FOURTH QUARTER
DECEMBER 31, 2012

DEIGHAN
WEALTH ADVISORS

MARKET COMMENTARY

Last quarter, we wrote that Congress would pass band-aid legislation at the eleventh hour to avert the full impact of the Fiscal Cliff. Though we were correct in this assumption, it wasn't due to any great foresight on our part. Congress has made such a habit of delaying decisions and holding the country hostage to politics, that an imperfect, eleventh-hour, backroom deal was almost a certainty. Markets of course rallied when the American Taxpayer Relief Act (ATRA) was announced, because it meant the nation would not be jumping headlong off the Fiscal Cliff. But now, as we look over the edge, the question becomes, will we change direction and move away from the cliff, or will we simply rappel down the mountainside? We've started doing the latter.

The Congressional Budget Office (CBO) estimates that, in 2012, the government generated revenues equal to 15.7% of GDP and spent the equivalent of 22.9% of GDP. This is clearly unsustainable. Fortunately, the ATRA manages to increase revenues from historically low levels. Unfortunately, this means taxes will be going up for most U.S. households, creating a drag on an already slow-growing economy.

Wealthier households will be the ones most impacted by tax increases in 2013. There will be a new 39.6% marginal tax-bracket for incomes over $400k ($450k if married filing jointly), and, for those same taxpayers, the tax on qualified dividends and long-term capital gains will rise to 20%. These rate increases are in addition to the new 3.8% tax on investment income and the new 0.9% Medicare tax on wages, both called for in the Affordable Care Act and assessed on taxpayers with incomes over $200k ($250k if married filing jointly). Please see the table on the next page for more information.

> "WEALTHIER HOUSEHOLDS WILL BE THE ONES MOST IMPACTED BY TAX INCREASES"

Middle and lower-income taxpayers, too, will see their paychecks shrink due to the expiration of the 2% Social Security Payroll Tax cut. This means someone earning $50,000 per year will pay an additional $1,000 in taxes, and someone earning just $32,749 will see their taxes rise by $655. These increases are not insignificant to middle and low-income households.

All combined, it's estimated that tax increases will result in a 1% fiscal drag on GDP growth in 2013. For context, the economy is expected to have grown somewhere between 2-3% of GDP in 2012, meaning the drag on 2013 growth will be material. It will be further compounded by a drag of 0.8% of GDP should the automatic spending cuts spelled out in the Budget Control Act of 2011, commonly known as the sequester, go into effect. The sequester, delayed by the ATRA, is scheduled to reduce spending on defense and other discretionary items.

No one disagrees that the country's fiscal imbalance is unsustainable and that some combination of tax increases and spending cuts is necessary, but the problem is that both of these cures threaten the immediate health of our economy. We have to take them in such high dosages that they are extremely unpalatable and come with nasty side effects.

For example, we could have gone over the Fiscal Cliff. Doing so would have set us on a better long-term fiscal trajectory, because it called for higher taxes and deeper cuts than what we'll get with the ATRA and ATRA Part II. However, the Fiscal Cliff would have almost certainly sparked a recession, and it wouldn't have done enough to eliminate deficits over the next 10 years. According to the CBO, had the full impact of the Fiscal Cliff been

MARKET COMMENTARY Cont.

allowed to occur, the budget would have come close to balancing in 2018, but then it would have deteriorated due to increased entitlement spending toward the latter half of the decade. Now, with the ATRA in place, Northern Trust estimates that deficits will only improve to around -$600 billion by 2018 before deteriorating again.

FISCAL CLIFF AGREEMENT		
Description	2012 Law	2013 Law (ATRA)
Ordinary Income Tax Rates	10%, 15%, 25%, 28%, 33%, 35%	Add'l 39.6% bracket for incomes >$400k ($450k if filing jointly)
Qualified Dividends & Long-Term Gains	0%, 15% for those in higher brackets	Add'l 20% level for those earning >$400k ($450k if filing jointly)
Medicare Tax on Net Investment Income	None	3.8% for those with MAGI's >$200k ($250k filing jointly)
AMT Threshold	Various	Indexed to inflation going forward
Social Security Payroll Tax	2% reduction	Reduction expires
Itemized Deductions / Personal Exemptions	No additional high-income phase-out	Phase-out of personal exemptions and up to 80% of deductions for incomes >$250k ($300k filing jointly)
Estate Tax	35% on estates over $5,120,000	40% on estates over $5,000,000

The Fiscal Cliff would have been like taking a well-known, powerful drug with a high cure rate, but with serious near-term side effects like blot clots or stroke. The ATRA, by comparison, is like taking a less-potent drug that doesn't seek to cure the illness as much as provide temporary comfort, and it comes with nagging side effects like nausea. The ATRA, in other words, is like rappelling down the mountainside.

