PATRIOT
INVESTMENT
MANAGEMENT

Dear Clients & Friends of Patriot Investment Management

The fall season is off to a tumultuous beginning, starting with the government shutdown, the renewed fight over raising the debt ceiling, and a woefully rocky roll-out of the enrollment website for the Affordable Care Act, also known as Obamacare. Hundreds of thousands of Federal workers were furloughed, national parks and monuments shuttered, and many public services were frozen, with no productive resolution to the gridlock in an extremely polarized and unpopular Congress.

The growing perception among investors is of both parties repeatedly crying wolf, as the markets have shrugged off yet another round of political maneuvering and brinksmanship in Washington; the eleventh hour deal came as expected. With the exception of emerging markets, the major indices are up for the quarter and the year, reflecting strong fundamentals underpinning the economy. The S&P 500 is up 4% for the quarter, and 15% year to date; while the Dow is up 1% for the quarter and 13% year to date; and the Russell 2000 is up over 6% for the quarter and nearly 28% year to date. Emerging markets have been relatively flat, returning nearly 6% for the quarter, but down 4% overall for the year. The interest rate on the 10-year bond has risen to 2.62% as of quarter-end, up from 1.84% at the first of the year.

Unemployment now stands at 7.2%, and core inflation is 1.7%, still off from the Fed's targets of 6.5%, and 2.5%, respectively, at which levels they have said they will increase rates. Due to the political wrangling, the tapering of bond purchases by the Fed has been pushed back well into 2014, as the real result of the 16-day government shutdown was an estimated cost of $24 billion, shaving .3% off the GDP. Janet Yellen, Bernanke's Vice Chair, will most likely succeed him in early 2014 as Federal Reserve Chair, providing continuity in Fed policy.

Despite all the negativity, the markets have been resilient throughout 2013, and we are optimistic for the fourth quarter, and into 2014. While we can expect more short-term noise early next year due to the next budget conflict, investors are increasingly dismissing the ineffectiveness and rancor inside the Beltway as a measure of the markets, and well they should; the markets and the economy are driven in the long run by real companies with real earnings, and not the noise of the latest headlines.

S&P 500	4.1%
Dow	1.0%
Russell 2000	6.4%
Emerging Mkts	5.9%
10 Yr Bond	2.62%
Inflation	1.7%
Unemployment	7.2%

Financial Education Starts At Home

Now that the school year is well under way, and the kids are settled into their routines, there is one thing that is probably lacking in their classroom curriculum - how to manage money.

Most kids are not taught money management in school; while Tennessee is one of the first states to adopt curriculum standards, just 4 states currently require financial education, and only 1 in 5 teachers feel comfortable teaching kids about money. In fact, a number of recent studies conducted since the financial crisis reveal the sobering reality that if children don't learn how to manage money at home, they often don't learn how to manage money at all.

For example, a 2010 Junior Achievement Survey found that 25% of teenagers don't budget - of these, 37% say they don't know how to manage their money, 32% say budgeting is for grownups, so it doesn't matter how they spend their money, and 42% aren't interested in money management. In a follow-up poll, researchers found that more than 33% of teens ages 14 to 18 think their parents don't talk to them enough about money and budgeting, and that 25% think they won't become financially independent until ages 25 to 27.

The most telling data comes from adults participating in the FINRA Investor Education Foundation's 2012 National Financial Capability Study. Consider these statistics; 56% of those surveyed have not set aside enough to cover three months' worth of expenses in an emergency fund, only 41% spend less than they make, and just 14% were able to answer correctly a series of five questions on financial literacy.

Compared to the last survey conducted in 2009, 18 to 34 year old respondents were more likely than older respondents to have experienced a drop in income. In addition, young adults were more likely to overdraw their checking account, be upside-down on a mortgage, take a hardship withdrawal from their retirement account and require financial help from family members. They were also less likely to be able to come up with $2,000 in an emergency, and 54% of those who have student loans are concerned they might not be able to repay them. When asked whether they thought financial education should be taught in schools, 89% of those surveyed said yes.

