COROMANDEL WEALTH MANAGEMENT

Quarterly Economic Update (Q3 2012)

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Wow – talk about another interesting quarter in the stock market!

The Dow Jones Industrial Average rose 4.3% during the third quarter and is up 10.0% through September 30, 2012. The S&P 500 is having an even stronger year, with a 5.8% rise during the third quarter and a 14.6% gain year-to-date. The NASDAQ also had a great quarter, increasing 6.17% and 19.6% year-to-date.

There are many forces driving these gains:

- Many analysts believe that the Federal Reserve's efforts to inject money into the financial system will help asset prices continue to go higher.
- Rising dividends are another source of support for the stock market as many investors continue to reinvest the proceeds. For example, in August, S&P 500 companies paid out a record $34 billion in dividends. **(Source: WSJ, October 1, 2012, C1, US Stock Investors Look Beyond)**
- Stepped-up efforts to aid the Euro zone, such as the European Central Bank's plan to buy government debt to reduce some nations' borrowing costs, gave many investors confidence to take on more risk, according to many analysts. The Federal Reserve's September 13, 2012, announcement of new stimulus measures for the U.S. economy also helped in this regard.

To the surprise of many investors, many U.S. stocks have nearly come full circle and are going into the final quarter of this year within shouting distance of all-time highs. Five years ago on October 9th, the Dow Jones Industrial Average closed at an all-time high of 14,164.53. As of Friday, October 5, 2012, the Dow closed less than 4% below its peak. **(Source: WSJ, October 6-7, 2012, B7, What A Trip)**

Let's look at what happened during this five-year period: the stock market halved and then doubled; bonds soared; the real-estate market crashed, then stabilized, and is possibly on its way back; and energy prices spiked, tanked and rose back, too. During this time, the U.S. government racked up massive new debts, and many other global economies also experienced significant changes in their economic pictures.

The 37% drop in the S&P 500 in 2008 was devastating for investors, but since then the stock market has yielded annual returns of 26.5%, 15.1%, and 2.1%. Dividend yield on the S&P 500 has also been steady at slightly above 2%. Many investors who left their money in the market are now ahead of where they were at the end of 2008. Unfortunately, many investors who wanted to keep their money "safe" are shaking their heads as to what to do now. **(Source: Bob LeClair's Newsletter, September 15, 2012)**

No one knows whether stocks and bonds will continue to climb or will hit a steep drop, but either way several experts constantly remind us that two important things to consider are:

- It is difficult to consistently time the market, and
- Diversify, diversify, diversify!

Many investors are worried about risks looming on the horizon—everything from key fiscal issues in the U.S. to the global economic outlook. The debt crisis in Europe remains unresolved and its economy is stagnating. In the U.S., earnings forecasts have also been reduced. With the presidential election only a few weeks away, major political uncertainty hangs over the U.S., especially when it comes to the Fiscal Cliff, when some very critical economic stimulus measures expire.

With all of these uncertainties, how has the market continued to do so well? There are a number of reasons. "International investors have used the U.S. stock market as a safe haven," says Lisa Shalett, chief investment officer at Bank of American Merrill Lynch Global Wealth Management. "They see it as a much better place to have been around the world than emerging markets, which have struggled, and a better place to be than Europe." **(Source: WSJ, October 1, 2012, C1 US Stock Investors Look Beyond…)**

The Fiscal Cliff

The term "fiscal cliff" was coined by the Federal Reserve chairman Ben Bernanke, and refers to the $550 billion in tax hikes and spending cuts that will take place automatically on January 1, 2013, unless the President and Congress take action to prevent it. **(Source: Kiplinger's Personal Finance, October 2012)**

Failure to modify the tax hikes and spending cuts would almost certainly induce a recession. The Tax Policy Center estimates that the fiscal cliff would hit 90% of U.S. taxpayers and cost an average of $3,500 in extra taxes per household. **(Source: USA Today, October 5, 2012, 5B, Investing: Protect Your Money from Stupidity)**

The fiscal cliff itself isn't giving money managers nearly as much reason to worry as the uncertainty surrounding it is. "Uncertainty is worse than knowing," said Leo Grohowski, chief investment officer at BNY Mellon Wealth Management. (Source: Investment News, July 16, 2012, page 34) The most uncertainty surrounds dividends, which have been increasingly popular, given the record low yields in fixed income, Mr. Grohowski said. Right now, the dividend tax rate is at 15%, but depending on what Congress decides, it could go as high as 43% for that bracket. "That's a pretty big spread of uncertainty," Mr. Grohowski said.

Unless Democrats and Republicans can agree to extend at least some of the Bush-era tax cuts or postpone some of the spending cuts mandated by the Budget Control Act passed last year, the economy will suffer. "The macroeconomics behind the fiscal cliff issue is horrendous," said Allen Sinai, chief global economist with consultant Decision Economics, Inc. "It's unthinkable that this might actually happen." **(Source: Investment News, July 16, 2012, page 34)**

Many advisors believe Congress will take steps to moderate some, if not all, of the tax changes before the end of the year. However, even if they don't, they could still pass laws next year retroactive to the beginning of 2013. Unfortunately, with all the uncertainty still looming today, markets are likely to be swayed by the headlines rather than fundamentals.

