WINFIELD
ASSOCIATES

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Customized Investment Portfolios and Private Wealth Advisory Services

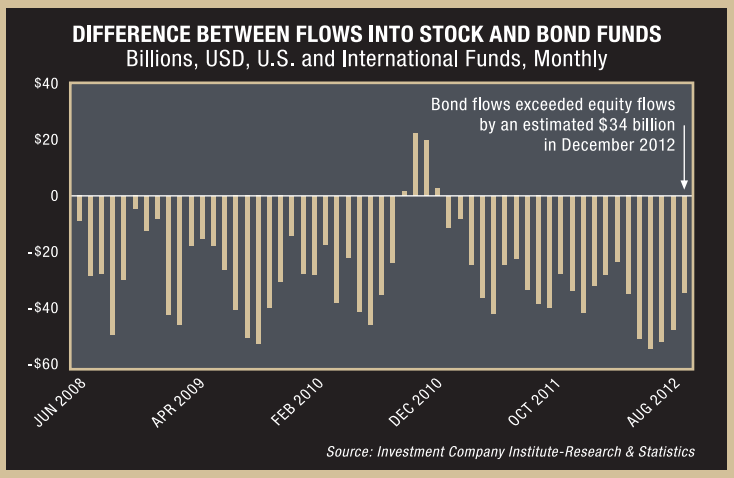
MARKET COMMENTARY

Despite the political rancor of the presidential election, equity markets fared surprisingly well in the fourth quarter of 2012. The S&P 500 declined only 0.4%, and for the full year, the index rose 16%. Other equity markets around the world performed even better. Among the strongest were the Thailand SET up 36%, the German DAX up 29% and the Japanese Nikkei up 23%. Going into January the markets have continued to rise, and, for the most part, the fiscal cliff has been averted. Even though the debt ceiling will be an issue later in the first quarter of 2013, the S&P 500 is currently within 4% of its all-time high and the overall market direction seems to be higher.

Perhaps the most prominent reason for ebullient markets relates to the world central banks' monetary policies of liquefying their monetary base or using quantitative easing. Essentially, this process puts more money into banks that can leverage the funds to be used for loans. With more liquidity, interest rates trend down and loans are less expensive. The process is designed to stimulate investment and to aid economic growth. In late December, the US Federal Reserve indicated its intention of extending its quantitative easing, which began in 2009, well into 2015. Bond purchases for 2013 are expected to be $750 billion, equivalent to 5% of US GDP, which could expand the Fed's balance sheet to $4 trillion. In the meantime, the Bank of Japan announced it will purchase 30 trillion yen, which is 6% of their GDP. For the other reserve currencies, the Euro and the pound sterling, their central banks' forecasts are not apparent, but in the past two years quantitative easing has been used and will likely occur again this year. With this world-wide expansive monetary policy, the environment for rising equity prices is highly favorable.

Another driver for higher stock prices is the turn from investing in bonds to stocks. Investors are apparently willing to assume more risk to earn higher returns as bond yields are trading at historic lows. If interest rates increase, bond values will decrease. The chart to the right shows the trend of money flows into bond funds versus stock mutual funds. From January 2007 through November 2012, $580 billion has flowed out of equities while $1.180 trillion has been invested in taxable and tax exempt bonds. Only during a short period in 2010 was the trend broken. While time will tell if we are at the beginning of a decisive move out of bond funds, the trend in December 2012 and into January 2013 appears to signal a change.

In addition to equity inflows and monetary easing, there are other reasons to be optimistic regarding higher stock prices. Housing starts bottomed in 2008 and are now trending towards a more normal level of nearly twice their low.



Auto production is also trending at nearly twice its low in the Great Recession. The European Union has at least stabilized, and compared to a year ago, the EU has found a better way to handle the fiscal crisis. Corporate cash is at record levels which should translate into higher dividends, increased capital expenditures and more mergers and acquisitions. Equity valuations are at the low end of their historic price to earnings ranges, making equity investing attractive. All of these factors should improve investors' confidence in equities.

Despite all of these conditions, as we have seen in the past few years, political situations can throw a wet blanket on optimism. The US debt ceiling controversy to be legislated in the first quarter of 2013 could be just that event. We sense that there is considerable posturing between debt limits and potential budgeted cuts, but compromises usually prevail, preventing a complete government shutdown as we saw in April 2011. There have been five government shutdowns since 1981, mostly for just a few hours or over a weekend. The shutdown in 1995-1996 occurred at various times, idling different governmental functions. In this instance of political stalemate, we believe that the concern surrounding "default" is merely a political bargaining chip. The US has the ability to meet its obligations simply by printing more money. The impending "default" is merely an extension of our politicians' unwillingness to compromise. In the end, we expect a compromise including some cuts and an extension of the debt ceiling to ultimately prevail.

Our investment strategy in recent months has been to reduce cash levels and government bonds (as yields on these vehicles are extraordinarily low) and use the proceeds to invest in higher yielding bonds or dividend paying stocks. We are retaining some cash for rainy day events or opportunistic investments and generally investing in quality stocks and diversified funds.

