

High Desert Investment Advisors

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Serving Your Personal Investment Needs Since 2003

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Attention to a Tax Issue

I am finally getting to my own tax filings, and am working thru the details and intricacies of the forms. Let me call to your attention an area on the capital gains forms that you will want to pay attention to.

On most 1099 forms there is a section titled **1099-B Proceeds from Broker and Barter Exchange**. Be sure that the total of all proceeds from your asset sales equals this number. Because we buy a lot of mortgage backed securities, you likely own some of these assets. You will need to report the **Return of Principle** as a net zero gain/loss, showing it as sale proceeds with a cost equal to the proceeds. If you have questions about this, you can call me for input. I don't provide tax advice, but I can tell you how I dealt with this issue when I did our taxes. Your accountant will know how deal with this issue, but many of you will be doing your own taxes and some will be using TurboTax as I did. Pay attention to this issue on your taxes.

MARKET ANALYSIS

What can we expect for the remainder of the year in the way of economic growth, and how will the stock market respond to that growth trend?

1. Expect the Fed to continue to add money supply to the system.
2. Expect the economy to respond the Fed's stimulus and resume a growth trend with an increasing momentum thru the end of 2012.
3. Unemployment percentages will fall, job opportunities will increase, and a general sense of confidence will build in the American population.
4. The stock market is likely to have a 10-15% range for the year, with a year end valuation approximating the current levels.
5. Near term, we can expect a downside move of perhaps 8-10% from recent highs.

INTERESTING TRENDS:

There are very interesting trends showing up in the monetary aggregates that seem to indicate an attempt by the Fed to withdraw the stimulus that was added during the first half of 2011. Since the middle of last year, M-1 has essentially shown zero growth. Late in the year it was pretty clear that the Fed attempted to withdraw some of that stimulus, and during that period, the private sector was able to pick up the slack by creating its own money supply. The so-called shadow banking system of investment banks and private equity provided an increasing turnover of money to allow the Fed to reduce its Base money supply. During the first quarter, 2012, this private sector contribution has slipped backwards and now the Fed is once again showing signs of stepping back into the marketplace to stimulate growth.

We do not hear any talk about this kind of stimulus from the media. There is lots of talk about the potential for renewed Fed action to stimulate the economy, and the pros and cons to such action, but no indication that the Fed has already taken steps to stimulate. Frankly, this is surprising in that financial reporters are not following the data closely enough to see these trends. Certainly, it is to be expected that the Fed will manage money

supply so that continued steady growth will occur. In fact, it is happening. What is more interesting is that the economy is still not able to create its own strong growth momentum.

In 2011, it appeared that this internal growth momentum was building. During the first quarter, 2012, that momentum has slowed.

A similar pattern occurred in 2010, when growth momentum seemed non-existent during the early months of the year. Then we saw a rather strong revival of the private sector right thru the end of the year. It was right after the first of the year, 2011, that this accelerating momentum collapsed, and the Fed stepped into the market with its quantitative easing, causing private equity once again to increase its own activity, and building what was hoped to be a sustainable growth pattern.

Since January 1, 2012, that growth pattern has slowed, and the Fed has once again stepped in to provide monetary stimulus. This stimulus has not been announced, and at this point is only a rather subtle increase in the Base.

The real question, for right now, is whether the private sector will “get back in the game” and will it respond to the Fed’s prodding by putting up private capital sufficient to allow the Fed to “stand down”?

We don’t know the answer to this question, and will just have to wait to see what happens!

My guess is that we can expect the Fed to continue its subtle approach to stimulating the economy. It is an election year, and that alone is sufficient incentive - based on historical experience - for the Fed to try to make the economy grow. At least, we know that there will be significant political pressure to take such action!

Longer term, the issues of greatest concern continue to weigh heavily on the economy and on the investment community:

1. The most important concern for the future is the size of the U.S. Government debt.
2. If Congress and the President do not find a way to reduce our government’s debt level, there will be severe economic consequences.
3. Debt reduction does not mean merely reducing the amount of debt created every year by its deficit spending. It means **SHRINKING THE DEBT**.
4. Additional concerns are the liabilities caused by the overall size of government and government expenditures. Both must be reduced.

Comment: With regard to point # 4 and the reduction of the size of government, I am suggesting that government has gotten too big for the ability of the American people to fund. This is not a statement regarding where the budget should be cut, only that it must be cut. I happen to believe that a universal healthcare program is needed. You may or may not agree with me. **Nevertheless, we need to pay for all of the programs we want to fund, without borrowing money to do so.**

Sincerely,

Dick Brackett
High Desert Investment Advisors

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