This Publication Brought To You Courtesy Of:

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CLIENT BULLETIN

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➢ *Debt Deal Done*

The debt deal passed last month – officially dubbed the Budget Control Act of 2011 – increased the U.S. governments “debt capacity” to $15.8 trillion by year-end. In laymen’s terms, the limit on the government’s credit card was increased by $2.1 trillion – enough to get them through the end of 2012. In exchange for the ability to borrow more money, Congress and the President agreed to cut spending by a total of $917 billion over the next 10 years along with additional spending cuts to be agreed upon later this year.

➢ *Congressional Committee Make-up*

These additional cuts will be made by the new 12-member Congressional Committee at left that has been tasked with identifying $1.2 trillion of budget savings over a ten-year period. This “Super” Committee is made up of six Republicans and six Democrats. I don’t hold out much hope that these appointees will be able to come to a compromise - four of them served on a previous deficit reduction panel and were unwilling to compromise on their respective deep-rooted convictions.

➢ *What if They Can’t Agree?*

If the Committee fails to find $1.2 trillion in spending cuts by Thanksgiving, or if Congress votes against the Committee’s recommendations, then automatic across-the-board spending cuts will be triggered beginning in 2013. These cuts will not affect Social Security, Medicare or Medicaid benefits and they will be evenly divided between defense and non-defense discretionary spending. The heavy hit to defense spending is thought to be a particular motivation for Republicans to compromise, specifically in regard to tax increases.

➢ ***How Much impact?***

Although cuts of $917 billion and $1.2 trillion over the next 10 years sound like a lot of money, let's compare the deal to a typical family budget.

The Federal House

2011 estimate

U.S. Revenue:	**$2,173,700,000,000**
Federal Expenditures:	$(3,818,819,000,000)
2011 Deficit:	$(1,645,119,000,000)
Existing Federal Debt:	$(13,528,807,000,000)
2011 Total Year-End Debt:	**$(15,173,926,000,000)**
"New" Budget Cuts (per year):	**$210,000,000,000**
Federal Debt After Budget Cut:	**$(14,963,926,000,000)**

Sources: Office of Management & Budget; Andrew H. Friedman

The Smiths' House

Eight zeros removed from the Federal House's numbers

Total Annual Income for the Smiths:	**$21,737**
Amount of Money the Smith Family Spends:	$(38,188)
Amount of New Debt Added to their Credit Cards	$(16,451)
Existing Balance on their Credit Cards:	$(135,288)
Year-End Total Credit Card Debt:	**$(151,739)**
New Budget Cuts (per year):	**$2,100**
Credit Card Debt After Budget Cut:	**$(149,639)**

As you can see from the Smith family example, agreeing to cut spending by $2,100 per year in the face of a $16,451 cash flow shortfall and a credit card balance that is roughly 7 times your income doesn't even begin to solve the problem – debt continues to climb at a rapid pace.

➢ ***No More AAA – What Does it Mean?***

The downgrade by Standard & Poor's of U.S Treasury debt from AAA to AA+ likely will not change the status of Treasury bonds as the safest, most liquid of assets. In fact, treasury bonds prices rallied immediately following the downgrade as investors continued to turn to treasuries as a safe haven. The downgrade, rather, is a blow to the psyche of Americans and their standing in the world's financial community. It should be viewed as a wake-up call to politicians to balance our government's budget and create constructive reforms.

➢ ***The Dollar's Place in the World***

The U.S. dollar is currently the world's reserve currency and has been since 1944. Recent economic conditions and the Standard & Poor's downgrade have prompted many to doubt the dollars ability to maintain that role. Currency movements, however, are a zero-sum game – a decrease in one currency must necessarily be countered by an increase in another currency. The question that needs to be asked, then, is what alternatives to the dollar exist? The fate of the Euro is unknown as many of Europe's economies struggle and unity is in doubt; China has its hands full attempting to maintain political, social, and territorial stability; and a decade-long recession and an aging population has plagued Japan along with the recent tsunami and near nuclear disasters. The growth fundamentals of the U.S. have not been permanently altered by the events of the past few years so as long as U.S. businesses continue to innovate and the economy continues to grow, albeit sluggishly, the U.S. dollar is likely to maintain its monetary leadership.