

*Marble Harbor Investment Counsel, LLC*  
*Excerpt from*  
*Third Quarter, 2012 Letter*

Dear Client:

16 Days or 12 Years.

The U.S. Congress has had 12 years to develop a thoughtful, long-term tax policy to replace the temporary tax cuts first implemented under President Bush. To date, they have come up with nothing. With the House already in recess, we doubt that anything will happen prior to the November elections. That leaves 16 days in a lame-duck session to craft a tax and fiscal plan to replace the expiring Bush tax cuts. If they fail, then starting January 1<sup>st</sup>, tax rates will rise back to the levels of 12 years ago, and a process called “sequestration” will kick-in that cuts federal budgets with the delicacy of a meat cleaver. The dual effect of these tax increases and budget cuts is being termed “The Fiscal Cliff.”

Why does it matter? Individually, we can expect significant increases in capital gains and dividend tax rates, in addition to estate and income tax rates. There may be as many as a million new job losses. Federal government services will be cut. Taken together this implies a cut of 4% from US GDP. With an economy that’s only growing about 2%, the math suggests that this shock treatment will send our slowly healing economy back into recession.

We suspect that Congress will indeed fail to develop a workable plan by January 1<sup>st</sup>, but that they will utilize that tried and true legislative tool: Kick the Can. That implies one more year of the Bush-era tax regime while the new Congress develops a plan over the course of 2013. While this isn’t ideal, it does give the economy another year to heal and at least postpones the dire implications of the Fiscal Cliff.

As you might suspect, the uncertainty of this has implications for businesses and workers. Families are being cautious in their spending – they don’t know what their tax rates will look like next year, and so are salting away a little extra savings. Concern over some political rhetoric about the elimination of the mortgage tax deduction is causing hesitation amongst first-time home buyers. And businesses, unsure about what regulations, taxes and the global economy will look like over the next few years, are not hiring. Without meaningful new hiring, the US economy will stay mired in a go-slow mode.

No one knows who will win the elections, or how the Fiscal Cliff will resolve. We do know that your companies are well-valued – with stocks yielding more than bonds, they continue to grow, albeit modestly, and they are financially strong enough to thrive no matter whom America elects. Please remember to exercise your franchise on November 6<sup>th</sup>!

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