New England GUILD
Wealth Management & Investment Advisors

Wealth Management Commentary

PROTECTING AND BUILDING YOUR FINANCIAL FUTURE

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Market Spotlight

	Returns			
	Qtr	Annual		
	4TH Qtr	YTD	3 YR	10 YR
Index				
S&P 500	-0.4%	16.0%	10.9%	7.1%
Russell 2000	1.9%	16.4%	12.3%	9.7%
MSCI AC World exUS	5.9%	16.8%	3.9%	9.7%
MSCI AC World	2.9%	16.1%	6.6%	8.1%
REITs	2.0%	18.9%	17.0%	10.6%
Barcap Agg. Bond	0.2%	4.2%	6.2%	5.2%
90 Day T-Bills	0.0%	0.1%	0.1%	1.7%

Despite a fog of uncertainty in Washington, DC and Europe, 2012 returns for both US and international equities will be a tough act to follow. Although the S&P 500 was slightly negative for the quarter, it managed to return 16% for the year. REITs and emerging markets were the 2012 asset class leaders; while stocks with a value-bias outpaced growth. Government bonds saw modest gains this year while bond sectors such as high yield, corporate and emerging markets were best performers.

Investors began the New Year with a familiar list of macroeconomic fears: US fiscal problems, European debt crisis, slower growth in China and conflict threats in the Middle East. The "fiscal cliff" was avoided with a last minute deal that clarified tax rates but delayed action on bigger issues. Postponing action on spending cuts has set the stage for more brinksmanship over the budget and debt ceiling that could lead to market volatility in the coming months. Although the bill extended tax cuts for most, it increased taxes for others and allowed the payroll tax holiday to expire for all workers. This is expected to have a negative effect on near term consumption and economic growth in the first half of the year.

On a positive note, stronger consumer and corporate balance sheets along with significant pent up demand, particularly in the cyclical auto and homebuilding sectors, could help the economy weather the slowdown and allow growth to accelerate in the second half of 2013. Business spending on technology could also help to pull the business cycle forward while subdued inflation will keep products affordable. The real engines of growth will continue to be emerging market economies - creating wealth, jobs and income to spend.

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Investment Commentary

Sell Certainty; Buy Bewilderment

Recent events in our lives make us all the more aware of how quickly things can change. The shootings in Newtown, CT, came out of nowhere. Devastating tsunamis, hurricanes, tornadoes, droughts, floods – now seem ever more common. The fall of the USSR, the decline of the Japanese economy, the demise of Lehman Brothers and Merrill Lynch – all make us aware of the mortality of structures that appear so permanent. Not all change is adverse. For years it has been generally accepted that the U.S. would someday run out of oil, yet with new technology we are now on verge of oil self-sufficiency. GE is now building new manufacturing plants in the U.S. Even fiscal cliffs can have a way of disappearing if/when we put our minds to it.

There is a message here, one that is not new but has been tested over the eons. Change is inevitable, for better or worse. We are struck by the words of the 13th century Muslim poet and Sufi mystic, Rumi, who said, "Sell certainty, buy bewilderment." Expect the unexpected. Do not take anything for granted. Stay alert. Be open to opportunity.

This is a theme that can apply to many, if not all, aspects of our lives. Obviously we choose here to interpret it in an investment context. We at The Guild are fond of saying that "every asset exists to satisfy a need for cash." Assets must be managed mindful of the factors that might influence the client's future needs for cash. We employ several strategies to do this: we try to understand as much as we can about future needs (hopes); we diversify risks as prudently as we are able; we stay alert to change, whether to the capital market environment or to our clients' individual circumstances; we try to err on the side of more conservative outcomes; we moderate expectations; and we adapt as change occurs. The idea is to reduce the probabilities and/or consequences of adverse outcomes.

We also benefit from the use of financial planning software that has proven helpful in understanding the sensitivities of the basic assumptions we use to assess individual circumstances with particular focus on what happens if bad things happen. By way of example, we establish a base case of a couple in their mid-60's, just retired, with $1 million of financial assets with a home worth $400,000 all paid for, income of $25,000 per year from Social Security and $25,000 from a pension and total spending of $100,000 per year. We use macro assumptions of an investment return of 6.5%, inflation of 3%, and a 20% tax rate. Our base case suggests this couple will have adequate means to live out their days without changing their lifestyle. Their net worth, currently at $1.4 million will be $1.5 million in 10 years and $1.3 million after 20 years.

	Net Worth (millions)		
	Current	**2022**	**2032**
Base Case	$1,400	$1,509	$1,257
a. If inflation rises to 4%		1,507	1,052
b. If investment return @ 5%		1,352	890
c. If a sudden market drop of 20%		1,166	670
d. If spending higher by 10%		1,362	811
e. If spending lower by 10%		1,654	1,703
f. If retirement delayed by 5 yrs		1,574	1,323

We would make the following observations from the data: The impact of higher inflation (scenario (a)) worsens over time. Lower investment returns (b) and/or higher spending (d) increase the rate of withdrawal as a percentage of assets and therefore erode the asset base more quickly. A sudden, early erosion of asset values (c) also increases the withdrawal rate and erodes capital. Actions taken by a client to either reduce spending (e) or increase income (d) can have a dramatic impact on future financial well-being. Obviously these alternative scenarios are within normal error ranges;

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more dramatic changes and/or combinations of the alternative assumptions can worsen outcomes dramatically.

