2013
Financial Market & Tax Outlook

Presented by:
Dan Zude, CFP - Northwest Bank & Trust Company
Glenn Blair, CPA - Blair, Thomsen & Company

February 7, 2013
What we discuss today is the law in effect as of TODAY.
Patient Protection & Affordability Act (Obama Care)

Additional Medicare Tax on Wages and Earned Income

- .09% on wages over $250,000
- Withholding begins at $200,000
- It does not increase the employer portion
- On combined husband and wife wages
- Applies to self-employment income
- Of course – a new IRS form
3.8% Tax on Investment Income

- Includes: interest, dividends, royalties, gain on sale of investments, and passive rental income
- Kicks in at $200,000 /single; $250,000 /married
- Lesser of income over above amounts or the investment income
- What is passive rental income?
- Personal residence misconception – only if gain exceeds exclusion amount
- Of course – a new IRS form
Increase in Medical Haircut

- From 7.5% to 10%
- Starts in 2013 except for people 65 already – then in 2017
## American Taxpayer Relief Act

**Add an Additional Tax Rate of 39.6%**

*Single Individuals - $400,000*

<table>
<thead>
<tr>
<th>If taxable income is:</th>
<th>The tax will be:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not over $8,925</td>
<td>10% of taxable income</td>
</tr>
<tr>
<td>Over $8,925 but not over $36,250</td>
<td>$892.50 + 15% of excess over $8,925</td>
</tr>
<tr>
<td>Over $36,250 but not over $87,850</td>
<td>$4,991.25 + 25% of excess over $36,250</td>
</tr>
<tr>
<td>Over $87,850 but not over $183,250</td>
<td>$17,891.25 + 28% of excess over $87,850</td>
</tr>
<tr>
<td>Over $183,250 to $398,350</td>
<td>$44,603.25 + 33% of excess over $183,250</td>
</tr>
<tr>
<td>Over $398,350 to $400,000</td>
<td>$115,586.25 + 35% of excess over $398,350</td>
</tr>
<tr>
<td>Over $400,000</td>
<td>$116,163.75 + 39.6% of excess over $400,000</td>
</tr>
</tbody>
</table>
American Taxpayer Relief Act

Adds an Additional Tax Rate of 39.6%

Married Couples Filing Jointly - $450,000

If taxable income is:

- Not over $17,850
- Over $17,850 but not over $72,500
- Over $72,500 but not over $146,400
- Over $146,400 but not over $223,050
- Over $223,050 but not over $398,350
- Over $398,350 but not over $450,000
- Over $450,000

The tax will be:

- 10% of taxable income
- $1,785 + 15% of excess over $17,850
- $9,982.50 + 25% of excess over $72,500
- $28,457.50 + 28% of excess over $146,400
- $49,919.50 + 33% of excess over $223,050
- $107,768.50 + 35% of excess over $398,350
- $125,846 + 39.6% of excess over $450,000

Heads of Household - $425,000
Increased Capital Gains Rate of 20%

But Not for Everyone

• See income levels on previous slide

• If less than that, keeps 15% or 0% rates
However, You Can Lose Deductions at Lower Levels

• Phase out of itemized deductions – previous law
  ♦ Lose up to 20% of deductions
  ♦ AGI limits $300,000 for married; $275,000 for heads of household; $150,000 for single

• Phase out of personal exemptions – see above income levels
New Estate and Gift Tax Rules

• Keeps the $5,000,000 unified exclusion
• New tax rate of 40%
• Makes portability permanent – merely file the form – change estate planning
• Lifetime gift tax exclusion is also $5,000,000
• Both are indexed to inflation
• Current year per donee gift tax exclusion is now $14,000
Other Provisions Extended for One Year

- IRA gifts to charity
- State and local sales tax deduction
- Teacher supplies deduction
- Mortgage insurance premium deduction
Some Provisions Made Permanent

- Child Tax Credit – but refundable portion is extended to 2017
- Earned Income Tax Credit – but the enhancement expires in 2017
Other Items of Note

- New and improved Schedule D
- New and improved Form 8949
Qualified Joint Venture

- New on Schedule E
- Only for spouses jointly owning income producing property
Charitable Deduction Caution