The mere threat of $600 billion in tax hikes and spending cuts is already delaying business spending. Big economic forces, both domestic and abroad, are combining to dampen growth. As the economy has cooled, so have the economists' forecasts. The average estimate of the 79 economists surveyed by Bloomberg is for gross domestic product to rise 2.1% in 2013, down from the consensus of 2.5% in May. The fiscal cliff poses the biggest threat. The combination of deep spending cuts and tax increases set to hit in January could strip as many as four percentage points off 2013 GDP growth. On top of that, the global economy is weakening, particularly in China and Europe, two of the biggest export markets for the U.S. China's industrial output is growing at its slowest pace since May 2009. Although Europe's leaders appear to be making progress in taming their debt crisis, much of the continent is already in recession. **(Source: Bloomberg, September 17-23, 2012, page 13)**

Global trade is stalling, dimming prospects that exports will buoy the U.S. economy in the coming months. The World Trade Organization just projected the global volume of trade in goods would expand only 2.5% this year, down from 5% last year and nearly 14% growth in 2010. The trade slowdown could worsen as momentum slips across the global economy. Europe was the epicenter of the weakness radiating from the global economy. Weak

exports have exacerbated a slowdown in China's domestic economy, which economists project will grow about 7.5% this year, which would be the weakest annual expansion since 1990. **(Source: WSJ, October 1, 2012, A1, Trade Slows)**

QE3

Federal chairman Ben Bernanke announced in September that the Central Bank will begin buying $40 billion of mortgage-backed securities per month starting in October and will continue to do so until the unemployment picture starts to show improvement. This is the Fed's third round of quantitative easing (QE3) since the 2008 panic with a goal of further reducing long-term interest

Recently, Mr. Bernanke extended the Fed's forecast for near-zero interest rates until the middle of 2015. His plan also includes continuing "Operation Twist," which exchanges short-term securities for those with longer maturities. **(Source: WSJ, September 14, 2012, A12, Bernanke Unbounded)**

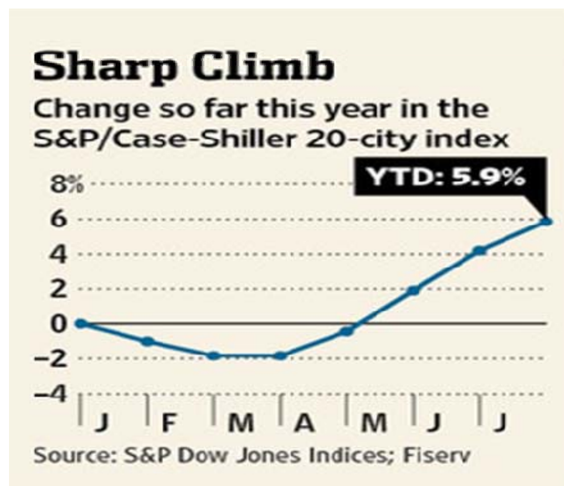
The Fed wants to continue pursuing its "dual mandate" of controlling inflation and reducing unemployment. "We have to do more, and we'll do enough to make sure the economy gets on the right track," Mr. Bernanke declared.

We still have not yet felt all of the ripple effects of these new policies, but one of them is the risk of future inflation, which Mr. Bernanke stated hasn't strayed too far above the Fed's 2% "core inflation" target. Unfortunately, this ignores the increase in food and energy prices, which consumers pay even if the Fed discounts them in its "core" calculations.

After three decades of decline, many investment advisors believe rates could be on their way back up soon. Pinpointing the timing of an interest rate rise is difficult, if not impossible. After the global economic crisis in 2008, many investors flooded into U.S. Treasury bonds, which consequently pushed their yields down. Unfortunately, if interest rates start increasing, the value of many bonds will decrease. There are several potential drivers of higher interest rates. One might be inflation. While it has been fairly tame for years, if commodity prices and other costs start to climb, inflation could begin to creep higher. A consequence of higher inflation is typically higher interest rates.

Housing Market

Home prices snatched their strongest gains since 2005, climbing 5.9% from January through July and signaling the housing market's steady trudge toward recovery. For the broader economy, the turn in housing could provide a much-needed boost if it continues. Rising prices could eventually lift consumer spending if homeowners begin to feel wealthier again. Housing construction, a big generator of jobs, also has the potential to play a major role in economic growth. **(Source: WSJ, September 26, 2012, A1, Housing Market Displays New Vigor)**



Rising prices largely reflect a dwindling number of foreclosed homes being sold by banks as well as stronger demand for those properties from investors. Foreclosures and other "distressed" homes typically sell at larger discounts, and with fewer of those properties selling, prices are under less pressure.

The median sales price for new homes in August was $256,900, up 17% from a year ago, and the highest level since December 2004. **(Source: Bob LeClair's, September 15, 2012)**

Rising demand, especially at the low end, is putting upward pressure on prices as traditional buyers, as opposed to investors, feel more confident about jumping into the market.

