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**Special points
of interest:**

- Stock Market Bottom Expected Mid-2012
- Education Key to Wealth Accumulation
- Expect Tax Rate Uncertainty Throughout 2012
- Investment Returns May Depend on Euro Area Developments
- Stocks Appear 30% to 40% Undervalued
- Are Assets Safe With Your Stockbroker?

Please Remain Seated With Your Seatbelts Fastened

As a pilot there are times when you are climbing through overcast with only your instruments to guide you. Often, especially in turbulence, ice, or heavy rain, there is a certain uneasiness as you continue to press higher. As you approach the top of the clouds, your first visual clue is increasing brightness. Then there are glimpses of blue and finally you are on top. There's an immediate sense of speed as the plane rushes past

the clouds and a nearly immediate sense of personal calm and clarity. During 2011, investors have been flying through a storm full of uncertainty and turbulence. It's uncomfortable and still pretty dark. As a pilot knows blue-sky is above, we know security valuations are historically inexpensive perhaps as much as 30% to 40% undervalued. In the end valuations win out over fear. A pilot's responsibility is to get you safely to your

destination. It's our job to help you meet your investment objectives. To do this, we must maintain a steady course, use our skills and training to avoid the mistakes that emotional reactions can produce and provide reassurance that the ride gets better, even enjoyable! For now, put your seats back, enjoy a bag of peanuts and a beverage of your choice. Soon you'll be able to unbuckle your seat belts and enjoy the view.

Our Macro-views for 2012

2011 was a year of diverging growth among major economies. We expect this divergence to persist this year. The global economy is expected to expand at a 3.4% rate. Developed market economies are expected to grow slowly, while emerging markets remain more resilient. The euro area is in a recession and its GDP is likely to fall. The global economy seems capable of withstanding a mild euro recession but a more disorderly outcome could still overwhelm the rest of the world. The housing market has yet to establish a floor. We expect home prices to continue to slide 7% as the

uncertain economic and employment outlook continues. Over the past year commodity prices provided one of the key shocks to the global economy. In the developed markets, oil prices were a factor. In the emerging markets, many agricultural prices exerted upward pressure. Our view for both energy and agricultural commodities is relatively benign over the first half of the year. However, the outlook is not without risk. If the troubles in Europe are not contained, prices for many industrial commodities are likely to fall. Our expectation is for a workable euro area plan to evolve during

Q1 allowing for industrial commodities to recoup some of the losses experienced over the second half of 2011. US interest rates are likely to remain low throughout 2012 as a result of growth concerns, costly regulatory reforms, shrinking safe assets, and an easy monetary policy. We look for the 10 year government yield to hold below 3%, ending the year closer to 2%. An escalation in the euro crisis could move yields near all-time lows of 1.5%. We expect equities to remain weak with risk to the downside during the first half with prospects for a meaningful rally developing later in the year.

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The European Debt Crisis 2012

It is quite probable that the European debt crisis will not be resolved anytime soon. It is realistic that the situation could get worse before the EU reaches a final agreement that is both realistic and effective. During December, US, European, and Japanese central banks announced an agreement to cooperate in ensuring dollar liquidity by reducing certain lending terms. This agreement at least temporarily allowed markets to move higher. Despite some forward progress it remains unclear how far the crisis will spread and how large its impact may be. Last year concern over the crisis was the largest factor influencing the market volatility. It's likely that similar volatility will continue this year. Thus far the volatility has generally resulted in sideways price

action. However, we have yet to experience any European shocks. If a shock does occur it's conceivable that stocks could fall 10% below current levels. It's hard to conceive of a nearly 40% fall that followed Lehman Brothers' bankruptcy during the 2008 financial shock. It's reasonable to expect that some extraordinary events may happen, probably during early 2012 to prevent a progressive freeze of the EU sovereign bond markets. If a shock does come, historic perspective suggests the markets might bottom mid-2012. The timing of any prospective shock and the speed and scale of any policy response will certainly influence the market's reaction. Given that global macro conditions are more robust than at the time of the Lehman collapse,