One might imagine it's none too pleasant rappelling down a mountain while nauseous, but that's increasingly what it feels like to savers. Being one of the few remaining groups with the ability to pay higher taxes, and having little organized political representation, the average American saver is truly under attack. Zero percent interest rates are delivering negative returns after inflation, which is in fact a shadow tax that reduces the real value of outstanding government debt. And now, savers face higher explicit taxes on dividends and capital gains. With savings rates already dreadfully low in the U.S., this all-out assault on savings and investment doesn't help improve household balance sheets, and it doesn't encourage people to save for things like retirement and medical emergencies. What it does is ensure that individuals will spend forward their future earnings in the form of consumer debt, because a dollar today is worth more than a dollar tomorrow. Those individuals who do save will continue to be forced into riskier assets to achieve their return goals and meet inflation.

As money managers, we're always mindful both of an investment's absolute value and its relative value. The latter informs where we should be invested, but the former informs whether we should be invested. Stocks, relatively speaking, remain attractive compared to many other asset classes, especially investment-grade bonds. But on an absolute basis, stocks seem fairly valued, if not slightly overvalued, considering their increased risks. Going forward, we continue to expect that risk assets will be supported by low interest rates and other accommodative policies. Therefore, stocks remain one of the largest components of client portfolios. However, we've kept them slightly underweight relative to typical, long-term allocations. We also expect that interest rates will not rise significantly throughout 2013, as the Fed has now set explicit guidelines (unemployment below 6.5% and inflation above 2.5%) for a rate increase. More so than in 2012, investors will have to work to combat the ill-effects of low interest rates in their portfolios, because stocks are unlikely to post another double-digit return and taxes will take a greater bite.

As we rappel down the Fiscal Cliff, the combined drag from increased taxes and reduced spending may threaten to stall the economic recovery. Still, the elections are behind us, Europe has made progress, and China has so far managed to engineer a soft landing. These are short-term positives that may lead to less volatility this year. Overall, we expect it to be a year where good relative value decisions will trump bad absolute value decisions. As always, we will do what we can to be opportunistic where it makes sense to do so, but we anticipate maintaining a focus on downside protection throughout the year, unless valuations become materially more attractive on an absolute basis.

From everyone here at Deighan Wealth Advisors, we hope you and yours have a happy, healthy, and prosperous 2013!

Matthew T. Skaves, CFA
Chief Investment Officer

A NEW YEAR'S RESOLUTION: ASSESSING "STUFF"

A popular 1980's bumper sticker once declared, "He who dies with the most toys wins!" Now, thirty years later, this credo may be the Baby Boomers' undoing. Like plaque in the arteries, our toys have piled up. Some have lost their charm, doing little for us save cluttering our lives and weighing us down.

Let's start with the big stuff. Many of us invested not only in toys, but in homes for the toys: lakefront property, coastal cottages, ski condos, hunting camps and other playgrounds. Often we justified the acquisitions with, "Well, what the heck, it is a good investment; real estate always goes up!" Certainly, we now know that real estate does not always go up. Recreational real estate cratered with everything else in 2008 and 2009, and property values are just starting to climb out of the abyss. However, the comparison between initial cost and current market value may be only a small part of assessing whether a piece of recreational real estate should remain on one's balance sheet. Here's why: recreational real estate is typically a use asset and not an investment asset.

Use assets consume our other assets rather than contribute to our bottom lines. They include most cars and toys, our residence, recreational properties, furnishings, clothing, personal electronics and so forth. As we rush through our busy lives, it is easy to forget that every use asset we own requires care and feeding. The question is, is it worth it? Returning to the example of recreational property, if one were to sit down and create a list of expenses associated with each property, the annual total might be sobering. If the total is modest, make another list. This time, assign costs to the time you spend doing things that could be hired out. Then, ask yourself, since your time on earth is not limitless, what is your time worth to you?

Certainly, many a precious memory has been made at a summer house or ski home, and certainly it makes sense to hold on to assets that bring us great pleasure, so long as we can afford them. However, it is also okay to let go of properties and "stuff" that is weighing us down financially, physically, and mentally. Sometimes it even makes sense to let a property go for less than the initial cost when visits seem more like work detail than recreation, and/or the annual maintenance costs would be better spent somewhere else. As Chuck Palahniuk said in the mid-nineties, "When you own things, they end up owning you."

