The Bryn Mawr Trust Company
Wealth Management Division

The US Debt Ceiling Debacle: Complacency for Now but Storms on the Horizon? October 7, 2013

Global capital markets traded in a tight range last week. Despite intense media focus on the federal government shutdown to almost the exclusion of all other news, market participants appear to be cautiously confident that US lawmakers will end the current impasse. At Bryn Mawr Trust, we also believe that the abrupt and all-consuming nature of the latest dysfunction in Washington, D.C. warranted our putting the matter into perspective. Here are some of our current thoughts:

The US Debt Ceiling Debacle: Complacency for Now but Storms on the Horizon?

The airwaves and printed matter are awash in the latest on the debt ceiling debacle, political maneuvering and possible short and long term implications for the US economy and capital markets.

The weekend was punctuated by numerous Washington, D.C. news programs, as both sides on the debate had national face time. Appearing on CNN and as reported on Bloomberg, Treasury Secretary Jack Lew said "Congress needs to pass a debt-ceiling increase by Oct. 17 or the U.S. will be 'dangerously low' on cash and risk defaulting on its payments." The federal debt ceiling currently stands at $16.7 trillion and the October 17 date is growing near. Despite the looming date, the capital markets have remained largely complacent. Thus far, there has been no evidence of a material de-risking/buying downside protection occurring in the equity markets. For example, trading volume in the equity markets on a daily basis has been at or below the average daily trading volume on a year-to-date basis. This fact was most evident last Monday (9/30), the last trading day of the third quarter, when there were no unusual volume spikes often associated with quarter end positioning.

In various conference calls on this subject, it was noted that periods of extreme uncertainty often result in the underperformance of small cap versus large cap domestic stocks. Over the last week or so, large cap domestic stocks, as measured by the Russell 1000, were down slightly, while small call cap stocks, as measured by the Russell 2000 rose modestly. Again, this is not characteristic of a de-risking environment. In essence, the market is assuming that a resolution is going to pass.

The other sentiment that is beginning to gain traction is that the deal will be a comprehensive package. The compromise agreement will cover both a Continuing Resolution (provides budget authority for Federal agencies and programs to continue until appropriations are made) and the raising of the Debt Ceiling (from $16.7 trillion).

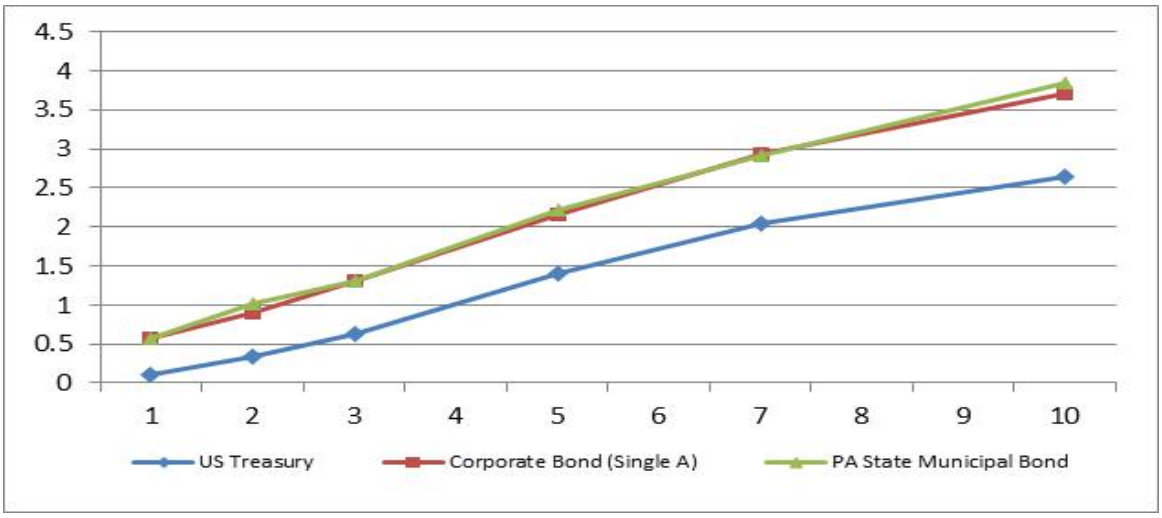
The lack of significant market reaction to the events in Washington, D.C. reflects a market view that the issue will be dealt with before the deadline. It has been reported by some research and news agencies that the October 17 date articulated by the Treasury Secretary is somewhat flexible and that the actual deadline, that is when the federal government runs out of funds, is later in the month. The longer that the uncertainty persists as the middle of October draws near, the greater likelihood that volatility emerges and a sell-off of some proportion occurs. Conversely, it seems clear to us that the market views a compromise as a precursor to a market run to the upside and thus the short sellers are being held at bay, at least for the time being.

