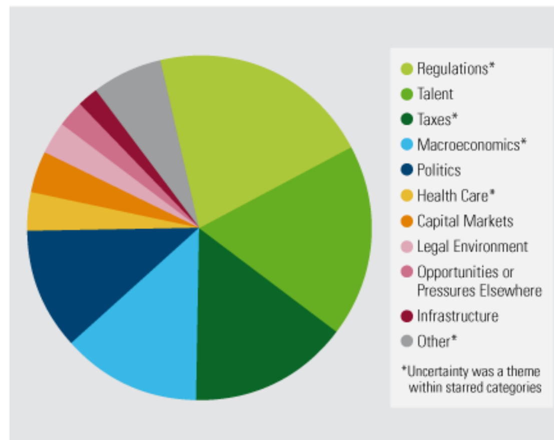
Pettinga Insights and Outlook

April 2012 | Vol. No. 1 | Investment Updates

The Tax Code and U.S. Competitiveness

While investors prepare for tax hikes in 2013, it isn't surprising to learn that taxes have become increasingly important when it comes to the economy and U.S. competitiveness. The Harvard Business School recently published results of a survey on U.S competitiveness, which aims to lay out facts and realities of international competition and implications for the U.S. In October 2011, about 10,000 alumni completed an in-depth survey on U.S. competitiveness. According to the survey, the greatest current or emerging weaknesses are perceived to be America's tax code, political system, K-12 education system, macroeconomic policies, legal framework, regulations, infrastructure, and workforce skills. Respondents were deterred from investing in the United States not only by a high statutory corporate tax rate, but also by the sheer complexity and uncertain future of the tax code.

Most Commonly Mentioned Impediments to Investing and Creating Jobs in the U.S.



Source: "Prosperity at Risk: Findings of Harvard Business School's Survey on U.S. Competitiveness" by Michael E. Porter and Jan W. Rivkin (January 2012).

Pettinga

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Our Firm

Pettinga Financial Advisors, LLC is an independent, fee-only financial services firm serving clients across the nation from our office in Evansville, Indiana.

We offer a no-obligation introductory meeting to interested persons and institutions to determine if we can add value to their individual situation.

Because you receive our services on a fee-only basis, you pay no sales commissions for our investment counsel. Nor do you deal with sales people tied to transaction commissions. Instead, you enjoy a personal relationship with a knowledgeable, unbiased advisor.

Your personal financial advisor focuses on the future you envision and commits to helping you Get There.

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U.S. Stocks and Bonds Before and After Taxes

Pettinga's Tax Efficient Investing 101.

- The most important element of tax-efficient investing is maximizing your qualified retirement plan contributions,i.e., 401(K), 403(b), etc.
- The second element is concentrating less efficient investments, i.e., those that generate taxable interest or high amounts of capital gain, in IRA accounts and qualified plan accounts.
- The third element is avoiding turnover of your portfolio. This has been the most difficult element to control in these highly volatile markets.

Even though investors don't always realize it, taxes can have a dramatic effect on an investment portfolio, especially in today's relatively uncertain tax environment. The tax law enacted in December 2010 was only intended to last for two years, and new changes may be effected in 2013.

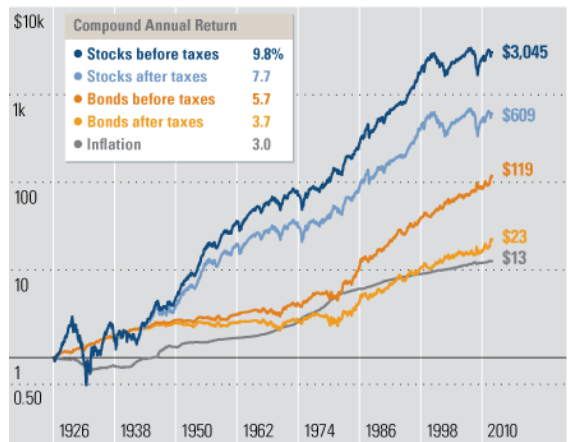
The image illustrates the hypothetical growth of inflation and a $1 investment in stocks and bonds before and after taxes since 1926. Over the long run, the adverse effect of taxes on investment returns becomes especially pronounced. Stocks are the only asset class depicted that provided any significant long-term growth. After considering taxes, government bonds barely outperformed inflation over this time period. In a world with taxes, focusing on fixed-income assets alone has not provided investors with a substantial increase in wealth. If you desire substantial after-tax growth, you may want to consider a larger allocation to stocks. Another alternative, if you are able, is to consider tax-deferred investment vehicles.

Government bonds and Treasury bills are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest, while stocks are not guaranteed. Stocks have been more volatile than the other asset classes.

