

WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

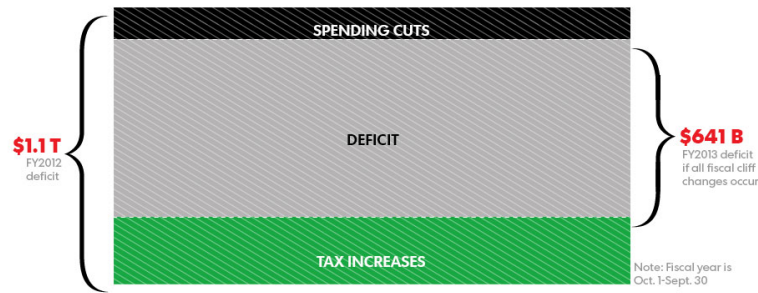
Lawmakers are currently busy working out a way to avoid the Fiscal Cliff set to occur at the end of this year. If left unresolved, the Fiscal Cliff could force the country into a recession. The Debt Ceiling will need to be raised once again, after it was raised late last year, and the longer-term debt dynamics of the country still need to be addressed.

The Fiscal Cliff

The Fiscal Cliff is a popular label for a group of tax breaks and spending cuts that are set to expire or take place at the end of this year. In totality, the Fiscal Cliff represents more than a 700 billion dollar shift in U.S. fiscal policy, which is roughly 4.5% of total annual GDP for the country (see following). If the Fiscal Cliff were left unresolved, it is widely predicted that the country will fall into a recession.

Fortunately, law makers agree that the Fiscal Cliff needs to be averted. Congressional leaders and the President are meeting frequently to work out a solution. There are several plausible outcomes to avoid the Fiscal Cliff. Congress may pass the responsibility of solving the issues of the Fiscal Cliff to the newly elected Congress when they take office next year by putting in place measures that will delay a permanent solution to sometime in 2013. There is also the possibility that law makers will come to an agreement before year-end, before the newly elected Congress takes office. The worst case scenario is that no agreement is made and we pass the year-end without any resolution in place. The majority of the Fiscal Cliff's negotiations center around the tax rates for high income households. The President is taking the position that closing tax loop

A raft of tax and spending changes scheduled to take effect in January will sharply reduce the federal budget deficit, but could also send the economy back into recession if they all happen at once.



How steep is the cliff?

If all the tax increases and spending cuts that are part of the fiscal cliff go into effect, here's how they would affect the economy and your tax bill, based on analyses by Moody's Analytics and the Tax Policy Center.

If the U.S. goes over the fiscal cliff ...

-  Tax increases and spending cuts will total more than \$700 billion in the first year. *Moody's Analytics*
-  The U.S. budget deficit will see its biggest one-year drop since 1969 relative to its share of the domestic economy, falling from 7.3% of gross domestic product to 4% in the fiscal year ending next Sept. 30. *The Congressional Budget Office*
-  The economy will fall into shallow recession in the first half of the year as GDP falls at an annual rate of 2.9% in the first half, recovering to 1.9% annualized growth in the second half. *The Congressional Budget Office*
-  By this time next year, 2 million more people could be unemployed and the unemployment rate - now 7.9% -- could reach 9.1%. *The Congressional Budget Office*
-  Almost every tax cut adopted since 2001 would expire. Taxes would rise on average of \$3,200 per household and an average of \$2,000 for middle-income households. *Tax Policy Center*

How the fiscal cliff affects taxpayers

Here's how taxpayers at different income levels would be affected if certain tax cuts or benefits that are part of the fiscal cliff are not renewed:

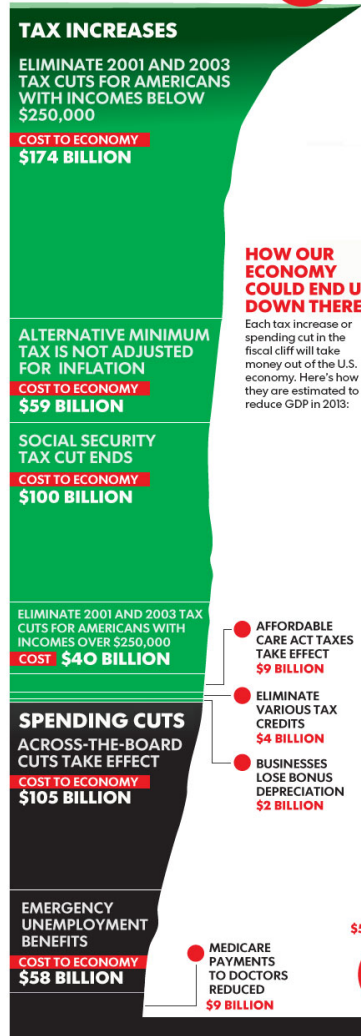
TAX CHANGES	LOWEST EARNERS	MIDDLE EARNERS	TOP EARNERS	TCP %			
Social Security payroll tax cut ends	\$120	\$364	\$672	\$1,135	\$19,500	\$2,542	
Affordable Care Act (Obamacare)	0	\$2	\$7	\$13	\$1141	\$20,583	
2003 Bush-era tax cuts	0	0	0	0	\$996	\$19,198	
2001 Bush-era tax cuts	0	0	0	0	\$2,282	\$45,002	
2009 stimulus	\$209	\$185	\$103	\$73	\$103	\$0	
Tax extenders ¹	\$28	\$74	\$135	\$267	\$1848	\$21,232	
Estate tax	\$3	\$37	\$75	\$158	\$747	\$5,210	
Other Bush-era tax cuts: (2001-03)	\$53	\$558	\$888	\$1,453	\$3,841	\$6,546	
Alternative minimum tax patch ²	0	\$12	\$104	\$440	\$1,265	\$222	
TOTAL	\$412	\$1,231	\$1,984	\$3,540	\$14,173	\$120,537	