As last week came to a close it had become apparent that the probability of a deal being struck had been pushed out until at least this week, at the earliest. The likelihood of a more comprehensive package is gaining some degree of momentum in Congress which, in our view, extends out the date for an agreement to be reached. It is well documented that a partial government shutdown has negative effects on the broad economy, not only in the public sector but also in the private sector (government contracts with private industry, for example). Further, any dilatory effects on economic growth will impact the Fed's timing as to the "taper" of its monthly purchases of treasury and mortgage securities.

We prefer to spend our energy in determining the longer term value of asset classes. In this regard, we reaffirm our view that equities remain the preferred asset class versus fixed income instruments. Our focus remains on asset allocation and security/fund specific selectivity, as the market indices and specific security correlations continue to delink. The headwinds for bonds are significant and the modestly positive real yield on the ten-year treasury, for example, offers little upside protection or competition for equities. Equally, we recognize that short term events shape market opportunities and we would wait for some definitive signs of a resolution to this crisis to emerge and use the opportunity to execute strategies in line with the long term goals of our clients.

US MARKETS	Index	W/W*	YTD*	TTM*
S&P 500 Index	1690.50	-0.07%	18.53%	15.71%
NASDAQ Comp.	3807.75	0.69%	26.10%	21.41%
Dow Jones Ind. Avg	15072.58	-1.22%	15.02%	10.75%
Russell 2500	419.62	0.38%	26.95%	27.93%
S&P Midcap 400	1255.44	0.91%	23.03%	26.00%
S&P Smallcap 600	608.28	0.28%	27.64%	29.35%
WORLD MARKETS	Index	W/W*	YTD*	TTM*
Frankfurt (DAX)	8,622.97	-0.44%	13.28%	18.04%
Hong Kong (Hang Sang)	23,138.54	0.06%	2.13%	10.12%
London (FTSE 100)	6,453.88	-0.90%	9.43%	10.74%
Tokyo (Nikkei 225)	14,024.31	-4.98%	34.91%	58.23%
MSCI Emerging Markets	1,007.92	2.07%	-4.48%	-0.12%
MSCI EAFE	1,816.70	-0.08%	13.26%	17.59%
Sector Weightings for the S&P 500	% of S&P 500	MTD*	QTD*	YTD*
Telecom	2.41%	0.06%	0.06%	2.29%
Utilities	3.12%	-0.53%	-0.53%	6.29%
Materials	3.55%	1.24%	1.24%	12.91%
Technology	17.89%	0.49%	0.49%	12.50%
Industrials	10.64%	-0.29%	-0.29%	21.54%
Health Care	13.13%	1.21%	1.21%	28.11%
Financials	16.28%	0.70%	0.70%	22.16%
Cons. Staples	10.00%	0.07%	0.07%	13.79%
Cons. Discretionary	12.49%	0.67%	0.67%	28.57%
Energy	10.49%	0.81%	0.81%	14.41%
FIXED INCOME Yields		2 YR	5 YR	10 YR
US Treasury		0.33%	1.41%	2.65%
PA State Municipal Bonds		1.01%	2.21%	3.85%
Corporate Bonds		0.91%	2.16%	3.70%
* W/W = Week Over Week				
* YTD = Year to Date				
* TTM = Trailing Twelve Months				

Fixed Income Income Yield Curves



Source: Bloomberg, L.P.

Division Head

Francis J. Leto

Executive Vice President

610-581-4730

fleto@bmtc.com

Investments

Ernest E. Cecilia, CFA

Senior Vice President

610-254-2030

ececilia@bmtc.com

Retirement Services

Kurt W. Angstadt

Vice President

610-581-4944

kangstadt@bmtc.com

Multi-Family Office

Judith W. Lau, CFP®

President

302-792-5955

judy.lau@lauassociates.net

Fiduciary Services

Elizabeth Roberts

Senior Vice President

610-581-4755

eroberts@bmtc.com

Custody Services

Anrita McGinn

Group Vice President

610-581-4722

amcginn@bmtc.com

BMT Asset Management

Richard K. "Chip" Cobb, Jr.

Senior Vice President

610-581-4770

ccobb@bmtc.com

The Bryn Mawr Trust Company of Delaware

Robert W. Eaddy

President

302-798-1792

readdy@bmtc.com

www.bmtcwealth.com