IdahoTrust

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# 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 adverted. 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

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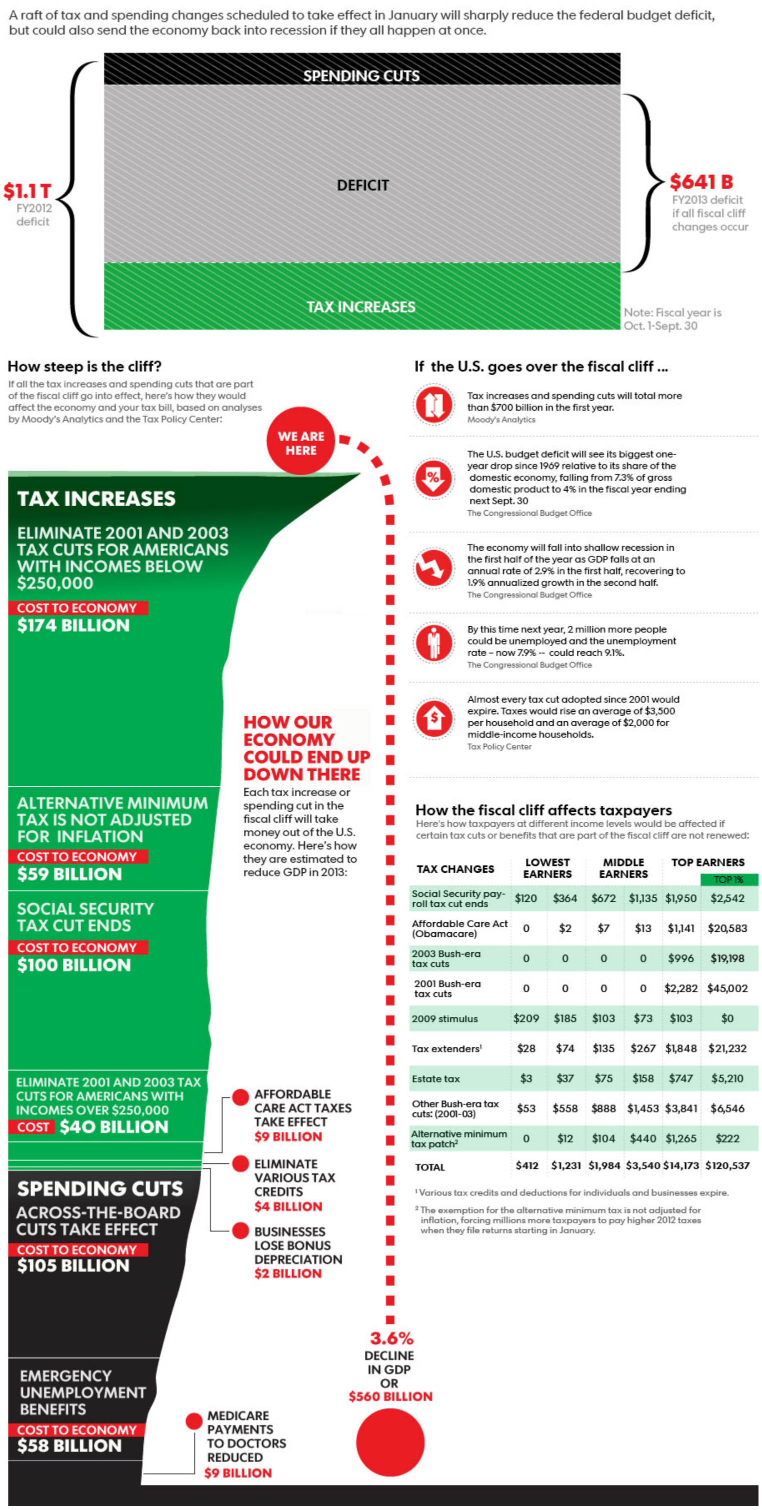


*Source: USA Today*

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 creditable 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*

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