DVI
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The Road Map for the Second Half

Uncertainty is one of the great enemies of any financial market. When investors are unable to glance around the corner and determine what the rules of the road are going to be, their natural reaction is to go on a buyers strike until the fog has lifted. Even under circumstances in which the facts, as they are finally revealed to the marketplace, are perceived to be negative for the nation's economy or for the growth of corporate earnings, often times that is of little importance. By simply reducing the level of forecasting uncertainty, investors have a greater degree of confidence and are willing to step up and make thoughtful investment related decisions.

The word "unprecedented" comes to mind as I attempt to describe the level of anxiety investors face today as they gaze into the crystal ball and attempt to figure out what will transpire over the next six or seven months. Maybe it is an environment not a whole lot different than the first half of 2012, but it sure seems like the line in the sand on so many issues is soon to be upon us.

Tax Policy - An Economic Headwind

If the expiration of the Bush era tax cuts was not enough, January 2013 looms large as many of the tax increases (*See Below*) associated with the Affordable Care Act will also go into effect.

Even for the most optimistic, glass is half full, small to mid-size business owner, staring down all of these tax increases and deduction phase outs would make any reasonable business

New Medicare Taxes

Wage / Self Employment Income	
Individual > $ 200,000 Married -Joint > $250,000	.9% on earned income above the threshold amount
Investment Income	
Individual > $ 200,000 AGI Married -Joint > $250,000 AGI	3.8% on the lesser of net investment income or the amount that exceeds the threshold level

AGI - Adjusted Gross Income (1040 line 37 , $ amount is pre deductions and exemptions)

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Route To:

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The Behavioral Investor

Brian Christensen, CFA
Senior Vice President

In 1979, Amos Tversky and Daniel Kahneman advanced the concept of Prospect Theory, which aims to explain irrational human economic choices and is considered one of the leading works on behavioral economics. Most financial and economic theory is based upon the idea that individuals act rationally with consideration for all available information before making a decision. The Harvard Business School description of its Behavioral and Value Investing course includes the following - "Capital markets are not efficient in the way that textbook theory suggests. Through their trading behavior, biased individual investors and rule–bound institutions can cause prices to deviate significantly from fundamental value." The recent frenzy leading up to the initial public offering for Facebook, Inc. shares and then subsequent sell-off would be a solid case study for the course. Since Tversky and Kahneman's first work, the study of human behavioral biases within the fields of finance and economics has moved from the depths of academia to the mainstream. Consulting firms have emerged for the sole purpose of studying human psychology and how we react to risky situations, pursuit of rewards and new opportunities for gain or loss. Some consultants even think they will one day be able to identify individuals as superior long-term or short-term traders or be able to rank investment advisory firms based upon neuroimaging technology.

Michael Pompian, currently a partner at Mercer Investment Consulting, has identified four behavioral investor types. Pompian asserts that recognizing behavioral patterns allows a person to sometimes differentiate between potentially good decisions or bad decisions. Traits of Pompian's four behavioral investor types, the Preserver, the Follower, the Independent and the Accumulator are listed below.

The Preserver
- Loss averse and deliberate in decision making
- Emotional relating to fear of losses and inability to make decisions
- Investing style is wealth preservation first and growth second
- Lower than average risk tolerance

The Follower
- General lack of interest in money and investing
- Follows fads or leads of colleagues, no original ideas
- Investing style is passive
- Risk tolerance is lower than average but often thinks it's higher than actuality

The Independent
- Engaged in the process and opinionated
- Original ideas, sometimes unconventional
- Investing style is active
- Above average risk tolerance

The Accumulator
- Interested and engaged, confident in abilities but at times overconfident
- Struggles to follow a structured plan, firm believer in the path chosen
- Investment style is active
- Risk tolerance high

To which of Pompian's investor types can you most identify? Over the years many of you have probably heard a DVI staffer use the term "sleep quotient". It was one of David Vaughan's favorites and we continue to be proponents of our clients maintaining a high degree of "sleep quotient". If your investor type is inconsistent with your financial goals and objectives and your "sleep quotient" is under duress, please don't hesitate to contact us so we can review. In the thirty-five years DVI has been in business, one constant has been that market and investor psychology have always played a role in decision making. Whether evaluating a prospective client's risk tolerance, restructuring a client portfolio to address a life event, or being opportunistic with an investment idea, at DVI the doctor is in.

Stuart Van Arsdale, CFA

Relationship Manager, Florida Region

Stuart is the newest member of the DVI team and brings to the firm over 25 years of portfolio management and research experience. He joined David Vaughan Investments in July 2012. He holds both a Bachelor of Arts in Economics and his Masters in Business Administration from Rollins College, and he also holds a Chartered Financial Analyst designation.

Establishing Florida Residency

Patrick Smarjesse, CEBS
Vice President

A frequent topic of conversation with more than a few of our retired Illinois clients recently has been the benefits of establishing permanent residency in the state of Florida. In years past, the primary reason for considering making Florida home was the warmer southern climate. Today people are increasingly recognizing that there are also many favorable financial reasons.

At the top of the list of financial advantages is the fact that there is no personal income tax, no inheritance tax and no estate tax in the state of Florida. There was a time when the state did apply an intangible tax (an annual tax based upon the value of one's intangible assets such as stocks and bonds); however, that tax has since been repealed. In addition to these tax advantages offered by the state, there are also attractive asset protection laws in Florida. The Florida homestead laws protect property from being seized by creditors (regardless of its value). In addition to the homestead protection laws, Florida Law exempts qualified retirement plan assets, IRA assets, life insurance cash values and proceeds of annuity contracts from the claims of creditors.

