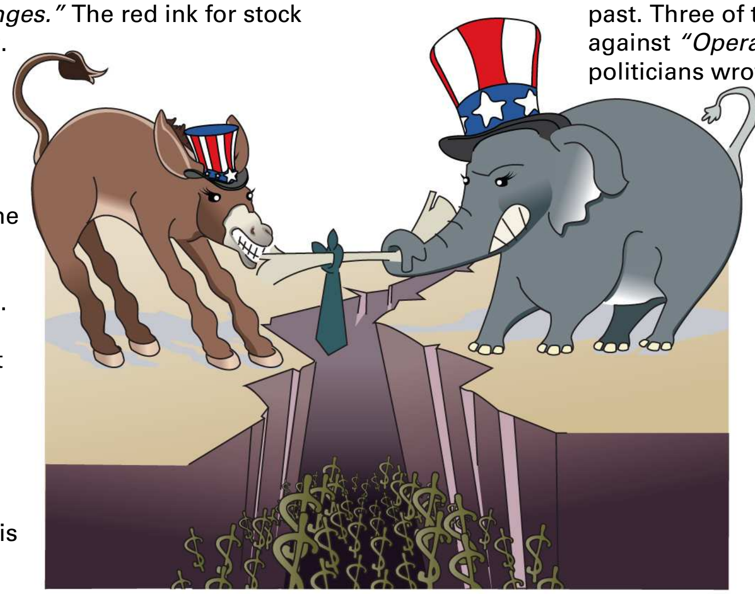
Investment Watch

3rd Quarter, 2011

Political Paralysis

The tug-of-war between our political parties over the debt ceiling, not only reinforced our uncertainty about the US recovery, but also, dimmed most Americans' view of our elected officials. Our politicians' *summer of squabbling* gave the rating agencies the ammunition they needed to downgrade the safety of the Almighty American Dollar. On August 5th Standard and Poor's (S&P) press release pronounced, "*We have lowered our long-term sovereign credit rating on the United States of America to 'AA+' from 'AAA'...The downgrade reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges."* The red ink for stock markets appeared immediately. The impact on our economy is as yet unknown.



S&P is the same rating agency that issued those questionably high quality ratings on subprime mortgage pools which were blamed for much of the 2008 financial and market meltdown. Many investors are upset at S&P's downgrading of US debt pointing to it as the catalyst which precipitated the recent market volatility both here at home and across the globe. After two years of a steady upward trend in the markets this gut-wrenching volatility brings back unpleasant memories of the 2008 crisis and undermines investor confidence.

Déjà vu? As we look across the pond, the European Union's financial trauma seems eerily familiar. Rather than centered in subprime housing debt like our 2008 meltdown, the EU is mired in a sovereign-debt crisis due to the Greek, Spanish and Italian fiscal deficits. Most of the developed world is faced with the hardships of budget deficits and public debt. Fiscal deficits, exacerbated by political inaction, are compounded by the populace's unwillingness to accept austerity measures. Germany and other rich countries of the EU must step up to stabilize the region. The rich countries, although displeased with bailing out their poorer neighbors, realize that their financial institutions, which hold much of Greece's debt, would bear the brunt of a bankruptcy.

So as Europe debates radical increases in bailout funds and how to restructure the Greek debt, here at home we are still battling the fallout from our housing crisis. The experts at MacroMarkets, LLC see US home prices finally hitting the bottom this year and recovering only dismally at a 1.1% rate through 2015. The housing bust has put one in five Americans underwater, made us feel poorer and chilled consumer spending which drives over $2/3^{rds}$ of our economic engine. Without a resurgence in housing, many feel that our economy cannot grow.

On September 21st Federal Reserve Chairman Ben Bernanke, reacting to the dismal housing forecast, employed another aggressive, unprecedented tactic dubbed *"Operation Twist"* hoping to reduce even further the historically low long-term interest rates. *"Operation Twist"* exploits the Fed's bloated balance sheet by swapping the short-term bonds for mortgage and longer-term bonds. If successful, lower rates may jolt the comatose housing market back to life, encourage companies to invest their cash hordes and spur consumers to loosen their wallets. The weak economy has deeply divided the Fed and unanimous consensus is a thing of the past. Three of the 10 Fed officials voted against *"Operation Twist"* and certain politicians wrote the Fed urging inaction.

Bernanke's controversial, aggressive actions are in stark contrast to the political indecisiveness across the globe. **Political paralysis** makes companies and investors doubt whether or not, that as a nation, we can lead the developed world by making the hard decisions required to reduce our deficit spending. The world-wide economic weakness and the growing belief that governments and central bankers are unable to take decisive action to promote growth is creating the volatility in the markets. In order to instill confidence in our political and financial systems decisive action must be taken to establish and meet reasonable fiscal targets.

Marked by a dormant housing market, frustratingly high unemployment and unsustainable deficits, this fragile recovery demands unified political strategy to thrive. Many Americans are fed up with our government's current inaction caused by fractious debates and political squabbling. Some experts cite this **political paralysis** as the leading threat to regaining economic stability.

In normal times **political paralysis** is just a nuisance, but now more than ever, America requires bipartisan cooperation and clear direction to remove uncertainty and regain the confidence in our ability to shape a positive environment for sustained economic growth.

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