DOMINION WEALTH
MANAGEMENT

August 2012 Newsletter
Cliffhanger

From the desk of Matt Brennan

George Steinbrenner, the long-time owner of the New York Yankees, passed away back in 2010. While he was a controversial baseball owner and media figure, the man consistently found ways to put a successful (and highly profitable) team on the field. Even in death, George Steinbrenner was successful. By passing away in 2010, George Steinbrenner's state completely avoided Federal Estate Tax. It is estimated that his $1.1 billion estate would have faced federal taxes of almost $500 million had he died the year prior (New York Times – 7/14/10).

And just how did this happen? Congressional gridlock back in 2009 had the unplanned effect of letting the tax lapse altogether and there was a one-time, unlimited estate tax exemption as a result. This year, the estate tax exemption is $5 million. This is set to expire on 12/31/2012 and will reset to $1 million if the Bush Era Tax Cuts are not extended. This is one of several tax increases to go along with several automatic spending cuts that will go into effect come 2013 and that collectively are being referred to as – "The Fiscal Cliff."

You have probably heard a great deal about this "Cliff" in the media over the past few months. It has been the buzzword used to reference the many major fiscal events occurring at roughly the same time. A brief summary –

- Expiration of the Payroll Tax Cut
- Expiration of the Bush Era Tax Cuts
- Expiration of Several Tax Relief Programs
- Healthcare Reform Taxes Go into Effect
- Emergency Unemployment Insurance Benefits Cease
- Automatic $1.2 Trillion Cuts in Domestic & Defense Spending
- Renewed Debate over Raising the Debt Ceiling

On the one hand, the Fiscal Cliff means the Federal Government would actually be in a position to save approximately $600 billion in 2013. On the other hand, the Fiscal Cliff means that we may be on course for a renewed recession. Ben Bernanke has quantified the cumulative effect to cause a 4 ½ % shrinkage in our economy when we can least afford this drastic of a slowdown. To Dominion

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Wealth, the Fiscal Cliff means 'uncertainty' – and nothing more. To clarify, investment markets respond poorly to uncertainty.

We do not see the Fiscal Cliff as any sort of trigger point or catalyst to calamity that you can set your watch to. We see it as one more hole (or holes) in the already weakened dam. We definitely do not see it as rationale for buying lots of stocks.

"Asset Price inflation is not growth" – Keith Mcullough, Hedgeye – 7/30/2012

From the 4th quarter in 2011 through the 2nd quarter in 2012, the S&P 500 is up just over 20%. Over that time period, we have witnessed Gross Domestic Product Growth Figures declining:

4th Quarter 2011 = +4.10% 1st Quarter 2012 = +1.97% 2nd Quarter 2012 = +1.54%

To take you down a path we've walked many times before, "Personal Domestic Consumption represents 70-72% of GDP" (Everybody). The largest segment of our population (the Baby Boom) is entering retirement, paying down debts, and building savings. In short, they are reducing their consumption. During the '08/'09 Credit Crisis and resulting Great Recession, the Government "valiantly" stepped in and bolstered spending to take the place of the frightened consumer. The Government is now facing

1. Slowing Growth
2. The Prospect of a Forced Reduction in Spending
3. Inflation Caused by Qualitative and Quantitative Easing

The consumer is now facing

1. Higher Taxes
2. Inflationary Pressures from Ongoing Stimulus Measures

When both the consumer AND the government tighten the purse strings and reduce spending, it could very well be stocks that wind up going over the proverbial "Cliff."

The logical question one should ask themselves is – "Why are stocks still going up?"

What we are seeing now is rising prices on falling volume.

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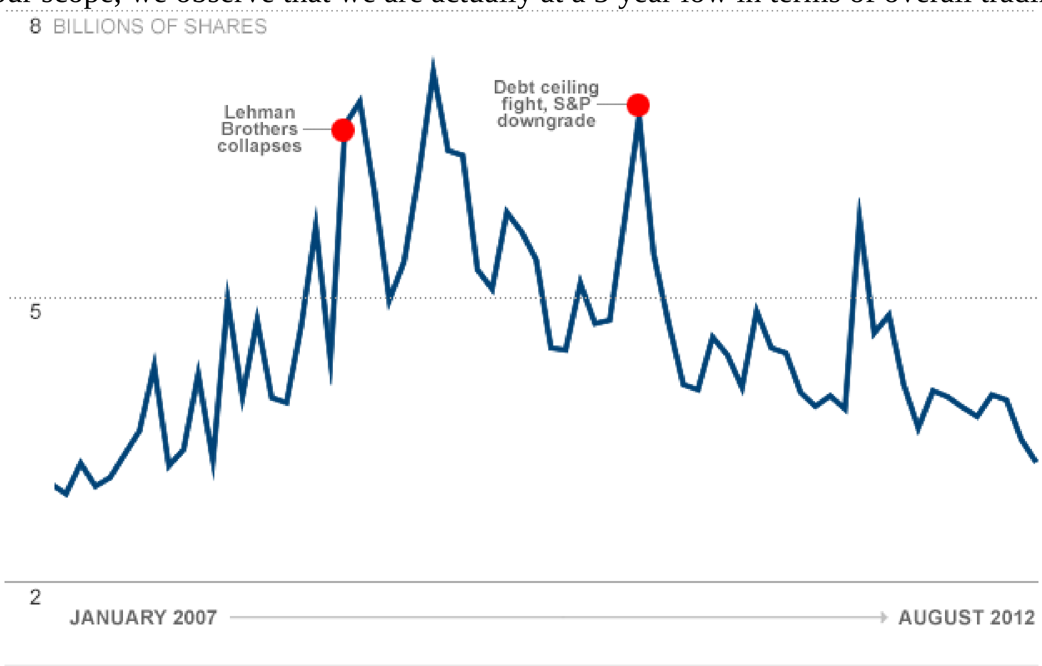
Looking at just the past month, we see a 4% increase in the S&P 500 coupled with a 50% decrease in trading volume –

(Source – BigCharts – custom)

Widening our scope, we observe that we are actually at a 5 year low in terms of overall trading volume



(CNN – 8/22/12)

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Rising prices on falling volume is considered a bearish indicator because it means that there are more buyers than there are sellers in the marketplace. These buyers, while decreasing in numbers, are gradually bidding up the price of stocks while essentially selling back and forth to each other. In 2010, investors had net withdrawals from Equity Mutual Funds totaling $37 billion. In 2011, investors had net withdrawals from Equity Mutual Funds totaling $130 billion.(Source – Investment Company Fact Book 2012). This past July marked the 15th consecutive month that investors had net withdrawals from US Diversified Equity Funds. (Source: Reuters 8/15/2012)

Would the last one out please turn off the lights?

Best Regards,

Matt

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