LADENBURG THALMANN

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Ladenburg Thalmann Asset Management
Post-Election Market Update
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Although the election is over, in many ways very little has changed. After seeing $6 billion spent during the 2012 elections, Barack Obama is still President, Republicans still control the House of Representatives, and Democrats still narrowly control the Senate. Investors have now shifted their focus to the looming fiscal cliff, which could send the U.S. into a recession, if many of the following issues are not addressed:

- Income tax rates for the highest bracket are set to increase from 35% to almost 44% (including new taxes and PPA)
- Many deductions and credits are set to be eliminated (the lifetime tax exemption could drop from $5 million to $1 million)
- Capital gains could increase to 20% and dividend tax rates could reach 39.6%
- Expiration of the payroll tax reductions, causing an increase to Social Security and Medicare
- Expiration of emergency unemployment benefits
- New healthcare reform taxes at 3.8%

Uncertainty surrounding these issues has caused the equity market, as a whole, to experience greater volatility and downward pressure. Specifically, concerns over an increase in the dividend tax rate has resulted in a sell-off in yield oriented equities and we believe the possibility of an increase in the capital gains rate is causing some investors to sell out of equities to realize gains in 2012. Since the election (Nov 7, 2012), the S&P 500 is down -5.09%, (as of Nov 15, 2012). Looking forward, we see 3 likely outcomes for the fiscal cliff's impact on the market:

- **Early compromise:**
  - An early compromise, occurring in early December, would likely extend the Bush tax cuts for households earnings less than $250,000, abandon the sequester on discretionary spending, and possibly slow down the phase-out of the payroll tax cut.
  - This would be positive for markets, but could also cause a surge in capital gains realizations, early dividend payouts, and early payments of annual bonuses, as corporations and upper-income households attempt to avoid paying higher taxes in 2013.

- **Last minute compromise:**
  - A last minute compromise, occurring in late December, would have similar effects to an early compromise, however, this would leave less time for corporations and upper-income households to outline their 2012 distributions and capital gains realizations, causing planning to be a little more speculative.
  - As one would expect, the longer the uncertainty continues, the greater the chance for increased volatility.

- **Late compromise:**
    - A late compromise, one that could be pushed into 2013, would be accompanied by much greater financial market and economic disruption.
    - In the long run, however, a late compromise could result in a positive scenario, as the threat of the expiration of all bush tax cuts may cause Republicans to compromise beyond what they originally planned.

Regardless of the outcome, it is important that any compromise reduce the deficit at a pace that is fast enough to satisfy the rating agencies, but slow enough so that economic growth is not hindered too much in the short term. Any of the above mentioned compromise scenarios could lead to a market rebound, as the fiscal cliff uncertainty would be removed, and investors and corporations would feel more comfortable deploying cash on hand. With Obama still in office, it is probable that the Federal Reserve will keep rates low for a long time and while we may not feel the effects of this immediately, this will likely negatively affect the US dollar and positively affect Gold. This should also benefit fixed income markets, as the Fed continues their quantitative easing efforts.