To take the quiz yourself, go to www.usfinancialcapability.org.

Talking with kids about money does make a difference, and can turn the tide of financial illiteracy in America. A Genworth survey found that adults ages 25 and over whose parents had set a good financial example were more likely to have a financial plan and feel confident about their financial future than did respondents whose parents did not set a good example.

Here at Patriot, we are passionate about financial education, both for our clients and for the next generation. Over the years, we have given talks to groups of high school and college students, as well as meeting one-on-one with clients' teens and young adults as they prepare for life at college and beyond. If we can be of service to you and your family in this area, or to someone you know, please give us a call; we'd be glad to help.

- **Additional Resources**

A great resource to start the conversation with teens and young adults is "Get a Financial Life" by Smart Money contributor Beth Kobliner, as is "Smart and Simple Strategies for Busy People" by Jane Bryant Quinn. "Raising Financially Fit Kids" by Joline Godfrey has age appropriate suggestions and exercises for younger kids.

See Charles Schwab's 2011 Teens & Money Survey Findings - http://www.aboutschwab.com/images/press/teensmoneyfactsheet.pdf

Saving For College

With the cost of higher education rising sharply over the past few decades, it is increasingly important to save as early and efficiently as possible to help pay for a child's education. College costs continue to rise 6% or more each year; even conservative estimates show tuition doubling every 12 years. The good news is there are a number of different ways to help save for a child or grandchild's education, and each strategy has unique tax benefits and restrictions.

- **Coverdell Education Savings Account**

Formerly known as educational IRAs, CESAs offer tax-deferred growth and can be used for a child's college and K-12 education expenses. Distributions are tax-free if used for education; otherwise, the earnings are taxed at ordinary income tax rates and incur a 10% penalty. The total amount that can be contributed in a given year is $2,000, and this total is per child, not per person gifting the money. In order to contribute to a CESA, you must have a modified AGI less than $220,000 for married filing jointly (or $110,000 for single filers). The funds must be used by the age of 30, or the account transferred to another beneficiary to avoid taxes and the 10% penalty.

- **529 College Savings Plan**

Like CESAs, 529s provide tax-deferred growth and tax-free distributions when used for qualified higher education expenses, which includes almost every accredited college, university and graduate school. Unlike CESAs, private K-12 schools are not included. Besides the tax benefits, their appeal lies in their easy access, the fact that they have no income limits, and their high contribution limits. For 2013, individuals can contribute up to $14,000 (the same as the gift-tax exclusion), and up to $28,000 for married couples filing jointly. In addition, 529s can be a great estate planning tool for relatives and grandparents, due to a provision that allows you to accelerate five years of gifting at one time into a 529 account, or up to $140,000 for a married couple filing jointly per beneficiary.

It is very important to choose a 529 plan that offers a wide range of choices but that also has low fees, as these can vary greatly between different plans. On the positive side, beneficiaries of 529 accounts can be changed at any time to another family member. This way, if one child earns a scholarship or doesn't need the money, the account can be transferred to another child or family member, or even back to the parents. There is also no age limit for using the funds. Like CESAs, any earnings that are withdrawn and not used for education expenses will be taxed along with a 10% penalty.

- **Custodial Accounts (UGMA and UTMA)**

Custodial accounts, known as Uniform Gift to Minors Act (UGMA) or Uniform Transfer to Minors Act (UTMA), are brokerage accounts that hold assets in trust for a minor child. The trustee, usually the parent or grandparent, then manages those accounts until the child turns 18 or 21 depending on the state (age 21 in Tennessee). Full-time students under age 24 pay no tax on the first $950 of unearned income and then the child's rate on the next $950. Any earnings above $1,900 are then taxed at the parent's rate. These accounts are flexible in that they only have to be used for the benefit of the child, and not solely for education. One drawback of custodial accounts is that the parent or trustee loses control over the money once the child reaches the age of majority; the account becomes the property of the child. Another drawback is that this type of account is viewed as an asset of the child, potentially limiting their qualification for financial aid. 529s and CESAs are considered assets of the parent, and therefore are less likely to penalize the student when determining aid.

