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Market Musings

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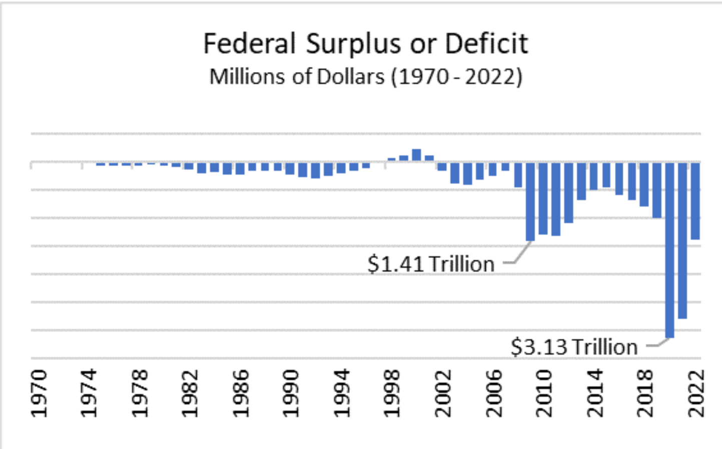
Over the long term, federal deficits have been an integral part of how the government provides economic stimulus. Each time the government creates and spends a dollar, demand for products and services increases. Excess spending or the creation of dollars creates inflation. On the other hand, increased taxes are likely to slow spending and lower inflation.



The Federal Debt Ceiling… Here we go Again!!

Last week the House of Representatives approved a bill that increases the federal debt ceiling while requiring allowances from Congress to limit entitlement spending going forward. If the Administration balks at these terms or fails to negotiate with Republicans, the federal government may be required to "shut down" if the funds are "not available" to keep the government running for about an hour. Historically we have experienced such shutdowns, but they were quickly resolved with little if any, economic damage. This time around is no different as the electorate does not forget politicians who voted to fire them unless they agreed to reduced federal spending.

The federal government's balance sheet is unique as it is not subject to traditional limits on debt like all the rest of us. If individuals or corporations cannot meet their obligations, then potential bankruptcy looms in addition to other unfavorable outcomes. Conversely, the U.S. government operates under a fiat currency rule whereby the dollar is not tied to any other variable such as gold or other currencies. In other words, the federal government makes money! In that case, there is no fundamental reason that government deficits and debt must be controlled. More importantly, in 2020 government handouts fueled inflation on the back of easy monetary policy.

History tells us that the U.S. has run budget deficits almost all the time. Eliminating or reducing budget deficits could undermine an economic recovery. There are efforts to curtail deficit spending that could impact future growth. However, to keep spending, politicians are proposing higher tax rates to finance that spending. The interaction of lower spending, higher taxing, and tight money (high interest rates) are policies that could destabilize the economy.

The likely outcome of this debacle will be a painless transition to higher debt levels after a little political infighting to achieve some type of a compromise that will keep both political parties happy… Here we go Again!!

"Don't look for the needle in a haystack, just buy the haystack."

John Bogle

Market Commentary

After a reasonably good start to financial markets in the first quarter, equities, especially large-cap growth stocks, moved ahead during April. Sparking that rally was a raft of good news on earnings for these larger firms. The move was surprising given the failure of two regional banks and a quasi-run on a few other regional banks. Substantial backing from the Federal Reserve kept the crisis from getting out of control. Foreign markets continued to forge ahead, especially in Europe where key countries are up double digits. Many Asian markets also posted double-digit returns on the back of strengthening fundamentals. Natural gas is still in the doldrums, as is the U.S. dollar, while gold has seen some buying interest and is up nearly 9% so far this year.

The projected "exhaust date" for the Social Security Trust fund was moved up by one year to 2034 from 2035, only eleven years from now. At that point, annual revenues would only be sufficient to cover 80% of total benefits.
(source: OASDI)