

Investment Update



September 2009

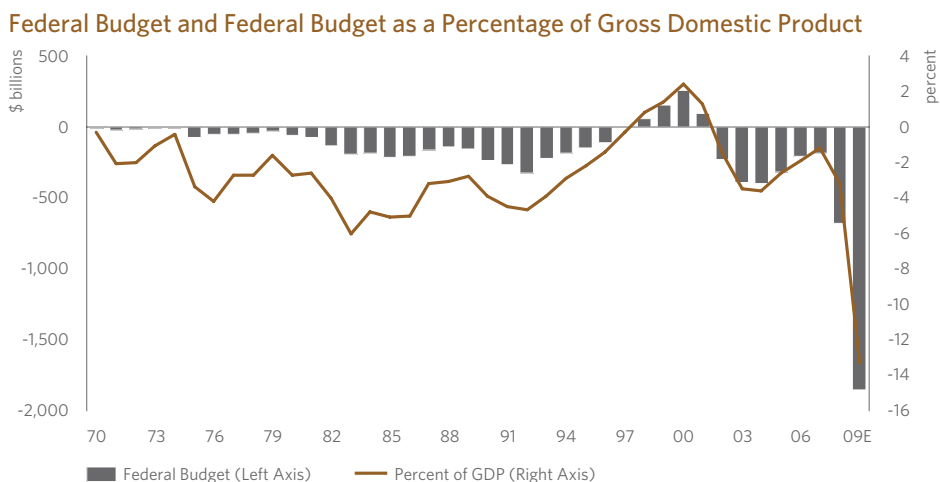
I Think They're Trying to Tell Us Something...

Many folks have become inured to the dire predictions about the effects of the government's exorbitant spending. However, when the government itself issues a concerning forecast, it is worth taking note. The following lengthy but informative excerpt is from the June 2009 summary of the *Long-Term Budget Outlook*, issued by the Congressional Budget Office (CBO):

"Under current law, the federal budget is on an unsustainable path — meaning that federal debt will continue to grow much faster than the economy over the long run. Although great uncertainty surrounds long-term fiscal projections, rising costs for health care and the aging of the U.S. population will cause federal spending to increase rapidly under any plausible scenario... Unless revenues increase just as rapidly, the rise in spending will produce growing budget deficits and accumulating debt. Keeping deficits and debt from reaching levels that would cause substantial harm to the economy would require increasing revenues significantly as a percentage of gross domestic product (GDP), decreasing projected spending sharply, or some combination of the two. CBO's long-term budget projections raise fundamental questions about economic sustainability. If outlays grew as projected and revenues did not rise at a corresponding rate, annual deficits would climb and federal debt would grow significantly. Large budget deficits would reduce national saving, leading to more borrowing from abroad and less domestic investment, which in turn would depress income growth in the United States. Over time, the accumulation of debt would seriously harm the economy. Alternatively, if spending grew as projected and taxes were raised in tandem, tax rates would have to reach levels never seen in the United States. High tax rates would slow the growth of the economy, making the spending burden harder to bear. Policymakers could mitigate the economic damage from rapidly rising debt by putting the nation on a sustainable fiscal course, which would require some combination of lower spending and higher revenues than the amounts now projected. Making such changes sooner rather than later would lessen the risks that current fiscal policy poses to the economy."

The message cannot be more clear: raising taxes without implementing spending cuts will not work. One hopes that the government heeds its own words!

The chart below underscores how critical the deficit issue has become. While a significant portion of the federal debt can be attributed to the stimulus package and other policies enacted to quell the financial market collapse, we clearly have reached the red zone. The bond market already has taken notice, as seen by the inching up of long-term interest rates. This initial reaction is somewhat good news as it signals that further increases are far less likely to go unnoticed, which has been the case in the past.



Source: U.S. Treasury, Office of Management and Budget, Haver Analytics

Saving Advice Brought to You by the Same People Who Caused the Deficit Mess

With the admonitions of the CBO top of mind, we were amused by our own recent Social Security statement, which seemed to have been written by the same author. The message on the statement read:

“Social Security is a compact between generations. For decades, America has kept the promise of security for its workers and their families. Now, however, the Social Security system is facing serious financial problems, and action is needed soon to make sure the system will be sound when today’s younger workers are ready for retirement. In 2016 we will begin paying more in benefits than we collect in taxes. Without changes, by 2037 the Social Security Trust Fund will be exhausted and there will be enough money to pay only about 76 cents for each dollar of scheduled benefits.”

In case you were wondering, that was not the funny part. What we found humorous was the section explaining that other supplemental savings — investments, pensions or retirement accounts — are needed to ensure that Social Security recipients have enough money to live comfortably during retirement. It further proclaims that saving and investing are important not only for individuals, but for the entire country! The statement also includes a link to a government-operated Web site dedicated to teaching all Americans the basics of financial management. Perhaps this training should be mandatory for Congress.

The Other Side of the Mirror

In moving to put the country’s fiscal house in order, members of Congress face challenges. One or another constituent group, or some political agenda item, is always on the receiving end of any contemplated budget reduction, making entitlement spending particularly difficult to control. These constituent groups all have a voice and, taken collectively, have political might. Agreeing to cuts that could potentially impact constituents is very difficult for politicians — especially those concerned about their prospective reelection.

The anticipated cost of living adjustment (COLA) to Social Security payments is a recent example of this phenomenon. Because current wage inflation is now negative (as measured by CPI-W, the consumer price index for urban wage earners and clerical workers), a COLA increase for 2010 recipient payments currently is not projected. Consequently, lobbyists are pushing for a “special” increase, citing that recipients need and depend on the COLA increase. Keep in mind that an outright cut is not even being contemplated — just the foregoing of an increase!

Calls for fiscal reform are not new. In fact, we have heard such calls for years. Yet, they have fallen on deaf ears. Passing the problem to the next guy is far easier. The default thus far has been simply to raise taxes or increase the deficit with the belief that no one will notice. The cost of such actions appears insignificant until the time comes to pay the piper. If we strain our ears, we almost can hear a haunting melody that certainly is not as far off as 2037.

How much more time can pass before these issues become insurmountable? We will have to wait for the answer to this question — but not for long. Washington needs to deliver constructive, sustainable remedies to our current situation or we, perhaps sooner than we think, will be responding to — rather than controlling — our situation.

Having met challenges of similar magnitude in the past, we believe the government can do it again.



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