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CLIENT BULLETIN

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- ***Not-So Super***

Last week, the "Super Committee" tasked with determining how to reduce the federal budget deficit by $1.2 trillion announced that it had failed to agree on a plan before its November 23 deadline. The Committee's failure triggers a process called "sequestration," under which automatic spending cuts of $1.2 trillion are implemented over ten years beginning in 2013. The sequestration cuts are to be split evenly between defense and non-defense programs. When added to cuts already agreed-upon in August, total cuts in defense spending will approach $1 trillion. Cuts to the Social Security, Medicare, and Medicaid programs – the biggest drivers of future government deficits - are not permitted in sequestration.

- ***What Happened?***

The committee's failure to reach an agreement is not surprising. Congress typically crosses hardened ideological lines and compromises only in the presence of a "forcing event" that requires it to do so to avoid drastic consequences. The November 23 deadline was an artificial contrivance of the August deal that increased the nation's borrowing limit; nothing happens as a result of the failure to meet it. Additionally, the major rating agencies made it clear that further credit downgrades would not occur as long as the cuts prescribed through the sequestration process are not blocked by Congress before they begin in 2013.

- ***Legality of Obama-care***

The Supreme Court recently announced it would hear challenges to President Obama's Affordable Care Act that was passed in March of 2010. The law's individual coverage mandate, which states that every American must have health insurance or pay a fine, is being challenged as unconstitutional and an infringement on American rights. Also at issue is the definition of the fine people would pay – is it a penalty or is it a tax to raise revenue to pay for the benefits of the plan? It is also being questioned whether or not this mandate can be removed while leaving the rest of the legislation intact. A Supreme Court ruling is expected sometime between March and June of 2012.

➢ *European Anxiety*

Watching Europe deal with their sovereign debt crisis evokes concerns of a Lehman Brothers-type event that leads to a global financial meltdown. While the situation is extremely complex, some comparisons to the United States are helpful:

€ The real estate bubble→derivatives→Lehman Brothers→financial crisis was a fast-moving, violent situation that no one saw coming (you wouldn't be hearing from anyone who did see it coming because they would be sipping a Piña Colada on a beach after shorting the market on a leveraged basis). Europe's situation is more of a slow-motion train wreck.

€ Unlike the U.S., which consists of 50 states in which we speak a common language, the EU consists of 27 countries that speak 23 different languages. Each country has a distinct and proud culture. The European Union is still in the experimental stage.

€ The Federal Reserve Bank of the U.S. has a dual mandate: 1) implement policies to support economic growth (and full employment); and 2) support price stability – i.e. protect against inflation or deflation. Europe's equivalent of our Federal Reserve, the European Central Bank (ECB), on the other hand, has the single mandate of price stability. Consequently, they do not feel as compelled to take action to address the economic issues of the situation. This has led to dramatically different responses to the respective crises. The U.S Federal Reserve has increased the size of its balance sheet by 220% in response to the financial crisis while the ECB has increased their balance sheet by 86% in response to their sovereign debt crisis.

€ In the U.S. we have a distinct fiscal re-distribution mechanism to offset the kinds of regional or state-specific weaknesses that the EU is facing. If a state has a unique economic problem (think Louisiana and Hurricane Katrina) they can receive federal funding assistance at the same time as their economic output decreases. There is no such federal funding mechanism in Europe.

➢ *Next Steps*

European policy-makers have the tools, capabilities and resources to stop the broadening crisis. After all, the overall debt to GDP ratio of the Euro zone is actually lower than it is in the United States. EU policymakers must take more dramatic and decisive action rather than the stutter-steps taken so far. That decisive action probably includes greater overall integration between the countries that make up the EU - a single currency requires greater fiscal integration. The ECB will also have to take a much more active role to get ahead of the problem rather than continually reacting with half-measures.

➢ *Investment Implications*

It is important to note that global stock markets are reasonably efficient discounters of future information. They are fully cognizant of the world's macroeconomic difficulties and have, in whole or in large part, already priced them in. Great companies here and abroad, seeing that Europe's economy is going to be challenged for the foreseeable future, will re-double their efforts in fast-growing areas such as China, India and Brazil as well as the slow but still growing United States. For both businesses and individuals, it comes down to being disciplined and taking advantage of opportunities.