretum. This public institution integrates education, landscape, and research that elevates the aesthetic, cultural, and economic quality of life in North Carolina. The Arboretum broadens contemporary expressions of landscape stewardship through conservation of the traditional values, environmental resourcefulness, and botanical mystique of the Southern Appalachian region.

Established in 1986 by the General Assembly as an inter-institutional facility of the University of North Carolina, the Arboretum came into existence nearly a century after this country's father of landscape architecture, Frederick Law Olmsted, first envisioned such an institution near Asheville

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