



OAKWORTH
CAPITAL BANK

COMMON CENTS

The election is finally over, and the market has fallen apart since. What in the world is that all about? Aren't stocks supposed to rally after a Presidential election? If so, why is this time different than the past?

Well, this go around, we have something everyone is calling the fiscal cliff looming at the end of the year. This is when all the various tax breaks and credits end, and automatic spending cuts kick in. If nothing happens, if the two sides don't reach a compromise, we could have a wicked way to start 2013. After all, a reduction in disposable income and government expenditures ain't what the Keynesian doctors ordered, and the economy isn't in as good a shape as we would all like.

So what is the hang up? Well, to hear the pundits tell it, the two political parties can't seem to decide on how to tax the so-called rich. This has been a bone of contention for some time, with the GOP coming across as intransigent, and the Administration appearing to engage in some sort of income class warfare. Frankly, it is kind of comical, and I wrote about this very thing in my column in the Montgomery Advertiser last week.

Since I don't feel like reinventing the wheel, let me just give you what I wrote there:

On Wednesday (11/7), the markets sank like a stone. I thought stocks typically rallied after Presidential elections. What gives? Are the markets saying they don't like Obama?

That would be an easy kneejerk reaction to make, but it doesn't hold up too well when you delve into the numbers. After all, just where are the investors? Well, intuitively, people who make the most money will have the most to invest. That makes sense, so what states have the highest incomes?

According to the Census Bureau's data for 2008, the top 10 states in terms of median household income were, in order: 1) Maryland; 2) New Jersey; 3) Connecticut; 4) Alaska; 5) Hawaii; 6) Massachusetts; 7) New Hampshire; 8) Virginia; 9) California, and; 10) Washington. How many of these states voted for Barack Obama? I will save you the trouble of looking it up, and give you the answer: 9. Only Alaska went for Romney.

Even more telling is the estimated popular vote total for the Top 10, according to the election data on foxnews.com on Thursday. It seems the 10 wealthiest states, in terms of median income, placed 15,665,534 votes for Barack Obama, or 58.8%, and 10,963,419 votes for Mitt Romney., 41.2%.

On the flip side, the bottom ten states in median household income, according to the Census, were, in order: 41) Louisiana; 42) Montana; 43) Tennessee; 44) New

Inside this issue:

Something to Think About	1-3
	6-7
Tables & Whatnot	4-5
Disclaimer	5

**True, Heaven prohibits certain pleasures; but
one can generally negotiate a compromise.**

Moliere

Something to Think About, *cont.*

Mexico; 45) Oklahoma; 46) Alabama; 47) Kentucky; 48) Arkansas; 49) West Virginia, and; 50) Mississippi. Of these states, only New Mexico voted for Barack Obama. The rest were red.

In case you were wondering, the estimated popular vote for these Bottom 10 states was: 5,407,304 for Obama, and 8,144,693 for Mitt Romney.

So, if the rich states voted overwhelmingly for President Obama, and the poor states voted, also overwhelmingly, for Mitt Romney, it is hard to say the market's reaction after the election was, or is, simply due to Barack Obama. That wouldn't make much sense. There has to be another reason, and I submit there is.

After months of campaigning, Americans woke up on Wednesday to find nothing really has changed in Washington. If past performance is indicative of future results, we face another two years, at least, of political partisanship when what we need are hard decisions. Unfortunately, neither side thinks the other is capable of leading, so we are back where we started.

You can call it frustration or resignation. You can call it what you will. Where the rubber meets the road, I would argue investors are scared our divided Federal government is incapable of working together, when working together it must.

So, folks in the South would argue, yes, it is Barack Obama's fault. However, folks up North and out West would say it is the House of Representatives fault. The Republicans didn't make a good enough showing for President, just as the Democrats didn't make too much of a dent in the House. Again, we are back where we started, and given public opinion polls from before the election, few are terribly excited about the prospects moving forward.

The biggest hold up to compromise has been how to tax the so-called rich, and neither side has been willing to budge an inch. Now, in what states do most of the rich live? That's right, and, laughingly, who did these states elect for President? Oh yeah.

So, what happens IF the Republicans cave in to the President's demands, and tax rates on the rich go up significantly in 2013? That's right, they will have gotten what they wanted.

And that ain't Barack Obama's fault.

Now, I have been known to get some nasty emails in the past from people who don't, um, appreciate my columns in the paper, and I was surprised to not get any this week. However, the numbers are what the numbers are, and the rich states voted for Obama, whereas the poor states voted for Romney. Why then is the Republican Party seemingly willing to take the economy over the fiscal cliff because it doesn't want to raise marginal tax rates on...the rich?

Not being a politician or even that into politics, it doesn't compute. The GOP is going to fight tooth and nail over not taxing the rich because that is what poor people want it to do? Of course, there are nuances and wrinkles, but that is what the numbers are telling us.

But, with all this talking about taxing the rich, what are we really discussing? Swedish tax rates? You know, it is kind of funny we aren't hearing about the particulars, and do you want to know why? Because neither side wants you to know them! If everyone knew what they are debating, there wouldn't be any more debate, because the public would demand an end to the foolishness.