David Durden v. Comm 2012-140

- David and his wife gave approx. $22,000 to their church
- Name of the church is “Nevertheless Community Church”
- Church gave them a receipt and they deducted the donation on their tax return
- IRS disallowed the deduction because of a flawed receipt – it did not include the words “no goods or services were given in consideration for the contribution”
- LOOK AT YOUR RECEIPTS!
Tax Items that Affect Everyone

- Charitable Deductions
- Job Hunting Expenses
- Mortgage Refinance Fees
- Forgotten Medical Expenses
- Iowa Section 529 Plan
- New Scam
Javier & Maria A Padilla v. Comm. TCS 2012-70

- IRS disallowed a $30,000 independent contractor payment for lack of substantiation
- Taxpayer took IRS to Court
- Taxpayer prepared Form 1099-MISC
- He also brought in another person
- Judge asked who guy was. Answer: the guy I paid the money to
- Judge asked the person if true. Answer: yes
- Judge allowed the deduction
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Economy... Steady as She Goes

- Unemployment on the decline
- Muted expectations produce good stock gains
- Most of the “fiscal cliff” is avoided, for now
- Debt ceiling cliff looms
U.S. Stocks Advance Again - Up 16%

- April payrolls disappoint
- China cuts growth estimate
- Greece & Spain worries rise
- S&P downgrades 9 EU nations
- May payrolls disappoint
- ECB announces bond purchases
- Health care legislation upheld
- July payrolls upside surprise
- President Obama reelected; focus shifts to fiscal cliff
- Optimism re: fiscal cliff; good housing data
- Fiscal cliff uncertainty

January
February
March
April
May
June
July
August
September
October
November
December
2012 Total Returns for Market Indices (%)
As of December 2012

- MSCI Emerging Markets: 18.64%
- EAFE: 17.90%
- Russell Mid Cap: 17.28%
- DJ Wilshire RESI: 17.12%
- Russell 1000: 16.42%
- Russell 2000: 16.35%
- S&P 500: 16.00%
- Barclays High Yield: 15.8%
- Barclays Muni Agg: 6.78%
- 10-Year Treasury: 4.41%
- Barclays Agg: 4.22%
- 30-Year Treasury: 2.70%
- Barclays US Treasury: 1.99%
- S&P GSCI: -0.26%

ECB Ignites “Risk On” Rally
High Quality Earns Its Keep
Consumer Stocks Lead the Way
Defensive Sectors Lag

S&P 500 Sectors

Financials: 27.2%
Discretionary: 21.7%
Telecom Services: 17.0%
Health Care: 16.5%
S&P 500: 14.1%
Industrials: 13.3%
Materials: 13.0%
Info Tech: 12.4%
Staples: 9.9%
Energy: 2.5%
Utilities: -0.1%
Lost Decade! What Lost Decade?

10-Year Total Returns for Market Indices (%)
As of December 2012

Emerging economies continue to lead the way but U.S. indices are gaining ground

... and high quality fixed income turns in a solid performance.
Operation “Twist” has Mixed Impact on Rates

- Treasury’s efforts to lower rates on the long end of the curve are modestly successful.
- Curve remains steep but low, anchored by a zero Fed funds rate.
- Risk of a sharp imminent rise in long term treasury rates remain low. We expect the 10 year to trade in its current range of 1.75% - 2.75%.

<table>
<thead>
<tr>
<th>US Treasury</th>
<th>3-M</th>
<th>6-M</th>
<th>2-Yr</th>
<th>5-Yr</th>
<th>10-Yr</th>
<th>30-Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yield as of Dec 31, 12 (%)</td>
<td>0.05</td>
<td>0.11</td>
<td>0.25</td>
<td>0.72</td>
<td>1.78</td>
<td>2.95</td>
</tr>
<tr>
<td>Yield as of Nov 30, 12 (%)</td>
<td>0.08</td>
<td>0.13</td>
<td>0.25</td>
<td>0.61</td>
<td>1.62</td>
<td>2.81</td>
</tr>
<tr>
<td>Yield as of Dec 31, 11 (%)</td>
<td>0.02</td>
<td>0.06</td>
<td>0.25</td>
<td>0.84</td>
<td>1.88</td>
<td>2.89</td>
</tr>
<tr>
<td>2012 YTD Change (bps)</td>
<td>0.03</td>
<td>0.05</td>
<td>0.00</td>
<td>-0.11</td>
<td>-0.10</td>
<td>0.06</td>
</tr>
<tr>
<td>2012 YTD Return (bps)</td>
<td>0.11</td>
<td>0.16</td>
<td>0.28</td>
<td>2.63</td>
<td>5.31</td>
<td>4.98</td>
</tr>
</tbody>
</table>
Spreads Compress Again in 2012 as Tailrisks from Europe and the Fiscal Cliff Subside

