



Dumb and Dumber

The new movie must have the White House and Congress all fired up, because it might be the only thing more dumb (aka stupid) than elected US leaders failing to negotiate any deals.

One side wants to spend all the tax dollars received like drunken sailors, and the other side, with almost zero leverage, wants to hold the economy and financial markets hostage via a government shutdown and a failure to raise the debt ceiling.

This is no way to run a country.

What is happening in Washington is not how reserve currency nations are supposed to act. It's how Third World nations behave.

The last seventeen government shutdowns dating back to 1976 last an average of 6.5 days, the longest being 1996 when the US government closed for 3 weeks. They survived them all. All the government's bills were paid, and the USA's credit held intact, but it truly is embarrassing nevertheless.

John Boehner, the Republican Speaker of the House has made it clear he has no desire that the USA will default when it hits the next debt ceiling, somewhere around October 17th. The US really has no choice but to ensure that its creditors are assured their investments in the US are safe and shall be paid on time.

It should be noted that for all the comments about how much US debt China owns, that number is about 8% of all US debt. The vast majority, nearly 2/3 of it, is held domestically by pension funds, endowments, corporations, citizens, etc.

Volatility from the shutdown and other political developments in D.C. will likely continue to rise. There is little incentive on either side to agree to a budget deal before October 17th because the shutdown has already happened, the government is no longer spending, and the markets have held in, which takes pressure off the politicians to act quickly.

With markets down 9 of the past 11 sessions, there are growing opportunities to take advantage of the Washington dysfunction. Historically, equities rally when uncertainty over a shutdown begins to subside. The lower GDP which will result from the stifled growth also means interest rates have room to move lower again, and maybe stay there longer than would be expected.

The Federal Reserve's decision last week NOT to taper seems to be the right one for the time being, given the extra uncertainty already there. A week long shutdown is estimated to reduce US GDP by 0.25%, so 3 weeks would be about 0.75% lower. This could be significant since Q4 GDP is estimated at only 2.5%.

While the media likes to provide cover for the White House and blame all this on the Republican House, people need to be reminded that President Obama was first elected in 2008. We are almost through 2013, and he has yet to pass a single budget since being elected. The last budget the President presented in May 2012 suffered the following defeat in Congress:

Senate 99 to 0
House 414 to 0

In other words, not even a SINGLE Democrat voted in favour of it. So US government spending keeps happening under a series of continuing revolutions.

Meanwhile, back in the real world, the real news is the American job crisis. Last week's ADP jobs numbers of only +166,000 underscores the real issue. This is the worst recovery out of a recession in US history. The real impact has been in small and medium businesses which have slowed dramatically, perhaps all in anticipation of Obamacare implementation?

Market wise, seasonal patterns have played out as expected with a weak June followed by a rally in July, then a 3-4% pullback in August. September which is usually the weakest month of the year, started out

strong (+5-6%) and since then moved down as stated earlier, 9 of the past 11 sessions.

During the last government shutdown under President Clinton, December 16, 1995 to January 5, 1996 (21 days), the S&P 500 declined 3.7%, only to jump 10.5% the subsequent month when a deal was reached. Closing down government in the past has generally had a minimal impact on markets. Obviously a default would have a deeper and more meaningful impact.

To let what has happened already is truly dumb. To push the USA towards any kind of perceived default would be even dumber.

Stay tuned,

Vito Finucci
Vice President and Director
Investment Advisor

P.S. As I wrote this, America Economist Thomas Sowell had a few comments of his own regarding the current events in Washington which I thought were worth sharing:

Even when it comes to something as basic, and apparently as simple and straightforward, as the question of who shut down the federal government, there are diametrically opposite answers, depending on whether you talk to Democrats or to Republicans. There is really nothing complicated about the facts. The Republican-controlled House of Representatives voted all the money required to keep all government activities going—except for ObamaCare. This is not a matter of opinion. You can check the Congressional Record.

As for the House of Representatives' right to grant or withhold money, that is not a matter of opinion either. You can check the Constitution of the United States. All spending bills must originate in the House of Representatives, which means that Congressmen there have a right to decide whether or not they want to spend money on a particular government activity. Whether ObamaCare is good, bad or indifferent is a matter of opinion. But it is a matter of fact that members of the House of Representatives have a right to make spending decisions based on their opinion.

ObamaCare is indeed "the law of the land," as its supporters keep saying, and the Supreme Court has upheld its Constitutionality. But the whole point of having a division of powers within the federal government is that each branch can decide independently what it wants to do or not do, regardless of what the other branches do, when exercising the powers specifically granted to that branch by the Constitution.

The hundreds of thousands of government workers who have been laid off are not idle because the House of Representatives did not vote enough money to pay their salaries or the other expenses of their agencies—unless they are in an agency that would administer ObamaCare.

Since we cannot read minds, we cannot say who—if anybody—"wants to shut down the government." But we do know who had the option to keep the government running and chose not to. The money voted by the House of Representatives covered everything that the government does, except for ObamaCare.

The Senate chose not to vote to authorize that money to be spent, because it did not include money for ObamaCare. Senate Majority Leader Harry Reid says that he wants a "clean" bill from the House of Representatives, and some in the media keep repeating the word "clean" like a mantra. But what is unclean about not giving Harry Reid everything he wants?

If Senator Reid and President Obama refuse to accept the money required to run the government, because it leaves out the money they want to run ObamaCare, that is their right. But that is also their responsibility.

You cannot blame other people for not giving you everything you want. And it is a fraud to blame them when you refuse to use the money they did vote, even when it is ample to pay for everything else in the government. When Barack Obama keeps claiming that it is some new outrage for those who control the money to try to change government policy by granting or withholding money, that is simply a bald-faced lie. You can check the history of other examples of "legislation by appropriation" as it used to be called.

Whether legislation by appropriation is a good idea or a bad idea is a matter of opinion. But whether it is both legal and not unprecedented is a matter of fact. Perhaps the biggest of the big lies is that the government will not be able to pay what it owes on the national debt, creating a danger of default. Tax money keeps coming into the Treasury during the shutdown, and it vastly exceeds the interest that

has to be paid on the national debt. Even if the debt ceiling is not lifted, that only means that government is not allowed to run up new debt. But that does not mean that it is unable to pay the interest on existing debt.

None of this is rocket science. But unless the Republicans get their side of the story out—and articulation has never been their strong suit—the lies will win. More important, the whole country will lose.

US Economist Thomas Sowell

(Source: The Gartman Letter 10/07/2013)

This information is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein. This commentary is based on information that is believed to be accurate at the time of writing, and is subject to change. All opinions and estimates contained in this report constitute RBC Dominion Securities Inc.'s judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. Interest rates, market conditions and other investment factors are subject to change. Past performance may not be repeated. The information provided is intended only to illustrate certain historical returns and is not intended to reflect future values or returns. RBC Dominion Securities Inc.* and Royal Bank of Canada are separate corporate entities which are affiliated. *Member-Canadian Investor Protection Fund.