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2013 AND BEYOND

By Loren Kayfetz, President, CERTIFIED FINANCIAL PLANNER®

That we have entered a period of volatility in financial markets is already old news. Ever since 2008, wide swings have occurred, sometime daily, weekly or even over several months. In every case, there are the pundits, experts, naysayers and soothsayers, all with knowledge of the coming apocalypse or shining golden era. We believe in neither case.

Personal Financial still believes in some fairly basic assumptions. Our clients want to both eat well AND sleep at night. So we look at the financial world and tune out the current noise. What we see in trends, both those that will affect us short term and longer term, is a continued transition from a US centric economic powerhouse to many emerging world financial leaders. And, while our convictions are based upon empirical data, it is often difficult to see beyond one's current frame of reference.

> Our clients want to both eat well AND sleep at night.

The US will continue to struggle with a heavy load of debt, an aging population, and an unwillingness to come to terms with the consequences of both. While there will be growth and continued opportunity, there will be constraints on the ability of businesses to thrive. So we continue to take a world view. 2013 will, with plenty of bumps in the road, be a progressive time.

Consumers drive economic growth to a great extent. Those with income will spend it to improve their circumstances. The growth of middle class in Asia, Central and South America, as well as Central and Eastern Europe will continue to command our attention. So we will continue to emphasize these regions for 2013 and beyond.

Many investors have concerns about fixed income. Due to the nature of bonds, there is concern that when interest rates and inflation rise, that bonds as a class will be losers. Indeed, strictly high quality US Government Bonds and Corporate Bonds will be adversely affected. But there is an extensive array of fixed income options, including Sovereign Bonds, High Yield, Emerging Market Debt and Municipal Bonds that act differently under

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COME SEE OUR NEW DIGS!

OPEN HOUSE PARTIES THROUGHOUT FEBRUARY

STOCK MARKETS AND PRESIDENTIAL ELECTION CYCLES

By Erin Hadley, Certified Financial Planner®

It's a new year, that time when many of us feel a renewed sense of optimism and possibility. Resolutions are made and our sights turn to the future. So, as we look to the year ahead, what might we expect in the economy and financial markets?

The uncertainty of the presidential election is behind us and our elected representatives came to an agreement on the fiscal cliff issues that had been hanging over us all. Regardless of how we feel about the results of these, we can look back through history to examine how markets have performed following these various outcomes.

Consider that, in the period between 1900 and 2008, according to Ned Davis Research, the Dow Jones Industrial Average (DJIA) has performed better when the incumbent party won the presidential election, with an average annual return of 15.1% (vs. -4.4% when the incumbent lost.) And this has been the case regardless of party. Average return during election years overall has been 7.6%. Additionally, in the period between 1961 and 2010:

- The S&P 500 index has had an average return of 21.3% with a Democrat in the white house and a Republican Congress.
- This is better than the 12.1% return in which the white house and Congress were both controlled by the same party, and far better than the 7.1% when either party was in the white house & Congress was split.
- But the greatest difference has been between our current situation and the reverse case of a Republican president with a Democrat Congress, which has averaged only 4.5%.

> ...between 1900 and 2008... the Dow has performed better when the incumbent party won the election.

What about over the next four years? According to David Kaas of Seeking Alpha, "going back to 1965, the S&P 500, on average, has performed better with a Democrat in the White House than with a Republican. The average annual compounded gain for the S&P 500 with dividends included, equaled 10.9% under a Democrat President, versus 7.3% with a Republican President."

This is not meant to imply that presidential cycles predict or explain market performance, rather it is presented to serve as context; we will know soon enough whether or not the future follows the patterns of the past. And while informative, we should also examine our expectations of the financial markets by examining our current economic environment.

As always, there is no shortage of pessimism to be found in the news. It is easy to point fingers at how bad things are and how slowly the economy is recovering; and while it is true that we still have a way to go, we are in a recovery. GDP growth continues at about a 2% rate, not incredible, but positive. Lipper just released their latest data on equity fund inflows: it was the highest since 2001.

