Secure Planning Inc.®
The Financial Counselor Program

October 2012

Stock Market Misdirection

Third Quarter 2012

Sometimes it seems the stock market really gets what is happening with the economy very wrong. In my opinion, the third quarter was one of those times.

The S&P 500 began the quarter at 1321 and ended at 1441, a very handsome gain of 120 points, or 9%. All in all, the stock market moved forward from the beginning of July right up until the end of September. It was not the jagged ride that we had in the second quarter, and appeared to be a nice move upward.

The factors that helped push the market higher were several:

- The crisis in Europe diminished, as the central bank decided that it would buy bonds of countries that were having deep financial issues. This reduced the pressure on the bonds of Spain, Italy and Ireland and helped either keep the interest rates stable or push them down a bit.
- In China, after a fear of economic collapse, encouraging news that the situation might not have been as bad as initially thought.
- On the U.S. domestic side, unemployment declined and the number of new filings for unemployment benefits began to decrease. Consumers seemed to be spending more and confidence grew that the worse might be behind us and real growth was resuming.

We now know that the situation in several countries that were being helped by the European Central Bank was not so good. Spain, in particular, seemed to be getting better, but now we are seeing that their troubles are much deeper than first thought. China appears to be having a number of problems that are impacting their economy. A glut in building construction, worker unrest and a drop in exports are pulling down their economy. In the U.S., the new job growth is not sufficient to materially move the unemployment rate, consumer spending was up and accounted for about 70% of GDP, while corporate earnings and growth were disappointing. The economy, which was projected to grow at an annual 3.3% rate, grew at an anemic 2% rate after only a 1.3% rate in the second quarter.

As of this writing, the S&P 500 has lost about 2% in October. This all goes to show that, at this point, caution is necessary for the short run. With the Presidential election coming up, the market may go through some turmoil as it makes bets on who will win the election.

Addressing the Fiscal Cliff

For some time now I have been addressing the "fiscal cliff" that looms at the end of this year. This cliff encompasses the automatic increase in taxes for all Americans, and a significant reduction in U.S. government spending that is mandated as of January 1, 2013. If these two occur without any intervention, the negative jolt to the economy will likely result in negative growth in the first quarter of 2013.

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

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As both Presidential candidates have addressed this issue, it appears that some action will take place after the election. President Obama is looking at raising taxes on the wealthy, those earning more than $250,000, with the idea of raising some increase in revenue while also minimizing government spending reductions. Governor Romney is talking about an overhaul of the tax code that would reduce the amount of itemized deductions allowed to between $17,000 and $25,000. This approach impacts the wealthy the most but would also increase taxes for some individuals earning as low as $100,000. Currently, the tax revenue to the IRS is about $1.3 trillion, with more than another $1 trillion not being taxed because of these tax breaks. If half of these breaks were eliminated, tax revenue would go up about $500 billion and we could balance the budget. If the government also lowered its expenses, we could begin paying back the deficit.

The financial strength of America is very important to our growth and to stability of business. Regardless of who is elected, the approach that Governor Romney is suggesting is gaining favor both in Congress and with the business community. All key players are realizing that taxes must increase and spending must subside.

The Bright Side of it All!

As I look at what is happening, I am beginning to believe that Congress will address the issue of the fiscal cliff. They will not do it in the best way possible because politics will get in the way of what is best. Still, if they tackle the problem in a meaningful way and don't kick the can down the road for another two years, we might be able to get on track to grow the economy in a meaningful way by taking our medicine now!

It seems clear to me that the United States is on the cusp of a potential "Golden Era!" As I have been saying for some time now, we have the highest productivity in the world, the best quality in the world, the most stable government in the world, and we now are energy independent! The biggest source of our energy is clean burning, low cost natural gas. We are showing a real interest in the United States becoming more environmentally friendly. We have it all. Now we have to figure out how to make it all work for us and the rest of the world.

Conclusion

Nothing is perfect. The economy has a lot of moving parts that integrate to form the whole. As investors, not speculators, we must take a long-term view with our investments. Today, the market is far stronger than four years ago when we were in the beginning of a meltdown. This year is better than last. It is my strong belief that by next fall we will see even more improvements. This will not be a smooth ride but we will get to a better place.

Ed Mallon

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