The Fiscal Cliff

January 04, 2013

What is the “Fiscal Cliff”?  
- “Fiscal Cliff” is a term many are using to describe the economic situation arising from the December 31, 2012 expiration of certain federal tax cuts and implementation of spending cuts.

- Although the U.S. technically went over the fiscal cliff at midnight on New Year’s Eve, the Senate and the House of Representatives passed a bipartisan bill (called the American Taxpayer Relief Act or ATRA) on New Year’s Day, which President Obama signed into law Thursday, January 3, 2013.

What does this mean to taxpayers?  
- ATRA extends the tax cuts enacted under former President George W. Bush for individuals making less than $400,000 and for households with income less than $450,000. It also delays spending cuts – for example, certain taxes associated with health care reform and reductions in military spending – that were due to go into effect January 1, 2013.

- Some additional provisions of the legislation include:
  - Limits on itemized deductions and personal exemptions for individuals making more than $250,000 annually and for married couples making over $300,000.
  - An extension of Federal unemployment benefits through the end of 2013.
  - An end to the payroll tax holiday, resulting in a 2% payroll tax increase for all workers.

What about the debt ceiling?  
- No deal on replacing or raising the debt ceiling was made. Most likely, Congress and the President will have to address this issue during the first quarter of 2013. Automatic cuts of $109 billion have been delayed until March 1, 2013.

Is there anything I can do as a retirement plan participant to prepare for this decision?  
- While the financial markets may react to the federal government’s decisions around the fiscal cliff, it doesn’t mean you have to. You may be best served by ensuring you have an appropriate long-term investment strategy in place and that you stick with it now and in the future.

- Current retirement account savings limits and tax treatments aren’t expected to be impacted at this time. Make sure any of your tax-related decisions are truly in line with your long-term financial goals.
While all this may be unsettling, it may be wise to stay calm and stay the course. Making quick decisions now, like getting out the stock market or even withdrawing your money, may not be in the best interest of your long-term retirement plans. Investment basics still count. Think about:

- How much you may need in retirement
- How long you have until you retire
- Your risk tolerance, asset allocation and diversification

If you are planning to retire in the next 10 years, read more about reducing risk in your portfolio.

As a general rule, follow the basics:

- **Keep saving**
  Even when the markets are down, continue to save. Saving over time allows for the potential of compounding and dollar cost averaging to work for you.

  - **The Power of Compounding:** The sooner you put money into your plan, the faster your money can grow. As the interest builds, that money is reinvested and you earn interest on the interest. So every dollar you save works even harder for you.

  - **Use dollar cost averaging:** Regularly investing a specific dollar amount regardless of the market's ups and downs is called dollar cost averaging. This means that when the market is high, you buy fewer shares and when the market is down, you buy more shares. Ideally over time your average cost per share will be lower than the average price per share.

- **Avoid timing the market**
  No one, not even the “experts,” can predict with certainty which investments will go up and which will go down. The cost of guessing wrong can be very high, causing an investor to miss the best periods of return, which can occur at unexpected times in any market cycle.

**Is there any “safe” investment?**
- All investing has risks. There is no one safe investment. However, asset allocation and diversification are investment strategies that may help reduce risk in your retirement account. Both follow the old adage, “Don’t put all your eggs in one basket.”
• Spreading your investments among the basic asset classes of stocks, bonds and cash alternatives, it may help reduce overall volatility and cushion the overall impact of market swings because different investments react differently. Further dividing your money within each asset class (diversification) can work the same way.

Dollar cost averaging does not ensure a profit or protect against a loss in declining markets. This investment strategy involves continuous investment in securities, regardless of fluctuating price levels. An investor should consider his or her financial ability to continue purchases in periods of low or fluctuating price levels.

Diversification does not assure a profit nor does it protect against loss of principal. Diversification among investment options and asset classes may help to reduce overall volatility.

Past performance is not a guarantee of and may not be indicative of future results.

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