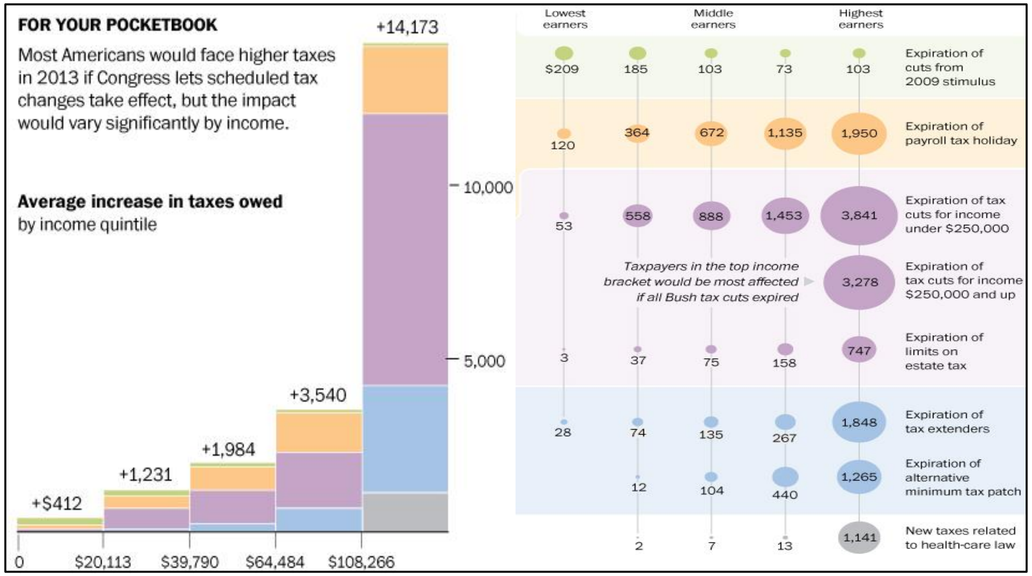
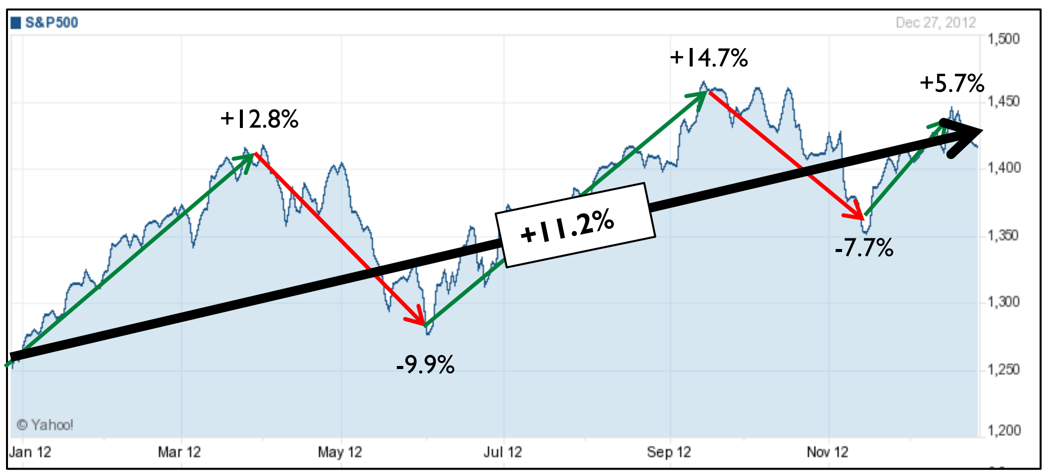
Market Recap

