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CLIENT BULLETIN

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- ***Greek Tragedy – The Setting***

Let me see if I have this whole Greek situation right: for decades the Greek government massively overspends to the point where its public debt is 175% of its GDP, along the way hiding deficits using financial instruments to mask billions of loans; Greece must turn to its healthier European Union (EU) co-members (primarily Germany) to avoid going bankrupt and agrees to take bailout loans; the EU puts conditions on the loans requiring the Greek government to stop spending more than it makes; this "austerity" begins to work & Greece's budget deficits begin to shrink and their borrowing costs go down. We seem headed for a happy economic ending but…

- ***Politics Invades***

During Greece's last election cycle, a politician runs on a platform basically consisting of "these people who loaned us money to bail us out are cruel and we are tired of being fiscally responsible. Elect me and I promise to return the government to the fiscal policies that got us into this mess"; said politician, Alexis Tsipras, is unsurprisingly elected; Tsipras, trying to deliver on his election promises, approaches EU leaders from possibly the weakest negotiating position ever: "if you don't forgive the loans that you made to us and let us go back to over-spending then we are going to default on the loans you made to us."

- ***Ongoing Drama***

Not surprisingly, Eurozone officials have been unimpressed with Greece's demands. This continuing tragic tale was seemingly coming to a head this week when €240 billion ($273 billion) of loans were coming due. On February 20th, however, Greece agreed to a four-month extension of the existing bailout terms, essentially kicking the can down the road until June. This merely postpones Mr. Tsipras' date with political and economic reality. Odds are that the EU will remain in the driver's seat on any new terms – a default by Greece would mean goodbye from the currency union and economic chaos in the country. The Greek people would suffer even more terribly than they already have for their government's actions. Once posturing is out of the way, an agreement to extend maturities and cut interest rates on the bailout loans should be possible.

- ***Nice Try But,***

Just in case you were thinking about it, don't try to deduct the following on your income taxes: a speeding ticket on the way to a business meeting; plastic surgery because your job requires you to keep up appearances, using pets or unborn children as dependents.

➢ *2012 Tax Data*

The IRS recently released data from the 2012 tax year. I have no desire to wade into the politically charged topic of how much tax various income groups should pay for two reasons: this type of redistribution talk focuses attention on how big of a slice various groups receive from the existing economic pie. The focus should be on creating a bigger economic pie so everyone benefits. Secondly, this discussion inevitably leads to questions about who is paying their "fair share" of taxes. Because the definition of “fair share” is subjective, the conversation typically collapses to accusations that someone other than ourselves should pay more taxes. So with those disclaimers, here is the empirical data from the 2012 data released by the IRS:

- The top 25% of income earners paid 85% of all federal income taxes;
- The top 10% of income earners paid 70% of all federal income taxes;
- The top 1% of income earners paid 38% of all income taxes;
  (Source: Internal Revenue Service).

➢ *Go Where the Money Is*

Data for ***estate tax*** returns for 2012 was also released. During 2012, the individual estate tax exemption was $5 million, meaning that if someone died in 2012 and their estate was worth less than $5 million they did not have to file an estate tax return. As a result, only a miniscule number estates filed returns. This doesn’t mean that the IRS ignored the returns, however. For estates between $5 milion and $10 million, the IRS audited 58.6% of estate tax returns and determined that heirs owed an average of $105,388 in addition to taxes already paid. For the 937 returns filed in 2012 for estates worth more than $10 million, the IRS actually conducted 1,087 audits, going over returns repeatedly. On average heirs were asked to pay an additional $819,243 per return.
(Source: Internal Revenue Service).

➢ *The Illusion of "Loss"*

A recent financial news article reported that Harold Hamm had “lost” twelve billion dollars. Harold and his company, Continental Resources, synthesized horizontal drilling and hydraulic fracturing that has unlocked the vast reserves of the Bakken Shale. In the summer of 2014, Harold's shares of Continental Resources peaked at a market value of $24 billion. In the recent halving of the world's oil prices and the significant markdown of many oil company stocks, his net worth declined by half - hence the headline that he "lost" twelve billion dollars. This could only be the case if you accept not one, but two common fallacies.

➢ *Mental Gymnastics*

The first is measuring Harold's experience in terms of the decline from its peak price to wherever it is now. This is an emotional quirk the folks in the white coats call mental accounting. They didn't ask Harold, but I'd bet almost anything that if they did, he would maintain that he has been enriched to the tune of twelve billion dollars - from the zero he started with to the current value. But wait, here comes the second mental lapse: the idea that the twelve billion dollar decline is "lost" to Harold. In point of fact, he hasn't permanently lost anything because he hasn't sold his shares. He has most certainly experienced a whopping decrease in the market value of those shares, but he's still got them, and the company still has its reserves of oil and gas in the ground. There is a critical difference between temporary decline and permanent loss.