The good news is that while we cannot control what happens in a macro sense, it is within our control and the client's control to mitigate their impact. This is why financial planning is such a useful tool, not just at the beginning to build an expectation, but on a continuing basis to monitor change and adapt as may be appropriate.

Market Spotlight – *Continued from page 1:*

Uncertainty, as well as the need for complex structural change worldwide, has created one of the more challenging investment environments in decades for investors. With nominal (pre-inflation) interest rates at historical lows, real yields (after inflation) for bonds or cash are very unattractive and in some cases negative. At the same time, fiscal and monetary policies that governments have used since the financial crisis in 2008-2009 carry implications for assets such as stocks (e.g., inflation and volatility).

To avoid risk, many investors have followed the crowds to perceived safety - out of equities and into cash or US Treasury Bonds. German philosopher Goethe once said, "The dangers of life are infinite, and among them is safety." Following crowds today can be as risky as ever, since today's returns from "safe investments" can prevent investors from achieving tomorrow's goals. Dr. David Kelly, Chief Economist for JP Morgan, concurs and recently suggested that the bumper sticker for 2013 should be "Stop waiting for the end of uncertainty!" He also pointed out that current valuation relationships among cash, bonds and stocks are not justified. As importantly, he reminded that patience, discipline and investing in a balanced way help protect against volatility and lead to investment success longer term. "Time and diversification are your friends!" We agree!

Fiscal Cliff Avoided???

January 1, 2013 brought about an end to the political struggle over income taxes going forward; touted as a "permanent" fix. Keep in mind that, in this respect, "permanent" is defined as no automatic changes or phase-outs are scheduled. Lest we celebrate too prematurely, Democrats and the President are insisting on additional taxes in return for future spending cuts. Notwithstanding, the new rules, as applied to individuals, are summarized below: (*Not an all-inclusive list. Feel free to contact us*)

PERSONAL INCOME TAXES

For 2013, Federal income tax rates remain unchanged for individuals with taxable income under $400,000 and joint filers under $450,000. Unlike many tax provisions that key off of Adjusted Gross Income (AGI), the new provisions are based on bottom-line taxable income (i.e., income after exemptions and deductions). Clients above the $400,000/$450,000 threshold will be pay 39.6% on income above these thresholds.

Having just stated the impact on rates, Congress has included two "back door" tax provisions that will result in higher taxes for individuals and joint filers with AGI (note, not taxable income) above $250,000 and $300,000, respectively. These provisions will reduce or completely eliminate personal exemptions and reduce itemized deductions for taxpayers in these brackets.

As to net long-term capital gains and qualified dividends, individual taxpayers with income above $400,000 ($450,000 for joint filers) will pay taxes at 20% on these components of income above the limits. However, only the layer of gains/dividends that cause the taxpayer to exceed the limits will be taxed at the higher rate; amounts under the limits will be taxed at the old 15% rate.

For taxpayers subject to the Alternative Minimum Tax, the yearly income threshold "patch" has been permanently fixed at $50,600 for individuals and $78,750 for joint filers, adjusted for inflation (expected to be $51,900 and $80,750 for 2013). Taxpayers with income over these thresholds will be subject to the AMT computation that may impose additional AMT tax. Taxpayers below these thresholds are exempt from the alternate computation.

FEDERAL STATE TAXES

Estate taxes for individuals with assets less than $5 million ($10 million for couples), remain unchanged at $0. Taxpayers with assets in excess of these inflation-adjusted thresholds will have the excess taxed at an estate tax rate of 40% (compared to the 2012 rate of 35%). The spousal portability provision that existed in 2011/2012 is now permanent allowing a couple the full $10 million exclusion, regardless of asset titling.

GIFT TAXES

The gift tax rate, like the estate tax rate, will be 40% beginning in 2013. The tax is applied only to gifts that exceed the annual, inflation-adjusted gift limitation ($14,000 in 2013) for a recipient. As before, certain payments made on behalf of an individual, properly made, are excluded (i.e., medical expenses, education, etc.).

PAYROLL TAXES

Beginning in 2013, Social security taxes on earned income increases to the old rate of 6.2% on wages up to $113,700. Employees will be assessed an additional Medicare tax of .09% on earnings exceeding $200,000 for individuals and $250,000 for joint filers. Note that employers are required to withhold the additional tax wages exceeding $200,000 regardless of the employee's marital status.

"OBAMACARE" TAX

A new 3.8% surtax on investment income for individuals with income over $200,000 ($250,000 for joint filers) takes effect 1/1/2013.

QUOTE: *"Congress is so strange. A man gets up to speak and says nothing. Nobody listens – and then everyone disagrees."* – Boris Marshalov

Our firm continues to grow by referrals from our clients. Thank you for recommending us.

THE NEW ENGLAND GUILD TEAM

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