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**MARKET COMMENTARY** November 2, 2012

| **Dow Jones Industrial Avg.** | **13,437.13** | **Standard and Poor's 500** | **1440.67** |
|---|---|---|---|
| 2012(YTD) +12.19% | 3rd Qtr. +5.02% | 2012(YTD) +16.44% | 3rd Qtr. +6.35% |

**Obama v. Romney** – "The man who smiles when things go wrong has thought of someone he can blame it on." Jones' Law (quoted in Murphy's Law)

**"Forward" or "Believe in America" –** One of the men offering these two slogans will be leading the country for the next four years, and the nation decides in less than a week. The contest, at times quite contentious, offers voters a clear choice. President Obama advocates a vision of a government-centric approach to economic growth, by which government describes the problems of consequence and constructs the solutions it regards as appropriate. Governor Romney envisions a more limited role for government. He suggests individuals and businesses should be allowed to make decisions based on their own "enlightened self-interest", thereby creating a more dynamic environment, which encourages initiative. The pivotal issue in the minds of many voters, and particularly for independents, is which candidate is more qualified to spark economic growth.

Before the ultimate winner can even begin to lay out his plans for spurring growth, he will be forced to deal with the dreaded "fiscal cliff". A series of tax increases are set to take effect on the first of the year, and they will be accompanied by draconian spending cuts. The cuts will be equally divided between the federal government's discretionary accounts and the military budget. There was hope a less rigid approach could be agreed upon by Congressional leaders. Now a compromise is, at best, a long shot given the limited time and the stacked legislative schedule.

Most taxpayers recognize no politician (particularly Washingtonians) willingly agree to any spending cuts. They cannot be expected to explain to some irate constituents that a particular program is simply unaffordable. More is always acceptable; less is not. Recognizing this simple fact reminds the average voter/taxpayer how the nation has managed to experience four consecutive years of deficits exceeding $1,000,000,000.000.00! This is not a partisan issue. Both parties are complicit. In spite of this sustained level of profligate spending, the economy continues to sputter. Any Keynesian economist would have "guaranteed" a recovery by now given this extraordinary level of government intervention. In fact, President Obama's advisors had that background, so he must have expected to see the textbook result - a robust recovery. Instead the country has seen its debt burden increase by $4 to 5 TRILLION over the past four years.

Unemployment remains at an unacceptably high level. The country is confronted with some unpleasant choices. If there are significant cuts to government spending, a recession may be the result. If taxes are increased enough to dent the deficit, a recession may be the result. If Chairman Ben Bernanke and the Federal Reserve decide to allow interest rates to rise, so savers are once again allowed to earn a fair return, a recession may be the result. Higher interest rates will reduce loan demand by business and consumers. In addition, any rise in interest rates will increase the cost of carrying our nation's $16 trillion debt, which in turn increases the budget deficit. The fiscal irresponsibility in Washington over the past twelve years created a fiscal Gordian knot, which will not be easily undone. Every corrective action generates an undesirable consequence. Whoever prevails in the Presidential contest next week has the unenviable task of shaping a multi-faceted compromise with a deeply divided, lame-duck Congress - a Herculean task to say the least.

**What Next?** The next President will need to pay immediate attention to the sputtering economy. Lackluster GDP growth and high unemployment have been two of the signature issues of this campaign. They clearly demonstrate the anemic growth, which has plagued the economy since the end of the recession. Little clarity was provided by either candidate during their debates of their plans to reinvigorate the economy. In fact many topics were given too little time. Neither the formats nor the moderators of the debates were able to channel the remarks of the candidates to address the most pressing issues confronting the nation. With print media on the wane and the big three television networks (i.e., CBS, NBC and ABC) shadows of their former selves, voters now have to depend more on themselves to uncover their candidate's positions on issues that matter to them. Enter the new campaigns fueled by billions of dollars and heavily reliant on negative advertisements, and you have a formula for utter confusion. Even at this late date, the result next Tuesday is anyone's guess.

Investors are confronting a maze of complexity too. They will not know until next week who will be leading the world's largest economy for the next four years. How will the tax code be altered next year? Is a recession on the doorstep or will corporate revenues and profits improve in 2013? Does the European Union manage to stabilize its economy and its banking system? Will China's leaders allow a resumption of growth and risk sparking inflation or will the military reassert itself resulting in increased tensions in the region? The list of international question marks has been truncated to prevent discouraged investors from burying all of their assets in the ground.

With so much uncertainty, investors are wise to maintain a defensive stance until more clarity emerges. This applies not only to equities, but to fixed income investments as well. The primary concern with common stocks is the earnings outlook. Corporate revenue growth and profit margins are shrinking, so earnings growth next year is expected to be spotty. If the next administration establishes economic growth as a top priority, business and consumer sentiment will lift the economy to three to four percent growth rather than the one to two percent level with which the country has been saddled.

Fixed income investors have little hope of acquiring a satisfactory yield on their current purchases in any sector of the bond market. With interest rates still declining and quality spreads narrowing, it is difficult to make a convincing case for even maintaining an investor's customary weighting of bonds. One other well publicized trend is the massive re-allocation of investor funds from equity mutual funds to bond funds. The obvious goal is to earn a modest increase in income. The risk of a far larger decline in principal may result if interest rates rise or if spreads return to historic levels.

**Changes to Consider -** Here are several standard year-end reminders. If you have IRAs and have reached 70 ½, you must take your Required Minimum Distribution (RMD) based on the total of all of your IRAs before the end of the year. Another suggestion is to take advantage of any capital losses carried forward by offsetting them with gains taken earlier in the year or gains realized before year-end. You may also be able to write-off as much as $3,000 of losses on your income taxes if you prefer. The exclusion is $13,000 per person if you are making gifts to children or grandchildren. Remember your favorite charities as well. Many have been struggling since the Great Recession and will be most appreciative of your support. Charles Schwab has reminded us they must be notified by December 7th to allow sufficient time to complete any gift transfers of securities in kind to other broker/dealers. Cash gifts may be made later but they should be received and cleared by the recipient prior to December 31st. Be sure to check with your accountant or tax adviser regarding all of these matters.

Enjoy your Thanksgiving and have a happy Holiday Season. JML