Dwayne M. Dills, CPA, PC
Financial Advisor and Certified Public Accountant

18-D Regent Park Blvd. • Asheville, NC 28806
Phone: 828-398-0258 • Fax: 828-225-3900

Financial Briefs

MAY/JUNE 2016

Federal Reserve Policies and Their Economic Impact

The policies of the Federal Reserve directly impact our economy, though the extent of that impact varies. In order to understand the effects of the Federal Reserve's policies, it's important to discern between these policies and those of the legislative branch.

While Congress focuses on a wide range of issues, when it comes to money, their task is what is referred to as fiscal policy: government spending, borrowing, and taxation. To keep the economy balanced and growing, the Federal Reserve steps in to enact what is called monetary policy, primarily focusing on our country's money supply — specifically, currency and price stability. These policies most often involve adjusting interest rates or lending policies to help maintain or reestablish stability with a focus on unemployment and economic growth.

There are two main categories of monetary policy: expansionary, which focuses on increasing the economy's money supply; and contractionary, which focuses on either slowing or decreasing the money supply. Contractionary policy might involve raising interest rates or reserve requirements to discourage lending in an attempt to slow expansion that may lead to inflation. On the other hand, expansionary policy is typically carried out during recessions or times of slow economic growth, when the Fed will often set lower interest rates or reserve requirements to encourage borrowing — particularly by businesses — in hopes of fostering economic growth and addressing unemployment. Monetary policy enacted by the Fed in the past decade has been largely of a more expansionary

Continued on page 2

Understanding the Federal Deficit

The federal deficit is often confused with federal debt, though the two are closely intertwined and impact the U.S. economy in several ways. A federal deficit is simply defined as the shortfall that remains when the government's expenditures exceed its revenue.

So who decides what is spent and what is collected as revenue? Each year, the annual federal budget is established by the president, who submits a budget request each February for the upcoming fiscal year (beginning October 1) after consulting with federal agencies and the president's Office of Management and Budget. This budget request outlines three key factors: 1) the amount government should spend on public services such as defense or education; 2) the tax revenues the government should collect; and 3) the recommended annual deficit or surplus.

The federal government has consecutively reported a deficit since 2002 and for 77 of the past 100 years. Last year alone, the Congressional Budget Office reported a deficit of $439 billion, putting the national debt at over $18 trillion at the fiscal end of 2015. Compared to recent years, this deficit was relatively low: in 2009, Congress reported a record-setting $1.41 trillion deficit and over a trillion dollars each year thereafter until 2013. Historically, deficits are highest during times of war, with reported U.S. government deficits dating all the way back to the aftermath of The American Revolutionary War. Deficits also spike during national emergencies, such as the subprime mortgage crisis.

What Do These Deficit Numbers Really Mean?

While it's difficult at best to absorb the enormity of these numbers, it's important to acknowledge that much of this debt is relative. Deficits and national debt should really be analyzed alongside the gross domestic product (GDP),

Continued on page 3

Federal Reserve Policies

Continued from page 1

nature, although this policy has most recently begun to take a different turn.

The Fed's most notable changes in recent years have been setting unusually low interest rates. Beginning in 2008, they initiated what would become a seven-year period of record-low interest rates with the goal of revitalizing the economy and encouraging spending. Lowering interest to speed up the economy is nothing new — the idea stems from the theory that lowering these rates will encourage spending and borrowing via lower-interest credit cards, loans, and mortgages. The hope is that as more money becomes available to spend, consumer demand will increase and businesses will expand to meet that demand. As prices slowly increase, confidence in the dollar and, therefore, investing will follow. As predicted, this seven-year period of low interest rates did just that, though many financial commentators argue that growth has been mediocre at best.

This is because economic growth is *nearly always* measured by a country's gross domestic product (GDP), which is essentially its output of goods and services. Critics of the government's recent fiscal and monetary policies note the diminished average annual GDP growth percentage of 1% from 2008–2014, as opposed to nearly 3% between 1988 and 2007. This lower GDP rate, coupled with a national debt that has more than tripled since 2008, has left many people and economic experts jaded about both monetary and fiscal policy.

Still, forecasters with a more optimistic outlook point to a mostly gradual increase in the GDP growth rate each year (with the exception of 2013), asserting that the 2014 GDP growth percentage of 2.4% marked the highest annual rate in four years, more closely resembling pre-2007 rates. Furthermore, *The S&P Case-Shiller Home Price Index* has noted a stronger housing market since 2012, with an average housing price increase of over 6% per year in spite of month-to-month sales fluctuations. This is up from a reported 33% price fall between the 2006 housing peak and 2012.

In light of labor market indicators, which the Fed believes point to both decreasing unemployment and sustained job gains, monetary policy has most recently begun to take a different shape. In December, the Fed announced plans to gradually increase interest rates in increments of .25% and .50% over the next three years. In addition to increased confidence in economic growth, they expressed concern that prolonged record-low interest rates could be dangerous in the event of another economic lapse, since they'd either be unable to slash interest rates or face lowering these rates into the negative zone.

