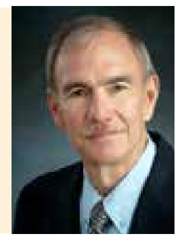
CLAYTON
FINANCIAL SERVICES, INC.

the Quarterly

Q4, 2012

Solid Market Returns in 2012

by Terry Milberger, CFA®
Director of Portfolio Management



In spite of some weakness at year-end, stocks, as measured by the broad-based Wilshire 5000, provided a total return of almost 14% in 2012. The Wilshire 5000 is an index intended to measure the performance of most publicly-traded companies headquartered in the U.S.

This year-end stock market weakness resulted in flat returns for the last quarter of the year. This weakness occurred for a couple of reasons. The U.S. economy showed signs of slower growth after nice gains earlier in the year. Some of this weakness can be attributed to slower growth in exports to Europe. The Euro zone continues to be plagued by recessionary conditions.

Investors have been anxious about the possibility of facing the fiscal cliff. The inaction by both major political parties to come together to forge an agreement has caused companies to postpone many important business decisions. Individuals have been concerned that their taxes would be increasing and that the possibility that many benefits could be lost.

Fixed income investors experienced a reasonably good 2012. The Barclays U.S. Aggregate Bond index had a total return of about 4% for the year. With interest rates already at historically low levels, this return is actually quite good. Investors have been drawn to bonds not for the absolute return they provide, but for their perceived safety in times of uncertainty.

Fixed income investors experienced a reasonably good 2012.

What does 2013 have in store after the fine returns stocks provided in 2012?

Fortunately, the political parties were able to come together in typical fashion at the last minute and reach an agreement to avoid going over the fiscal cliff. Although some major issues were left unresolved, at least individuals and businesses now know the rules they must live by and the tax rates they will be subject to. Finally, a great deal of uncertainty has now been resolved.

The outlook for the U.S. economy in 2013 is quite good. The U.S. economy has made an important transition in that drivers of growth have shifted toward domestic demand and

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Inside this issue…

SAVE THE DATE!

Economic and Investment Seminar

Plan to attend our Market Update Seminar to hear Clayton Financial Service's outlook for the future. In addition, we will be discussing the federal deficit and its impact.

Space will be limited so let us know if you plan to attend!

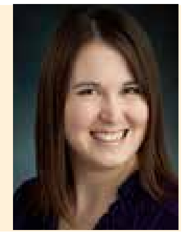
Presenter: Randy Clayton, CFP®

Times: **Tue. Feb. 5, 2013**
2:00 pm only
Wed. Feb. 6, 2013
2:00 pm only
Thur. Feb. 7, 2013
2:00 pm & 6:00 pm

Place: Clayton Financial Services Office,
716 S. Kansas Ave.
Topeka, KS

529 Ownership—Child, Parent, or Grandparent?

Barbara Heller
Senior Financial Planner



Saving for a child's education is an important part of financial planning. As a parent, you want to save in advance to help with future, often overwhelming, costs of a higher education. As a grandparent, you may want to help your children provide for their children. A 529 plan is the most common vehicle used for education planning due to the significant tax benefits. Quite frankly, using this investment vehicle seems like a no-brainer. However, one major consideration that can actually have a large impact on future financial aid is how one chooses to title ownership of these accounts.

A 529 account can be opened by any adult and anyone can be named as a beneficiary. The main question is: How will the ownership affect future financial aid calculations? Below is information on the possible affects each type of ownership can have on this issue.

Student Ownership:

This is where the student is listed as the owner of the 529 account or it is owned in a custodial relationship where the student is the minor (UTMA or UGMA accounts). This form of ownership is discouraged for nearly everyone as it is the most detrimental to the financial aid calculations.

- Student assets carry more weight on the Free Application for Federal Student Aid (FAFSA). 20% of student assets go toward the Expected Family Contribution (EFC) compared to the parent rate of 5.64%.
- Because the student is the owner, they have the power to withdraw funds for any purpose, including non-qualified (non-education) purposes. Not only can this have tax consequences, it is not the purpose for these savings.

Parent Ownership:

This is the most common form of ownership. A parent is the owner with the student (child) as the beneficiary.

- The parental assets have a smaller effect on the EFC (only 5.64%).
- Assets are removed from the parent's estate for estate tax purposes.
- Parents maintain control of the assets (even though they are not in their taxable estate any longer).

Grandparent/Other Individual Ownership:

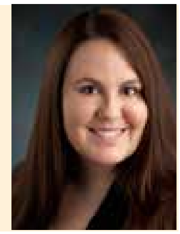
This form of ownership occurs when other family members or family friends wish to help fund education savings. While they could make a contribution to a 529 plan owned by the student's parent, often the individual would like to maintain control of those assets and thus name themselves as owner.

- These assets are NOT listed on the FAFSA as either student or parental assets. This can make ownership by a non-parent seem like the best option from a financial aid perspective. However, while the account value is not included, any payments made to the student or on their behalf for qualified expenses are included in the student's INCOME portion of the FAFSA the following year. Student income is included in the EFC calculation at a rate of 50%.