the markets are likely to avert a post-Lehman type performance. By mid-2012, we expect more clarity towards a resolution of Europe's problems. We also expect the possibility of equity market action to differ substantially between the first and second halves of 2012. Early on, strongly defensive sectors such as pharmaceuticals, food, transport and telecom are likely to outperform. Many are already outperforming. However, as risk appetite increases cyclical sectors such as machinery, marine transportation, steel nonferrous metals and trading companies are all likely to appear more bullish. Our strategy is to remain defensive in the short-term and gradually repositioning portfolios for a market rebound.

***Higher taxes on
the the rich
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Rich-Poor Divide—an Education Gap

According to the Organization for Economic Cooperation, income inequality rose in 17 of the 22 OECD countries surveyed between the mid-1980s and late-2000s. The positive conclusion of the cross-country study was that the widening gaps were not inevitable and technological forces driving incomes apart could be successfully countered by appropriate government policies. The gap between rich and poor widened most sharply in the US, Germany, Finland, Israel, Luxembourg and New Zealand. In the US, Israel, and Turkey. The incomes of the top 10% are 14 time higher than those of the bottom 10%. Notably the rise of inequality has been a rise in the rewards to well-educated individuals who

have benefitted from new technologies. Workers with little education or training have been left behind. Technological progress in the manufacturing and service sectors which has accelerated since the mid-1990s, has benefited highly-skilled workers most. Tax and benefit systems are doing less to mitigate inequality than in the mid-1980s and the trend towards globalization has had little impact on the gap between rich and poor. The report recommends using the labor laws to equalize rights between all employees, focusing on education, and more redistribution from rich to poor. According to the OECD higher taxes on the rich “might not be the most effective” in the form of higher income taxes.

Instead, improving compliance, eliminating tax breaks, and reassessing the role of taxes on all forms of property and wealth would be viewed as more effective. Education appears to be the single most important factor contributing not only to reduced wage dispersion but also to higher employment rates. “The evolution of earnings inequality could be viewed mainly as the outcome of a ‘race between education and technology’.” In summary, providing improved education is the most important long-term solution. Taxing the rich is not a fix. In fact, it may be damaging. However, done properly, revamping the tax code could help close the divide between the rich and poor.

During 2010, Congress and President Obama extended the lower Bush-era tax rates on individual income through 2012. With the prospect of another expiration now less than one year away, individuals once again face uncertainty over future tax rates. If Congress fails to pass a more permanent tax structure before the end of the year, income tax, estate, and gift tax rates would revert to pre-2001 law. Such an event would usher in tax increases for all classes of taxpayers. There is nearly unanimous support for preventing tax increases to low- and middle-income taxpayers, the fight over taxation of higher-income individuals continues. Exacerbating the conflict are new taxes scheduled to take effect in 2013 as a result of enacted increases in the Medicare Hospital Insurance tax for high-income individuals. These increases impose taxes of 0.9% on wages and 3.8% on investment income. The president often frames

the debate in terms of allowing the 2001 and 2003 tax cuts to expire for singles with income above \$200,000 and couples with income over \$250,000. The deeper issue is the extent to which higher-income taxpayers should bear a greater tax burden under a reformed income tax? President Obama's proposal is to allow the top two individual income tax rates to rise to 36% and 39.6% in 2013. The top rate for ordinary income is currently 35%. The president also proposes to increase long-term capital gains and qualified dividend rates to 20% (currently 15%) and to phase-out itemized deductions. Furthermore, the president supports a new minimum tax on income of individuals earning more than \$1 million. Should 'Obama Care' withstand current legal challenges and/or not be repealed by Congress and should the President's tax proposals be enacted, the impact on higher-income tax payers would be

significant as could be the effects on the economy and the markets. Most likely, Congress will be unable to agree on a tax plan until after the November 2012 elections. This would leave it to a "lame duck" Congress to make last-minute decisions which may or may not make good law. What direction a lame duck session may travel will have a lot to do with the tone and outcome of the elections for both Congress and the White House. Also having an influence will be the strength of the economy and employment, progress made on tax issues before the elections, and reactions to previously enacted deficit measures. Most likely uncertainty will be with us throughout 2012, and possibly longer, unless Congress can agree (a true oxymoron) on a comprehensive long-term plan. Without such a law, how best to plan your taxes and investment portfolio in part becomes a matter of making educated guesses.

