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INVESTMENT & TAX UPDATE

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The Fiscal Cliff—Possibilities and Probabilities

So the election is over. Now the big focus is the "Fiscal Cliff." This when several things converge all at once—the expiration of the 2003 so-called Bush Tax Cuts, drastic spending cuts if a budget deal isn't reached, the expiration of the payroll tax holiday, the expiration of special tax credits, and new taxes to fund the Affordable Care Act.

We've been spending a lot of time researching this and considering the many possible outcomes. They range from the Not-so-Good, the Bad, and the Ugly. Each component by itself can have a minor negative effect on the economy. However, according to an October report by Goldman Sachs, the expiration of <u>all</u> fiscal cliff programs, including the sequester of defense and domestic spending, could potentially lower our current GDP of about 2% to a negative 2%-2.5% during the first half of 2013, triggering a mild recession and other financial ripples through the economy.

The Fiscal Cliff (Or Slope?)

Congress can make decisive progress dealing with the Fiscal Cliff, muddle its way through, or blow it through political gridlock. This creates a lot of possibilities and their probabilities. ***From Monday's stock market rally and the readings and political developments we have seen since the election, we believe that the fiscal cliff is most likely going to be a fiscal slope.*** Congress has more than one shot to get it right, with several opportunities to phase it in or minimize the impact. This makes predicting the probabilities and charting an appropriate course of action difficult.

How do you prepare for so many possibilities? If we knew for certain that XYZ will happen and how it will unfold, we can take specific steps. But we don't know, and neither does anyone else, especially with so many possible XYZs out there.

Therefore, with so many XYZs with different probabilities, we believe your best strategy should be prudent diversification. And not just now for the impending fiscal slope, but for other unknown future events.

Year End Tax Planning for Taxable (non-retirement plan) Accounts

We are currently reviewing the realized gains and losses report and the taxable income report for all of our non-retirement plan and other non-taxable accounts. Once this review is complete we will send them to you and your tax professional early next week so that you can do some informed year-end tax planning. ***It has been a good year so far, so you can expect to see capital gains on your report.***

We are also making some strategic investment changes in the Large Cap category in nearly all of our accounts, which will take place in December. These will also result in reportable capital gains. Our logic is that since we need to make these changes, it is better to do them now when we know for certain that the maximum Federal capital gains rate is 15%. If the Bush tax cuts are allowed to expire, the capital gain rate may be much higher.

Many of our clients have capital loss carry forwards from previous years that can be used to offset these gains. We encourage you to dig up last year's tax return and look at **Schedule D, line 14**. That will give you an approximation of how much of the realized gains we are reporting will be offset, and therefore not taxable.

Thank you!

In the spirit of Thanksgiving, we are grateful for the opportunity to serve you. We wish you and your loved ones all the best for a fun and gratitude-filled holiday.