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THE SEIA REPORT

Successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

POLITICAL PRIZEFIGHT

OVERVIEW: *"Auld Lang Syne and the Fiscal Cliff"*
Congress is poised for another showdown on taxes and the budget deficit later this year—and this time, like any memorable heavyweight title bout, it has a name. Fed Chairman Ben Bernanke, leader in monetary policy, coined the year-end fiscal policy decisions as the "The Fiscal Cliff." While it doesn't pack the same punch as "The Thrilla-in-Manila," the stakes are higher.

Option 1: *If Congress doesn't act* and fails to pass legislation by December 31st, New Years Eve will not only mark the end of the Bush-era tax cuts that have been in place for a dozen years, but it will also mark the beginning of automatic cuts to domestic spending and defense programs that would total $1.2 trillion over 10 years. The Congressional Budget Office (CBO) estimates that these changes would increase tax revenues by $399 billion and reduce federal spending by $103 billion. Combined with other smaller changes, the total roughly sums to $560 - $606 billion, about half the $1.2 trillion 2011 deficit. In simpler terms, falling off the "fiscal cliff" would cut the 2013 deficit in half and significantly reduce the trajectory of future deficits/debt for the next generation.

But according to the CBO and the International Monetary Fund (IMF), this perfect-storm combination of increased taxes and reduced spending would create a 4% reduction in economic output. With recent GDP numbers below 2%, a reduction could lead the U.S. into another recession. In recession government revenues (taxes) decrease due to a decrease in national income, so the questions loom: Would the projected $399 billion in increased tax revenue simply disappear due to weaker economic activity? Would our debt and deficit actually be greater due to recession? Because recessions reoccurring prior to full recovery from a prior recession are extremely rare, policymakers really can't predict the outcome.

Option 2: *If Congress does act* and extends all existing laws indefinitely, the U.S. may avoid recession but deficits and the debt would rise rapidly over the next decade. Large debts would slow the economy over the long-run and dramatically increase interest costs. To see the effect of large debts, one only needs to go to their nearest ocean and look across—the economic results and corresponding malaise in Japan and Europe are in part caused by too much debt.

America's rock and a hard place decision is whether we avoid recession now at the expense of larger and longer-term problems later. The good news is that the U.S. still has choices. Countries like Japan, Greece and potentially Italy and Spain no longer have this choice as they kicked the can down the road one too many times.

HOW DID WE GET HERE: *"The limits of duct tape"*
The "fiscal cliff" was not premeditated but rather came together from a patchwork of temporary Congressional fixes. It began two years ago during a lame duck session in December 2010, when Congress passed an act that extended the Bush-era tax cuts for an additional two years. It also authorized a one-year reduction in the Social Security (FICA) payroll tax, subsequently extended for another year the following December. Throughout this whole process, federal unemployment benefits were extended and payments to Medicare physicians were frozen, also through the end of 2012.

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POLITICAL PRIZEFIGHT

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We took another step toward the fiscal cliff in August 2011, when Congress finally resolved the turbulent debt-ceiling crisis. The resulting law provided for a "Super-Committee" to produce bipartisan legislation by late November 2011 that would decrease the deficit by $1.2 trillion over the next ten years. Unfortunately, the committee miserably failed in its mandate and as a result, the original August Act directed across-the-board cuts (known as "sequestration") split evenly between defense and domestic spending beginning at the end of, you guessed it, 2012.

In yet another move toward the brink, passage of Obamacare came with new taxes, including an increase in the Medicare payroll tax and a new surtax on investment income for those in higher income levels. These and other levies are scheduled to start at the end of 2012.

WHAT TO EXPECT: *"Promises of a Re-match"*

Unfortunately, this title bout ahead of an approaching election leaves many unsure of what will ultimately happen. But the "fiscal cliff" is not just a year-end story; it is part of a bigger problem and the partisanship from our elected politicians is the cause. The world-envied U.S. economy did not rise to power in an atmosphere of uncertainty. Business leaders plan ahead as they need to make budget and personnel decisions months and years in advance. The recent 1-year extensions and other political gimmickry have CEOs as well as investors on their heels. January is now only 4 months away and the uncertainty over 2013 policy may be having an effect right now. Economists argue that businesses have already started to curb investment and hiring plans in advance of a tightening of fiscal policy, further cutting into an already weak GDP. The economy can improve if we get a much needed dose of clarity. So what can investors expect? Unfortunately the best scenario for the economy has the least likelihood of occurring.