- **Roth IRAs**

While Roth IRAs are excellent options as retirement savings vehicles, they also have a provision that allows distributions to be made penalty-free before age 59 ½ for education purposes. Contributions may be withdrawn tax-free; earnings are taxed at ordinary income tax rates. Like CESAs, Roth IRAs have contribution and income limits. In 2013, individuals under age 50 can contribute $5,500 per year, or $6,500 if over 50, and must not have modified AGIs over $112,000 ($178,000 for joint filers). A phase-out applies above these amounts.

If you haven't yet begun to save for your child's education, now is a great time to start. To learn more, please discuss with your advisor which type of account is right for your situation.

A Conservative Approach is Our Philosophy

With all the uncertainty that the latest budget debate and government shutdown has created, it is helpful to remember that headlines will come and go, creating short-term noise in the markets, but keeping a long-term focus and maintaining your investment plan will help to ensure you reach your goals.

By taking a conservative, prudent approach to investing, and adhering to the following principles, this time-tested and empirically proven method can help you earn attractive, risk-adjusted returns over the long term.

- **Diversification is Key...** Having a broadly diversified investment portfolio greatly increases your chances for success by reducing market risk while capturing market return. When combined with proper asset allocation, diversification is a powerful tool for managing risk and reward.

- **The Right Mix is Critical ...** Asset allocation is the most important decision an investor can make; academic studies have repeatedly shown that a properly allocated portfolio is the single largest factor in determining the level of future returns.

- **Market Timing is Risky...** A successful timing strategy requires three correct decisions: when to get in the market, when to get out, and when to get back in again. Decades of empirical research by hundreds of academics and economists have yet to find conclusive evidence that market timing works.

- **Costs Matter...** An investor's earnings comprise the market rate of return less fees and expenses. By reducing costs, an investor captures more of the market return. Compounded over time, that can mean hundreds or even thousands of dollars saved. Those savings stay in the portfolio, and continue to work for you.

Many investors are their own worst enemy. Giving in to emotion, buying low and selling high, and jumping into and out of the markets greatly reduces total return. Following a disciplined investment strategy takes emotion out of the equation.

Patriot News & Community Events

We here at Patriot are proud to announce we are celebrating our 20th anniversary in 2013! Since our humble beginnings in 1993, we have grown to 15 advisors and 6 staff members, and we now manage over $527 million in assets. Our strong belief in providing unbiased, objective advice to our clients, and our ongoing commitment to service and professional excellence has made us one of the largest fee-only firms in Knoxville. We would like to thank each and every one of our clients for our continued success, and we are grateful for the opportunity to serve you.

HonorAir Knoxville made its 15th flight to Washington D. C. on October 9th, despite the government shutdown. Patriot is a proud supporter of this worthy cause, whose goal is to fly every East Tennessee WWII veteran to see the WWII memorial. Flights are also open to Korean War veterans. You can learn more at www.honorairknoxville.com.

Save the Date! This year marks the 20th anniversary for the Buddy's Race Against Cancer 5k Walk 'n Run, to be held on Sunday, November 10, 2013, at World's Fair Park. All funds raised through this event are used locally by the Thompson Cancer Survival Center to provide much needed cancer screenings and education to thousands of medically underserved individuals in the East Tennessee area.

Patriot is a proud sponsor of the Buddy's Race, and we would love to have you join our team this year. If you would like to participate, register at www.buddysrace.org, select 'Join a Team', and click on 'Patriot' from the drop down menu. You can also register the day of the race.

We Appreciate You!

Thank you for placing your confidence and trust with us, and we welcome your questions and comments.

We are committed to helping people reach their financial goals - if you know someone who could benefit from our expertise, please let us know and we will be happy to assist them.