



## Tug 'O War

The primary concern of investors at the moment is the US Debt ceiling discussions taking place in the US Senate and House of Representatives. It has become crystal clear the "kicking the can down the road" is no longer a convincing strategy.

In my opinion, this is one of those troubling scenarios that is a low probability event, but with a huge negative impact if not resolved. I believe the politicians will come to their senses in time to avoid the self imposed August 2<sup>nd</sup> deadline over the debt ceiling issue, but even if they don't, there have been many precedents to compare to, and the net result has been muted.

If a deal is not agreed upon, the negative impact on both US equity and bond markets would be very large. In fact, all global debt markets would be negatively impacted.

While a default is unlikely, a bigger possibility is a downgrade in the near future of the USA's AAA credit status.

I don't want to downplay the short term pain that could occur if the US fails to raise their debt ceiling in the next few days or so. Most strategists seem to be complacent, and perhaps underestimate how polarized the politicians are on the issue. Both sides (i.e. political parties) have little incentive to compromise.

There have been 11 times since 1980, so when the talking heads on TV say this is unprecedented, they once again do not speak the truth.

Some statistics of interest:

- US Public Debt approx. \$14.3 trillion
- In 2010, for every dollar spent by the US government:
  - 62.6 cents was collected in taxes
  - 37.4 cents was borrowed
- US Federal Spending in 2010 (\$3.456 Trillion)
  - \$600 Billion was Discretionary
  - \$416 Billion Mandatory
  - \$197 Billion Net Interest
  - \$793 Billion Medicare/Medicaid
  - \$701 Billion Social Security
  - \$689 Billion Defense Department

- US Tax Receipts in 2010 (\$2.162 Trillion)
  - \$865 Billion Social Security
  - \$191 Billion Corporate Income Taxes
  - \$669 Billion Individual Income Taxes
  - \$140 Billion Other
  - \$67 Billion Excise Taxes

With almost 50% of the US population taking benefits from the government and only 55% of the citizens actually paying taxes to fund benefits for the other 45%, the last thing the nation needs is another recession at this point.

Part of the problem is both parties seem to be dominated by the extremists, on the Republican right, the TEA party, and on the Democratic left, the extreme socialist tax and spenders. Should they not vote with their respective constituents, they may be signing their own political pink slips for the 2012 elections?

What many people (and the media) don't seem to realize is that there have actually been 11 government shut downs since 1980. The last one was 1995 and lasted 21 days. The average lasted 2 days. Of those 10 shut downs, markets were down only twice, one month after the shutdown began, and the median was a 2% increase. The losses were both in the 2% range.

So despite the media's attempts to paint another "end of the world" scenario, this too shall pass.

Lets hope they do it right. Quickly.

Stay Tuned

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