

## DEBT CEILING ISSUE

We have been giving much thought to the debt ceiling issue. As you may have been reading, this is not the first time the country has faced this problem. In both the Johnson and Carter administration, this exact case arose. The analysis we have been evaluating by various respected experts offers many conflicting opinions about the reactions of markets to this debt ceiling issue. Our thoughts on how this affects you – you do have a well thought out plan (that is the foundation for decision making) and a well diversified well allocated portfolio. This does not mean we stick our heads in the sand and ignore what is happening. It does mean you will have asset classes that might suffer and that others might benefit from what does or does not happen. Treasuries have remained strong leading up to the August 2<sup>nd</sup> deadline. Vanguard's Ken Volpert is head of taxable fixed income at Vanguard, one of the largest holders of Treasuries in the United States. Mr. Volpert cited several reasons for the continued attractiveness of Treasuries, including the United States' position as the world's largest and most diverse economy, the dollar's role as the world's reserve currency, and the current strength of our economy relative to much of the rest of the developed world.

"With much of Europe and Japan facing even greater pressures, investors don't have many safer alternatives right now," he said. "Treasuries would be under greater pressure if the U.S. didn't play as big a role on the world economic stage and most of the other developed countries weren't facing greater challenges."

But Mr. Volpert stressed that both the U.S. economy and Treasury investors face potential headwinds if policymakers don't make difficult decisions to reduce the size of the deficit.

Mr. Volpert is cautiously optimistic that an agreement on raising the debt ceiling will be reached. He indicated that if an agreement also produces meaningful deficit reduction, it would be well-received by the bond markets and be good news for Treasury investors.

While it is unclear what would happen if the debt ceiling can't be resolved by the August 2 deadline, Mr. Volpert noted that the United States would be in uncharted waters. It's difficult to say how investors would react, he said. "Because of the risks associated with this uncertainty," he said, "I think Congress and the President will reach an agreement."

Mr. Volpert stressed that investors should not overreact to the current environment, but instead make sure they are prepared for the uncertainty. "The best way to do that is to hold a diversified portfolio of bond, stock, and money market funds so investors can earn the expected risk premiums available in stocks and bonds, and importantly also have adequate liquidity from holdings in the money market funds," he said.

This last point is crucial. Your investment plan contemplates your cash needs. This means you do not need to sell holdings during potentially volatile market conditions in order to satisfy short term needs.

We believe your portfolios are appropriately positioned and action is not required at this time.

Please do not hesitate to call us if you would like to discuss this issue.

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