The COMPASS Chronicle

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Fiscal Cliff Decision Reached

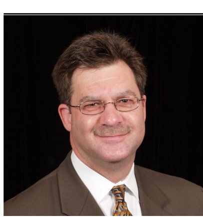
Congress passed the American Taxpayer Relief Act of 2012 on January 1st, 2013, providing taxpayers with clearer expectations about what lies ahead.

Social Security Payroll Tax Reverts to 6.2% from 4.2%: Back in 2010, President Obama and Congress cut the Social Security payroll tax rate for individuals to 4.2% instead of 6.2%. The rate remained at 4.2% for 2011 and 2012, but this cut was set to expire in 2013. Congress' recent vote decided to let it expire, which means that all taxpayers will now pay 2% more in Social Security taxes this year.

Most Bush-era Tax Cuts Extended, Except for the very Rich: In 2001 and 2003, legislation passed under President Bush lowered marginal tax rates for most U.S. taxpayers, reduced dividend and capital gains taxes, and enhanced a number of tax credits. The tax package passed on January 1st, 2013 extends most of these tax cuts for taxpayers with incomes lower than $400,000 (individuals) and $450,000 (married couples). Taxpayers with incomes above the thresholds listed will face a 39.6% tax rate instead of 35%, but only on income that exceeds the thresholds. Their capital gains rate would also increase, from 15% to 20%. Also, a new 3.8% surtax on investment income (to fund Obamacare) will be imposed on individuals making more than $200,000 and married couples making more than $250,000.

Estate Tax Higher, AMT Indexed to Inflation: The inheritance threshold above which the estate tax applies was supposed to revert to $3.5 million instead of $5 million, but according to Congress' decision, it will not. However, above the $5 million threshold, the estate tax rate will now be 40% instead of 35%. Other provisions include that the Alternative Minimum Tax (AMT) would be indexed to inflation, and federal unemployment benefits would be extended for a year.

Advisor Corner



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Monthly Market Commentary

The worst of the fiscal cliff crisis was averted as Congress managed to come to a deal at the eleventh hour. As part of the deal, tax rates will go up for high-income earners, and the payroll tax holiday will expire, affecting income earners across the board. The new tax rates may slow the economy, but also decrease some of the uncertainty. Markets reacted positively, with the S&P 500 jumping more than 4% in the first week of January.

GDP: The third and final estimate for third quarter real GDP growth was revised sharply higher to 3.1%, from an initial estimate of 2.0% and also higher compared with the second quarter real GDP growth rate of 1.3%. This makes it the third-best quarter of the 13-quarter recovery. Consumption and import/export figures were revised upwards, while inventories were less of a contributor than previous estimates.

Employment: In December, 155,000 jobs were added, mainly from strong growth in the health-care and construction sectors. More importantly, hours worked and hourly wage rates were also up. Taking into consideration average hours, average wages, and employment, Morningstar economists believe that total private wages grew at a stunning 0.7% in December (8.4% annualized). Given that there was limited inflation in December, these gains may flow almost immediately to consumers. Going into January, with higher taxes, this large income growth will provide consumers with a substantial cushion. The unemployment rate in December inched up slightly to 7.8%.

Housing: Original housing market forecasts for 2012 ranged from more doom and gloom to minuscule improvements. Instead, the U.S. got a year of considerable advancement, with home inventories down significantly, which has led to higher prices across the board. With inventories so low, it is now difficult to buy a home in many markets, especially on the West Coast. Home builders are also constrained by raw material prices going up, as well as a shortage of construction workers. Morningstar economists believe that home price gains of 5% or more for all of 2012 are pretty much certain, but volume-related housing metrics will slow in 2013 given these supply constraints.

Auto: Auto sales in December were at about 15.4 million units, down slightly from the 15.6 million units sold in November, which benefited from required replacements associated with Hurricane Sandy. The auto industry has been a real plus for the U.S. economy. The durable goods sales category (mainly comprised of autos), has been the single largest contributor to the economic recovery so far. While much of Europe is struggling with declining auto sales, the U.S. managed to pull out another year of very impressive growth.

Retail: Holiday sales (essentially November and December) were up 3.1% from a year ago. Sales in December showed a sharp improvement compared with November, which reflected the impact of accounting for layaway sales, Hurricane Sandy, and the timing of Cyber Monday this year. Overall, the holiday season was good, but not great. Consumer headwinds were substantial, ranging from Hurricane Sandy at the beginning of the season to worries about the fiscal cliff at the end of it. Thankfully, improved consumer incomes, falling gasoline prices, cooler temperatures, and more discounting at the end of the season, all helped boost sales.

