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The Super Bowl of Investing: Fear vs. Faith

by Vinton Fountain

During the recent holiday season, I was blessed to enjoy the company of friends and family. This year, more than any other, I remember the conversations led us to the topic of our collective future as a country. Having just completed an election cycle, the talking points were fresh and full of emotionality.

As I participated fully in the punch-bowl conversations, I witnessed what I believe is the primary issue facing our investment markets in 2013. It is the battle between fear and faith in our future. I am not referring to spiritual faith here, although I would encourage it, but rather faith (belief) in our place in the world. I will call this the "Super Bowl of Investing," and this polarization sets up what is the biggest game of all time.

The good news is that this battle has been around a long time and will always be central to the human condition. Indeed, our country and markets have been traumatized by the oldest trick in the political playbook, scare the heck out of them, and they will act irrationally (based on fear). Robert Frost offered his perspective when he said, "There's nothing I'm afraid of like scared people."

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The politicians, media (TV, radio, internet), book publishers, and product providers have united on the side of fear-mongering in order to accomplish their self-motivated goals. Go to any of these sources and observe how they attempt to take advantage of our precarious situation. You see, fear can be a self-fulfilling prophecy, driving out faith. I do not have the space to document its destruction here.

On the other side, faith (belief) has a quiet game plan that is based upon a basic belief that we will persevere no matter how great the challenges. This team is based on intellectual courage, wisdom, and mental toughness, with a historical record that suggests we will adapt and advance, regardless of difficulties. The history of this country reflects that this team has a very high-winning percentage. Thomas Jefferson framed the battle with, "How much pain they have cost us, the evils which never happened."

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Let's say in the strongest possible terms that I believe we have extremely serious problems in our country. In fact, I would say these structural problems threaten our prosperity more than any time in my lifetime. I am worried, but I believe we will endure and prosper.

The reason I am writing about this now is because we will need this perspective to win our Super Bowl. The war between fear and believing can be and has to be won by belief in ourselves. Now, more than ever, we should be vigilant with courage and confidence. There will be plenty of opportunity for doubt and despair, but our challenge is to choose a healthier outlook. It will allow more happiness, less worry and a better life. That is my promise.

I believe this adversity, and the ultimate sacrifice, will make us stronger than ever. In the Super Bowl of Investing, odds are in the favor of faith, and I suspect it will not be a close game. And most importantly, we have a choice and it is within our control. As Aristotle said, "Happiness depends on ourselves."

It is hard work, but it is the right game plan.

Vinton

The Grand Bargain?

by Buck Beam

Just before midnight on New Year's Day, Congress passed the American Taxpayer Relief Act to avert the "fiscal cliff," and avoid the automatic tax hikes scheduled to take effect January 1. Now that the deal has been struck, I thought we could look at some of the primary tax law changes that will result. (For even more info on this topic, refer to the chart on page 3.)

Income Tax Rates: The maximum rate has increased from 35% to 39.6% for individual filers with income greater than $400,000 and household incomes of more than $450,000. Individuals and couples below these thresholds will not see their federal income tax rate rise. As you will see below, that does not necessarily mean their tax bills are not going up.

Dividends and Capital Gains: Long term capital gains and dividend tax rates will increase from 15% to 20% for anyone in the new 39.6% top bracket. All other filers have been spared an increase in rates on dividends and long-term gains and the 0% rate was preserved for taxpayers in the 10% and 15% brackets.

Estate Taxes: The estate and gift tax exemption was permanently set at $5 million per individual, and will be indexed to inflation moving forward. The top tax rate on estates over that threshold will rise from 35% to 40%. The estate and gift tax remains "unified," allowing an individual to use his or her entire exemption while alive or at death. Additionally, the recently added "portability" of each spouse's exemption to the other spouse was made permanent, effectively raising a couple's exemption to $10 million.

Deduction and Exemption Phase-Outs: Personal exemptions and itemized deductions – including charitable donations and mortgage interest – will begin to phase out for taxpayers with adjusted gross incomes above $250,000 for individuals and $300,000 for couples.

Affordable Care Act: In 2013, two new taxes take effect as a result of the Affordable Care Act. The first is a 3.8% tax applied to net investment income above an adjusted gross income threshold of $250,000 for couples and $200,000 for individuals. The second is a 0.9% tax applied to earned income above $250,000 for couples and $200,000 for individuals.

Other provisions:

Payroll Taxes are being restored to 6.2% from the current 4.2% on the first $113,700 of earnings due to the expiration of the "payroll tax holiday."

The **Alternative Minimum Tax** has been permanently indexed for inflation, so Congress will not need to patch that amount each year.

A **Medicare** "doc fix" was extended for 2013, which will avoid drastic cuts in Medicare payments to physicians.

Tax credits for earned income, children and college expenses have been extended through 2017.

Charitable IRA donations were retroactively restored for 2012 and for 2013. This allows taxpayers 70½ and older to donate up to $100,000 of IRA assets directly to a charity, and to count the donation towards the filer's required minimum distribution (RMD) for the year.

These changes are a lot to take in, and it is difficult to tell how each of us will be affected. We expect more clarity during the year, and we will be working hard to find ideas and solutions for enhancements to portfolio tax efficiency. Taxes are and have always been the highest cost for any investor, and this legislation only makes that more true. Time will tell if we will feel any "relief."

Buck

Disclaimer: *This information is a summary only and is believed to be from reliable sources. Fountain Financial Associates does not give specific tax advice and this should not be construed as such. Sources include the Tax Policy Center and the Senate summary of the legislation.*

Interested in testing your own assumptions?