¹ Various tax credits and deductions for individuals and businesses expire.

² The exemption for the alternative minimum tax is not adjusted for inflation, forcing millions more taxpayers to pay higher 2012 taxes when they file returns starting in January.

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LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.



Source: USA Today

holes and changing deductions will not raise enough revenue to restore fiscal balance alone. The President has proposed to Congress to extend the Bush-era tax cuts for the middleclass and increase taxes for the most fortunate 2% of Americans (see opposite).

Investors are worried that the Fiscal Cliff will have an effect similar to that of the 2011 Debt Ceiling debate. Investors can take comfort in the fact that negotiations are already going better than last year's. Congressional leadership at this point recognizes that tax revenues will have to increase as part of a deal to restore fiscal balance. There is also a consensus to extend the middle class tax breaks, which is a large portion of the Fiscal Cliff and possibly causing the most

anxiety amongst investors. Despite the early consensus among law makers, there are still more negotiations to come.

The Debt Ceiling

Along with the Fiscal Cliff another important fiscal matter coming to the forefront is the Debt Ceiling. The maximum allowed debt outstanding for the U.S. will be reached as soon as January of 2013. The last time the Debt Ceiling was raised was in the fall of 2011. The political brinkmanship that led up to the critical decision to raise the Debt Ceiling rather than default



Table 3. 2013 Taxable Income Brackets and Rates Under President Obama's 2013 Budget

Rate	Single Filers	Married Joint Filers	Head of Household Filers
10%	\$0 to \$8,950	\$0 to \$17,900	\$0 to \$12,750
15%	\$8,950 to \$36,250	\$17,900 to \$72,500	\$12,750 to \$48,600
25%	\$36,250 to \$87,850	\$72,500 to \$146,400	\$48,600 to \$125,450
28%	\$87,850 to \$183,250	\$146,400 to \$223,050	\$125,450 to \$203,150
33%	\$183,250 to \$203,600	\$223,050 to \$247,000	\$203,150 to \$227,300
36%	\$203,600 to \$398,350	\$247,000 to \$398,350	\$227,300 to \$398,350
39.6%	\$398,350+	\$398,350+	\$398,350+

Source: The Tax Foundation

on its U.S. debt obligations by lawmakers largely led S&P Credit Services to downgrade the U.S.'s credit rating which sent the market in turmoil and Treasury bond prices sky high.

U.S. Debt Dynamics

One of the major focuses last year for the credit rating services, besides the political responsiveness to addressing fiscal concerns, was for lawmakers to develop a credible plan to reduce the nation's debt dynamics in the medium term. In 2011, S&P Credit Services warned that a further downgrade to AA was possible if within the next two years they see less spending cuts than were agreed to. Currently the country's debt-to-GDP ratio is approximately 105%, an all-time high.

New Investment Tax

In 2010, in conjunction with the President's 2010 health-care overhaul, a new 3.8% investment income surtax was introduced and the Supreme Court ruled to uphold this tax last July. The new tax will affect the net investment income of joint filers with an adjusted gross income of more than \$250,000 or \$200,000 for single filers starting January 1, 2013. The 3.8% increase will be applied to long-term capital gains and dividends which are currently taxed at 15%. The new investment tax may push more investors into tax-exempt securities and tax advantaged investment vehicles like IRAs, Roth IRAs, 401(K)s and defined benefit plans which are all exempt from the tax.

The Fiscal Cliff will have long lasting effects to the country's fiscal policy. Fortunately, law makers are cooperating much more effectively than what took place during the Debt Ceiling debate last year that cost the country its AAA credit rating. A positive resolution to the Fiscal Cliff could buoy markets, aid the country on its road to fiscal balance and most importantly remove fiscal uncertainty which would help companies and markets.

S&P 500 Index

3 Month	1.27%
Year-to-Date	14.95%
1 Year	16.12%
3 Year	11.23%
5 Year	1.34%

MSCI EAFE Index

3 Month	6.32%
Year-to-Date	13.68%
1 Year	12.61%
3 Year	2.97%
5 Year	-4.72%

Barclays Aggregate Bond Index

3 Month	0.49%
Year-to-Date	4.36%
1 Year	5.51%
3 Year	5.68%
5 Year	6.03%

As of 11.30.2012

Contact Us

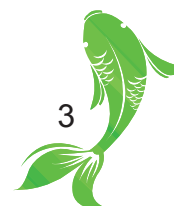
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