First Quarter 2013

GALECKI FINANCIAL MANAGEMENT — FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	0.91%	-0.38%	15.98%
Russell Midcap Index	2.25%	2.88%	17.28%
Russell 2000 Index	3.56%	1.85%	16.35%
Dow Jones Industrial Average	0.79%	-1.74%	10.24%
Morgan Stanley EAFE Index	3.21%	6.60%	17.90%
Barclays Aggregate Bond Index	-0.14%	0.21%	4.22%

INDEX RETURNS

The fourth quarter of 2012 was a mixed bag for equities. Domestic stocks were relatively flat for the quarter while international stocks surged.

The S&P 500 was down 0.38% in the fourth quarter but finished the year up 15.98%. Mid-cap stocks as measured by the Russell Midcap Index were up 2.88% in the quarter and finished the year 17.28% higher. Small-cap stocks as measured by the Russell 2000 Index were up 1.85% in the fourth quarter and finished the year up 16.35%. The Dow Jones Industrial Average was down 1.74% in the quarter and finished the year 10.24% higher. After a rough start to the year, International stocks recovered nicely in the final three months. The EAFE index was up 6.60% in the fourth quarter to finish the year up 17.90% and the Emerging Markets index finished the year up 18.63% in 2012.

Bonds were positive in 2012 with the Barclays Aggregate Bond Index rising 4.22%. Global bonds were also positive for the year with the Barclays Global Aggregate Bond Index increasing 4.32%.

ECONOMIC REVIEW AND OUTLOOK

The economy grew in the third quarter at an annualized rate of 3.1%. This was above most analysts' expectations. The early estimates for growth in the fourth quarter are in the 1.5% ï 2.5% range.

The Index of Leading Economic Indicators declined 0.2% in November following a 0.3% increase in October. The Index is positive on a year/year perspective. This is an indication that the economy should continue to see slow economic growth. Industrial production rose 1.1% in November, the most in two years.

The labor market is improving. The ADP jobs report showed that 215,000 jobs were added in December, and the unemployment rate remained at 7.8%. Weekly initial unemployment claims are below the key 400,000 level.

The ISM manufacturing index increased to 50.7 percent in December. A reading above 50 suggests an expanding manufacturing sector. The ISM Non-Manufacturing index came in at 56.1% in December which was 1.4 percentage points higher than November.

U.S. corporations have been running very lean and consumer demand has remained strong. Third quarter earnings came in at $24.36 for the S&P 500 companies. Estimates for the calendar year 2013 are in the $105-$113 range. The forward P/E ratio for the S&P 500 is roughly 13, which is well below the 20 year average of 16.

Housing has continued to be a bright spot for the U.S. economy. Building permits (an indication of future construction) increased 1.1% in November to an annual rate of 899,000. This is 26% higher than the November 2011 number of 709,000. In addition, new home sales rose to an annual rate of 377,000 in November. This is 15% higher than a year earlier and the highest rate since April 2010 when sales were inflated by the $8K credit.

Internationally, things are improving. The European Central Bank offer to be a safety net for sovereign bond purchases has minimized the risk of defaults and a Eurozone breakup. The global manufacturing PMI rose for a third straight month to 50.2 percent, placing it into expansion territory for the first time since May. Japan is making significant efforts to weaken the Yen and stimulate inflation. China's economy is rebounding thanks to government infrastructure spending.

EQUITY AND BOND MARKETS

Since 2007, roughly $1.4 Trillion has moved into bond funds and ETFs. During this time, equity funds have seen outflows of $405 billion. With the 10-year Treasury yield at 1.8% and inflation running around 2.2%, the real rate of return for investing in a 10-year Treasury bond is actually negative.

U.S. equity markets are nearing their all-time highs. Although stocks could be due for a short-term correction with the upcoming debt-ceiling deadline approaching, domestic stocks could reach new highs in 2013. If this happens, additional cash and fixed income could flow into stocks and push them even higher in the second half of the year.

International developed markets appear to be stabilizing and many are sitting at attractive valuations. Sovereign debt will continue to weigh on these developed economies, but stock prices reflect these concerns. Emerging markets finished the year very strong and could resume their upward trend over the next 12-18 months.

Real Estate was one of the best performing asset classes in 2012. Yields have come down on most REITs, but remain significantly higher than equity dividends or fixed income yields. Real Estate domestically and globally could continue to push higher over the next few years as investors search for alternative investments and higher yields.

Most commodities underperformed in 2012. As global demand for commodities waned, prices remained stagnant. The Goldman Sachs Commodity Index was only up 0.26%, while Gold was only up 6.93%. Commodities could recover nicely in 2013 as global demand begins to pick up.

We recommend that you review your overall equity and fixed income allocation to make sure it is appropriate for you given your risk tolerance and time horizon. Remember to keep a long-term focus and not worry about the short-term fluctuations.