Federal income tax is calculated using the historical marginal and capital gains tax rates for a single taxpayer earning $110,000 in 2010 dollars every year. This annual income is adjusted using the Consumer Price Index in order to obtain the corresponding income level for each year. Income is taxed at the appropriate federal income tax rate as it occurs. When realized, capital gains are calculated assuming the appropriate capital gains rates. The holding period for capital gains tax calculation is assumed to be five years for stocks, while government bonds are held until replaced in the index. No capital gains taxes on municipal bonds are assumed. No state income taxes are included.

Stocks in this example are represented by the Standard & Poor's 90 index from 1926 through February 1957 and the S&P 500® index thereafter, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Government bonds are represented by the 20-year U.S. government bond, and inflation by the Consumer Price Index. An investment cannot be made directly in an index.

U.S. Stocks and Bonds
Before and After Taxes: 1926–2011



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index.

Monthly Market Commentary

Most of the economic news released during the past few weeks pointed toward slow but steady progress in the U.S. economy, despite some market volatility that was attributed to news out of the Federal Reserve. Markets rallied based on a Ben Bernanke speech that suggested the economy was not out of the woods yet and that quantitative easing remained an option if things worsened. Markets also collapsed on the release of the minutes from the Federal Reserve Open Market Committee, which indicated that the economy was stronger than the Fed had anticipated and offered no hints that more quantitative easing was being considered.

Employment: March saw a disappointing 120,000 jobs being added; the lower number was mainly a result of a large decline in private-sector retail jobs and the continued contraction of the public sector. This is a significant drop from the revised 240,000 jobs in February and revised 275,000 jobs in January. The unemployment rate fell slightly, to 8.2%.

Manufacturing: Manufacturing data in February remained mixed but still showed an improvement from January, at least in terms of durable-goods orders. As export demand weakens and growth slows in the auto sector later this spring, Morningstar economists are not expecting a lot of growth (or declines) from manufacturing in 2012. The economic key continues to remain in the hands of U.S. consumers, with a potential added boost from housing and construction markets.

Housing: Real estate data continued to be relatively inconclusive as abnormal weather wreaked havoc on the data, causing most real estate numbers to show better results on a year-over-year basis than on a month-to-month basis. The Case-Shiller Home Price Index (seasonally adjusted) for the three months ending in January was flat compared with December, while the year-over-year numbers showed some improvement. Month-to-month pending contracts for February were down 0.5% and have now declined for two of the last three months, while year-to-year pending contracts were up a stunning 9.2%.

Although the media remains thoroughly confused, with many outlets featuring month-to-month weakness while others ran headlines trumpeting a new boom based on the year-over-year numbers, Morningstar economists believe that the truth lies somewhere in the middle.

Retail: The International Council of Shopping Centers reported 4.1% year-over-year same-store sales growth in March, matching the gains in February. Warm weather and an earlier Easter helped boost the numbers, with both apparel and department stores showing an improved growth rate.

Quarter-end insights: The first quarter of 2012 saw the U.S. economy gaining strength as other world economies slowed. Morningstar economists believe that slow but steady U.S. GDP growth, moderating inflation, and rising employment growth may be on tap for the remainder of the year. While better employment has helped a number of sectors, including housing, restaurants and even health care, other sectors such as industrials continued to worry about slowing demand from Europe and China. Slowdowns in these regions may be harmful to individual companies but not necessarily to the overall U.S. economy—many of those goods are not produced in the U.S. Overall, companies poised to benefit from a relatively strong U.S. economy with limited exposure to non-U.S. markets may be better performers. This includes small-cap companies that typically had a smaller portion of their revenues from non-U.S. sources. Around the world, government data suggests that China's typical 10% growth rate is likely to fall to 7.5%. A slowdown in China combined with a less generous U.S. Federal Reserve will likely bring in commodity prices, significantly affecting commodity-based economies (such as Australia and Brazil) as well as capital goods-related exporters (such as Germany).

Burst Bubbles

Diversify, Diversify, Diversify.

- At Pettinga, we believe that maintaining a well-balanced portfolio is the best way to avoid the impact of bubbles. This was shown in dramatic fashion during the bursting of the tech bubble. Investors who concentrated their investments in high tech investments sufferred the most while well-diversified investors fared much better.

In the financial world, a "bubble" designates an investment trading in high volume at prices that are considerably higher than its underlying value. Price and value tend to realign eventually through a sudden price drop, known as a crash or a bubble burst.

Two of the scariest bubbles that burst during the last decade were the tech (or dot-com) bubble in 2000 and the housing bubble in 2007. Many fear that inflated oil and gold prices may indicate an impending commodities bubble in the next few years.

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