**Mark Levy’s Economic Update – Tuesday, January 8, 2013**

The compromise that was reached last week between the President and Congress pushed the equity markets significantly higher over the short term. In simple terms, the Bush era tax cuts were extended for most workers. Americans that earn $400,000 or more ($450,000 for married couples) will see their income taxes increase from 35% to 39.6%. These same high earners will see their capital gain and dividend taxes rise to 20% from 15%.

The measure also caps itemized deductions for those individuals making $250,000 or more ($300,000 for married couples). Though this provision does not actually increase tax rates, its limiting of itemized deductions functions as a de facto tax increase for those subject to it. The compromise also indexes for inflation the estate tax, which goes from 35% to 40% for those with assets in excess of $5.12 million.

So, why did the equity markets rise? They rose because the compromise offered relief from the imminent financial pain that would have occurred should the Bush tax cuts have completely expired along with government spending reductions that the sequester would have initiated.

Looking ahead to 2013, there is more for our government to address. The debt ceiling along with spending will be center stage topics soon. Corporate earnings are also beginning to come in and it will be interesting to see if any collateral damage shows here from the fiscal cliff battle.

The current economic recovery is running at about half the speed of recent recoveries, and the speed of a “normal recovery”. Investor expectations remain low and I believe this is the key to a continuing rising market for equity prices. The famous investor and money manager, John Templeton, said, “Bull markets are born on pessimism, grow on skepticism, mature on optimism and die on euphoria”. At the moment, skepticism seems the order of the day and that should bode well for equity markets for the foreseeable future. Remember, investors that invest relying on emotion generate very poor returns for themselves.

Behind the scenes there is good news. Government receipts vs. expenditures have been improving, the Dow Transportation index is near all-time highs and there are reasons to believe the United States GDP will surprise to the upside over the next few months. If so, equity markets will respond.

2012 was a year of good returns, but lots of fear. We don’t expect 2013 to be much different and we consider that a good thing. - Mark

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