



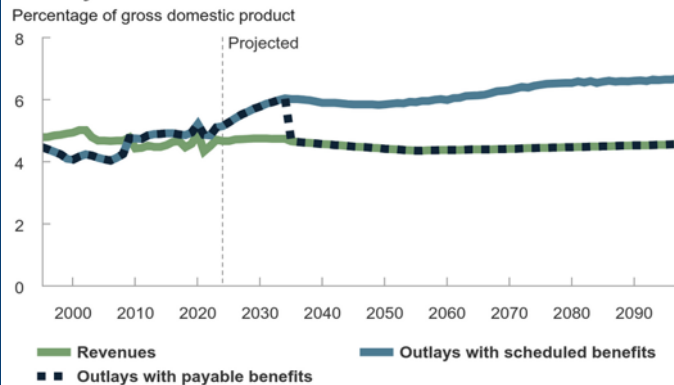
Market Musings

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As seen in the chart, the Social Security system is forecast by the trustees to have a financial problem in the coming years. The sooner Congress resolves the problem, the less tumult it will cause in the future. The problem is that the government has refused to seriously address this conundrum.

Social Security's Outlays and Revenues, With Scheduled and Payable Benefits



The Future of Social Security

Fears of a collapse in Social Security payments to retirees are permeating the narratives of “futurists,” who make the case for disaster ahead as the government announced that the Social Security Trust Fund will run out of reserves by 2032. What they fail to mention is that payments from current workers will continue to fund the system, so retirees would experience about a 22% cut in benefits if the government did nothing. Historically, the federal government has stepped in to avoid a default in the system. The last time such a change was made was in 1983, when the retirement age was gradually increased, some Social Security benefits were taxed, payroll taxes were increased, and other financial changes were made.

The government is working on revamping the benefits system, similar to the changes made in 1983, to put a Band-Aid on the program until the next crisis. What is different this time is: (1) raising taxes on benefits given to higher-wage earners and (2) gradually increasing the retirement age before qualifying for benefits. There is also the possibility that the government will use general tax revenues to close the funding gap. So far, we have not heard any serious proposals that could gain bipartisan support for such a realistic plan.

One proposal appears less designed to solve the potential Social Security problem and more like an end run to raise taxes on the rich. Today, Social Security deductions from payroll are capped at a certain level of income. This level rises gradually over time to offset the inflation adjustment for current Social Security beneficiaries. The proposal is to eliminate the cap altogether. While this idea seems reasonable on its face, the result could be major increases in payroll taxes for highly paid individuals, as well as a big increase in corporate personnel costs, since the current system requires companies to match individuals’ payments.

Some politicians want the system to invest in financial markets, where investment returns could be higher and increase the size of the system’s reserves. Today, the system is no longer buying government securities since the system pays out more in benefits than it receives in income. The Treasury is selling bonds to pay the difference. Strangely enough, solving this problem has not caught the attention of many politicians, since they do not see a solution that would satisfy their constituents.

“The stock market is a device for transferring money from the impatient to the patient.”

- Warren Buffet

Market Commentary

For the most part, global equities cooled in July, with U.S. small- and mid-cap stocks underperforming their large-cap peers, as the S&P MidCap 400 and S&P SmallCap 600 declined by 2% while the S&P 500 fell less than 1%. Asia-Pacific equities were mixed to mostly down, as Korea and Taiwan experienced sharp pullbacks, falling 23% and 6% over the month, reducing their YTD gains to 64% and 53%, respectively. European indices closed in positive territory, with the S&P Europe 350 gaining 1%. Major Latin American indices were positive, with the S&P Latin America BMI up nearly 5%. Fixed-income markets generally delivered slightly positive returns in July, though returns varied across sectors and regions as investors balanced central bank expectations, inflation data, and geopolitical developments. July was a positive month for the U.S. dollar on the back of expectations for no interest rate cuts and periodic safe-haven flows.

According to Federal Reserve Data, construction spending for manufacturing in the U.S. is up 93% since the fourth quarter of 2021, reflecting a supportive policy environment for manufacturing investment.