PORTFOLIO MANAGEMENT

There was a lot to digest and navigate in 2012. We began the year by wondering if the entire Eurozone was going to break-up and create a global financial melt-down. We did not know if the Euro was a currency that would even survive, let alone appreciate. May brought a 9.9% decline in the S&P 500. The economy slowed to a crawl in the summer for the third year in a row. The election brought significant uncertainty to the domestic economy and markets. And finally, the Fiscal Cliff discussion and media coverage brought confusion and concern.

We continued to believe in our models that stocks were attractively priced. We put our cash to work in June by investing in the iShares Mid-Cap Growth fund. This move was very well timed as we made more than 9% in six months. Our Global Real Estate fund made more than 23% last year. The international investments pushed up hard in the fourth quarter to finish the year with higher returns than our domestic allocation.

The bond side of our portfolio had a tremendous year in 2012. Our bonds returned on average more than 9%. This was helped by a 16% rate of return on our high-yield bond funds, which we sold in November. Our global bonds also had fantastic returns in excess of 14%. Finally, our inverse bonds posted very solid numbers with the rise of inflation expectations. In fact, we like this idea so much, that we added another inverse bond in November. We believe that our fixed income side of the portfolio is well positioned to handle a rising interest rate environment that should arise over the next five years.

FINANCIAL PLANNING

The American Taxpayer Relief Act was enacted on January 2, 2013 by the U.S. Senate. The Act prevented a number of tax increases that were scheduled to go into effect in 2013 and restored many tax breaks that were set to expire. The Act did, however, raise taxes for some high-income individuals. The following is a summary of some of the key provisions of the Act:

Tax Rates: For most, income tax rates will remain at the 10%, 15%, 25%, 28%, 33% and 35% levels. However, a 39.6% rate is now applicable for single filers with income over $400,000 and joint filers over $450,000. Thresholds will be adjusted for inflation in years after 2013.

Personal Exemption Phase-out: The Personal Exemption Phase-out was reinstated for those making more than $250,000 for single filers ($300,000 for joint filers). Under the phase-out, the total amount of exemptions that can be claimed by a taxpayer (over the income thresholds) is reduced by 2% for each $2,500 that the taxpayerôs AGI exceeds the threshold.

Pease limitations to “high-earners”: The previously suspended ñPeaseò limitation was re-instated with an income threshold beginning at $250,000 for single filers ($300,000 for joint filers). For taxpayers subject to the ñPeaseò limitation, the total amount of their itemized deductions is reduced by 3% of the amount by which the taxpayerôs AGI exceeds the threshold. The reduction is capped at 80% of total itemized deductions.

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Capital Gains/Dividend Rates: The top rate for capital gains and dividends will permanently increase to 20% for single filers with income exceeding $400,000 ($450,000 for joint filers). (This does not account for the 3.8% Health Care Surtax.) Capital gains and dividends will remain at 15% for taxpayers in a greater than 25% tax rate but below the $400,000/$450,000 thresholds. Taxpayers below a 25% Federal tax rate will not be subject to capital gains and dividends tax.

Transfer Tax: The $5,000,000 exemption amount for estate, gift and generation-skipping tax was kept intact and will be indexed for inflation. The portability feature will continue, allowing the estate of the first spouse to die to transfer his or her unused exclusion to the surviving spouse. The top estate and gift tax rates were increased from 35% to 40%.

Permanent Alternative Minimum Tax relief: The exemption amount for AMT was permanently increased to $50,600 for single filers and $78,750 for joint filers, retroactive back to 2012. The exemption amounts will be indexed for inflation.

American Opportunity tax credit extended: The American Opportunity tax credit which allows eligible taxpayers to claim a credit equal to 100% of the first $2,000 of qualified tuition and related expenses, and 25% of the next $2,000 of expenses, was extended for five years.

Qualified Charitable Distribution: The ability to make tax-free required minimum distributions from IRAs directly to charity was revived for 2012 and 2013, with a special provision allowing distributions taken in 2012 to be transferred to charities through January 31, 2013. Another provision allows certain distributions made in 2013 to be deemed as made on December 31, 2012. This option is only available to individuals age 70 ½ or older.

In addition to the new tax legislation, the Health Care Surtax of 3.8% went into effect on January 1, 2013. The 3.8% Medicare surtax is applicable to single taxpayers with modified adjusted gross income over $200,000 (joint filers over $250,000). The surtax is assessed on the lesser of; net investment income, or the excess of modified adjusted gross income over the threshold amount.

Starting in 2013, the annual gifting amount was increased from $13,000 to $14,000. If you plan to make gifts, we recommend considering the gifting of appreciated stock in lieu of cash gifts. The 2013 IRA contribution limits were increased from $5,000 to $5,500 with a $1,000 catch-up contribution available for individuals age 50 or older. Additionally, the 401(k) deferral limit was increased from $17,000 to $17,500.

This is merely a brief summary of the numerous tax law changes for 2013. We will continue to update you as we learn of any further revisions and can apply them to your financial plan.

- Galecki Financial Management Investment Committee