[Graph showing the comparison between High Yield and Investment Grade spreads from 2007 to 2012, with a significant drop in 2012 indicated.]
Portfolios: Great Risk. Adjusted Returns.

- **Conservative Growth Portfolio**: 40% Stocks, 60% Bonds
- **Balanced Portfolio**: 50% Stocks, 50% Bonds
- **Growth & Income Portfolio**: 70% Stocks, 30% Bonds
- **Growth Portfolio**: 90% Stocks, 10% Bonds

Adjusted Returns:
- Conservative Growth Portfolio: 9.57
- Balanced Portfolio: 12.18
- Growth & Income Portfolio: 14.09
- Growth Portfolio: 15.89
Key Economic Themes

Now, Here comes the Sun?

1. Employment
2. Inflation
3. Fed Policy
4. Housing
5. Gross Domestic Product
1. Employment: Getting Over the Hump

- Payrolls holding steady at 153,000 per month
- Companies now hiring enough workers to keep up with labor force growth but high productivity is a headwind
- Initial jobless claims fall to lowest level since January of 2008 last month
- Increase in participation rate will keep the unemployment rate high but falling by year end
Labor Force Participation is Below Trend

Actual

Trend

%

%
Employment: Leveling Off

Claims Signaling Better Employment Prospects Ahead

Initial Claims

![Graph showing initial claims over time from 1967 to 2012. The graph indicates a general leveling off in claims with fluctuations throughout the years.]
Employment: Job Creation

Unemployment Rate

Change in Non-Farm Payrolls - ‘000 (Right Axis)

Unemployment Rate - % (Left Axis)
2. Inflation: Not a 2013 Problem

- CPI 1.7% vs 3.1% in 2011.
- Core CPI unchanged from last year and below Fed target of 2.0%.

No prospects for inflation:
- Slack labor market
- Subdued wage growth
- Stable commodity prices
- Household deleveraging

We see inflation rising slightly by year end as 2nd half growth improves.

<table>
<thead>
<tr>
<th>Year</th>
<th>Blue Chip consensus</th>
<th>Our forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>2.7%</td>
<td></td>
</tr>
<tr>
<td>2010</td>
<td>1.6%</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>3.1%</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>1.7%</td>
<td></td>
</tr>
<tr>
<td>2013 Est.</td>
<td>2.0%</td>
<td></td>
</tr>
</tbody>
</table>
Consumer Prices

Year-over-Year % Change

- Headline CPI
- Core
U.S. Average Hourly Earnings

Year-over-Year % Change – Seasonally Adjusted

2008 2009 2010 2011 2012 2013
Velocity of Money

Printed but Not Being Spent

Latest: 1.57%
Excess Reserves of U.S. Depository Institutions

Billions of Dollars

2003 2005 2007 2009 2011
What Could Boost Velocity?

Continued Expansion of Bank Lending

[Graph showing the YOY change in bank lending from 2004 to 2012 with a peak of 5.11% around 2008 and a downturn thereafter.]

