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# Peering Over the Fiscal Cliff

**October Market Review From Your Portfolio Management Team—November 9, 2012**

Well, after seeing over $6 billion spent on campaigning and ads, the nation has decided to leave things pretty much as they were before the election. Barack Obama will serve another term as President, the Democrats will continue to control the Senate, while the Republicans will continue to control the House of Representatives. Our sympathies go out to those who live in the swing states and had to endure the incessant television and radio ads. Now we can go on with our lives.

But, of course, no sooner do we begin to take down the campaign signs that dot the neighborhoods and highways do we come face to face with a looming economic disaster—the so-called 'Fiscal Cliff.' It's amazing how quickly concepts and phrases can bubble up into the lexicon. At the beginning of this year, no one had ever heard of this concept; however, if you Google that phrase today, you will get over 100 million references.

As we mentioned briefly in last month's Update, the Fiscal Cliff represents the dual whammy of automatic tax increases, coupled with government spending cuts that are slated to take effect after January 1. Beginning on January 1, the tax cuts put in place by George W. Bush in 2001 are set to expire unless Congress votes to modify or extend them. Republicans and Democrats are at odds (no surprise here) with Republicans wanting to extend the tax cuts while the economy remains sluggish or make them permanent for everyone. Democrats, including the President, want families making more than $250,000 annually to pay at the rate before the Bush tax cuts went into effect. With only seven weeks left in the year, many observers are skeptical that the lame duck session of Congress (which includes the members who have just lost their re-election bids) will be able to take action before year end. This would leave it to the new Congress to take fast action and pass some modifications or all taxpayers could face higher taxes—not a healthy outcome for our economic recovery.

Secondly, as a result of the debt ceiling debacle from 2011 when Congress and the President could not agree on extending the debt ceiling, they agreed to a set of draconian spending cuts with the expectation that Congress would be able to get together and come up with some type of compromise. The spending cuts are across the board and hit entitlements such as Medicare, as well as, defense. The cuts were meant to be severe enough that even the uncompromising and intransigent Congress would be able to agree on cuts less draconian. Well, here we are in early November, and there is no compromise or even discussion among the parties. Obviously, the election has been distracting everyone until now, but there are a number of tough issues to decide, and Congress is setting itself up for another game of 'kick the can down the road.'

Between now and early next year, we will hear even more about this issue as time is growing short to address this problem. At stake is the health of the economy, as most economists believe that if no changes were made to either taxes or spending, the economy would slip back into recession. That is an outcome that neither political party wants to see.

What is interesting is that the stock market has performed so well this year, even though this cliff was looming on the near horizon. Apparently, investors are taking the position that at the eleventh hour, Congress and the President will do the right thing and take the steps necessary to keep us from going over the ledge.

**What does this mean for you?**

In our more conservative strategies (Income, Income & Growth, and Conservative Growth), we have continued to make our investment focus in various bond funds, with relatively modest allocations to stock funds. As a result, those accounts are more insulated in case no compromise is made and stocks are sold.

For those of you in our more aggressive strategies (Tactical Growth and Core Equity), we have increased our allocation to stock funds in response to the rising trend from the overall stock market. On the other hand, we have some of the holdings in more defensive areas, such as health care, utilities, and REITs, reflecting some concern over the sluggish economy, as well as, the uncertainty brought on by this issue.

The stock and bond markets will be focused on the negotiations and wranglings going on here in Washington over the next few months. At this point, investors seem to believe the politicians will work out a reasonable compromise; however, we want to make sure we have some cushion in place in case Congress stumbles and sends us over the Fiscal Cliff.