



Paul R. Ried Financial Group, LLC
Security for your future

A MESSAGE FROM YOUR FINANCIAL TEAM

Fourth Quarter 2012

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Dear Clients,

It turned out to be a pleasantly surprising year for most investors in 2012. After all, if investors were told this time last year that corporate earnings would come in significantly below expectations and US GDP growth would also be lower than consensus, few would have predicted that the result of such a scenario would be strong double-digit gains for the stock market.

Fiscal Cliff

There is a strikethrough the words "Fiscal Cliff" not because congress managed to avoid it by coming to a make shift agreement. Instead it is because I hope I don't have to see or hear the term again (we all can dream). If you feel the same way, you're not alone. In fact, "Fiscal Cliff" made the top of this year's "Banished Words List" published by Lake Superior State University, which has been publishing the list since 1976 and includes words or phrases it believes should be banished for "Misuse, Overuse and General Uselessness". Second on the list was "Kick the can down the road".

That was an amusing combination considering the fact that the Fiscal Cliff deal Congress ultimately reached basically kicked the can down the road, not addressing the deficit in any meaningful way.

The Fiscal Cliff deal was officially named the "American Taxpayer Relief Act of 2012". At 154 pages, you might assume that it ushers in a lot of changes for 2013 as compared to 2012. However, for the most part, that is not the case. The majority of the bill simply extends and/or makes permanent tax policies that were in place for 2012. In fact, the word "extension" appears 186 times in the bill.

However, there are some key changes which will take place in 2013. Below we have listed some of the highlights/lowlights of the bill.

Key Changes in Effect For 2013

Payroll taxes increase 2% - The social security portion of payroll taxes for workers will move back to 6.2% from 4.2% (and to 12.4% from 10.4% for the self-employed), as they were prior to 2011. This was one of the few things that was not extended which will affect the largest group of people. As a result all working taxpayers will begin seeing their paycheck reduced in 2013 (this applies to the first \$113,700 of wages in 2013).

A new income tax rate of 39.6% for “High-Income Households” - A new income tax rate of 39.6% (instead of 35%) will apply to income above \$400,000 for individuals (and above \$450,000 for households).

The tax rate on Long-term capital gains and qualified dividends increases to 20% for “High-Income Households” - The long-term capital gains and qualified dividends tax rate increases from 15% to 20% for individuals making over \$400,000 (and \$450,000 for households). Note that this does not include the additional investment income tax of 3.8% for all individuals making over \$200,000 or households making over \$250,000 as a result of the Patient Protection and Affordable Care Act (otherwise known as Obama care).

Estate tax rate increases to 40% - The estate tax rate increases from 35% to 40%. The exemption amount for 2013 is \$5.25 million for individuals, up from 5.12 million in 2012, as it has been indexed to inflation.

Tax-Free Distributions from IRAs for Charitable Purposes - Individuals age 70.5 or older can make tax-free qualified charitable distributions from their IRA accounts directly to certain charities. This originally expired in 2011 but has been reinstated for 2013 and includes retroactive rules for 2012.

New Roth 401K conversion rules - Individuals can now convert funds inside a traditional 401K plan into a Roth 401K regardless of age or employment status. However, the plan sponsor must have a Roth deferral option to make the switch.

Looking Forward

Markets reacted positively to the fiscal cliff deal since it did not significantly raise taxes or cut spending which would have created larger headwinds for corporate profits. Unfortunately, it also did not address the problem of unsustainable deficits.

While the media will continue to focus on the debt ceiling “deadline”, the more important issue is what spending cuts are eventually enacted. A “deal” of some type is the likely outcome, even if it is just to delay significant cuts once again. Contrary to popular belief, a failure to raise the debt ceiling would not result in default on US debt since more than enough funds come in monthly via taxes to cover the interest on the debt. However, it would be things like Social Security payments and veterans’ benefits that would be impacted, and it is in no politician’s best interest to solicit the wrath of those voters.

Regardless, the continued importance of broad diversification remains. There are many factors at play in the world economy, from the more concrete aspects like demographics, to the random whims of politics. The range of possible outcomes remains wide.

As always, we continue to monitor the economy, the markets, your asset allocation and individual fund management teams, making adjustments as appropriate. Should you have any questions or concerns, don't hesitate to e-mail or call our office.

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