Year-end insights: Despite odd weather patterns, presidential election jitters, and fiscal cliff concerns, 2012 was filled with much positive news for the U.S. economy. This included higher oil production, an improved auto industry, decreased commodity prices, and a stabilizing housing market. Unfortunately, the same could not be said about Europe, which entered a recession, or China, whose growth slowed dramatically. The relative strength of the U.S. economy also translated into benefits for consumers, who experienced steady employment growth, stable inflation, rising financial assets, and a nicely improving real estate market.

Life Insurance: Types and Needs

By Louis E. Conrad II, CFA

- Life insurance is one of those financial vehicles that can be used to reduce the financial risk if you are not around long enough to sufficiently fund your family's financial goals.
- If you need life insurance, be sure to pursue it while you are still healthy (insurable) and premiums are more cost-effective.

Despite the end of the Mayan calendar, we are all still here. Yet, as Benjamin Franklin expressed in a letter many years ago, two things are known with certainty: death and taxes. While taxes have been the subject of other articles in The COMPASS Chronicle, including an article regarding the fiscal cliff on page one, this article discusses how you may offset the financial risk of your passing.

Types of Life Insurance

Two general types of life insurance exist: term and permanent.

Term insurance is a policy with a set coverage period, or term, of usually five to thirty years, though some policies may provide the option to extend the original term (known as renewable term). If the insured dies during the term, then the stated death benefit is paid to the policy's beneficiaries. As "pure" insurance, term policies do not provide a buildup of cash value like permanent insurance, but term policies are also less expensive than permanent insurance for a similar death benefit.

Different types of term insurance are available, including:

* Level Premium Term—premiums are fixed for a guaranteed period of time and the death benefit remains constant throughout the policy's term.

* Decreasing Term—also known as mortgage insurance, where the death benefit slowly declines over time, but the premium generally remains level.

* Increasing Term—a rarely used variation of term insurance, which provides a death benefit that gradually increases during the life of the policy. Premiums generally increase as the death benefit increases.

Some term policies have convertible or renewable options at the end of their term. Convertible term policies convert to a permanent insurance policy with a higher premium, but no proof of insurability is usually required at the time of conversion, which normally must occur within a certain time after the policy is issued or before you reach a certain age. Annual renewable term policies usually offer the option to renew your term coverage without a new medical exam. Such policies are initially less expensive, but the annual premiums increase as you grow older. Group policies provided through employers are usually annual renewable term and often do not require proof of insurability.

Permanent insurance can provide coverage throughout your entire life. Such a policy accumulates a cash value, which the owner can access by borrowing through a policy loan or surrendering the policy to receive its surrender value.

Different types of permanent insurance are available, including:

* Whole Life—provides a guaranteed death benefit and cash value for a guaranteed premium, which normally remains fixed. The policy earns dividends, which may increase the tax-free buildup of the policy's cash value and, perhaps, the policy's death benefit. One drawback is that the internal rate of return of such policies may not be competitive with other savings vehicles.

* Universal Life—offers more flexibility than a traditional whole life policy, such as allowing adjustments to premium payments and death benefits, along with the potential for greater growth in a policy's cash value.

* Variable Life—includes an investment component tied to stock and/or bond returns, though returns are not guaranteed.

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Life Insurance: Types and Needs, continued

Permanent insurance is usually appropriate for estate planning needs, such as to pay estate taxes, to fund a special needs trust, to care for elderly parents, to leave a legacy to your children or a charity, or for your final expenses.

How Much Life Insurance Do You Need?

You may see standard formulas used in calculating life insurance needs that suggest having 5 – 7 or 8 – 10 times your annual income in life insurance death benefits. In most situations, I approach a client's life insurance needs differently—focused squarely on reaching their financial goals rather than a multiple of their current income.

Other than where permanent insurance makes sense as indicated above, I often suggest clients consider term insurance that would meet their family's other financial risks and goals, such as to cover (1) mortgages and other debts; (2) educational expenses; and (3) income replacement and retirement needs. This entails creating projections of what these financial risks will be over time and then purchasing term insurance in appropriate amounts to neutralize these risks.

If you have questions regarding your existing life insurance or whether you are adequately insured, please contact us for an insurance analysis.

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