



The Bryn Mawr Trust Company

WEALTH MANAGEMENT DIVISION

Eye of the Storm or Are We Free to Move about the Cabin?

The Encyclopedia Britannica defines the eye of a storm as, “a central region of clear skies, warm temperatures and low atmospheric pressure”. The eye is surrounded by the eyewalls, which are the most dangerous part of the storm. It would not be stepping out too far in comparing the present situation in Washington, D.C. to that of a cyclone. In meteorological terms, the capital markets may have transitioned from the outer ring of the storm, through one side of the more turbulent eyewall and entered the relatively more tranquil eye of the storm on October 10, 2013. Last Thursday, House Republicans agreed to meet with the President and work on an agreement to at least temporarily raise the debt ceiling. Global equity markets reacted with glee, sending the major equity market indices up 2%, on average, to pre-cyclone levels. Those discussions broke down as we entered the weekend and began the new week without a deal.

The question remains as to whether we are now in the eye (calm before entering the other side of the eyewall) or will we hear the captain come on the intercom and announce that “you are now free to move about the cabin”. There is always the accompanying order and caution to keep one’s seatbelt fastened due to unexpected turbulence.

At Bryn Mawr Trust, we believe that that this most recent episode of Potomac dysfunction will likely result in at least a temporary agreement to extend the borrowing limits out to the early part of the first quarter of 2014. Recent public opinion polls have shown that the Republican Party has been damaged by the government shutdown and Senate Republican leaders have been putting pressure on the Speaker of House and majority leader, John Boehner to get “his house in order” with little success. The more conservative faction within the House Republicans made their failed plea to ditch Obamacare. While this was accompanied with anger and patriotic flare, it was at best, a doomed experiment from the beginning.

We believe that the probable outcome is that there will be a bipartisan compromise which will be put together in the Senate between Democrat Majority Leader Harry Reid, Republican Minority Leader Mitch McConnell, and most likely Vice President Joe Biden involved in some capacity. The compromise will allow for an increase in the debt ceiling. There will probably be at least one contingency and that is, an agreement to craft a budget sometime before the end of the first quarter of 2014. It currently appears that a delay on the medical device tax or an agreement for submission of proper credentials for healthcare eligibility benefits will not be part of the final agreement, although this may change.

We have stated that, a default, even if considered “technical” by the US, is untenable. Disruptions both domestically and abroad continue to erode confidence in this country and its capital markets.

This morning, the Wall Street Journal reported from Fitch Ratings, “Fitch placed its triple-A rating on the U.S. on ‘rating watch negative,’ saying a downgrade is possible by the end of the first quarter next year. Even if Congress reaches a short-term deal to avoid defaulting on U.S. debt, Fitch said the budget impasse has undermined confidence in the effectiveness of the U.S. government and economic policy”.

The comment by Fitch is another indication of the damage already inflicted on the credibility of US fiscal policy. We continue to believe that consumer and business investment spending is growing, albeit a modest pace relative to previous recoveries. The dysfunctional fiscal mess in Washington, D.C. will have a slowing effect on actual demand due to partial government shutdowns already inflicted, as well as the aforementioned credibility. The markets may eventually relish the notion that the delay in passing the debt ceiling will also delay the “tapering” by the Federal Reserve regarding its extraordinary monthly purchases of treasuries and mortgage securities.

The markets have a short memory and once this latest crisis becomes a rear view mirror event, focus will resume on third quarter earnings releases and 2014 company guidance, as well as the ever popular “to taper or not to taper” – it fits the Potomac Shakespearean atmosphere.

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