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WEALTH MANAGEMENT

United States Economy on Hold

After the economy rose in the summer, businesses and consumers entered the third month of the third quarter cautious due to uncertainty regarding fiscal deliberations in Washington. That caution was validated when Congress failed to enact a new budget for the current fiscal year, thus shutting down the government on October 1, 2013, and barely avoiding a United States debt default on October 17.

As a result of the shutdown, complete economic data inclusive of September and the third quarter is not available. However, early reports of consumer and business spending, job creation and housing activity point to a decided retrenchment in economic activity as the third quarter ended. In addition, preliminary data for the month of October led us to believe that retrenchment continued, and in some areas worsened, as we began the fourth quarter. This was due to the government shutdown and, more importantly, the worrisome agreement fashioned by Congress to re-open the government and increase the federal debt ceiling.

After enduring a two week federal government shutdown, Congress and the president agreed to extend budget authority to January 15, 2014, and a debt ceiling increase to February 7, 2014. Thus, the specter of another government shutdown and possible debt default have merely been postponed to early next year and now the public is fearful the painful experience of early October will be repeated after January 1, 2014.

Consumer and business confidence have been shaken. Recent surveys show both declining along with marked slowdowns in consumer and business spending. September's employment report showed a surprising decline in private sector job creation (126,000) and the July job numbers were revised to one of the weakest levels (89,000) in 12 months. This confirms indications of the business reticence towards hiring we had seen coming into the fall. Even the great economic locomotive of residential housing is showing signs of slowing. While this is more reflective of this summer's rapid rise in mortgage rates and home selling prices, current and prospective softness in housing sales and mortgage applications will be reflecting consumer concern about the economy and their own financial security and lenders' unease about extending credit to potentially risky borrowers.

Outlook

The government shutdown and the uncertainty created by the short term solutions to the budget and debt ceiling issues will, in our opinion, result in a significant suppressant to United States economic growth in the fourth quarter. These issues will also negatively impact third quarter GDP readings which have been delayed. Where previously we expected second half economic growth of two to two and a half percent, we now believe the third and fourth quarters will struggle to aggregate two percent and that will be largely due to a recovery in consumer holiday spending reprieved by the postponement of government fiscal issues to after the new year. But even here we have lowered expectations for holiday spending due to the continuing economic uncertainty. We believe deviations from this two percent GDP level are more likely to be on the downside.

We know most observers now believe Congress will not allow another government shutdown and potential debt default given the adverse impact of the recent experience. They trust the economy will "snap back" from the current torpor aided by a continuation of the Federal Reserve's quantitative easing program well into next year as a result of the current economic weakness. We are not so sanguine. The policy and ideological differences between Democrats and Republicans are insurmountable in our opinion. We expect a repeat of the October experience with another short term solution. The Fed has been able to stave off recession with massive liquidity injections but they have not been able to stimulate demand and accelerated economic growth with such policies. We do not expect Republicans will allow a debt default so a solution there could carry through the November 2014 Congressional elections. Those elections will become a watershed event for the political and fiscal future of the country. It is clear the present Congressional makeup will not foster bipartisan solutions to the country's basic fiscal and public policy issues. Voters will have to decide next year which party they want to govern and implement fiscal and public policy going into and possibly beyond the 2016 presidential election.

As a result, we continue to project that the U.S. economy will exhibit fits and starts on a monthly and quarterly basis around a two percent growth target. However, it is very possible we could see GDP growth below two percent until there are longer term economic solutions that give consumers and businesses greater confidence to spend. Events in Washington will continue to shape the economic outlook and so we must be prepared to make adjustments as developments occur.