- The best outcome for the nation would probably be a "grand bargain" (or a "draw" to keep the boxing metaphor going), both sides agreeing to a longer-term plan that addresses both taxes and spending. It would reform taxes by raising revenue, broadening the base, and simplifying the code to make the economy even more productive for the next generation. It would curb spending by tackling the 800-pound gorilla of entitlements and specifically Medicare. It would provide all the benefits of the fiscal cliff but spread them out over multiple years so as not to shock the economy into recession at any one point in time.

- The more likely scenario is that Congress and the President agree to punt the issue into 2013 and kick the can down the road—playing the familiar game once again and pushing uncertainty out a whopping 3 months or so. Tax cuts would not expire and spending cuts would be delayed until new elected officials arrive in the new year.

- Alternatively, depending on the outcome of the election, Congress and the White House could reach a compromise in December on some tax and spending provisions, with the election having a significant impact on what those compromises might be.

- Finally the fourth scenario is that Congress and the White House fail to reach any compromise whatsoever and are unable even to agree on how to delay the looming measures. The economy then goes over the cliff.

The outcome of the 2012 elections matters, but resolution of our economic issues is tough regardless of whether Democrats or Republicans are in control. We live in an era of unprecedented partisanship but perhaps the elections of 2012 can resolve the longstanding philosophical differences between the parties about the role and size of government and how to grow the economy. Both parties now have a compelling interest to compromise. The Democrats need to cut a deal to avoid the gutting of key social programs, while Republicans need to avoid a general tax increase that might well be blamed on them. But if there is no such agreed upon moment, politicians will most likely gear up for the next fight because, like any good heavyweight title bout, a rematch is sure to follow.

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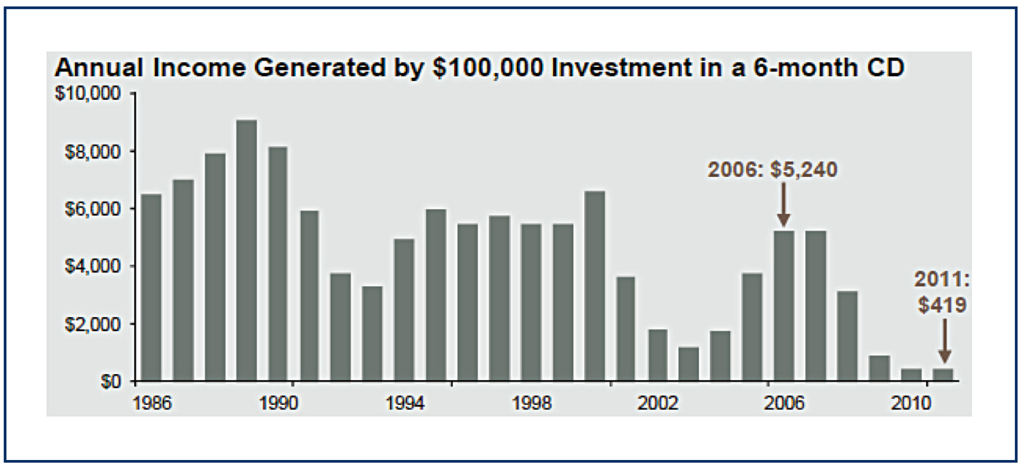
With rates near zero, is inflation a risk, and where do I get ‘safe’ yield?

By Gary K. Liska, MS, CFP®, AIF®

In past downturns and times of economic uncertainty, investors could sit on the sidelines, keep pace with inflation and protect their purchasing power. No more. In 2006 a $100,000 six-month CD earned an annual income of $5,200. Today, that CD earns $419. That is not a misprint: $419.

The Federal Reserve recently suggested that it intends to keep these rates low until 2014. That means central banks will most likely maintain accommodating rates and policies for an extended period of time. If you do a simple calculation and figure in even modest inflation, you, as an investor, are earning zero to even negative real interest rates.

Looking at the present: What can you, the investor do? First of all, do NOT chase yield without understanding the inherent risk involved. Stay short-to-intermediate with maturities, and have a “quality bias” to your security selection. Remember, even during this extended period of ample uncertainty, there are some certainties—to begin, rates will stay low for some time. So here are some actionable investment ideas for today.



