

Given that news involving political rhetoric and the debt ceiling are inescapable lately, we've been fighting the urge to publish on this topic. We've finally arrived at the point where we just can't help ourselves. Now the problem is where to start...

More than a few of our clients have called recently to express their concern about the potential default of our government and the impact that might have on their portfolios. Should I sell all the stocks? Should I sell everything? We don't think so. Here's why.



Reacting to political gamesmanship is not a strategy – tactical or strategic. There are so many reasons that, in the end, the debt ceiling will be raised and checks will go out to all bond holders, social security recipients, and government employees. Even if it's not, it wouldn't be the first time that “non-essential government employees” went temporarily unpaid and “non-essential services” went undelivered. It happened in 1995 and again in 1996. The world didn't end. In addition, since the Budget Act of 1974, Congress has been required to sign off on spending each year. So, technically, the debt ceiling is redundant.

But, you might ask, what about the ramifications of the US debt rating dropping a notch or two and the dollar losing its status as currency of choice in global markets? Our elected officials are keenly aware of the tidal wave of negative activity that would accompany a US downgrade—at least as a result of an action so easily pinned on one party of the other. All investors required to hold AAA securities would have to sell. Government agency debt explicitly backed and foreign entity debt implicitly backed by Treasuries would also be downgraded. Interest costs for future US borrowing would increase (granted from some of the lowest rates in history), unemployment would increase due to the restructuring of the cost of doing business. The list goes on. Another reason we don't believe it will happen.

Add in that projected revenues into the Treasury's coffers in July and August can cover interest payments on debt and much of the essential services. Add in the proceeds of the sales of some of the securities held by the Fed, and the shortfall would be significantly less.

So, you might further query, why are the rating agencies so keenly and loudly focused on a government shut down this time if we've experienced them before? Herein lies the rub. The danger isn't the short term violation of the debt ceiling, not having a budget, and a few folks not getting paid for a week. The danger is the longer term implications of a country that has vastly increased its current, and more importantly future spending commitments, and has no plan for addressing that very crucial issue. We need a string of budgets where revenues support spending priorities. This is not news. Toss in the fact that rating agencies took in on the chin in the 2008-2009 mortgage-related crisis for totally missing the boat. Thus, they are trying desperately to get out ahead of the curve so they don't totally lose their relevance in the investment community or be subjected to punitive regulation as a result.

As I type, headlines are popping up about a bipartisan plan from the so-called "Gang of Six" senators and President Obama's warm reception of it. I'm betting some version of this will be approved at 11:59 pm on August 1st.....

The longer term implications of this for your portfolio are this:

- We still see slower moderate equity growth so dividends are important.
- We still see strong growth outside the US so owning companies that derive a portion of their profits outside our borders are important.
- We believe the market will generate positive returns but also remain unsettled given both US and European debt issues. So a little more cash than normal, while it may keep a lid on returns occasionally, is the best way we know to reduce risk.
- Despite the worries about US debt, our government bonds are still considered a global safe haven and demand for them has driven rates quite low. They may go a little lower, but we believe longer term they will increase.. So we will continue to look for income from bonds from other issuers.

We don't hold ourselves out as market timers. We prepare longer term investment plans with strategic asset allocations for all of our clients. However, sometimes the shorter term realities of our interconnected global markets create tactical opportunities where we can add value. We believe this is one of those times.



We always welcome the opportunity to discuss with our clients the strategies we have created for them. If you think it would be helpful to have a conversation with us, please give us a call.

Warmest regards,

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