Secure Planning Inc.®
The Financial Counselor Program

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Where Did the Fiscal Cliff Go?

Fourth Quarter 2012

The stock market made sense to me to some extent in the fourth quarter of 2012. I had expected that the equity markets would take a downturn as we approached Election Day. The reason is that the stock market does not like the unknown. Not knowing who the President will be worries people. Once the election was decided, the problem of the "fiscal cliff" placed a dark cloud over the market.

At the beginning of the quarter, the S&P 500 stood at 1441. By November 14th it fell to 1355. That is a drop of 6% in seven weeks. Congress then began to talk about the fiscal cliff and from day to day, the market, depending on the news, rose or fell. The saving grace was that, by the end of the year, Congress had agreed on a tax plan and the fiscal cliff was averted.

Putting the quarter into perspective, if you had gone to sleep on September 30th and awakened on January 1st, the net change was about 1% negative. The S&P 500 went from 1441 at the beginning of the quarter to 1426 at the end.

Quarter's Economic Results

As of this writing, the results of the fourth quarter were good. Corporate earnings, overall, are up. Many corporations paid dividends in late December to let stockholders take advantage of the lower dividend tax. Job growth continued. New unemployment numbers were down. Consumer spending was up as was consumer credit. Changes were made to the tax rates but had little impact on this quarter. This positive information has helped move the S&P 500 up to 1483, as of January 17th, or a gain of 4%, since year's end.

Looking at the Year 2012

Overall, the year 2012 was a good year for both the stock and bond markets. The S&P 500 was up about 14% for the year. As bond interest rates decreased, the principal value of bonds increased, resulting in gains. Most of the gains for the year were achieved during the first and third quarters. A substantial downturn occurred in the second quarter of the year as well as a modest downturn in the fourth quarter.

Looking Forward Short-Term

Both business and consumer confidence seemed to be positive in the fourth quarter. This does not take into account the changes in the tax law and the looming need to raise the national debt ceiling.

The payroll tax was allowed to return to its former rate, thereby increasing the tax on working Americans by 2%, a direct reduction in take home pay. Putting it another way, a family of four that earns $100,000 will pay $2,000 more in payroll tax. This could have a material impact on consumer spending.

In addition, the cost of health insurance rose about 10% in many parts of the country. For that same family making $100,000, they might now see their take home pay cut by about $720, for the added cost of health insurance.

Read more of Ed's thoughts on his blog at http://secureplanninginc.blogspot.com

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For the past several years, most middle class workers have seen little increase in salaries. If, as indicated by the fourth quarter information, families have taken on more debt, they will be forced to pay this off, even as they see paychecks shrink. This too may have a negative impact on the economy.
Depending on what Congress and the President decide to do with spending reductions this year, we could see the reduction in government spending impacting the economy in a negative manner. The first quarter of this year will give us some idea of what is going to happen. While the stock market seems sanguine about these areas for now, it could change.

Good News in the New Tax Law

For some years we have not had a predictable estate tax exclusion in the United States. This exclusion is the amount on the estate of a deceased person for which no estate tax needs to be paid. With the passage of the American Taxpayer Relief Act of 2012, this amount is now locked in at $5 million per person and is indexed to inflation. It should cover most Americans' estates, except for the truly wealthy. The tax rate has risen to 40% on everything over $5 million, but it had been 50% not long ago, so even the rich got a benefit. The new estate tax exclusion applies not only at death but is unified, so you can give away the money while alive, up to $5 million (this is in addition to the $14,000 annual gift exclusion, which was also raised).

Another piece of good news is that the tax rate on dividends and capital gains remains at 15% for those couples earning less than $450,000 and singles earning less than $400,000. For others, the rate will be 20%. Some added taxes for singles making $200,000 or more and couples making $250,000 or more relate to the 3.8% Medicare Surtax (used to pay for part of Obama Care) and a phase-out of personal exemptions and limits on itemized deductions.

Interest Rates

For more than 30 years, interest rates have been moving downward. This has meant that investments in CDs, savings accounts or bonds have been earning less and less. This period has been known as a bull market in bonds.
Currently, the interest rates are being held at all-time lows by the actions of the Federal Reserve Board (FRB). They have been buying bonds and mortgages at the rate of over $80 billion a month, putting more money in the economy and keeping rates low.

The FRB has indicated that they will continue the policy until they feel the economy is headed upwards in a meaningful way. They have suggested that this policy will be in effect until the early part of 2014. At some point in time, the FRB will stop this purchase program and allow interest rates to rise again. When this happens, the value of bonds will decrease as the interest rates increase. As an investor, you will not want to own longer-term bonds and will want to stay with short duration bonds.

Conclusion

I believe that the United States has four main benefits over most other countries. First, we have a stable government. The day after the election last year, everyone went about their business and accepted the outcome. Second, we have the highest productivity in the world. Third, we have the best quality in the world. Fourth, we have very inexpensive energy in the form of clean burning natural gas. These factors should result in greater manufacturing taking place in the U.S. Over all, this implies that for the long term, U.S. equities should remain strong.

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