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The Fiscal Cliff:

It is even more complicated than you might think

What is this *fiscal cliff* we have been hearing so much about? Federal Reserve chairman Ben Bernanke coined this new phrase, one we are sure to hear with increasing intensity over the coming months. The tax and spending landscape is scheduled to change dramatically...go 'over the cliff' as it were...on January 2, 2013, unless congress and the president agree to a suitable compromise. The dawn of the new year simultaneously heralds the expiration of the Bush tax cuts, the expiration of the current payroll tax holiday, the expiration of temporary alternative minimum tax relief, a significant increase in estate tax rates, and implementation of new taxes associated with the Affordable Care Act. Capital gains taxes and taxes on qualified dividends are scheduled to increase as well. Furthermore, major spending restrictions kick in at the same time through budget 'sequestration,' a mechanism that will force drastic budget cuts if no 'deal' is achieved by year-end.

In baseball terms, we are in somewhat of a 'pickle'. If delay or postponement averts the fiscal cliff, we simply reinforce the pattern of accumulating crushing debt. On the other hand, if sequestration-required cuts go forward full force, serious damage could be inflicted on the economy. There are even risks to a brokered 'deal' somewhere between these two extremes. A brokered compromise that balances revenue increases and spending cuts is perilous as well. It would change the state of play, strangle our all too fragile economic recovery and drive us back into recession.

Is a doomsday scenario likely to unfold? Almost certainly not. While our politics have become deeply polarized and intransigence has become rampant, no one wins if economic calamity befalls us. It is hard to imagine that our politicians will not find a way to blunt the full effects of this approaching crisis. So is the frenzy of concern about the fiscal cliff much ado about nothing? Not at all. We must be vigilant.

I am reminded of the recently publicized antics of the goat that spent five days perched on a rocky ledge in the United Kingdom. The locals were alarmed so the community put together a rescue team. Onlookers watched the rescuers get to within a few feet of the goat when all of a sudden 'Billie' jumped off the ledge unharmed, soon grazing the grassy field below. I am inclined to think that our politicians will navigate our economy off the ledge safely, but I suspect the negotiations to be anything but orderly. I think that there will be high drama, roiling the markets as we move to the brink. The near-term result may more closely resemble kicking the can down the road than a grand solution.

Who got us in this mess anyway? Our politicians in Washington, DC, are certainly implicated. I believe we can all agree that our politicians have not found a way to collaborate on our behalf for years now even as we disagree on how to apportion the blame. Let us not forget, though, our own complicity. We elected these politicians and too often we've demanded services we've been unwilling to pay for.

The backdrop for fiscal cliff negotiations is not very different than it was before our recent election, with the Presidency and Senate in Democratic hands and the House of Representatives in Republican hands. However, elections have results. President Obama ran on a platform of raising taxes on higher income taxpayers so we can be certain he will press his case. It will be interesting to see how Republicans respond. It seems they may be willing to talk but it is far too early to count on an optimistic outcome.

I love swimming and diving. When I was around ten, I would try a variety of different dives off the diving board. One of my favorites was to spring high off the board, crouch into a seated position, land my butt on the diving board again, and then bounce high and then into the pool. As you can guess, my mother was none too thrilled with this technique. One day, I pushed my body out a little too far so that my butt missed the board altogether. The board scraped my back before I fell into the pool. Ouch! The episode was painful but short-lived. As you might have guessed, I never did it again.

In a similar fashion, the fiscal cliff has the potential to be a painful but time limited episode on a crooked road to fiscal sanity. Mike and I feel that over the short term we are going to see a spike in market volatility. For many of our accounts, we are a little more defensive than usual. However, we anticipate significant investment opportunities once this ugly crisis begins to resolve. We expect to redeploy cash and reposition portfolios a little more opportunistically when the dust begins to settle. As I have been saying over the last several years, many corporations have enormous cash reserves that they would like to put to work. When they see clear direction of economic policy coming from Washington we suspect that much of the cash now on the sidelines will be put to work, jolting the economy forward.

Too great a reliance on emotions can lead to destructive decisions. I hope that our politicians do not let their emotions interfere with the hard decisions facing them over the next several months. Investors, too, would do well to resist emotions that lead to rash financial decisions. As always, please call or email us to process this report and any other concerns you may have.

Molly, Erin, Mike and I want you to know that we are honored and grateful for the opportunity to play a role in your financial affairs. Happy Thanksgiving!

Sincerely,



Gregory Bork Jr.

LPL Registered Principal

The economic forecasts set forth in this presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.