OCTOBER 2021 MARKET COMMENTARY

Markets broadly, with the exception of commodities, pulled back from highs in September. Volatility came mainly on political headlines out of Washington as Congress "plays political chicken" with the Debt Ceiling and a looming government shutdown. Commodities, historically viewed as a store of value in times of concern about inflation and a rise in market volatility, broadly returned 5.0% during September as measured by the Bloomberg Commodity Index. The broad equity market, as measured by the Standard and Poor's 500 Index, still stands up 14.68% for 2021.

So, what is going on in Washington? The government runs on a fiscal year—it runs from October 1 of the budget's prior year through September 30 of the year being described. Since Congress could not pass the more than a dozen annual bills that dictate Federal spending before September 30th, government would shut down at midnight on September 30. However, Congress did scramble to pass an emergency spending bill that will fund government operations through December 3rd. Though the bill funds the government through December 3rd, Treasury Secretary Janet Yellen has advised that the Treasury only has enough cash on hand to fund operations through October 18th without Congress acting to raise the debt ceiling.

What is the debt ceiling? While each year Congress passes a budget that outlines spending on infrastructure, programs, and salaries for Federal workers, they also tax people to pay for all that spending. For years, the government has been spending more than the tax revenues raised. This is called deficit spending and each year raises our national debt. The debt ceiling is the cap on the amount of money the US government can borrow to pay its debts. In the simplest of terms, in a household it would be the amount of credit available whether on a line of credit or credit card. So, while Congress passed an emergency spending bill authorizing spending through December 3rd and avoiding a shutdown of the government, without further action by Congress, the government will hit its "credit limit" on October 18th and would not be able to pay its bills.

Has this happened before? Yes. Unfortunately, we experienced political showdowns in 2011 and 2013 over the debt ceiling. In modern times, no G7 (a forum of the seven largest advanced economies) member has defaulted, and with the US being the largest in the world, a default would have catastrophic implications for the global economy. So, needless to say, and however troublesome it may be, a vote for the debt ceiling is a major bargaining chip. As politics become more polarized, both sides of the aisle in Congress, and factions within each party, are able to use their votes as leverage to advance programs and initiatives they feel strongly about. While in 2011 and 2013 deals were reached and the debt ceiling was raised, it wasn't without collateral damage. Standard and Poor's downgraded US debt from AAA in 2011 and in 2013 Fitch put the US government on a rating watchlist for a potential downgrade.

But don't Democrats control Congress? Yes. Democrats do control both houses of Congress. They hold a majority in the House of Representatives and in Senate they hold 48 seats, two independents caucus with the Democrats, and the tie-breaking vote is Vice President Kamala Harris. If you are asking yourself why they don't just vote through their spending bills and raise the debt ceiling, it is a great, albeit complicated question.

Typically, this type of vote would require 60 Senate votes, not just a simple majority. This would require a few Republicans to cross the aisle. However, in a procedural maneuver known as reconciliation, the Senate could reduce the sweeping spending bill into separate bills and pass them through both houses of Congress with simple majorities. However, this is problematic.

Republican leaders would prefer reconciliation as they could politically have "clean hands" in raising the national debt, something Democrats would like to avoid. Senate Majority Leader Schumer indicates that such a sweeping spending bill being separated and passed through Congress through reconciliation is unprecedented and has vowed that doing so is a non-starter. In addition, it is not clear that Democrats could pass the bills through reconciliation. Senator Manchin is holding out on raising the debt limit for a reduction of the Democrats' signature infrastructure spend. And certain factions within the Democratic party in the House are requesting certain concessions on items for their constituency, specifically Democrats from high-tax states have signaled that they would negotiate for a return of the full State and Local Tax (SALT) deduction.

So, what now? Well, in politics, anything can happen. While every member of Congress understands the far-reaching implications of a default—and it is ultimately a very unlikely scenario, we will likely see a lot of political maneuvering and posturing in the coming days. We are watching closely for what deals are made as it will make hints towards tax policy and spending in the coming year. President Biden and leaders of both parties have expressed their desire to have a resolution by the end of the week. Ultimately, we believe a bill will be passed, but we expect volatility in the interim. We view any short-term volatility as a long-term buying opportunity and will be vigilant over the coming days and weeks for entry points for clients putting new money to work in the markets.

As always, should you have any questions, please contact our office.

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