



JMH Wealth Management, LLC

No Adults in the Room

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Once again, we are facing financial market distress. The trigger this time is political infighting by Congress and the Obama Administration over raising the debt ceiling to accommodate the level of spending that they have already voted on and approved. Cloaked in their new found fiscal conservatism, Congress has decided to make a stand against their own excessive spending by choosing not to increase the federal debt ceiling that will be reached on August 2nd. Few would disagree with the need to limit spending and reduce the long term deficit path we currently find ourselves on, but is holding the debt ceiling hostage the most effective mechanism? I doubt it.

Implementing a discipline of reduced spending and modifying the tax code, including selective tax increases (and/or the elimination of certain tax breaks) would certainly lead us toward greater fiscal responsibility. However, creating a climate that encourages robust economic growth and confidence is critical to improving the long term budget deficit and on that measure, the current contrived Congressional and Administration donnybrook fails completely. This morning's economic report that GDP was weaker than expected for the 2nd quarter of 2011 and revised sharply lower for the 1st quarter suggests economic activity is already slackening. A further downward push from Congress and the Administration is not helpful.

The timing of this fight could not come at a worse time. With the Eurozone continuing to deteriorate and European country credit ratings falling like dominoes, now is not the time to introduce U.S. political risk to the world's safe haven investments, the U.S. dollar and U.S. treasury securities. I fear a default, even for a few days, and the resultant formal downgrade of our AAA rating for U.S. treasury securities, will cause irreparable harm long term and further diminish our economic influence in the world. We could well be facing the tipping point in U.S. economic hegemony and permanently altering the calculus of international investors regarding the risk free perception of U.S. government securities.

Given this financial market backdrop, what should investors do? At the moment, I have less than 1% of client money invested in U.S. treasury securities and all that money is in treasury inflation protected securities (TIPS) with the next maturity scheduled for January 15, 2012. Client bond portfolios hold corporate bonds with the exception of the TIPS, reflecting my long standing concern with the bubble in treasury securities and their less than AAA rating. The reality is that the U.S. government has not earned an AAA rating for years and the rating agencies are simply playing catch up once again. I have preferred to own corporate bonds where I have the ability to better analyze potential cash flow and

repayment. Further, all bond maturities are less than five years, thereby limiting the interest rate risk of the portfolios during this period of historically low interest rates.

In terms of stock holdings, I have focused for some time on free cash flow and overall debt levels in searching for companies to invest in. I feel strong free cash flow and relatively low debt levels provide companies with greater financial flexibility to react to changes in the business climate. In a general stock market decline, the thought is these types of companies will perform better on a relative basis and rally back more quickly from any weakness. Additionally, I am currently underweighted in terms of my allocation to stocks across most portfolios and holding some extra cash. Market dislocations often create selective buying opportunities.

It's important to remember that this too shall pass. Congress and the Administration will strike some type of deal eventually and everyone can get back to the more typical self-interested politics that characterizes Capitol Hill. Stock prices were already at unattractive valuations and this crisis will likely remedy that excess. Bond investors may have a different perspective on risk by the time everything is worked out and that would be a good thing. Everyone is far too complacent regarding bond risks.

The longer term implications of this political struggle are worrisome. Global investors will never view U.S. treasury securities in the same risk free light again and that is problematic for a country that is likely to rely on overseas funding for the foreseeable future. And more immediately, does Washington's antics freeze economic activity to the point of driving us perilously close to another economic recession? We shall see. Thanks for reading this and I hope you will call or email me with any questions or comments.

Jeffrey