LPL Financial

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Dear Valued Investor:

Now that tax day has arrived and 2013 tax returns have been filed, we can assess the impact of the fiscal cliff. Remember the fiscal cliff: the deal in Washington that raised taxes and averted the fiscal cliff at the beginning of 2013? Though it may have been a big story a year ago, it may be having a big impact in 2014.

Tax collections from individuals in the first quarter of 2014 were up 15%—totaling an additional $35 billion. This higher tax burden may have weighed on consumers and investors this year, as they may have had to forego purchases or sell stocks to cover their tax liability. This is a big contrast to 2013, when tax refunds were up a whopping 15%, amounting to a record share of after-tax income and may help to explain the better pace of consumer spending and market performance in the first quarter of last year.

The fiscal cliff was resolved with a rise in payroll taxes for all workers, higher marginal rates for high-income earners, the resumption of the phase-out of exemptions and deductions, and an increase in the maximum tax rates on capital gains and dividends. Much of that was felt last year. But, historically, most taxes that are not withheld during the year from paychecks are paid in the following year in the weeks leading up to tax day. That means that this year we may have seen a significant portion of the fiscal cliff deal impact on the economy and markets with a one-year lag.

Now that tax day has arrived, perhaps any drag at stores or in the markets due to the higher tax burden may fade. Already, there are signs the consumer is spending again. Yesterday's report from the Commerce Department surprised with a strong jump in sales at American retailers with a pickup in categories ranging from cars to furniture and clothing. Clearly, more favorable weather and other factors are helping boost the confidence of consumers, too. Last week's reading from the Bureau of Labor Statistics on first-time filings for unemployment benefits fell to the lowest level in seven years. As the economic outlook improves and any selling to fund tax payments subsides, stocks may continue their upward trend.

Paying your taxes is no fun, but doing them may be even worse. Does it feel like filing your tax return has become more complicated than ever and you get fewer and fewer breaks? You may be right. After all, 100 years ago the Form 1040 was short and, after a simple income section, it had only seven lines of deductions to complete. Check out this line from the good old days of 1913, when things like losses due to shipwrecks were considered a General Deduction:

> *"4. Losses actually sustained during the year incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise"*

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I am hoping you didn't have any shipwreck losses in 2013. And I think it is likely, with help from rebounding economic strength, that the economy and markets will avoid disasters in 2014. As always, if you have questions, I encourage you to contact your advisor.

Sincerely,

Jeffrey Kleintop, CFA
EVP, Chief Market Strategist