Source: JP Morgan Asset Management. Data are as of 3/31/12.

ILBs (inflation linked bonds) or TIPS (treasury inflation protected securities): These should be the foundation of your fixed income strategy, hedged for inflation. There are several ways to invest along the yield curve and manage duration. Issued by sovereign governments, ILBs and TIPS are designed to protect investors from inflation.

Short-term corporate bonds: These offer attractive yields, which tend to be higher than comparable government debt, and many have outstanding balance sheets and near-term stability.

Floating rate bonds: These provide attractive risk-adjusted return potential, particularly during a low-to-rising rate environment. They also offer short maturities where the income “floats” with the market and can offer protection when interest rates rise.

Emerging market currencies/bonds: Emerging market (EM) countries largely offer attractive yields, better growth prospects, demographics and fiscal positions. However, there is currency risk, and we advise holding them in dollar-denominated vehicles vs. owning them in local currency debt. As the number of “safe havens” continues to dwindle, we believe investors will increasingly recognize the relative safety of EM sovereign debt.

High-yield bonds: This is riskier corporate debt with very attractive yields and low duration, but they can be good investments as corporate profits/balance sheets improve with the economy.

Looking ahead: Make future inflation a central theme in discussions of portfolio construction. Walking the tightrope between inflationary and deflationary economic forces is one of the biggest challenges for investors. Inflation is one of the few “solutions” to combat the developed world’s massive debt problems. We expect inflation to be modest but to rise over the next three to five years. A key driver of inflation is the printing of money by central banks. Increased dollars in circulation (i.e., devalued currency) force trading partners to pursue their own inflationary policies. As the concern for inflation intensifies, you will need to consider longerterm risk assets that produce income. These should include REITS, MLPs, dividend stocks and convertible bonds. Also start considering gold and certain commodities. Build your strategy and “wish list” to take advantage of “pivots” in investor risk. Also, spend extra time understanding risks and your volatility tolerance, that is, what you are willing to miss out on by protecting principal, versus what you are unwilling to lose. When uncertainty wanes, be ready for the potential pivot to inflationary pressures and rising interest rates, as the $9 trillion in cash that is now on the sidelines begins to move. In summation, uncertainty does not and should not translate into “investor paralysis,” meaning doing nothing. As we have seen, there are actionable solutions today.

Will Interest Rates Rise?

What factors might influence the Fed in the near future?

Provided by Peter Montoya

Here's a trivia question for you: when was the last time the Federal Reserve raised the benchmark U.S. interest rate?

The answer: June 29, 2006. On that day, the federal funds rate hit 5.25%. It has declined ever since, and it has stayed at 0%-0.25% since December 16, 2008. The Fed expects to hold interest rates at 0%-0.25% through late 2014, and some analysts think they will remain there into 2015.

All that noted ... when should the Fed make a move with rates, and what might happen when rates approach something like historical norms?

Right now, the Fed has little incentive to make any moves. Our economy generated only 75,000 new jobs per month in the second quarter of 2012 compared to 226,000 a month in the first quarter. Unemployment is currently at 8.2% and we have housing and business sectors that are far from healed. Hiking the federal funds rate in such an environment would seem nonsensical. In fact, the Fed's rationale for its current policy is that interest rates need to stay at or near these levels until we reach full employment (a 5-6% jobless rate). Low interest rates help to encourage business investment and big-ticket purchases, though they are no boon to retirees.

Does the economy warrant further easing? Maybe not. The federal government's second estimate of Q2 GDP (+1.5%) exceeded the +1.2% consensus forecast of economists polled by Briefing.com. That might signal the Fed to hold off on QE3.

When might rates rise? It might be a while. Right now, we have very mild inflation: as of June, the Consumer Price Index was up just 1.7% across the past 12 months, within the Fed's target. Demand for capital isn't what it was before the recession, encouraging lenders to stay competitive. The Fed, the Bank of Japan and the European Central Bank have all printed more money, which encourages low interest rates in the short term.

Of course, bloating the money supply might stimulate inflation in the long run. Some see greater inflation on the horizon: a June Pimco analysis forecast inflation rates rising during the next 3-5 years, citing shifts in exchange rates and rising commodity prices as potential drivers. Earlier this year, Slate founder and Bloomberg View columnist Michael Kinsley warned of "a fierce storm of inflation sometime in the next few years" that will "wipe out a big chunk of the national debt, along with the debts of individual citizens, and the savings of others."