AMERICAN TAXPAYER RELIEF ACT OF 2012

On January 1, 2013, Congress passed the American Taxpayer Relief Act of 2012, which President Obama signed into law. The act makes permanent many of the tax cuts and other provisions that were temporarily enacted during the Bush administration, although it raises rates and limits deductions for some of the highest earning taxpayers. It also temporarily extends some deductions and tax breaks that have been enacted over the past few years, including extending some provisions that had expired at the end of 2011. A number of details of the act are provided below:

Income Tax Rates: The same six marginal tax rates – 10%, 15%, 25%, 28%, 33%, and 35% – will continue to progressively apply to the taxable income of individual taxpayers below the "applicable threshold." However, a 39.6% rate will now apply to taxable income in excess of that threshold. For the purposes of this higher tax rate, the applicable threshold is $450,000 of taxable income for married taxpayers filing a joint return and surviving spouses, $425,000 for heads of households, $400,000 for single taxpayers, and $225,000 for married taxpayers filing separate returns.

Long-Term Capital Gains Rate: The long-term capital gains rate remains at 15% for taxpayers with taxable income below the previously referenced "applicable threshold" used for determining whether the taxpayer is subject to the 39.6% bracket (0% capital gain rate if the taxpayer is in the lowest two tax brackets). For taxpayers with income in excess of the threshold (i.e., those subject to the 39.6% marginal tax rate), long-term capital gains in excess of the applicable threshold are taxed at a rate of 20%.

Dividends Rate: Qualified dividends will be taxed at the same rates and in the same manner as capital gains.

Limitations on Itemized Deductions (Pease Limitation): The overall reduction in itemized deductions for high income taxpayers will return for the 2013 tax year. The amount of this reduction is equal to 3% of the amount by which that taxpayer's Adjusted Gross Income (AGI) exceeds an applicable threshold, with the reduction capped at 80% of the amount of itemized deductions otherwise allowable which are subject to the phase-out. This limitation will not apply to the itemized deductions for medical expenses, investment interest, allowable gambling losses and casualty and theft losses. For the purposes of this limitation, the applicable threshold is $300,000 of AGI for married taxpayers filing a joint return and surviving spouses, $275,000 for heads of households, $250,000 for single taxpayers, and $150,000 for married taxpayers filing separate returns.

Personal Exemption Phase-out (PEP): For taxpayers with adjusted gross incomes in excess of an applicable threshold, the personal exemption phase-out will also return starting in the 2013 tax year. This phase-out works by decreasing the amount of the personal exemption available by 2% for each $2,500 ($1,250 for married filing separate filers) a taxpayer's AGI exceeds the threshold until the personal exemption available to that taxpayer is $0. For the purposes of this phase-out, the applicable threshold is $300,000 for married taxpayers filing a joint return and surviving spouses, $275,000 for heads of households, $250,000 for single taxpayers, and $150,000 for married taxpayers filing separate returns.

Alternative Minimum Tax (AMT): Starting with the 2012 tax year, the AMT exemption amounts have been permanently indexed for inflation, meaning that Congress will no longer have to pass a "patch" every year or two to increase the exemption. The applicable exemption amount is $78,750 for married taxpayers filing a joint return and surviving spouses, $39,375 for married taxpayers filing separate returns, and $50,600 for single taxpayers and heads of households. These exemption amounts will be adjusted annually for inflation for future tax years.

Estate, Gift, and GST Tax Rates: For decedents dying and gifts made after December 31, 2012, the estate, gift, and GST tax rate is 40%.

Estate, Gift, and GST Tax Exemptions: The estate and gift tax exemption amount is now permanently set at $5 million, adjusted annually for post-2011 inflation, as is the GST tax exemption amount. The exemption amount available in 2013 is estimated to be $5.25 million. The portability of a decedent's unused exemption amount to his or her surviving spouse has also been made permanent.

While the new law resolved many questions surrounding estate and tax planning, the rates and exemptions described above are only a summary of the changes to the law. We encourage you to review your specific plans with an estate planning attorney and a qualified tax advisor.

MARKET PERFORMANCE

	4Q 2012	2012
Dow Jones	-1.74%	10.24%
S&P 500	-0.38%	16.00%
Nasdaq	-2.65%	17.45%
Russell 2000	1.85%	16.35%
MSCI EAFE	5.43%	13.40%
Barclays Agg	0.22%	4.22%

WHEN TO WORK WITH WINFIELD

PRIVATE INDIVIDUAL INVESTORS

- Manage accumulated wealth, inheritances and settlements to meet investment objectives

ENDOWMENTS AND FOUNDATIONS

- Manage assets with a long-term growth strategy while meeting investment policy requirements

BUSINESS OWNERS

- Customize investment portfolios to meet investment objectives and lessen risk of concentrated assets
- Defer taxable earnings in profit sharing plans
- Manage and advise 401(k) plans

BUSINESS PROFESSIONALS

- Customize investment portfolios, manage stock options and consolidate 401(k)/IRA plans to meet investment objectives and lessen risk of concentrated assets

RETIREES

- Customize investment portfolios to meet investment objectives with the option of drawing income
- Management of IRAs, trusts and taxable accounts

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