Unemployment

The U.S. unemployment rate fell sharply in September to its lowest level since January 2009, suggesting that summer job growth was stronger than previously thought. The unemployment rate slid to 7.8%, the Labor Department said, falling below 8% for the first time since Barack Obama's inauguration. **(Source: WSJ, October 6, 2012,A1, Hiring Notches Modest Gains)**

The surprising plunge in the official rate of joblessness has prompted certain parties to cry "foul." They are stating that these numbers are prompted by political reasons and are not calculated properly. However, it is more important to look at what the long-term numbers are in order to see how unemployment is at this moment. As stated in a Wall Street Journal article, "You don't need a conspiracy to know the job market is still lousy." The reality is that more than three years into our economic recovery, 12.1 million Americans are still out of work. **(Source: WSJ, October 6-7, 2012, A12, Happy Days Are Not Here Again)**

The November Presidential Election and the Economy

The slow U.S. economic recovery and persistently high unemployment rates have made the economy one of the central issues in the 2012 presidential campaign. With job creation the top priority for many U.S. voters, President Barack Obama and GOP contender Mitt Romney have outlined competing policy proposals that they say would stimulate the economy and boost hiring.

In September 2011, President Obama proposed a $447 billion stimulus bill to create new jobs through public investment in infrastructure and education, along with payroll tax cuts for the middle class. At the same time, President Obama has called for raising income taxes on the top 2 percent of earners, while extending the Bush-era tax cuts for the rest of the population--a plan passed by the Senate in July 2012 and then rejected by the House of Representatives.

Meanwhile, Mitt Romney and many other Republicans have advocated extending the Bush tax cuts for all Americans as a way to stimulate the economy and facilitate job creation. Mitt Romney's economic plan is largely centered on cutting taxes at the corporate and personal levels, while balancing the budget through federal spending and entitlement cuts. Mitt Romney has vowed to repeal the two signature pieces of legislation from President Obama's term--the health-care and financial reforms laws of 2010--which he argues can hurt the United States economically. In the summer of 2012, the Obama and Romney campaigns battled over the role of entitlements and other federal programs, with both sides accusing the other of seeking to make significant changes to Medicare.

The upcoming election should provide direction for next year's leadership position, but most likely will not produce immediate results. We will be carefully monitoring this situation and will keep you informed when we have meaningful facts on how the elections results will affect your investment plan.

Restoring Investor Confidence

Many nations today suffer from the reluctance of investors and CEOs to invest in new businesses, jobs or ideas. Many investors have adopted a wait-and-see attitude because markets are missing the two components essential for confidence: trust and certainty.

Many investors are angry and cynical

because for five years, they have consumed an almost daily diet of headlines announcing doom and gloom. Scandals in the financial industry have left many investors believing that the markets are stacked against them. Those who stayed the course over the ten years through 2009 suffered a "lost decade," with negative total returns on the S&P 500. Many investors see little consensus in the government for tackling the long-term fiscal and competitive challenges facing our economy. This has resulted in a lack of trust in political institutions, uncertainty about the road ahead, and paralysis in various markets.

Restoring investor confidence begins by recognizing that for all the challenges we still face, there are signs of life in the financial markets. Investors with a long-term perspective have benefited from the rally in U.S. equities over the past four years. There is also cause for cautious optimism about the outlook for the global economy, including the actions to prevent the breakup of the Euro; continued, if slower, growth in China; and the beginnings of a U.S. housing recovery.

Markets will remain volatile—however, this also creates opportunities to invest at attractive prices.

Continued progress, however, requires action from both the government and financial sectors to restore the trust and certainty missing today.

There are a couple of ways to help restore confidence. First of all, immunize yourself from the news media. Second, remember that you don't know what's going to happen, nobody else knows what's going to happen, so don't spend time worrying about things you can't control. It's a simple rule to live by: "Don't worry about things you don't have to worry about!"

As always, if your personal situation has changed you require a meeting before our next scheduled review, please call us immediately.

Thank you for your continued loyalty.

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Currently, income tax and estate planning tax rates are scheduled to change dramatically in 2013. *Has someone reviewed your investments to see how these changes affect your portfolio?*

Is the tax basis for all of your existing investments listed on your statements?	***Yes***	***No***
Did your investment professional do a full review of your tax forms and show you how your investments are impacting your tax forms?	***Yes***	***No***
Did your investment professional offer you a report on the steps investors can take to reduce their taxes?	***Yes***	***No***
Does your investment professional consider tax consequences and tax alternatives as they make new recommendations?	***Yes***	***No***

If you answered *NO* to any of these questions, then you may not be maximizing your tax strategies and you could be a candidate for a *TAX HEADACHE*!

We would like to invite you to come in for a complimentary consultation to review your investments and how the new tax law changes could affect them in 2013.

To schedule to this complimentary consultation, please call George Gagliardi at (781) 728-9001 and he would be happy to assist you.

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