

## Debt Ceiling Update

7/23/2011

Dear Client:

I decided yesterday to reduce equity exposure in your portfolios going into the week before this debt default deadline (Aug 2). We therefore sold both funds in the Quant section of your portfolios Friday 7/22. We had a somewhat higher cash position anyway, so this adds to that. We now have about a 30% equity exposure going into this situation - about half our normal level, depending on your model.

What is the situation? All we heard last week was that Congress and the Administration were "getting closer" to an agreement. That felt hopeful. But everything I saw told me the opposite - they weren't getting any closer. Last night, after the market closed, it was announced that Congressman Boehner had walked out of talks w Pres. Obama, saying he wouldn't negotiate w him any further. Maybe that's posturing. Maybe they will still come to an agreement in time. I still think that is very possible, and that a certain amount of this is just hype. But we can't take the chance it isn't.

Here's what I think is likely at this point, starting with the most optimistic:

1. They pull this together in the next week and come up with an agreement that cuts spending substantially - say \$4 trillion at least - raises taxes somewhat, and of course raises the debt ceiling (all scenarios do that);
2. They come up with a moderate package with lower spending cuts - \$2 trillion range - and tax increases that are put off until after the election;
3. They come up with a bare bones package with minimal spending cuts and little or no tax increases;
4. They don't agree and the situation is unresolved at the deadline.

Notice I didn't say "...and default" for #4. Even if #4 happens, I don't actually believe the Government will default on our debt (hence the word "hype"). Rather option 4 would mean that the Government would slash spending on programs and divert that money to pay interest and bond maturities. That wouldn't be pretty, and it wouldn't be a secret. People would be affected immediately, and there'd be an uproar, we'd all watch the news 24/7, and the people we pay to prevent this from happening (i.e. Congress and the Administration) would finally cobble together something to restore the status quo. I don't see this as the most likely scenario, but we have to be prepared in case even the unlikely occurs.

What will be the impact of any of these scenarios? Rating agencies have already placed US debt on negative watch (and will downgrade if a default occurs). Further, world markets cannot be heartened by these shenanigans in Washington. Therefore this situation has already hurt our standing in my view. But having said that #1 would be positive for the markets, though less than it might have been if an agreement like this had been done before now. #2 would be slightly positive to neutral. #3 would be confusing and somewhat negative for markets. And #4 is definitely negative, how negative is anyone's guess. As stated, I still believe #4 is very unlikely. But it's still possible so....

The problem is I think we're past the point of any huge positives here, and that's why I took this action. I could be wrong, but it seems to me there's some level of risk in all the scenarios now because of the damage this infighting has done to our image. Therefore I have taken steps to reduce risk. We sold on an up day and week and so we will wait this out and decide on the next move when there is more clarity.

Let's keep our balance though. As awful as it seems now, this is a temporary situation and it will pass. Difficulties create opportunities. Historically markets correct, and then they rebound. As a nation, we need to address the real problem: excessive spending and debt. We have no choice, it's just a matter of time. We've already begun that process actually, this is just the "wake up and smell the coffee" stage so it's early and it's ugly, but we'll get there.

If you have any questions, as always feel free to call.

Sincerely,

Peter J Nagle, CFP, M.A.R.

*Disclosure: The preceding was provided by Peter J Nagle Financial Management, LLC, a Registered Investment Adviser located at 155 Broad St, Milford, CT 06460, (203)874-3133. This report has been derived from information considered reliable but it cannot be guaranteed as to its accuracy or completeness. Certain sections of this Commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, and when redeemed, may be worth more or less than their original cost. Investors should consider the investment objectives, risks, charges and expenses of any investment carefully before investing. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on*