Perhaps a useful New Year's resolution would be to give careful thought to the status and future of the "stuff" in our lives.

Jean M. Deighan, JD, CFP®
Chief Executive Officer

INVESTMENT CHANGES

The following investment changes were made in the most recent quarter. Depending on your holdings and investment policy, these changes may not be applicable.

Removed
Progressive Corporation
Ticker: PGR

Progressive evolved from its humble beginnings as a nonstandard provider of discount auto insurance into one of the largest auto insurers in the United States. Policy growth, however, has slowed, and we're less confident in the company's ability to grow signficantly going forward. The auto insurance market is highly competitive with low switching costs, and customers typically choose carriers based on price.

The stock performed in-line with the market in 2012, though it slightly lagged its insurance peers. Early in the

SOUNDBYTES

In early-December, Jenifer Wilson and Jean Deighan attended a one-day strategic planning seminar in Boston sponsored by Charles Schwab. The seminar broke the strategic planning process into manageable steps and provided advisors with tools to write a strategic plan.

In mid-November, Jean Deighan traveled to Chicago for Schwab's 21st Annual IMPACT Conference. Among the speakers and commentators were Alan Alda, Erskine Bowles, Peter Diamandis, Robert Gates, and Alan Simpson. Breakout sessions covered a wide variety of topics, from investments, to economics, to practice management.

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INVESTMENT CHANGES Cont.

quarter, PGR met our valuation target, and we decided to exit the position as a result.

Added
iShares S&P Mid Cap ETF
Ticker: IJH

This fund is inexpensive and sufficiently liquid, providing cost-effective exposure to medium-sized U.S. companies. It tracks the S&P 400 Index, which falls between the larger S&P 500 Index and the smaller S&P 600 Index with minimal investment overlap. The fund will most commonly be used as a core mid cap holding in larger accounts.

Added
iShares S&P Small Cap ETF
Ticker: IJR

Like IJH, this fund is also inexpensive and sufficiently liquid, providing cost-effective exposure to small U.S. companies. It tracks the S&P 600 Index, which coincides with the larger S&P 500 and S&P 600 Indexes with minimal investment overlap.

Added
Vanguard MSCI EAFE ETF
Ticker: VEA

This fund benefits from good liquidity and one of the lowest expense ratios around. Soon, it will switch from tracking the MSCI EAFE Index to tracking the FTSE Developed ex North America Index. Though there are some differences between these two indexes, they track very closely and we expect the impact to be immaterial over the long term. Vanguard made the switch with costs in mind; MSCI's licensing rights are more expensive than FTSE's, and Vanguard is trying to keep expenses low.

Disclaimer

HANNAH PROMOTED TO A HIGHER PLANE

Hannah Porter, Vice President of Client Relations, was promoted unexpectedly on December 6, 2012. She was 15 years and seven months old, but, to many, her joyful enthusiasm made her appear forever young. She was, in fact, a woman of a certain age, and it finally caught up with her.

Hannah had a long and distinguished career at Deighan Wealth Advisors, joining the firm in early 1998. She was very serious about her firm responsibilities and sniffed many a dog out of client portfolios. She was the official client greeter and was widely loved. She was also an avid sailor and cross country skiing companion. She will be greatly missed at the firm, but we are confident she is embracing her new assignment with her usual vigor. She is survived

by her human families: the Porters at home, and her colleagues and clients at Deighan Wealth Advisors.

DEIGHAN
WEALTH ADVISORS

TELEPHONE 207-990-1117

FACSIMILE 207-990-1551

www.deighan.com

DEIGHAN WEALTH ADVISORS
455 HARLOW STREET
BANGOR, ME 04401

JEAN M. DEIGHAN, JD, CFP®
CHIEF EXECUTIVE OFFICER
jeandeighan@deighan.com

JENIFER L. WILSON, CFA, CFP®
PRESIDENT & CHIEF OPERATING OFFICER
jeniferwilson@deighan.com

MATTHEW T. SKAVES, CFA
CHIEF INVESTMENT OFFICER
matthewskaves@deighan.com

LUCIE E. ESTABROOK, CTFA
VICE PRESIDENT
lucieestabrook@deighan.com

KAREN S. MITCHELL
OFFICE MANAGER
karenmitchell@deighan.com