U.S. non-farm payrolls increased slightly more than

expected in December and the unemployment rate held at a four-year low of 7.8%. Jobs are continuing to be created each month (not enough to replenish the supply of jobs to those currently unemployed, but it is going in the right direction.) U.S. non-farm job reports over the past two months showed gains in payrolls, working hours and earnings and small business optimism rose in December, higher than expected (from Scott Minerd of Guggenheim Partners.)

As of this writing, the Dow is up 2.93% year-to-date, the S&P 500 is up 3.22%; while it won't always be rosy, we're off to a promising start.

2013 TAX CHANGES

By Nicole Hanson, Certified Financial Planner®

It felt for a moment like staring into the abyss but we did not fall off the Fiscal Cliff!

The showdown, which lasted until the 11th hour (and technically, a little beyond), was unpleasant to watch and both sides left the negotiations unhappy. However, the resulting tax changes are fairly moderate and you may be surprised to find that your 2013 taxes are not substantially higher than they were last year unless you sold a home or a great deal of investment assets. Here is the bad news and good news for taxpayers in 2013:

The Bad News
If you are a high-income household making more than $400,000 (single) or $450,000 (married filing joint), your tax bracket will be up to 39.6% from 35%.
Those in the new high tax bracket will also be subject to a capital gains rate of 20% (up from 15%) as well as the 3.8% Medicare Surtax.

The "Payroll Tax Holiday" has ended and so payroll taxes will increase from 4.2 to 6.2%.

The Pease itemized deduction phase-out is reinstated and the personal exemption phase-out will be reinstated. The thresholds are $300,000 for married filing joint, $275,000 for head of household, and $250,000 for single. If you make above those amounts your itemized deductions and personal exemption will be reduced.

The top estate tax rate will be increased from 35 to 40%.

The wage ceiling on which Social Security is taxed has been increased to $113,700. Medicare tax is unlimited, but if you earn more than $200,000 an additional 0.9% will be withhold.

The Good News
Congress permanently indexed Alternative Minimum Tax (AMT) for inflation. This prevents 60 million Americans from being hit by AMT.

The annual gift exclusion was raised from $13,000 to $14,000.

The $1,000 child tax credit and $2,500 tax credit for college tuition have been extended for 5 more years.

IRA-to-charity exclusion from taxable income remains, including a special provision that allows transfers made in January 2013 to be treated as made in 2012.

The $5 million federal gift tax, estate tax, and generation-skipping transfer tax exemption was made permanent and indexed for inflation.

COMMON INVESTOR MISTAKES (AND HOW TO AVOID THEM) PART 2 OF 3

By Dr. Brad Klontz, Psy.D., Certified Financial Planner®

""…inbred human propensities to swing from euphoria to fear and back again seem permanent… generations of experience do not appear to have tempered those propensities…"

- Alan Greenspan, Economist and former Chairman of The Federal Reserve

When it comes to investiAng, we are our own worst enemies. Rather than being dependent on quantitative financial realities, markets are driven by cognitive biases and human emotions. When we are excited and see others making money we want to dive in. Whether it is a rare tulip bulb in 1670 Netherlands, a 2000 internet stock, or a 2006 piece of prime real estate in Florida, when we feel like we are missing out, it makes us crazy. When we follow our instincts, we just can't help buying high.

When we sense impending doom we feel implored to sell and pull all of our money out of the market. Financial planner across the country received sell-it-all-now calls from client as "fiscal cliff" madness hit the airways. Prudent planners suggested to clients that they not engage in reactionary investing and stay put. As it turned out, the anticipated crash didn't materialize, and instead, we saw large stock market gains as the markets breathed a collective sigh. The prudent planner, however, did not take credit for timing the market correctly. He or she knows that the markets could just as easily have dropped. Boring as it sounds, the prudent planner's recommendations are the same in market bubbles and market crashes: develop a strategy to meet your goals, invest and diversify accordingly, rebalance and adjust along the

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various scenarios. We continue to believe that fixed income is an appropriate and significant part of any investor's portfolio.