YOY Change in Bank Lending


-10 -5 0 5 10 15 %
High Inflation Not an Immediate Concern

- Disposable Income Growth
- Nominal GDP Growth
- Money Multiplier
- Home Price Growth
- Bank Credit Growth
- Headline CPI Inflation
- Core CPI Inflation

1974-1975
1979-1981
Today
3. Fed Policy

- Persistent high unemployment, a moderate growth outlook, and contained inflation will keep the Fed on the sidelines for the foreseeable future.
- Bond buying (QE) will continue into 2014 in order to keep mortgage and other borrowing rates low.
Breaking News - Fed Defines Full Employment and Price Stability as:

- **Full Employment**: Jobless rate of 6.5% or less
- **Price Stability**: Inflation rate of 2.5% (or maybe slightly higher).
- **Implications**: No rate hikes until the unemployment rate declines to 6.5%
  OR
  Inflation gets out of control
Jobs Numbers May Mean Low Rates for Years

150,000 Jobs per Month vs Labor Force Participation Rate

<table>
<thead>
<tr>
<th>Years to 6.5% Unemployment</th>
<th>Participation Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>62.6</td>
<td>0.67</td>
</tr>
<tr>
<td>62.8</td>
<td>0.83</td>
</tr>
<tr>
<td>63.0</td>
<td>1.75</td>
</tr>
<tr>
<td>63.2</td>
<td>3.17</td>
</tr>
<tr>
<td>63.4</td>
<td>4.75</td>
</tr>
<tr>
<td>63.6</td>
<td>6.58</td>
</tr>
<tr>
<td>63.8</td>
<td>8.75</td>
</tr>
<tr>
<td>64.0</td>
<td>11.5</td>
</tr>
<tr>
<td>64.2</td>
<td>15.92</td>
</tr>
<tr>
<td>64.4</td>
<td>17.92</td>
</tr>
</tbody>
</table>
Jobs Numbers May Mean Low Rates for Years

Levels of GDP vs Unemployment Rate

Years to 6.5% Unemployment

<table>
<thead>
<tr>
<th>GDP Level</th>
<th>Years to 6.5% Unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.25% - 2.75%</td>
<td>5.8 Yrs</td>
</tr>
<tr>
<td>2.76% - 3.25%</td>
<td>2.5 Yrs</td>
</tr>
<tr>
<td>3.26% - 3.75%</td>
<td>2.0 Yrs</td>
</tr>
<tr>
<td>3.76% - 4.25%</td>
<td>1.3 Yrs</td>
</tr>
</tbody>
</table>
4. Housing: Stage Set for Dramatic Turnaround

- Housing related activity remains far below its “bubble” peak of 2006.

**BUT**

- National Association of Home Builders Index is now at its highest level since April 2006.
- Starts rose in December to an annual rate of 954,000 units – highest level since June 2008.
- Housing affordability index remains high.
- Excess supply shrank significantly in 2012.
Housing Activity Has Large Multiplier Effect Across Economy

Transactions
- Banks
- Attorneys, Appraisers
- Title & Mortgage Insurers
- Realtors

New Homes
- Homebuilders / Construction Workers
- Timber / Building Materials
- Land Sales

Existing Homes
- Remodeling / Renovation
- Building Materials
- Contractors
- Electrical & Mechanical

Household Durables
- Furnishings
- Carpeting / Flooring
- Appliances
Housing Starts

Housing Starts Highest Level Since June 2008

Single Family
Multi Family
Total

Million

2.5
2.0
1.5
1.0
0.5
0.0

Housing: Prices Rise Dramatically

% of Zip Codes with Positive HPA


%
Housing: Months of Supply

Excess Supply Continues to Dwindle

- Months Supply
- Existing Homes
- New Homes


Months Supply
Housing: Affordability

Yet Affordability Remains High
Housing: Something’s Gotta Give

- Housing Starts
- Household Formation
- Demolitions*

* Assumed demolition rate of 300,000 per year
5. Gross Domestic Product (GDP)

- Hangover from the European recession, hurricane Sandy, and the fiscal cliff slows first half growth.
- China, Emerging Markets and even Europe become tailwinds by year end (global growth 3.5%).
- Second half acceleration as signs emerge that fiscal restraint will be mostly delayed and moderate.