The Tax Policy Center has devised a calculator to help you crunch the numbers. Find it at **http://calculator.taxpolicycenter.org/**

In and Around the Office

Due Diligence

In December, Vinton, Buck and Chris joined 30 other independent advisors from NC and SC for our annual investment company due diligence meeting in Charlotte. Over two full days, we interviewed 25 different investment companies and their portfolio managers and analysts. In the fall, Vinton attended Fidelity's annual due diligence meeting in Boston, while Buck made a due diligence trip to American Century Investments in NYC. These meetings are a great opportunity for learning and keeping in close contact with the portfolio managers utilized in client portfolios.

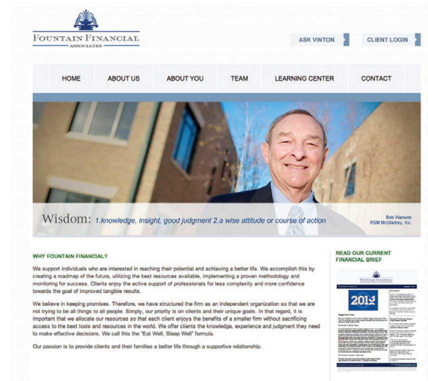
Save the Date

Our 2nd Annual Earth Day Shred Event is scheduled for April 20th. Please keep this in mind as you begin your spring cleaning. More details to come.

New Year, New Look

We are proud to report that we have recently released our new website! Here some of the new features:

- New look with enhanced navigation
- Revised "Learning Center" with timely access to archived newsletters, articles and financial briefs
- Updated client login interface



In Appreciation

Thank you for suggesting friends to receive our newsletter. Visit our "Learning Center" at **www.fountainfinancial.net** for market updates and previous newsletters. We appreciate your feedback.

2013 Tax Changes

(for more in-depth info, see "The Grand Bargain" on page 2)

	2012	2013
Top rate on income[1]	**35%** Income threshold: $388,350 (joint and single filers)	**39.6%** Income threshold: $450,000 (joint) $400,000 (single)
Top rate on long-term capital gains and dividends[1]	**15%** $70,700 (joint) $35,350 (single)	**20%** $450,000 (joint) $400,000 (single)
Net investment income tax[2]	None	**3.8%** $250,000 (joint) $200,000 (single)
Personal exemption phaseout & Pease limit on itemized deductions[2]	None	$300,000 (joint)
Social Security tax, employee share	**4.2%** Earnings up to $110,100	**6.2%** Earnings up to $113,700
Medicare tax surcharge	None	**0.9%** Earnings above $250,000 (joint) $200,000 (single)
Top rate on estates	**35%**	**40%**

[1] Taxable income [2] Adjusted gross income Sources: ***The Wall Street Journal***, Tax Policy Center; Senate summary of tax bill

Words Worth Repeating

It's not that I'm so smart; it's just that I stay with problems longer.

Albert Einstein

Success always comes when preparation meets opportunity.

Henry Hartman

The greatest amount of wasted time is the time not getting started.

Dawson Trotman

Contrary to Popular Opinion

by Chris Riley

The 2007-2008 pullback of global stock markets continues to leave a lasting impression on many investors, resulting in continued anxiety over global markets. Trillions of dollars still sit in low-yielding savings instruments, and while strong demand for the safety of fixed income has driven yields to their current low levels, our goals of buying a home, saving for college, retirement, etc. still require capital growth. But let's face it – we're only human, and the proliferation of bad news has continued over the past four years. It's hard to get behind an opinion that differs from the majority, and we often assume that the consensus view is the correct one. Stock equity outflows continue to be significant, even following a substantial rebound from the 2008 market lows, but history has proven time and again that outflows from equities have preceded some of the best bull markets in our history.

Overall, 2012 results were very good in the face of many challenges. To the surprise of many, two of the best performers in the past year were financial and real estate-related securities. Meanwhile, US Treasuries and CDs continue to see strong inflows at around 1% yields. So what can we all learn from this? Maybe it's that we should look for some less-enamored market areas to include in our allocation plans, and be willing to add to investments when the majority of folks are withdrawing. Now, I know that's not easy and likely never will be! It takes vision, courage and humility to buy assets at low prices; but there is a reward, if patience and diligence are exercised. What could we see take place in the next few years? A rebound in Europe? Stability in Japan? An improved outlook in the US? There is no crystal ball for such predictions, but if the past is any indication, success may be found in the investments that have the most room to improve versus those that have little, if any.

> "The cleverly expressed opposite of any generally accepted idea is worth a fortune to somebody."
>
> **F. Scott Fitzgerald**

A few things that some investors may not be fully appreciating are:

- Unemployment has declined from a peak over 10% to below 8%.
- US household debt has fallen to its lowest level in over 30 years.
- S&P 500 companies' cash as a percentage of total assets is near a 50-year high, and corporate profits have tripled since the 2008 low – back above 2007 levels!

But as anyone will tell you, we have a long way to go! We have massive budget issues, entitlement reform, continued underemployment, global tension, limited resources in the face of an exploding global population, and so much more, to tackle. It is a daunting challenge, but there are many opportunities for progress, very often in places where we least expect them. Looking at the investment process from a contrary viewpoint could prove to be a very profitable decision indeed.

***Sources:** Standard and Poors, Compustat, BEA, JP Morgan Asset Management, US Bureau of Labor Statistics, Federal Reserve.*

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