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CLIENT BULLETIN

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- ***Let's Make a Deal***

Acting only when absolutely compelled to, Congress passed a bill that lifted the $14.3 trillion debt ceiling in exchange for up to $2.4 trillion in budget cuts over the next 10 years and President Obama quickly signed it into law today. The $240 bil./year in cuts are just a band aid leading to the next crisis point which is the 2012 budget which begins ***this*** October so keep your seatbelts fastened. You could say that this agreement has just kicked the can down the road except that analogy is not entirely accurate – politicians have rolled a snowball down a hill and we all know what happens when that occurs.

- ***Is the Ceiling Necessary?***

Given all of the pain it caused and the fact that politicians have historically just raised the debt ceiling as it was reached, some have suggested that a self-imposed debt ceiling is unnecessary. While the debate over the debt limit has been torturous, it has served its' purpose by focusing the attention of Congress, the White House and the public on the importance of reducing the size of the nation's deficit and the growth of our debt. For the first time since its' 1917 inception, the ceiling actually had an impact. Doing away with the debt limit at this point could also signal to the world that we have given up on efforts to put our financial house in order.

- ***Life without AAA?***

Even with a short-term plan in place to raise the debt ceiling, the U.S. government may still have their bond credit rating downgraded by the major rating agencies – S&P and Moody's. This prospect has less to do with the debt ceiling than it does with the general lack of budgetary control in Washington. If the rating agencies feel that the plan has not addressed the fundamental debt & budgetary issues they could still move forward with a downgrade. This must to be taken with a grain of salt however – the rating agencies were extremely late to the game during the recent financial crisis by staying mum while the spending that got us here was going on. Their credibility has been significantly eroded.

➢ *Now Where Do We Stand?*

Now that the debt limit issue is temporarily behind us, we need to look at where we stand in regard to the nation's deficit and debt. After all, the problem isn't the debt ***limit***; it is the ***debt*** and the behavior that got us here. U.S. debt currently amounts to 70% of our GDP and government spending has risen from 18% to 24% of GDP since 2000. Hopefully the 24% figure will be the peak. Social Security, Medicare and Medicaid funding, which together represent 58% of the federal government's current spending and over 80% of its' future financial obligations, were not included in the deficit reduction discussion thereby ensuring that a long-term fix is not in place. The surest way to damage these programs is to leave them as they are.

Source: Congressional Budget Office

➢ *Who Holds the Debt?*

It is important and interesting to know who holds the $14.3 trillion of U.S debt. The largest amount ($4.5 trillion) is owned by foreign countries with China ($1.2 trillion) and Japan ($900 billion) leading the way. $3.6 trillion is owned in the form of treasury bonds held by individuals, investment companies, pensions and corporations. $2.7 trillion is owed to the social security system because surpluses generated by that program in the past have been "borrowed" by the treasury; $1.9 trillion is owned by other government trust funds similar to social security and $1.6 trillion is owned by the Federal Reserve System. Note that the last three lenders merely represent different arms of the federal government lending money to each other – a muddled situation to say the least.

➢ *Watch the Companies*

Not all of the news out there is bad. While the global macroeconomy is experiencing a sluggish recovery from the financial crisis, corporations, namely large U.S. corporations are recording record profits. Why the dichotomy? The answer lies in the responsiveness of companies in cutting costs (hence 9% unemployment) as sharply as their revenues declined which left them instantly leveraged to even a modest recovery. Additionally they have paid down debt and built up cash to historic levels. In case it didn't strike you, these are exactly the opposite steps taken by governments worldwide.

➢ *Greece*

Euro zone leaders recently provided a second bailout for the Greek government by agreeing to loan them $157 billion over three year at 3.5% interest. The loan is widely recognized to be a tourniquet for the situation and some level of default by the Greek government is expected. The objective of the loan is to buy time to allow the global economy to heal further so that Greece's problems don't metastasize to the larger economies of Spain and Italy. Essentially officials are trying to put more distance between the dominoes so when Greece defaults they won't take down other countries with them.