Blue Chip consensus 2.0%          Our forecast 2.2%

- Baseline Scenario: Gradual economic improvement over the course of 2013.
- Housing
- Manufacturing
- Employment
- Energy
Focus has Shifted Away From the Fiscal Cliff
2/3 has Been Dealt With

Components of the Fiscal Cliff (4.4% of GDP)

- Bush Tax Cuts – Wealthy (0.5%), $81
- Payroll Tax Cut (0.6%), $126
- Unemployment Insurance (0.2%), $35
- Sequestration (0.5%), $87
- Alternative Minimum Tax (0.7%), $106
- Healthcare Tax Increases (0.1%), $24
- Other (0.3%), $50

Headwind
- Bush Tax Cuts – Middle Class (0.5%), $187

No Longer a Headwind
Leading Economic Indicators - % Change

Positive:
• Unemployment Claims
• Stock Prices
• Building Permits

Negative:
• Manufacturing
• Capital Goods Orders
First Half - Trendless Indicators

Economic Indicators Scorecard

- Strong
  - Corporate
  - Capital Expenditure
- Weak
  - Manufacturing
  - Employment
  - Global

- Recent Trend
  - Worse
  - Better

- Recent Trend
  - Credit/Banking
  - Consumption
  - Housing
Second Half - What Could Go Right in ‘13

Improving Housing Market
- Added to GDP for the first time in 6 years in 2012
- Usually the first sector to lead out of a recession
- Average level of starts employs 2 million people

Rising U.S. Energy Production
- 2011 exports more than imports for 1st time since 1949
- 1,000 more oil rigs now than in 2009

U.S. Manufacturing Renaissance
- Becoming cheaper to bring production to the U.S.
Summary – Our Outlook

- Payroll numbers will grow but overall unemployment rate will only fall slowly.
- Excess capacity and lack of wage pressure keeps inflation in check.
- High unemployment and benign inflation allow the Fed to keep rates low for a long time.
- Housing recovery gains steam to finally become net contributor to GDP.
- U.S. shakes off cliff hangover in the 2nd half. Growth accelerates but another year of 2.0 - 2.5% growth.
Our Playbook!
Understand US Economic Cycles

Knowing where you are in the economic cycle can tell you a lot about how a particular stock will perform.
**Mixed Trends But Signs of Improvement**

### Phases

<table>
<thead>
<tr>
<th>RECOVERY</th>
<th>BOOM</th>
<th>SLOWDOWN</th>
<th>RECESSION</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Activity rebounds (GDP, IP, incomes, employment)</td>
<td>• Growth peaking</td>
<td>• Growth moderating</td>
<td>• Falling activity</td>
</tr>
<tr>
<td>• Credit begins to grow</td>
<td>• Credit growth strong</td>
<td>• Credit tightens</td>
<td>• Credit dries up</td>
</tr>
<tr>
<td>• Profits grow rapidly</td>
<td>• Profit growth peaks</td>
<td>• Earnings under pressure</td>
<td>• Profits decline</td>
</tr>
<tr>
<td>• Policy still stimulative</td>
<td>• Policy neutral</td>
<td>• Policy contractionary</td>
<td>• Policy eases</td>
</tr>
<tr>
<td>• Inventories low; sales improve</td>
<td>• Inventories, sales grow, equilibrium reached</td>
<td>• Inventories grow; sales growth falls</td>
<td>• Inventories, sales fall</td>
</tr>
</tbody>
</table>

**Graphical Representation**

- **U.S.**
  - Recovery
  - Expansion
  - Contraction

**Relative Performance of Economically Sensitive Assets**

- Green = Strong
Economic Cycles and Market Sectors Work Together… Conclusion

- Activity rebounding
- Credit growing
- Inflation low

- Profits growing
- Policy stimulative
- Cyclical stocks strong
**“Put Me In, Coach”**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Early</th>
<th>Mid</th>
<th>Late</th>
<th>Recession</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financials</td>
<td>+</td>
<td></td>
<td>--</td>
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<tr>
<td>Consumer Discretionary</td>
<td>+</td>
<td></td>
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<tr>
<td>Technology</td>
<td>+</td>
<td>+</td>
<td></td>
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<tr>
<td>Industrials</td>
<td>+</td>
<td>+</td>
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<tr>
<td>Materials</td>
<td>+</td>
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<td>+</td>
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<tr>
<td>Consumer Staples</td>
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<td>Health Care</td>
<td></td>
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<td>Energy</td>
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<td>Telecom</td>
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<td>Utilities</td>
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<td>Stock</td>
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<td>---------------</td>
<td>---------------------------------------------------------------------------</td>
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</tbody>
</table>
| Lowes         | Consumer Discretion | • Has lagged Home Depot  
• Obvious beneficiary of improved housing market |
| Comcast       | Consumer Discretion | • Potential to increase prices  
• Ability to monetize NBC Universal content to cable |
| Danaher       | Industrials   | • Long history of growth both organic and through accretive acquisition   |
| United Tech   | Industrials   | • Goodrich acquisition paying off  
• 22% EPS estimate for 2013 |
| Boeing        | Industrials   | • Dreamliner entering its profit cycle  
• Airline industry beginning a major upswing |
Equity Market Forecast