Yesterday, I read an old-ish article from Forbes magazine addressing this very issue. The writer directed the

Something to Think About, *cont.*

reader to the Tax Foundation's website (taxfoundation.org) to play with an income calculator which shows the difference in taxes between: 1) if we go over the fiscal cliff and all tax breaks end, and; 2) the Republican proposal, and; 3) the Democratic proposal. Being a curious sort, I went there, and, frankly, spent too much time devising various scenarios. I simply had to know what all the fuss is/was about.

When I finished, I typed out my column for this week's Montgomery Advertiser, and, again, instead of reinventing the wheel, here it is:

What is the real likelihood the economy will go over the fiscal cliff at the end of the year? This concern is spooking the markets and impacting business decisions.

I am not a bookie. Still, I believe Washington will come to an agreement by the end of the year, and the US will avoid going over the proverbial fiscal cliff. Right now, there isn't a lot of evidence to support this belief. I simply can't fathom the two political parties being so stubborn as to deliberately engineer an economic slowdown over partisan politics, even though everything suggests they will be.

Call me a dreamer, or hopelessly naïve. However, as I type, this is what I think will happen.

The Administration and the House will come to an agreement which will put a band-aid on the problem. They will pluck the low-hanging fruit, leaving the really hard questions for another day. The tax code will still be a complicated mess, and we will run a sizable deficit next fiscal year as well. Nothing will have fundamentally changed.

Basically, Washington is going to push on a string, barely, and both sides will proclaim a victory of sorts. Shoot, if the powers that be could stick their heads in the sand, they would do so in a second. No one wants to truly flatten and fix the tax code. No one wants to take a chainsaw to various entitlements programs and military spending.

Where the rubber meets the road, no one really wants to change what we are doing; they want the other side to have to change things, and then take the blame when the ramifications happen. In the meantime, the two parties are going to argue over the fiscal equivalent of a bag of peanuts until they are blue in the face. At which time, one side will blink ever so slightly, and both sides will claim victory for "the American People."

So, what is the real hang up? When you see the real differences, you will wonder: All of this heart-ache for that? Consider this: according to the Tax Foundation, a married couple with no dependents, each making \$150,000/year, would have a total 2013 Federal tax burden (income and payroll) taxes of \$97,708 should the Bush tax credits expire at the end of the year.

The Republicans have countered with a proposal that would have this same family pay \$68,711 in income tax and \$18,350 in payroll taxes, for a total of \$87,060. The Administration has proposed they pay \$70,487 in income taxes in 2013, and \$14,284 in payroll taxes, to equal \$84,770. Yeah, you read that right.

If the Tax Foundation's calculator is correct, and I have no reason to believe otherwise as it is a right-leaning group, the current Republican proposal is more expensive for this \$300,000 family than the President's! In fact, the President's proposal doesn't start getting more expensive until household income gets close to \$375,000.

Shoot, even the Administration's proposal is considerably cheaper than letting the Bush tax cuts expire completely! The whole thing is madness; you would hope both parties would realize this, and quit holding the country hostage.

Important Economic Releases

Release	Survey	Actual	Prior	Comments
NFIB Small Business Optimism (Oct)	93.0	93.1	92.8	<p>The thought process is Hurricane Sandy skewed October economic activity, and there is undoubtedly some measure of truth to that.</p> <p>So, we have to take this week's data with a grain of salt. Still, regardless of Sandy, or whatever excuse, the data certainly does NOT suggest the need to manufacture a slowdown in consumer and government spending through the so-called fiscal cliff.</p> <p>As such, take this week's economic releases as another reason Washington will come to a compromise by the end of the year.</p>
Producer Price Index (Oct)	0.2%	-0.2%	1.1%	
Advance Retail Sales (Oct)	-0.2%	-0.3%	1.3%	
Consumer Price Index (Oct)	2.1%	2.2%	2.0%	
Initial Jobless Claims	375K	439K	361K	
Philadelphia Fed (Nov)	2.0	-10.7	5.7	
Total Net TIC Flows (Sept)	\$50.0B	\$4.7B	\$63.5B	
Industrial Production (Oct)	0.2%	-0.4%	0.2%	
Capacity Utilization (Oct)	78.3%	77.8%	78.2%	

Tables & Data Points

<u>STOCKS</u>	Dow Industrials	S&P 500	NASDAQ	Russell 2000	Nikkei 225 (¥)	DJ STOXX 50 (€) Price
12/31/10	11,577.51	1,257.64	2,652.87	783.65	10,228.92	2,792.82
12/31/11	12,217.56	1,257.60	2,605.15	740.92	8,455.35	2,216.55
10/25/12	13,103.68	1,412.97	2,986.12	816.82	9,055.20	2,483.43
11/1/12	13,232.62	1,427.59	3,020.06	827.85	8,946.87	2,533.87
10/25/12	12,811.32	1,377.51	2,895.59	793.65	8,837.15	2,479.13
11/1/12	12,542.38	1,353.33	2,836.94	769.48	8,829.72	2,461.77

