



PRIVATE CAPITAL MANAGEMENT

A Division of GUARANTY BANK AND TRUST

P: 303.370.0055
F: 303.370.0066

pcm-inc.com

250 Steele Street | Suite 350 | Denver, CO 80206

Third Quarter 2012

“A politician is a man who will double cross that bridge when he comes to it.” - Oscar Levant

Historically, election years are good ones in the stock market and this one appears to be no exception. The S&P 500 continued to march higher during the third quarter and is up +14.6% year-to-date and a whopping +30% from a year ago. You may recall that at this time last year the situation in Europe was bleak and the U.S. economic data was quite weak. At that time we acknowledged economic risks but remained invested; we are pleased with that decision. Recently the Federal Reserve announced QE3 (or ‘QE∞’, the open-ended purchase of \$40B in mortgage backed securities a month until employment improves). To us, this is a clear indication that, right or wrong, Ben Bernanke is the only one doing anything about anything to try and help this economy. We remain hopeful that the gridlock in Washington will begin to break soon because it is not good for the economy.

“In this world nothing is certain but death and taxes”

One of Benjamin Franklin’s famous quotes weighs heavy this year. Unfortunately, there is a lot of uncertainty in the U.S. tax code as rates on ordinary income, interest, dividends, capital gains and gifts and estates are set to rise in 2013. In our view, this uncertainty has been a drag on the economy because business owners cannot effectively plan for the future when the rules of the game are likely to change. It seems clear that nothing will be done before the Nov. 6th elections, but after that, the House of Representatives has scheduled only 16 working days to address this issue before adjournment on Dec. 14th, leaving little time to make any sweeping changes to the tax code.¹ Several of the main changes that we believe are most relevant for our clients are listed below.

Income Tax Brackets: Income taxes could rise for all Americans, with the lowest bracket increasing from 10% to 15% and the highest from 35% to 39.6%. **Long-Term Capital Gains:** The top tax rate on long-term capital gains is scheduled to revert back to 20% from 15% currently. **Qualified Dividends:** Currently taxed at 15%, qualified dividends are set to be taxed as ordinary income, at nominal rates up to 39.6%. Additionally, a 3.8% flat surtax, enacted to help pay for the health-care overhaul, will be applied to the investment income of most married taxpayers with an Adjusted Gross Income of \$250,000 or more. **Payroll Taxes:** Individuals share of Social Security taxes would rise from the temporary 4.2% rate to the normal 6.2% rate and the self-employment tax rate would rise from 10.4% to 12.4%. **Alternative Minimum Tax:** Without the extension of temporary exemptions, the IRS estimates an additional 28.6 million taxpayers could get snared by this parallel tax system. **Estate Taxes:** Exemption levels are set to fall from \$5.12 million per individual to \$1 million and the maximum estate tax rate will increase to 55% from 35% currently.

While the details of both the President and Governor Romney’s plans for taxes are still murky, it appears Obama would raise taxes on the highest earners from 35% to 39.6% to offset keeping the Bush-era tax cuts for the middle class. Romney is proposing cutting all income tax rates by 20% and offsetting that by eliminating some tax deductions for a revenue neutral approach.

Some experts think that both houses of Congress could agree to extend the current rules for up to a year, buying time to make more fundamental changes to the tax code. If one party blocks the other from extending the current tax code, it would likely take months for lawmakers to reach an agreement, but new tax laws could be made retroactive to the beginning of the year.

In addition to the uncertainty around taxes, budget sequestration calls for \$600 billion of cuts to defense and domestic discretionary spending over 10 years. The Congressional Budget Office estimates the impact of higher taxes and this budget sequestration is enough to push the economy back into recession. We’re hopeful the folks in Washington don’t go ‘Thelma and Louise’ off the Fiscal Cliff!

Corporate Tax Competitiveness... 4th Highest Taxes

The chart below paints a pretty clear picture of the United States’ competitive positioning on corporate tax rates. Our #4 Ranking means only Argentina, Chad and Uzbekistan have higher effective marginal corporate tax rates. Surprisingly, corporate income tax is only about 8% of U.S. federal revenue.