Whether you are happy or not with the results of the recent elections in the US, the fact remains that we have, as a free, democratic society, chosen our leaders. They will lead, and along the way, more "crises" will occur. None, in our view, merit drastic action. Does that mean we are not active? Of course not! Each of our client's situations will continue to be reviewed and refinements recommended as needed. The best course of action is to expand our vision beyond today.

Health, happiness and all the good things that life can bring you in this new year!

COMMON INVESTOR MISTAKES (continued from pg. 3)

way, and stay the course. As boring as it sounds, the prudent planner's recommendations are the same in market bubbles and market crashes: develop a strategy to meet your goals, invest and diversify accordingly, rebalance and adjust along the way, and stay the course. Studies have shown conclusively that market-timing efforts are losing strategies. If you are lucky, you may guess correctly once, twice, or even three times. However, with market timing, it is not a question of if you will lose, but when and how big.

In my last article, I explored the common investing mistakes of overconfidence, reference point fixation, and playing with the house's money, and how they wreak havoc on investor portfolios. What follows are several other mental mistakes afflicting investors:

Seeking pride and avoiding regret
Researchers have identified what has come to be called the "disposition effect." In an effort to feel good about their financial acumen, investors have a tendency to sell winning positions, even when they shouldn't. In an effort to avoid feeling like an idiot, investors also have a natural inclination to avoid realizing a loss, even when they should. As such, when left to their own devices, investors will off-load their winning positions to lock in a gain and cling tightly to their losing positions, waiting for the stock or asset to come back to where it "should be." The disposition effect adds to an undisciplined, market-timing approach with negative tax consequences (higher taxes in capital gains and missed opportunities to harvest tax loses).

> In an effort to avoid feeling like an idiot, investors also have a natural inclination to avoid realizing a loss...

Risk aversion
Suffering a financial loss can be downright disturbing. In our December 2012 study published in the *Journal of Financial Therapy* ("*Financial Trauma: Why The Abandonment of Buy-and-Hold in Favor of Tactical Asset Management May be a Symptom of Posttraumatic Stress*") my Kansas State University colleague Dr. Sonya Britt and I measured symptoms of posttraumatic stress in financial planners in the wake of the 2008 financial crisis. Ninety-three percent of the financial planners we studied were experiencing medium to high levels of posttraumatic stress. Big financial losses can be traumatic. The experience of a traumatic event can result in changes in one's belief structure in an effort to avoid further traumatic experiences. After a financial loss, some investors become much less willing to take risk. As a result, they may sell at the bottom of the market when they realize avoiding regret is impossible, and be on the sidelines when the market inevitably turns upward. The Great Depression led to an entire generation of risk avoiders, many of whom, with their cash stuffed under their mattresses, missed out on one of the biggest bull-run in history. Since hitting a bottom in March 2009, the market has more than doubled. Investors who exited the market in the wake of the 2008 crisis, missed out on the subsequent market recovery.

Trying to break-even
Sometimes a financial loss creates a feeling of desperation in the other direction. Rather than avoiding risk, some investors double-down in an effort to make-up their losses. Research has shown that the desire to break even after a financial loss can be even more powerful than the impulse to avoid taking necessary risk. This effect has been illustrated at the horse race track, where gamblers take more long shot bets at the end of the race day, and at the Chicago Board of Trade, where traders who lose money in the morning increase the riskiness of their investing later in the day. Losing our heads in an attempt to break-even results in compounded losses and an eventual decision to excessive risk avoidance in this generation or the next (where children and grandchildren experiencing the effects of high financial risk-taking can develop an excessive risk avoidance).