The total effect of all these rules can be confusing to calculate and there is no simple answer that works for everyone. Depending on account value and timing of distributions, different ownership will be better for different individuals. Make sure to discuss your situation with your financial planner to decide which is best for your situation so you are aware of the impact 529 plan savings will have on a student's ability to receive financial aid.

Fiscal Woes: To Be Continued

Alyse Jackson
Portfolio Analyst



Congress has proven, once again, to be as predictable as they are maddening. As expected, a last minute deal was reached in regard to the "fiscal cliff" that has averted a crisis—for now, at least. The deal addressed the most pressing issues, but kicked the can down the road on many others. It deferred most tax hikes on the majority of taxpayers and extended emergency unemployment benefits for one year. There is a breakdown on the tax changes as a result of the deal below.

The fiscal cliff deal failed to address some very important issues. There are larger budget concerns such as reducing the deficit or raising the debt ceiling that were not addressed. It also delayed automatic spending cuts to defense and to domestic spending for two months. This will coincide with the timeframe that the nation is forced to deal with its borrowing limit toward the end of February. This means that the fiscal battle is far from over.

Shortly after the inevitable February debt limit fight, Congress will be faced with another fiscal concern. The government is set to run out of money for all programs at the end of March. After passing a six-month spending bill last September, Congress will need to pass another resolution to fund federal agencies through the end of 2013. The bottom line is that the fiscal cliff deal was an important part of long-term deficit reduction and economic growth, but there is a lot of work to be done. There are many fiscal matters that will arise in Congress this year. In the meantime, Clayton Financial Services will be investing with this calendar in mind and positioned in a way to best meet your goals.

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Breakdown of Tax Changes

Income Tax Rates: Top Income Tax Rate (450K Joint, 400K Single) will permanently increase from 35% to 39.6%.

Limits on Exemptions and Deductions: Permanently reinstates the phase-out of personal exemptions and the limitation of itemized deductions for single filers with AGI $250K+ and joint filers with AGI $300K+.

Payroll Tax: Employee contribution to Social Security taxes increase to 6.6% from 4.2% on income up to $113,700.

Alternative Minimum Tax: Permanently patched to avoid raising taxes on the middle class.

Estate and Gift Tax: Permanently extends the lifetime estate and gift tax exemption of $5.12 million (with annual inflation adjustments). However, it increases the top tax rate from 35% to 40%.

Capital Gains and Dividends: Permanently extends the 0% and 15% tax rates for long-term capital gains and qualified dividends for single filers making less than $400K and joint filers less than $450K. The top rate will permanently increase to 20% for filers with incomes above those listed previously.

Medicare Surtax on Net Investment Income: The new 3.8% Medicare tax enacted under the healthcare law was not repealed so it will take effect as scheduled in 2013. This tax applies to single filers with modified AGI above $200K and joint filers with modified AGI above $250K. As a result, the four different rates for long-term capital gains and qualified dividends (depending on the investor's modified AGI and taxable income) are: 0%, 15%, 18.8%, and 23.8%.

Annual expiring provisions: Two-year extension (through 2013) of dozens of tax provisions that expired in 2011.

2009 Stimulus-Related Tax Relief: Five-year extension of certain tax credits enacted in the 2009 stimulus bill. This would include the American Opportunity Credit and child and earned income credits.

Solid Market Returns in 2012... *continued from page 1*

away from export demand. This increase in domestic demand has been led by an acceleration in the recovery of the housing sector. Recently, the number of homes for sale has dropped to the lowest level in the last 10 years. This has been accompanied by a 10% increase in the median home price over the last year. This housing recovery, aided by the low level of mortgage rates, could well last for several years. Motor vehicle sales are also proving to be a good source of domestic demand for goods. Sales in 2012 have increased to the highest selling rate in the last 5 years.

This increase in domestic demand is important because it usually enjoys self-reinforcing factors such as job gains, improved business and consumer confidence, and increased credit availability. This should increase the strength and length of the current economic recovery.

Coupled with this acceleration in domestic demand should be better growth from China and the Euro zone in 2013. The European Central Bank, the equivalent of our Federal Reserve, has been lowering interest rates and increasing liquidity into the financial system. There are beginning to be signs of better growth due to these policies. China's leading indicators of future economic growth have improved for three months in a row. Although it will not be the engine of economic growth that it was a few years ago, its reemergence as a premiere global grower would be a major plus.

Although the economic landscape indeed looks positive for 2013, there will surely be periods of market volatility as we move through the year. Normally, the stock market experiences a decline of 5% at least three times during a year. In addition, stocks typically have a 10% pullback once a year. Knowing they do occur on a somewhat regular basis, we try to take advantage of them when they do happen.

Although we do have positive expectations for 2013, we stand ready to make change to our investment strategy should those expectations change.

Thanks to all who were able to join us for our Holiday Open House on December 6th.

We were overwhelmed by the fantastic response we received and hope you all had as much fun as we did! All of us at Clayton Financial Services wish you and yours a prosperous 2013!