Top individual tax rate could rise to 39.6% in 2013 under Obama plan

Are Your Assets at Risk to B/D Failure?

With the recent fall and bankruptcy of MF Global and the alleged misappropriation of customer funds of over \$1 billion, it raises the question about the safety of customer's assets at securities broker/dealers. While MF Global was also a securities broker/dealer and a member of the Securities Investor Protection Corp., the misappropriation did not occur in securities accounts (stocks, bonds, etc.) but rather from commodity accounts not covered by SIPC. Typically, commodities customers deal in futures transactions that are collateralized by cash (cash equivalent) deposits. By regulation, these funds must be segregated from the firm's assets. In MF Global's case, the firm may have

illegally tapped customer funds for firm purposes. While customers have received a portion of their funds back, it's unclear if they will recover 100%. Stark Financial does not invest customer funds in commodity futures (which are ineligible for SIPC protection) and therefore client's funds are not at risk to loss due to misappropriation. All US securities broker/dealers are members of SIPC. SIPC is a federally mandated, member-funded corporation. SIPC's focus is restoring funds to investors with assets in the hands of bankrupt and otherwise financially troubled brokerage firms. SIPC covers cash and securities, such as stocks and bonds. Through SIPC cus-

tomers accounts are protected up to \$500,000 (of which \$250,000 can be in cash). Since many customer accounts exceed \$500,000 in value, select (not all) broker/dealers provide additional coverage. For example, many SFA client accounts are domiciled at Pershing LLC, a Bank of New York Company. In addition to SIPC protection, accounts at Pershing are afforded protection within an aggregate loss limit of \$1 billion, of which \$1.9 million can be cash awaiting reinvestment. At Pershing, the additional protection is provided from Lloyd's of London in conjunction with other insurers. For specific coverages other than at Pershing, check with your financial advisor.

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*"Helping Clients
Balance Risk and
Return"*

WE ARE ON THE WEB

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Stark Financial Advisers is a registered investment adviser affiliated with R.M. Stark & Co., Inc., an SEC registered broker dealer. SFA seeks to achieve positive returns over a long-term investment horizon by creating and maintaining the optimum portfolio for each investor. We view the optimum portfolio as one having the highest potential return consistent with the risk tolerance and investment horizon of the owner.

We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit www.starkadvisers.com.

Pursuant to Rule 204-3 of the Investment Advisers Act of 1940, we are required by the Securities and Exchange Commission to offer each client a copy of Form ADV Part II that describes our firm and methods of operation. To receive a copy, please call our Managed Account Services Department at (800) 410-0704.

The Efficient Frontier Graph

As part of our Asset Allocation Analysis we always include the Efficient Frontier graph. As an investment manager, our goal is to produce optimal portfolios for predetermined levels of risk. For securities in our universe we know today's price. Their accumulated values at the end of a time horizon are random. As random quantities, they are assigned expected returns, volatilities, and correlations based on historic data. On the graph, the curve runs along the top of the achievable region.

Above the curve is a region which is unachievable risk-return space. Below, for every point there will be at least one constructible portfolio from the universe of securities. Portfolios that correspond to points along the curve have the optimal risk/return allocation.

*"An investment in
knowledge always
pays the best
interest"*

Benjamin Franklin

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**As always the professional staff at Stark
Financial Advisers thanks you for your
confidence and business**

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