# BEACON'S POINT: WAITING TO EXHALE

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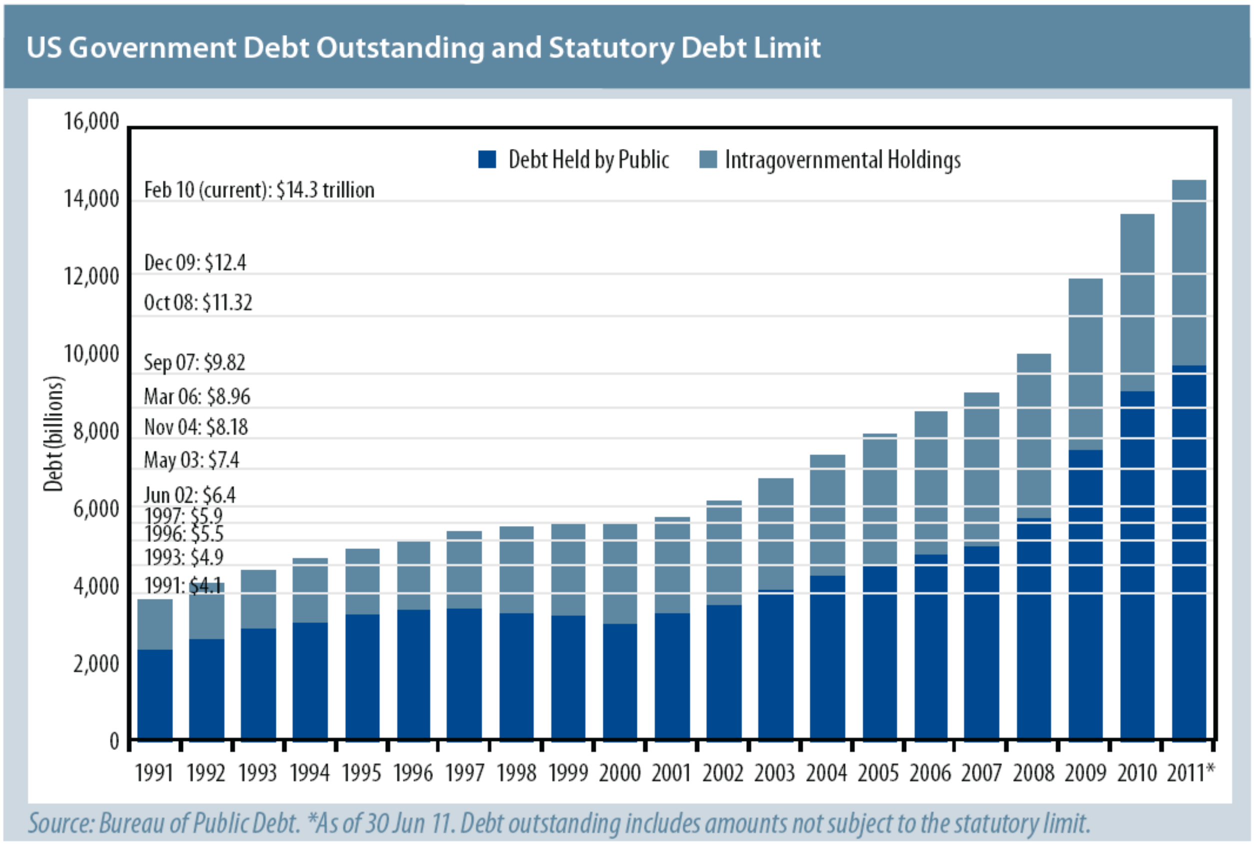
## Waiting to Exhale

Along with the rest of the world, we are anxiously watching events unfold and waiting for a resolution of the U.S. debt ceiling stalemate. The $14.3 trillion limit is, in essence, the total amount of money the U.S. government is authorized to borrow to meet its existing obligations, including paying interest to existing holders of U.S. Treasuries. The following chart, courtesy of Western Asset Management, shows the acceleration of growth in the U.S. government debt outstanding and the periodic step-ups in the debt ceiling, approved by Congress over the past 20 years.




*Source: Western Asset Management Company*

Washington remains divided over how to avoid a default by the U.S. government. It is becoming ever more difficult to follow the intricacies and fast-changing dynamics of the various proposals put forth by each side as the August 2nd deadline looms closer. A vote on the Boehner debt-limit plan, which was planned for Wednesday, July 27th, was postponed in the face of opposition from both conservatives and the White House. Republican and Democrats have yet to find the common ground necessary for a successful vote on the debt ceiling issue.

If no agreement is reached by Tuesday of next week, the U.S. government could potentially be in technical default and lose its AAA credit rating. This would result in higher borrowing rates and interest costs across the public and private sector and could further jeopardize the economic expansion, which is already showing signs of deceleration. Some analysts believe that a U.S. downgrade is possible even if the debt ceiling limit is raised before the deadline and a default is avoided. For instance, rating agency Standard & Poor's has warned that it may cut the U.S. government's credit rating to AA if the eventual agreement cuts the budget deficit by less than $4 billion over the next decade and lacks strong bipartisan support.

Beacon Pointe continues to expect a debt ceiling resolution in the coming days, although there is still significant uncertainty around possible changes to tax rates and government spending as part of a deficit reduction deal. Congress has raised the statutory debt ceiling 85 times in history and we believe it will do so again. Treasury markets are not showing signs of panic, implying a low probability of a negative outcome on the vote. Furthermore, we believe that even if a technical default occurs, it will be short-lived. The U.S. government is not insolvent, it still has the ability to service its debts, but a delay of payments would be disruptive to the domestic economy and global financial markets. Volatility would pick up and risk aversion would replace risk appetite. More defensive assets, sectors, and securities (potentially including - ironically - U.S. Treasuries) are likely to outperform.

There is no question that our country's deficit problem is a very serious one. The current fiscal position of the U.S. government is simply unsustainable. The budget deficit reached 9% of GDP and is still growing. According to Standish Mellon, part of that deficit is cyclical and thus likely to shrink as the economy recovers. But, as the firm points out, "there is a sizable portion related to entitlement programs that is structural and will persist long after the economy gets back on its feet."

Consider the following statistics, courtesy of Michael Higley's "By The Numbers" (Source: Natixis Global Associates):

- "The U.S. government's annual budget deficit has increased more than 10 times in just the last 4 fiscal years. Our actual budget deficit was $161 billion in fiscal year 2007. Our projected budget deficit for fiscal year 2011 is $1.645 trillion (Source: White House)."

- "The US government estimates that it will spend $430.4 billion on interest paid on our Treasury debt in fiscal year 2011, equal to $1 out of every $9 we are expected to spend (Source: Treasury Department)."

- "In April 2011, the International Monetary Fund forecasted that the United States (based upon our country's current tax and spending projections) will be able to borrow money in the global debt marketplace for a maximum of 15 additional years, i.e., to the year 2026 (source: International Monetary Fund)."

Markets dislike uncertainty, but uncertainty often creates opportunities. Once the opposing sides' put their differences aside in order to find a long-term solution, even if it requires a certain level of compromise, the U.S. can begin to work its way out of its current predicament. A credible deficit reduction plan is key; Congress and the White House have to agree on the size, the time frame, and the nature on the deficit cuts (i.e. better control of entitlement costs vs. reduced discretionary spending vs. higher revenues). The U.S. is at a crossroads; it has the opportunity to embark on a more prudent and absolutely necessary road to restoring its fiscal health.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.