Few economists feel that America is risking hyper-inflation. Most see tame consumer inflation for years ahead, and the Congressional Budget Office's 2012 edition of its Budget and Economic Outlook forecasts the government's PCE price index advancing no more than 2.0% annually through 2022. Yet policymakers have been stung by macroeconomic forces before ... and it may happen again.

What will bond investors do if they climb? If interest rates kick up, what investor will want to be stuck with a 1-2% TIPS return? He or she may end up selling that Treasury at market value. Think back to the 1970s, when long-term bond investors lent the government their money at 5-6%, then saw inflation go from 2-3% to almost 13%. This is a historically extreme example, but worth noting. If the federal funds rate rises 3%, a longer-term Treasury might lose as much as a third of its market value as a consequence. On June 12, 2007, the yield on the 10-year note was at 5.26%.[9]

On the other hand, another argument is that Treasury yields could be low for years. More than a few economists see a well-worn path from eras of easy credit and poor lending practices to excessive debt, then asset bubbles, then sustained economic slumps with minimal yields on long-term bonds.

You don't have to go back too far to find paybacks for years of high total public debt. Besides the credit crunch and downturn of 2007-09, you have the current examples of Greece, Italy, Spain, Ireland and France, the Latin American debt crisis of the early 1980s (with Mexico's default), Japan's 1989-90 crisis and our own Great Depression.

Why make money a little less cheap? Raising interest rates in the near future could actually accomplish some objectives. It could help to improve retiree income and retirement savings potential. It could encourage banks to loosen reins on their excess reserves. It could prompt those uncertain about homebuying to take the plunge.

Are the stock and commodities markets ready for an interest rate hike? Maybe not, but some notable voices – among them St. Louis Fed President James Bullard, Richmond Fed President Jeffrey Lacker and Charles Schwab – have publicly made the case for a rate hike before the jobless rate returns to normal levels. Should the economy heal at a faster pace, the federal funds rate might move north sooner than we think.

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SEIA Welcomes Financial Advisor Hampton C. Adams

Signature Estate & Investment Advisors, LLC would like to welcome Hampton C. Adams to our Irvine office. Hampton is the newest addition to SEIA and we are excited to be working with him. Mark Copeland, Senior Partner, in the Irvine office says "Hampton's experience and insight is a great addition to our office. We are excited to expand our office with an advisor of his caliber."

Hampton received his Bachelors of Science degree in Engineering from the University of Southern California (USC) in 1986. He then went on to complete his M.B.A. at the University of Virginia (Darden Graduate School). Hampton is currently a member of the CFA Society of Los Angeles.

Since 1988 Hampton has been in the financial services industry with a focus on equity research, institutional investment management and investment banking. Many notable individual clients, executive groups and corporations have retained him for seminars and private consultations. He is featured in the press often as a financial expert and quoted for his insights on the markets.

Hampton currently resides in Newport Beach, California with his wife and four children.

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SEIA DONATES $10,000 TO THE "BRIDGING THE GAP" PROGRAM AT THE SIMON WIESENTHAL MUSEUM OF TOLERANCE

In keeping with SEIA's commitment to the youth of our community, a gift of $10,000 was made to The Museum of Tolerance's Bridging the Gap Program.

This special program uses video conferencing technology for special speakers to share their powerful stories with groups of Students grade 5 and up who are unable to visit the museum. Bridging the Gap regularly serves students in remote areas across the country that would not otherwise have the chance to meet and interact with a Holocaust Survivor. They offer programs regularly to schools in Alaska, Hawaii, Ohio, Montana, Wisconsin, Michigan and Texas.

Current special speaker programs include:

- Holocaust Survivors – These quiet Hero's of humanity describe their unique story of surviving the Holocaust.
- From Hate To Hope – Speakers share their experiences of hate crimes and unique experiences that brought them together.
- From The Depths of Hate – Speakers reveal their experiences of the white supremacy movement and encourages students to take responsibility for their actions.

For Students able to visit the museum, special exhibits exist including the "Hall of Testimony". This is a specially designed room of witness where students can see and hear unforgettable stories of the courage and sacrifice of Holocaust victims and survivors.