Interest rate changes aren't the only monetary policy tool implemented by the Fed. As our Central Bank, the Federal Reserve also controls reserve requirements and lends money to U.S. banks. In December, the Fed tightened these lending policies, announcing a .25% interest rate hike on emergency loans to banks. They also declared they would no longer lend any emergency funds to banks facing bankruptcy. Part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the new policy will essentially shelter taxpayers from inheriting the potentially costly burden of banks' financial mistakes.

Critics of these new policies, particularly the Fed's decision to raise interest rates, argue that historically, interest rates have only been raised during times of increasing inflation; they assert that with inflation still low by historic standards, the rate hike decision could discourage buying and investing, further stalling the economy from stronger growth.

Please call to discuss the impact of economic trends on your finances.

Is Personal Savings Increasing or Decreasing?

Your personal savings rate is the net amount of money you save as a percentage of your disposable income. Each month, the Bureau of Economic Analysis (BEA) calculates this rate collectively for all Americans.

Since the 1960s and first half of the 1970s (when the personal savings rate averaged nearly 12% per year), personal savings rates in the U.S. have generally declined, bottoming out at an average of just 2.9% between 2005 and 2007. Since 2008, personal savings rates have nearly doubled to an average of 5.7%, peaking in 2012 at 7.2% before dropping down to 4.8% for both 2013 and 2014. In general, the savings rates since 2005 reflect a shift in thought: from one of higher spending most likely generated by soaring stocks, real estate prices, and home refinancing, to a more conservative approach in light of the housing crash and 2007–2009 recession.

While lower savings rates can prove bad for the economy in the long run — spelling trouble down the road for retirees or people who might experience unexpected financial trouble — some economists believe they can be good in the short term, particularly if the economy needs a boost in spending to get moving in the right direction again. On the other hand, growing savings rates won't negatively impact the economy if they accompany income growth, allowing Americans to simultaneously save, pay down debt, and make purchases.

You can calculate your own personal savings rate by dividing the amount you save each month, year, or quarter by your after-tax monthly, yearly, or quarterly income. Please call to discuss whether your current investment plan supports your long-term personal goals.

Federal Deficit

Continued from page 1

taking the true size of our economy into context. The GDP is the total value of final goods and services produced within a country, generally measured on an annual basis. If our GDP is growing at a higher rate than our national debt, there may be little cause for concern. The relationship between the two is measured by the ratio of national debt (in currency such as dollars) to the GDP. This debt-to-GDP ratio is a commonly used measure of a country's financial health; and the lower this ratio's percentage, the better. Countries wishing to join the European Union, for example, had to have a ratio under 60%. The U.S. Bureau of Public Debt reported a debt-to-GDP ratio of 102% in 2014, though this is still much lower than the highest reported U.S. debt ratio of 122% in 1946.

How Does National Debt Impact Individuals?

High national debt can have several negative impacts on the economy, including the following:

Lower wages. Investing in government debt translates to money not being invested in companies, which can lead to stumped economic growth and wages.

Higher interest rates. With each new deficit, the government needs to sell more Treasury securities to finance the debt. In order to make these securities more attractive to foreign investors, banks, and the general public, the government will often increase interest rates to render the securities more attractive. This can lead to higher interest rates in general.

Standard of living inequality for future generations. Lower wages, slower job growth, and higher interest rates all spell hardship for upcoming generations who may have to survive on less or prolong retirement dates.

Looming crises. If deficits and national debt growth go unchecked, U.S. debt investors could very well demand higher returns, ultimately leading to an unprecedented financial crisis.

What Is the Long-Term Solution?

Political parties continue to debate over how to fix both the continued annual deficit and the growing national debt dilemma. The general consensus remains that both annual budget deficits and the national debt must be addressed in a way that strengthens the economy, though political parties will likely continue to disagree over tax hikes versus spending cuts as the best solution.

Ironically, many people pay more attention to the federal budget and national debt than they do their own personal finances. When scrutinizing deficits and debt at an individual level, it is important to understand that managing personal debt coupled with a sound savings and investment plan should be your highest priorities.

Please call to discuss your individual financial health.

Recent Employment Trends

During the recession of December 2007 to June 2009, unemployment rates rose from 5% to 9.5%, peaking at 10% in October 2009. Since that period, unemployment has gradually dropped each year, with an average of 5.3% in 2015, a seven-year low more closely resembling prerecession unemployment figures. Economists generally agree that a healthy unemployment rate is 4–6%, arguing that a 0% unemployment rate is impossible because of the inevitability of frictional employment, a term used to account for people in between jobs; and structural employment, which accounts for workers without the skills necessary to fill current open positions.

Traditionally, low unemployment correlates to higher wages. When unemployment rates are high, wages are low and vice versa.

In the spring of 2014, a report by the United States Conference of Mayors showed that in spite of unemployment rates rebounding, wages were down an average of 23% when compared to wages prior to the 2008–2009 recession. This is nearly double the wage gap following the 2001–2002 recession. Some economists are concerned that because these stagnant wages are inconsistent with increased productivity, many workers have been asked to do more for less pay.

