DELTA
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Economic Comments

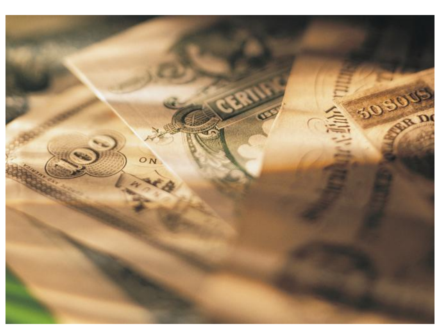
Congress had the opportunity to sharply improve, on a temporary basis, the nationôs budgetary situation by jumping off of the so-called fiscal cliff. Even if a totally inelegant method, going over the cliff would have sharply pushed the federal budget towards being balanced. To our disgust, but unfortunately not to our total surprise, Congress and the Obama Administration proved incapable of crafting a grand compromise to fix the government's rapidly deteriorating financial situation. Instead, they focused on near-term politically palatable fixes.

Once again, the nationôs supposed leaders kicked the financial football further downfield - thereby making the final future resolution of the budget all the more painful when a solution is finally crafted. While income taxes were increased, no action whatsoever was taken on the 800 pound gorilla ð unfunded and out of control federal entitlement spending.

As of early January, the U.S. Treasuryôs borrowing ceiling has been hit and the federal government is only paying its bills through internal juggling of funds. With Republicans refusing to discuss lifting of the credit ceiling without substantial spending cuts and Democrats refusing to entertain any spending cuts despite the debt ceiling, a new political donnybrook will occur within the next several weeks.

In taking the most recent action, legislators and the President acted to appease most voters in the near-term while worsening the longer term economic prognosis. Rather than crafting a new framework where our expenses and income are fairly evenly matched, the decision was made to provide what most Americans want (i.e. lower taxes) rather than what they need (a sustainable and roughly balanced federal budget).

Given the viciousness of the political infighting and the pandering to the nationôs less skilled workers, comparisons to Imperial Rome readily come to mind. The only positive from the year-end legislative action was the establishment of reasonable, and permanent estate/gift tax exemptions of 5.25 million and the restoration of the payroll tax to its prior higher level.



The saving grace in the U.S.ôs ongoing budget fiasco is that in the land of the blind, the one eyed man reigns supreme. As things stand currently, no other major nationôs economic/budget situation is sharply better. In fact, the U.S. has been viewed since the popping of the financial bubble in 2008 as the globeôs safe haven. The unfortunate outcome of this perspective is that this safe haven perspective has allowed the country to continue in its

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profligate ways far longer than it would otherwise have been able to do so.

Shockingly, and despite the slow moving disaster in Washington, the economic prognosis for 2013 is relatively positive. Although negatively impacted by the current budget/deficit stale mate, consumer confidence remained relatively strong in December. In the same vein, December unemployment remained stable at 7.8% with non-farm payrolls adding a respectable 155,000 new jobs. In spite of the Federal Reserveôs continued easy money policies, inflation and core inflation numbers finished the year up only incrementally ð thereby providing additional flexibility to policy makers.

Manufacturing showed renewed strength at yearôs close on the back of new orders, improved employment data and continued export strength ð a marked change from the modest contraction seen in Novemberôs report. In the critical housing arena, homebuilding outlays increased modestly and achieved their highest level in four years. The Federal Reserveôs Open Market Committee further underscored this positive mood in the notes from its December meeting where the committee suggested the possible early termination of the current bond buying program, the so called Quantitative Easing 3 (QE3). Having been adding $85 billion per month to the Fedôs assets, unwinding the Fed Reserveôs now $2.9 trillion balance sheet will create a substantial challenge.

However, the discontinuation of this bond buying program would be the first step towards weaning the U.S. economy off of its drug-like dependency on easy money. By hinting at this action, the central bank was trying to highlight its belief that the economy is no longer needful of massive monetary creation and to psychologically prepare the markets to the quickly approaching removal of this financial crutch. In a new twist, the U.S. central bank for the first time linked its action to a precise unemployment rate. Once the U.S. unemployment falls beneath 6.5%, the Fed plans to discontinue these bond purchases.

Driving additional enthusiasm for the upcoming year is the nascent U.S. housing recovery, the continued natural gas boom, the improved small business credit markets, and robust corporate profit margins. The major caveat is whether Congress and the President can agree to a budget framework that puts the U.S. government on a long-term sustainable trajectory. Economic growth likely faltered in the 4th quarter as the fiscal cliff fight heated up. Our nationôs politicians must reach across the aisle NOW and create a compromise so that both our near-term and long-term economic prospects can remain bright.