**Economy:** Modest but sustainable growth, accommodative Fed policy and low inflation are positive for stocks

**Valuation:** Price to earnings ratios have risen but remain below average

**Profits:** Profits will grow at around an 8% annual rate to 108.00 to 109.00 of S&P earnings

**Wild Cards:** ❓❓❓
### Valuations Suggest Now Good Time to Buy

#### Average Annualized S&P 500 Price Returns (%)

<table>
<thead>
<tr>
<th>S&amp;P 500 P/E Entry Level</th>
<th>1 Year</th>
<th>2 Year</th>
<th>3 Year</th>
<th>5 Year</th>
<th>10 Year</th>
</tr>
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<tbody>
<tr>
<td>&lt;8</td>
<td>13.6</td>
<td>10.6</td>
<td>8.5</td>
<td>10.2</td>
<td>11.1</td>
</tr>
<tr>
<td>8-10</td>
<td>8.3</td>
<td>10.9</td>
<td>12.3</td>
<td>12.0</td>
<td>9.0</td>
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<tr>
<td>10-12</td>
<td>12.3</td>
<td>12.9</td>
<td>11.5</td>
<td>8.0</td>
<td>8.3</td>
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<tr>
<td>12-14</td>
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<td>8.8</td>
<td>6.7</td>
<td>6.2</td>
<td>7.4</td>
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<tr>
<td>14-16</td>
<td>11.4</td>
<td>7.3</td>
<td>6.5</td>
<td>6.8</td>
<td>6.5</td>
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<tr>
<td>16-18</td>
<td>3.3</td>
<td>1.8</td>
<td>2.3</td>
<td>3.1</td>
<td>2.6</td>
</tr>
<tr>
<td>18-20</td>
<td>3.5</td>
<td>3.4</td>
<td>3.5</td>
<td>4.0</td>
<td>3.1</td>
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<tr>
<td>20-22</td>
<td>2.4</td>
<td>5.8</td>
<td>7.4</td>
<td>8.2</td>
<td>6.2</td>
</tr>
<tr>
<td>22-24</td>
<td>-4.8</td>
<td>4.2</td>
<td>7.2</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td>&gt;24</td>
<td>-3.3</td>
<td>-2.5</td>
<td>-2.9</td>
<td>-0.7</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

Now Tech Bubble

---

Average Annualized S&P 500 Price Returns (%)

<table>
<thead>
<tr>
<th>S&amp;P 500 P/E Entry Level</th>
<th>1 Year</th>
<th>2 Year</th>
<th>3 Year</th>
<th>5 Year</th>
<th>10 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;8</td>
<td>13.6</td>
<td>10.6</td>
<td>8.5</td>
<td>10.2</td>
<td>11.1</td>
</tr>
<tr>
<td>8-10</td>
<td>8.3</td>
<td>10.9</td>
<td>12.3</td>
<td>12.0</td>
<td>9.0</td>
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<tr>
<td>10-12</td>
<td>12.3</td>
<td>12.9</td>
<td>11.5</td>
<td>8.0</td>
<td>8.3</td>
</tr>
<tr>
<td>12-14</td>
<td>8.9</td>
<td>8.8</td>
<td>6.7</td>
<td>6.2</td>
<td>7.4</td>
</tr>
<tr>
<td>14-16</td>
<td>11.4</td>
<td>7.3</td>
<td>6.5</td>
<td>6.8</td>
<td>6.5</td>
</tr>
<tr>
<td>16-18</td>
<td>3.3</td>
<td>1.8</td>
<td>2.3</td>
<td>3.1</td>
<td>2.6</td>
</tr>
<tr>
<td>18-20</td>
<td>3.5</td>
<td>3.4</td>
<td>3.5</td>
<td>4.0</td>
<td>3.1</td>
</tr>
<tr>
<td>20-22</td>
<td>2.4</td>
<td>5.8</td>
<td>7.4</td>
<td>8.2</td>
<td>6.2</td>
</tr>
<tr>
<td>22-24</td>
<td>-4.8</td>
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<td>7.2</td>
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</tr>
</tbody>
</table>