Another figure to consider when looking at employment rates in the U.S. is the underemployment rate, which you can think of as a measure of how well American workers' skill sets are being utilized. The underemployed are people working in positions that fall below their actual skill or salary capacity, such as an accountant working as a waiter, along with the number of workers employed part-time but seeking full-time positions. The underemployment rate reported by the Bureau of Labor Statistics includes unemployed people as well. In 2015, the U.S. underemployment rate was at nearly 15%.

Beyond lower wages, both unemployment and underemployment can negatively impact the economy in several ways. Reduced wages means reduced disposable income, translating to less overall spending and slower growth for businesses. Additionally, more people collecting unemployment benefits — typically funded from federal and state imposed employer taxes — can hamper economic growth. Employers pick up much of the tab for these benefits in the form of increased tax rates, a financial burden that can ultimately affect their expansion and ability to hire more workers. Furthermore, some economists assert that prolonged unemployment can lead to decreased incentive to find new employment.

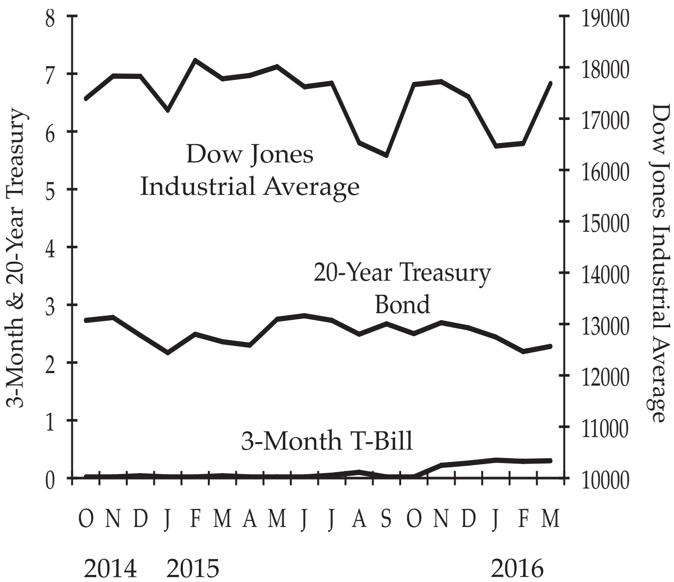
Business Data

Indicator	Jan-16	Feb-16	Mar-16	Dec-15	Mar-15
	Month-end				
Prime rate	3.50	3.50	3.50	3.50	3.25
3-month T-bill yield	0.31	0.29	0.30	0.26	0.04
10-year T-note yield	2.04	1.78	1.91	2.24	2.00
20-year T-bond yield	2.44	2.19	2.28	2.60	2.36
Dow Jones Corp.	3.40	3.25	3.04	3.43	2.83
GDP (adj. annual rate)#	+3.90	+2.00	+1.40	+1.40	+2.20

	Month-end			% Change	
Indicator	Jan-16	Feb-16	Mar-16	YTD	12-Mon.
Dow Jones Industrials	16466.30	16516.50	17685.09	1.5%	-0.5%
Standard & Poor's 500	1940.24	1932.23	2059.74	0.8%	-0.4%
Nasdaq Composite	4613.95	4557.95	4869.85	-2.7%	-0.6%
Gold	1111.80	1234.90	1237.00	16.5%	4.2%
Unemployment rate@	5.00	4.90	4.90	-2.0%	-10.9%
Consumer price index@	236.50	236.90	237.10	-0.1%	1.0%
Index of leading ind.@	123.40	123.10	123.20	-0.6%	1.7%

— 2nd, 3rd, 4th quarter @ — Dec, Jan, Feb Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield
October 2014 to March 2016



News and Announcements

Does the Gender Wage Gap Still Exist?

Each fall, after compiling information gathered from its national monthly surveys of approximately 60,000 households from the previous year, the U.S. Bureau of Labor Statistics (BLS) publishes the *Highlights of Women's Earnings*, which notes the average weekly wage and salary earnings of both men and women employed full-time and the female-to-male earnings ratio. In 2014, that ratio was 82.5%, pointing to the lowest-ever gender pay gap of the 73.9% of all men and 61.1% of all women employed full-time.

For 2014, the BLS reported that 12% of women worked 35–39 hours per week (compared to just 5% of men), while 26% of men worked 41 or more hours per week (compared to 15% of women) — which could account for some of the reported wage discrepancy. Approximately 52% of female employees and 57% of male employees reported a 40-hour work week, closing some of the gap with an 89% female-to-male earnings ratio.

The good news is women's real weekly earnings have been on the upswing for the past three decades. In fact, men at all educational levels have trailed women in wage increases for the past 35 years. For example, female employees with a bachelor's degree or higher saw an overall 31% increase in wages, compared to a 15% increase among men. This gender wage gap trend increases as educational levels decrease. For example, while men with a high school diploma encountered a 20% *decrease* in wages since 1979, women at the same educational level saw a 3% increase.

When examining the gender wage gap by occupation, though the number of women workers lead men in four out of seven occupational categories, their weekly median earnings matched those of men in just one field (health practitioner support technologists and technicians). The highest gender discrepancy was in legal occupations, with women earning just 56.7% of men.

FR2016-0113-0002