Analyst Corner

Several quarters ago, we added Western Union (NYSE: WU) to our firmôs buy list. On our initial evaluation, we were particularly impressed by the strong demand for WUôs services, the companyôs enormous number of agent providers and WUôs attractive cost structure. Unfortunately, following November projections by management of business retrenchment and tepid growth for 2013, the stock shed almost a third of its value. On closer inspection, however, we believe that this downward move was sharp over-compensation for some near-term disappointment and that WUôs core strengths remain undiminished. As such, we have added this holding to a number of portfolios and continue to anticipate attractive, risk-adjusted returns from this unique franchise.

Market Comments

Setting the stage for 2011, U.S. economic growth was on a 2% pace, subpar by historic standards. Overseas, Japanôs economy was on the cusp of another recession, Europeôs economy continued to contract and Chinaôs pace of growth was slowing. Given these factors, poor investor sentiment as 2011 closed was no shock. Despite the many challenges facing the global economy, and with substantial help from the easy money policies of the worldôs central banks, global stock markets provided a pleasant surprise by going on an upward surge during 2012. Emerging stock markets produced gains of 18.2% while developed markets were up 17.3% for the year. On the home front, U.S. markets, the worldôs strongest market of the last several years, lagged the pack ð albeit with a still impressive 16.0% advance.

Driving Wall Street higher was the much, and rightly, maligned financial sector as investors embraced the still risky sector. The market laggard was the recent market star, the utilities sector, with its 2.9% decline as investors focused on tepid demand growth and the likelihood of sharply higher interest rates in the relatively near future.

On the bond front, the U.S. position as an economic safe haven combined with Fedôs enormous bond buying program, the previously mentioned QE3, has kept yields near historic lows for much of the year. As such, the bond market did not take well to the Fedôs year-end hint that its largesse could soon be over. This unanticipated news caused a sharp reduction in Treasury prices with the yield on the 10-year bond rising by 0.30 percentage points, to above 1.9%, in a two day period. Also, weighing on bond yields has been the failure of politicians to agree to a grand compromise on the U.S.ôs budget/ deficit situation.

All of the challenges previously discussed would appear to bode poorly for stocks in 2013. The problem with this conclusion is that history shows that poor economic conditions and even anemic corporate results are not predictive of poor future market returns in any given period. A recent analysis by the Vanguard Group suggests that 45% of market returns are correlated to price/earnings multiples with the remaining performance not being readily predicted by any defined factors!

The take away from this lesson is that even though there are many areas of concern, the markets can still do well in the current, and highly uncertain, environment. 2012 would be a perfect example where global markets performed uniformly strongly in the face of a highly uncertain, if not poor, backdrop.

While not necessarily espousing the belief that stocks will have another strong year in 2013, we do emphatically believe that equities are extremely attractively valued relative to other major investment classes. Based on a number of key valuation metrics, stocks have rarely been valued this inexpensively relative to their primary alternatives of fixed income and cash. That being said, more prudent investors will continue to focus their attentions on maintaining the necessary levels of emergency cash reserves while also seeking, and investing in, an appropriate risk adjusted basket of investment assets.

Performance as of 12/31/12

	Close	Month	1 Year
DJIA	13,104.14	0.79%	10.24%
S & P 500	1,426.19	0.91%	16.00%
NASDAQ Comp.	3,019.51	0.31%	15.91%

	Quarter end yield	Prior Year end yield
10 yr. U.S. Treasury	1.76%	1.87%

Planning Thoughts

Every now and again, the blind squirrel can find an acorn. Not surprisingly, the U.S. Congress in this situation is the fluffy tailed squirrel. Congress did an enormous disservice to the nation by enshrining the Bush era income tax cuts for all but higher earners without addressing the enormous, and rapidly growing, entitlement programs of Medicare, Medicaid and Social Security.

However, as a small sop to rational thought, legislators did finally eliminate a decade of uncertainty created by the temporary and ever changing set of gift and estate taxes. By making a permanent estate exemption of $5.25MM, adjusted for future inflation, all but the wealthiest will be able to protect their assets from estate taxes. Furthermore, estate taxes (above the exemption amount) are now fixed at 40%. Importantly, Congress also enshrined the concept of tax advantaged position for dividends and capital gains by fixing the maximum rates at 20% (along with the new 3.8% Medicare surcharge) which is sharply lower than ordinary income tax rates.

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