Now Tech Bubble
Wild Cards – Yes, No, Maybe

• **January Effect - Positive**
  - As the first five days of January go, so goes January. As January goes, so goes the entire year.
  - This indicator is correct over 85% of the time and is very positive for 2013.

• **Election Cycle - Neutral**
  - First two years typically the slowest for the markets averaging a little over 3%.
Stocks – Lower Risk, Lower Return

• We look for the S&P 500 to be trading at approx. 14.5 times earnings by year end as we expect little multiple expansion.

• Last year we forecast 101.00 of S&P earnings on a multiple of 14 times for a 2012 price target of 1414 and 12.4% return. Actual was 1426 close and a 13.4% return.

• Based on earnings of 108.00 and applied to a 14.5 earnings multiple, we project a 1566 S&P 500 level and a stock market return of approx. 9.8% at year end 2013.
Equities: Attractive Source of Income

Percentage of S&P 500 Stocks with Dividend Yields Greater than the 10-Year U.S. Treasury Yield

Caution
The Search for Yield

- Stocks are not Bonds!!!
- Preferred Stocks are not Bonds
- REITS are not Bonds
- MLPs are not Bonds

Bond Attributes

1. They are less volatile

<table>
<thead>
<tr>
<th></th>
<th>Annualized Return</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Stocks</td>
<td>5.1%</td>
<td>16.1%</td>
</tr>
<tr>
<td>U.S. Dividend Stocks</td>
<td>6.6%</td>
<td>14.9%</td>
</tr>
<tr>
<td>REITs</td>
<td>8.9%</td>
<td>22.7%</td>
</tr>
<tr>
<td>U.S. Bonds</td>
<td>6.0%</td>
<td>3.5%</td>
</tr>
</tbody>
</table>

2. They mature eventually!
Bond Market Due to Break

Stock Inflows

Bond Inflows

$Mil

2008 2009 2010 2011 2012
Muted Volatility in 2012

S&P 500 Daily Price Volatility

<table>
<thead>
<tr>
<th>Year</th>
<th>Calendar-Year Trading Range</th>
<th>Average VIX Index Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-Term Average</td>
<td>28 pps</td>
<td>21</td>
</tr>
<tr>
<td>2011</td>
<td>21 pps</td>
<td>24</td>
</tr>
<tr>
<td>2012</td>
<td>17 pps</td>
<td>18</td>
</tr>
</tbody>
</table>
Don’t Get Scared INTO the Market Either!

2009  +26.46
2010  +15.06
2011  +2.11
2012  +16.00

Only 2 down markets in the last 11 years!
Average Frequency of Market Corrections

- **5%**: 3 Times Per Year (5% correction from 1420 = 1349)
- **10%**: Once Per Year (10% correction from 1420 = 1278)
- **20%**: Once Every 3.5 Years
Fixed Income as a Shock Absorber

<table>
<thead>
<tr>
<th>Percentage Allocation</th>
<th>Annualized Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Stocks</td>
<td>9.91%</td>
</tr>
<tr>
<td>80% Stocks, 20% Bonds</td>
<td>9.40%</td>
</tr>
<tr>
<td>60% Stocks, 40% Bonds</td>
<td>8.71%</td>
</tr>
<tr>
<td>40% Stocks, 60% Bonds</td>
<td>7.83%</td>
</tr>
<tr>
<td>20% Stocks, 80% Bonds</td>
<td>6.77%</td>
</tr>
<tr>
<td>100% Bonds</td>
<td>5.54%</td>
</tr>
</tbody>
</table>
Action Step

Schedule a portfolio review today with your investment professional and get your portfolio on the road back to balance.

Contact Cody Allen at 563.388.2628

Thank you for joining us!