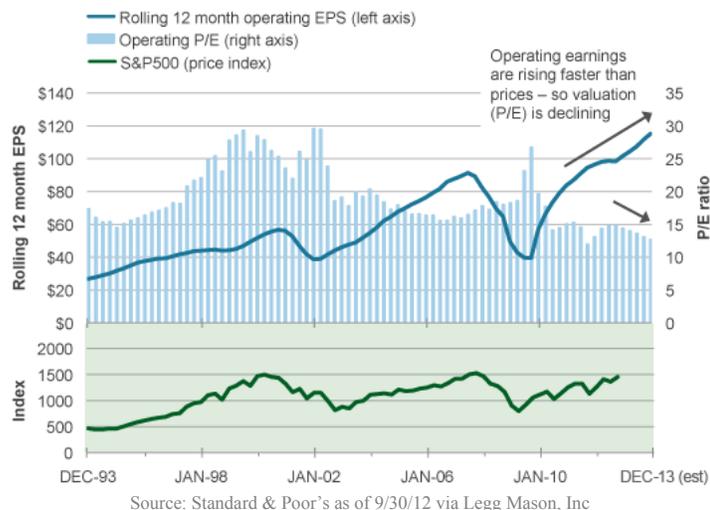
As economist Richard Rahn notes: “The corporate income tax is a leading candidate for causing higher prices to consumers, lower wages to workers and lower returns to investors. It misallocates capital, resulting in higher levels of unemployment and lower levels of economic growth and opportunity, and it taxes income that has already been taxed at least once before.”² Unfortunately, some large multinational corporations, as an obligation to maximize shareholder value, have moved their headquarters out of the United States to countries with lower taxes. To help combat this problem in Canada, our neighbor to the north reduced its federal rate by 31% from 2000 to 2010, yet corporate tax revenue remained roughly constant as a share of GDP. It’s conceivable the reduced federal revenue from a lower corporate tax rate could be completely offset by improved conditions for new jobs and investment in the United States. While the issue is complex, corporate tax competitiveness is an important part of economic vitality and should be addressed.

COMPARATIVE TAX RATES		
Marginal effective tax rates on corporate investment, selected countries, 2012:		
Country	Marginal effective tax rate, %	Rank
United States	35.6	4
Japan	30.4	9
Germany	24.6	21
Canada	19.9	34
China	18.5	41
Mexico	17.5	45
Singapore	9.3	77
Chile	6.7	83
Bulgaria	5.0	88
Hong Kong	3.9	89

THE WASHINGTON TIMES

Markets rise, but valuations have been declining

As the chart below shows, the S&P 500 Index has been moving higher (green line) with prices following the upward trend in earnings (blue line). However, the forward Price/Earning (P/E) valuation metric (blue bars) has actually been declining as investors remain skeptical that earnings growth will continue at this pace.



Profit margins are already near record levels so revenue growth will be an increasingly important driver of future earnings growth. Inflation (read QE3) will help boost sales numbers, but greater clarity on fiscal and debt issue will also be necessary.

Giving back

As we have in mentioned in the past, U.S. companies have been hoarding huge amounts of cash in response to the financial crisis of 2008 and due to uncertainty about the economy. This is slowly starting to change. During the 3rd quarter, U.S. domestic-listed common stocks paid out a record \$398 billion, with actual cash dividends up 19% year over year and the forward indicated dividend payout reaching a new all-time high, up 14.5% from year-end 2011.³ Surprisingly, companies are still only paying out 34% of their earnings in dividends, far below the 52% historical payout rate.³ Due to the strong returns in the equity markets, the dividend yield decreased slightly to 2.7% but is still relatively high compared to CD's, treasuries or bonds.³ S&P Dow Jones senior index analyst, Howard Silverblatt, expects double digit growth in actual dividends during the 4th quarter and sees a potential double-digit gain in 2013. Silverblatt estimates that from 2003 through 2012 investors will have saved an estimated \$358 billion via qualified dividend tax cuts, a favorable tax treatment that is set to expire at the end of this year.