<u>BONDS</u>	3-Mo UST	6-Mo UST	2-Yr. UST	5-Yr. UST	10-Yr. UST	30-Year UST
12/31/10	0.13	0.19	0.60	2.01	3.30	4.34
12/31/11	0.01	0.06	0.24	0.83	1.88	2.90
10/25/12	0.11	0.15	0.31	0.82	1.82	2.98
11/1/12	0.09	0.15	0.28	0.74	1.73	2.90
10/25/12	0.09	0.14	0.26	0.64	1.62	2.75
11/1/12	0.08	0.13	0.24	0.62	1.59	2.73

<u>OTHER</u>	Prime	Fed Funds	3-Month LIBOR	Gold/troy oz.	Oil— WIT/brl.	\$/Euro	JPY/\$	\$/GBP	CAD/\$
12/31/10	3.25	0.25	0.30	1,421.40	91.38	1.337	81.19	1.559	0.994
12/31/11	3.25	0.25	0.58	1,566.80	98.83	1.296	76.99	1.551	1.017
10/25/12	3.25	0.25	0.31	1,712.00	86.05	1.294	80.31	1.612	0.995
11/1/12	3.25	0.25	0.31	1,715.50	87.09	1.294	80.13	1.613	0.997
10/25/12	3.25	0.25	0.31	1,726.00	85.09	1.275	79.47	1.599	1.000
11/1/12	3.25	0.25	0.31	1,713.80	85.45	1.275	81.18	1.587	1.001

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Something to Think About, *cont.*

For grins, I ran the numbers all the way up to each spouse earning up to \$3,000,000 in W-2 income per household, and both current Republican and Democratic proposals are preferable to letting the Bush tax cuts expire with a compromise of some sort.

That is the math. Those are the numbers, and our politicians should know them, so perhaps we should relax. They aren't that stupid, are they?

Now, make no bones about it, both parties' proposals are preferable to the fiscal cliff, and they aren't as far apart as the headlines would have you believe! That is why neither party wants you to know it! The Administration doesn't want the public to know the specifics because it isn't as "harsh" on the rich as simply letting everything expire, and that was a pillar of its platform. The GOP doesn't want the public to know because it has made a stink about the Administration gouging the rich, etc.

I mean, tell Joe Sicks Washington is spending all this time, effort, and money over a 1% difference on a family with W-2 income of \$400,000, and he would look at you cross-eyed. Then tell him both proposals on the table are 3% less, total tax bill, than the alternative fast approaching at the end of the year, and he would ask you: "are you kidding me?"

That is why I think we will see a compromise between now and the end of the year. There is no reason NOT to compromise! When the worst case scenario is better than the probable case scenario, which happens how often, decision making becomes decidedly easier.

Of course, there are the proposed spending cuts, but the two sides don't seem to be too far off on those either, as here is what the Wall Street Journal's Damian Paletta and Carol Lee had to say in an article this morning:

Critics of the cuts, which were put in place by last year's Budget Control Act deal to raise the debt ceiling, have said they could derail what remains a weak economic recovery. Democrats and Republicans have separately tried to design plans to replace the sequester....

By postponing the sequester cuts, Washington would essentially push off a number of large deficit-reduction decisions into mid-2013. This would include a long-term plan to replace the remaining sequester cuts, a plan to overhaul the tax code, and separate decisions about how to restructure Medicare and Medicaid.

The plan that has been discussed by White House officials is similar in many ways to what lawmakers have discussed. It would terminate the spending cuts for a period of six to 12 months, and replace the cuts with more targeted reductions and revenue increases. House Republicans have proposed a similar model, though they have called for terminating the cuts to defense programs only and haven't accepted a deal to include tax increases as part of any package.

You can read this another way: neither side really has the stomach to enact spending cuts right now. It would be far, far easier, in so many ways, to push the proposed spending cuts off a few months to have more time to work out a deal. Frankly, I can't imagine Washington NOT doing this; however, the tax code needs to be set moving into 2013, so, again, it is back down to taxes. What is Washington going to do about those? Because the spending cuts they enacted when dealing with the debt ceiling simply aren't going to go through the way they are currently written. Stranger things have happened, but not too many.

With all of this in mind, the markets have stunk, and I mean stunk, as investors wring their hands and gnash

Something to Think About, *cont.*

their teeth over this fiscal cliff mess. As a result, everything is shaping up nicely for a rally after the political gamesmanship ends, and the more we sell-off now, the stronger the rally will be later. In the meantime, folks who were going to take capital gains in December are going ahead and doing it now, making matters that much worse.

That is what is currently going on, to no one's real satisfaction. Strange, isn't it? As, I thought the political process was basically a popularity contest! It seems more like a battle of egos more than anything else, and it is currently costing us a lot of money in lost market capitalization....in fact, quite literally hundreds of billions of dollars since the election.

So, is this time any different than previous times? We shall see, we shall see.