Once you have acquired your home or condominium, the process involved in making Florida your permanent home is fairly simple:

- File a Declaration of Domicile with the court in the county where you will reside.
- Establish a checking/savings account in the State.
- Register to vote.
- Maintain a valid Florida driver's license or ID Card.
- Apply for Florida license plates for your vehicle(s).
- Make certain that your Florida home is the primary delivery site for your US mail.
- Maintain proof of payment for utilities on the Florida home.
- Consider using the Florida address on your Federal income tax return.

We strongly suggest that clients seek guidance from their tax advisors prior to making the decision to relocate. Because the state of Illinois does not tax distributions from retirement accounts, those whose primary source of income is generated from a Qualified Retirement Plan or IRA Rollover may experience minimal tax savings by declaring Florida residency. On the other hand, those who expect to receive a significant amount of non-retirement income, such as deferred compensation or proceeds from Non-Qualified Stock Options, are likely to have significant tax savings by deferring that income until the tax year in which their relocation is official.

Individuals who have Trust Agreements in force that are governed by Illinois Law are also encouraged to notify their legal counsel of their decision to relocate. Many people are surprised to learn that, despite their Florida residency, Illinois property of which they retain ownership remains subject to the State of Illinois estate tax exemption limit. As noted in the Spring 2012 edition of the DVI Quarterly Perspective, the Illinois estate tax exemption ($3.5 mm) is significantly below the current Federal estate tax exemption amount ($5.0 mm).

Prior to joining the firm, Stuart worked for SunTrust Bank as Senior Vice President and Strategic Wealth Advisor where he was responsible for portfolio management and managing client relationships for private wealth, foundation and endowment accounts. He has also worked as a Managing Director for Trusco Capital Management where he held various senior portfolio manager roles: overseeing and managing separate accounts and sub-advised mutual funds.

Stuart's extensive experience in portfolio management and in servicing both high net worth individuals and institutional investors will be a tremendous asset to DVI and our clients. As Relationship Manager of the Winter Park Office, he will concentrate on serving the needs of current and prospective DVI clients within the Florida region.

Please feel free to contact Stuart directly at stuart@dviinc.com or 407.622.5133 on any of the matters listed above.

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owner take a long deep breath. Even Congress, inept as they appear to be, has to realize that with a fragile U.S. economy the magnitude of the proposed increases and phase outs would have a material negative impact on small business job growth. The path of least resistance here once again appears to be kicking this can down the road into early 2013, with the Bush era tax cuts not expiring in December, and a further extension of the payroll tax holiday, but with taxpayers facing higher taxes associated with Obamacare.

Potential Tax Rate Changes

	2012	Scheduled 2013	Absolute Increase	% Increase
Wage Income: (Top Marginal Rate)	35.00%	39.60%	4.60%	13.14%
Total Payroll Taxes: (Employee & Employer Social Security / Medicare)	13.30%	16.20%	2.90%	21.80%
Capital Gains: (Includes 3.8% healthcare tax)	15.00%	23.80%	8.80%	58.67%
Qualified Dividends: (Top Marginal Rate plus 3.8% healthcare tax)	15.00%	43.40%	28.40%	189.33%

Source: JP Morgan

If the economic headwind from higher tax rates is not enough, what some have described as the "fiscal cliff" also lies ahead in early 2013. As part of last year's debt ceiling negotiations, $65 billion in negotiated cuts are to take effect with half of the reductions automatically coming from the Defense Department budget. Some have said that in combination with the expiring tax cuts the total negative impact to our nation's economy could be as much as 4 to 5 percent of annual GDP or somewhere in the neighborhood of $600 to 650 billion. With a Federal Reserve that is slowly but surely running out of bullets, an economic drag of this magnitude should not be taken lightly, and Chairman Bernanke and the Congressional Budget Office (CBO) have both already voiced concerns to Congress.

Fiscal & Election Calendar

- October 1 - The 2013 U.S Fiscal Year begins
- November 6 - National Elections
- November 13 - Congressional Lame Duck Session begins
- January 1 - Automatic Spending Sequester Triggered
- January 3 - 113th Congress Convenes
- January 20 - Presidential Inauguration
- February 14 - Debt Ceiling Hike Possibly Required

A Vote of Confidence

Corporations and individuals alike appear to be retrenching as the combination of the European sovereign debt/banking crisis and a slowing Chinese economy appear to be taking its toll on our nation's economy. They also appear to be hitting the pause button as they weigh the economic impact of the recent Supreme Court ruling affirming the constitutionality of the Affordable Care Act.

When it is all said and done, investors remain deeply skeptical and continue to seek out investment strategies with lower perceived risk despite capital market returns that were quite reasonable in the first half of this year. Expectations for any positive outcomes prior to the election on both tax and fiscal policy continue to be extraordinarily low. The consensus continues to be that neither party will advance an agenda that will break the current gridlock. With expectations set so low, any progress whatsoever on Capitol Hill would be viewed positively by market participants. Any hint of what the future glide path will look like out of Washington would provide the markets a much needed vote of confidence.

Will Williams
President

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