Our new home

It is with great pleasure and excitement that we announce the deal with Guaranty Bank and Trust closed July 31st. While it has only been two months since PCM was acquired by Guaranty Bank, we could not be more impressed with the caliber of people at this historic Colorado bank. We are proud to be the investment management platform for this first class organization and look forward to continuing to deliver the service and results our clients expect from our team. Please call us for additional information.

PCM welcomes Giles R.A. Fox, CFA

We are pleased to announce that Giles, R.A. Fox, CFA has joined Private Capital Management as a Senior Vice President and Senior Research Analyst. Giles has over 25 years of investment experience

including work as a Portfolio Manager and Equity Analyst at Denver Investments and as a Partner and Portfolio Manager at Tempest Investment Counselors. He is a Chartered Financial Analyst (CFA) Charterholder and has an MBA from the University of Virginia. Giles is a past president of the CFA Society of Colorado and serves on the board of The Gathering Place Endowment, The Denver Ballet Guild Endowment and The University Club. Giles is a great addition to our research effort and to our Investment Committee. Welcome aboard Giles!

A fresh new look

The new Private Capital Management website is now up. It includes better information about our firm, investment philosophy and investment process, senior employees and an archive of our Quarterly Commentaries. Please take a look at www.pcm-inc.com. As always, your feedback is appreciated!

Thank you

We would like to take this opportunity to thank each and every one of our clients for their support during the transition with Guaranty Bank and Trust. Needless to say, we were more than pleased that 99.9% of our clients' assets under management remained with PCM after the acquisition. We view this as a vote of confidence in PCM and our investment process. Thank you.

By the numbers...

Index	Close	3 rd Quarter	Year to Date
S&P 500	1441	+5.8%	+14.6%
MSCI EAFE	1511	+6.1%	+7.0%
MSCI Emerging Markets	1003	+7.0%	+9.4%
Barclay's US Aggregate Bond	122	+0.9%	-0.5%
DJ UBS Commodity	149	+9.7%	+5.6%

Data provided by Thomson Reuters as of 9/28/2012

1 Laura Saunders "Countdown to a Tax Hike" Wall Street Journal 9/11/12

2 Richard Rahn "RAHN: US should ax destructive tax" The Washington Times 9/24/12

3 Shirley A. Lazo "Plentiful Payouts" Barron's 10/8/12

Disclosures

Investment Products: Not FDIC Insured – No Bank Guarantee – May Lose Value
Not Bank Guaranteed – Not insured by any federal government agency.

Private Capital Management (PCM) is a division of Guaranty Bank and Trust. Opinions and information presented have been obtained or derived from sources we believe to be reliable, but we cannot guarantee their completeness or accuracy. Opinions represent PCM's judgment as of the date of the report and are subject to change without notice. This material is for general information only and is not suitable for all investors. It is not soliciting any action from any particular investor. This presentation is not an offer to buy or sell, or a solicitation of an offer to buy or sell the securities mentioned. The investments discussed or recommended in this presentation may be unsuitable for some investors depending on their specific financial position and investment objectives. Private Capital Management and/or its personnel may trade for their own accounts, be on the opposite side of customer orders, and have positions in securities related to issues mentioned in this presentation. Investing in foreign securities presents certain risk that may not be present in domestic securities. Fixed income securities are subject to availability and market fluctuation. These securities may be worth less than the original cost upon redemption. Past performance does not indicate future results. The value or income associated with a security may fluctuate. There is always the potential for loss as well as gain. Asset allocation does not assure or guarantee better performance and cannot eliminate the risk of investment losses. PCM does not provide tax or legal advice. Please consult appropriate tax or legal advisors to determine how this information may apply to your own situation. The indices and benchmarks mentioned for comparison purposes are unmanaged. You cannot purchase an index. S&P 500 Index is an unmanaged capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets consisting of 21 emerging market country indices. The Barclay's U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The Dow Jones Commodity Index is an index composed of the futures contracts on 19 physical commodities. Additional information is available upon request. Dated: 10/9/2012