Average Increase in Taxes Owed and Breakdown of Tax Increases



Source: Moody's Analytics; Tax Policy Center

YTD S&P 500



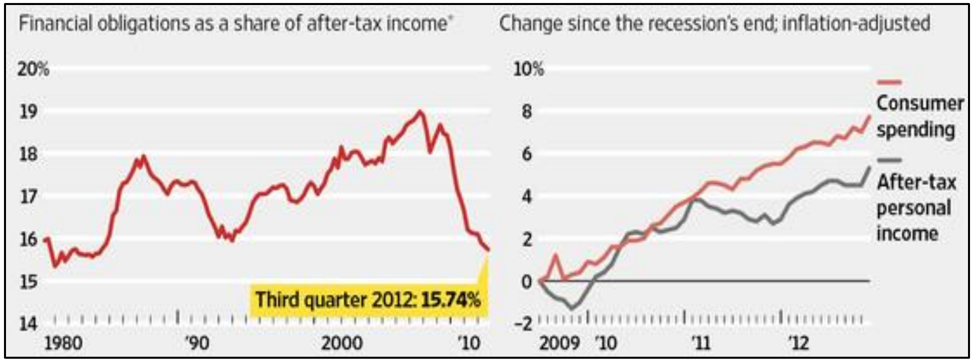
Source: Yahoo! Finance

There are few signs of progress in resolving the fiscal cliff deal before January 1. Taxes on all Americans are set to rise when the low tax rates established during the Bush administration expire. According to the Tax Policy Center, middle income families would have to pay an average of about $2,000 more in taxes next year. Households in the lowest 20% of earners would pay an average of $412 more. The top 20% would pay an average of $14,000 more; the top 1% $121,000 more. More than half of the tax increases would come from the expiration of tax cuts approved in 2001 and 2003 and additional tax cuts in the 2009 economic stimulus plan. About 20% of the tax increase would come from the expiration of the payroll tax cut enacted in 2010. This change would cost someone making $50,000 about $1,000 a year and a household with two high-paid workers up to $4,500. The rest of the tax increase would be derived mainly from the expiration of the most recent alternative minimum tax patch. It is projected that the AMT would impact 30 million Americans, up from 4 million today, if another patch is not introduced.

As 2012 comes to a close, U.S. stock markets have posted solid gains for the year. Investors can reflect on the resiliency of markets in the face of significant macroeconomic and geopolitical uncertainty. Despite the many risks – fiscal cliff, European debt crisis, hard landing in China, and Middle East political unrest - the S&P 500 has returned 11% YTD, excluding dividends. However, the market had significant short-term, sentiment-driven trends along the way. An investor capable of ignoring her emotions and the market trends did quite well if she remained invested throughout the year. Given the significant moves higher and lower, 2012 will likely go on record as being one of the better years for investors who based buy and sell decisions on valuation and not sentiment.

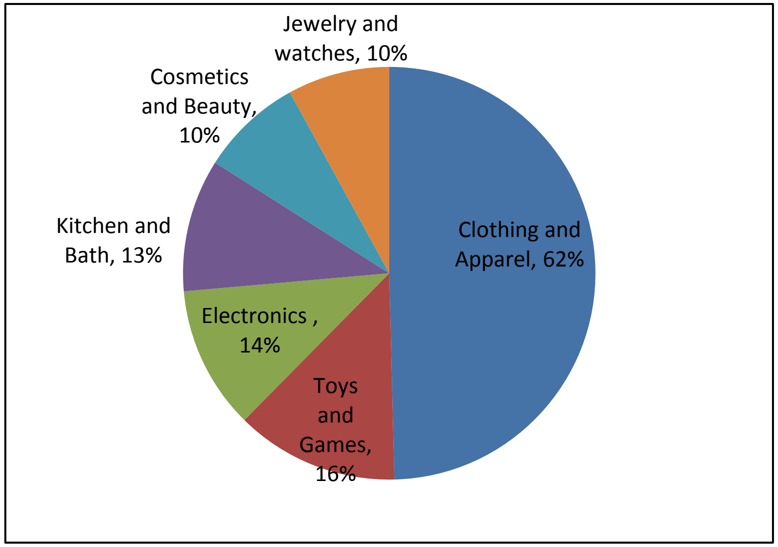
Market Recap

Household Debt and Consumer Spending



Source: Federal Reserve; Commerce Department; WSJ

Christmas 2011 Most Frequently Returned Presents



Source: MarketTools

Household debt payments are at their lowest level in decades. According to the Federal Reserve, households spent 10.6% of their after-tax income on debt payments, the lowest level since 1983. Debt payments are lower due to several factors. After borrowing heavily during the housing boom, many families have devoted much of the past five years to reducing debts and rebuilding savings. Not all such deleveraging has been voluntary. Foreclosures and bankruptcies have played a major role in reducing household debt, while tighter lending standards have made new borrowing difficult for many people. For those who do qualify for loans, record-low interest rates have made it far cheaper to borrow and have allowed millions of families to refinance their mortgages, often significantly reducing monthly payments. Falling debt payments are helping to support consumer spending at a time when unemployment remains high and wage growth is barely keeping pace with inflation. Consumer spending has risen 7.7% since the end of the recession, compared with a 5.3% increase in wages.

With the holiday gift-giving period behind us, much attention for retailers turns to gift card spending and gift returns/exchanges. According to a MarketTools study, apparel accounted for 62% of returned gifts last Christmas. Other presents that customers brought back included toys and games (16%), electronics (14%), and kitchen and bath products (13%). All of those returns can wreak havoc on retailers' bottom lines. Returns are anticipated to be higher this year than in years past. Data from the National Retail Federation shows that returned merchandise is expected to cost retailers about 9.9 cents for every dollar's worth of sales (up from 7 cents per dollar in years past). With holiday sales expected to total about $469 billion this season, merchants will see a reduction in sales revenue of about $46.4 billion when customers want a refund.

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