Dear Friend: September, 2012

Rising Tax Environment

We hope this mailing finds you well rested after a relaxing and fun filled summer! The tranquil markets in July and August have allowed Locust Capital to experience the same for the first time in three summers!

The fourth quarter is quickly approaching and there are many themes to keep in mind as we come into the final stretch of 2012. These include:

- The Presidential Election in November
- Developments in Europe and the effort to stabilize the situation
- Expiration of the Bush era tax cuts (also known of as" The Fiscal Cliff' or Taxmageddon)

While the above three issues will dictate the behavior of the global markets between now and year end, we wanted to share with you our insight and thoughts on the tax issues at hand.

The Bush tax cuts (the tax rates in effect for the past decade) are scheduled to expire at the end of 2012. Republicans believe the cuts should be extended for all taxpayers. Democrats believe they should be extended only for taxpayers earning less than $250,000.

The fate of the Bush cuts will likely be decided by a "lame-duck" Congress convening between Thanksgiving and Christmas of 2012. The dysfunctional Congress that returns for that session will be the existing Republican-led House and Democratic-led Senate- regardless of the election results! President Obama, too, will still be in office at the end of 2012: either he will have been re-elected feeling newly empowered to enact his policies, or he will be a lame-duck president who can attempt to do what he believes is right without concern for the consequences.

President Obama has publicly stated that he will veto any further extension of the Bush Tax cuts for families earning more then $250,000. If he carries out this threat, then the Republicans must either accept a compromise that raises taxes only on the affluent or watch the tax cuts expire for everyone. Under both scenarios affluent taxpayers will pay higher taxes in 2013.

This is not the end of the story. To help finance the health care reform law passed in 2009, Congress approved two new taxes to take effect in 2013. Beginning next year, families whose overall incomes are above $250,000 will pay a new Hospital Insurance Tax of 0.9%. Additionally, investors will be taxed an additional 3.8% on taxable investments (interest, dividends, capital gains, rent, and royalties). The higher rate will not apply to non taxable income (i.e. municipal bonds) or to amounts withdrawn from qualified pension plans and IRA's.

If these additional taxes under the health care reform (3.8% plus 0.9%) are combined with the expiration of the Bush tax cuts, the effect in 2013 will be as follows:

- Top marginal rates on ordinary income increase to 43.4% from 35% (a 24% increase)
- Top marginal tax rates on capital gains increase to 23.8% from 15% (a 59% increase)
- Top marginal tax rates increase on dividends to 43.4% from 15% (a 190% increase)
- Estate tax exemption drop to $1.0 MM (from $5MM)
- Estate tax rate increase to 55% from 35 % (a 57% increase)

By taking action this tax year, investors may be able to reduce the effects of future tax rates increases. Some of the strategies to consider include:

- Sell assets in 2012 to take advantage of the existing capital gains rates
    - Relevant for business and financial assets
    - Take advantage of "wash sale" rules, if you desire to keep the asset
- Elect to receive optional ordinary income this year rather than in a later year when tax rates may be higher
    - Relevant for deferred compensation plans or qualified stock option that are "in the money"
- Increase attention in the future to harvesting losses and buy and hold strategies
    - Focus on harvesting losses to offset taxable gains
    - Tax deferral afforded by buy and hold strategies becomes more valuable
- Defer discretionary deductable payments (i.e. charitable contributions to later years)
- Convert IRA's to ROTH IRA's (refer to our website for a detailed article on the subject)
    - Converting may create a significant tax consequence that should be paid with non-qualified savings
- Consider Gifting to lessen your estate
- Increased consideration should be given to investing in Municipal (tax-free) Bonds
    - From 1926 to 2011, investment grade bonds averaged an after tax return of 3.7%, whereas municipal bonds (tax-free) returned approximately 5.7%.

Locust Capital has always stressed the importance of tax efficient investing and our strategies take into consideration many of the above concepts. The likelihood of future tax increases has influenced the processes and methodology by which we construct and manage portfolios. By placing income generating assets that are taxed at high rates in tax deferred accounts we are able to reduce our client's tax bill and keep your net investment return closer to their gross return.

We are as anxious as you to see how the above tax issues play out through the end of the year. Although we cannot forecast the outcome, we can say that both political parties stand to lose if nothing is accomplished. As your trusted advisor, we are paying close attention to these issues and are ready to react if warrented.

Best Regards,

Locust Capital Management, LLC