



September 30, 2013

Dear clients and friends,

***"Cuando creíamos que teníamos todas las respuestas, de pronto, cambiaron todas las preguntas."***  
-Uruguayan novelist Mario Benedetti

It has been a while since we've written to you about **political intransigence** and its effect on the financial markets. And though the topic is chronically on our minds being so near the District, we find it unsettling to bring it forward for discussion at this point in time, nearly coincident with the fifth anniversary of the Lehman Brothers bankruptcy and the financial crisis that followed.

As you are surely aware, the US government is on the brink of its first partial shutdown in 17 years at midnight tonight, with no signs of compromise in either the House or Senate to avoid it. Shutdowns are not new to Capitol Hill, and arguably not even rare. The Congressional Research Service points out there have been seventeen shutdowns since 1977, with almost all of them lasting three days or less. The longest battle spanned 21 days in December 1995 and January 1996, as then-President Clinton sparred with House Speaker Gingrich over government spending on Medicare, public health, the environment and numerous other budget items that parallel the ones in today's fiscal fight.

The question for investors to ask is, "What happened to the financial markets then?"

And the short answer is: *Not much*. Though perhaps it didn't seem like it at the time.



As you can see in the chart above, the S&P 500 index fell a little over 2.5% in mid-December 1995 in advance of the shutdown, but proceeded to recover through its duration. Stocks then fell almost 4% in January 1996, though the shutdown had ended! At the time, headlines in the financial press suggested the shutdown's effects on the economy would be long-lasting and particularly painful. Yet, the stock market rally resumed shortly thereafter. To put the worst

of those moves into a current-day context, a near 4% decline from current levels might seem alarming, but would only put the US stock market back where it was at the end of last month!

Our ever-vigilant compliance department (and a modicum of common sense) reminds us to now insert the standard financial industry disclaimer “**past performance is not indicative of future performance.**” We don’t know if the stock market will react similarly this time. No one does. We don’t know how long a shutdown will last and how much economic drag it will induce. No one does. And we don’t know if this game of political “chicken” will lead to the unthinkable – an actual default by the US on its debt obligations.

We suspect that if we did have the answers, we would find, as Mario Benedetti suggests in our opening quote, suddenly the questions would change!

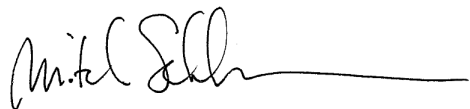
But it’s true we’ve seen this game before. In Summer of 2011 the US government threatened to inflict grievous bodily harm upon itself with a debt default. Standard & Poor’s downgraded US debt from its AAA status in response, not because the country doesn’t have the ability to pay its debts, but for the first time ever it suggested it was *unwilling* to pay them. Political intransigence in all its glory! Curiously, the end result of the 2011 debt debate turns out to have been a fairly good piece of legislation, the so-called “sequester,” which has helped reduce the US budget deficit to a relatively manageable 4.2% of GDP.

The **recent rally in US Treasuries** underscores the fact the US remains the global reserve currency and has more than sufficient means to pay its bills. Yes, the government may shut down tonight if no continuing resolution is passed, but we expect this situation should ultimately be righted.

Of greater concern at the end of the third quarter of 2013, as it was in 2011, is the **situation in Europe**. Recent comments from the Managing Director of the European Stability Mechanism suggest Greece may soon need another bailout. And Reuters news service just posted a headline stating “Italy’s coalition on brink of collapse as politicians fail to agree on fiscal deal.” Sound familiar?

Of course in the coming quarter we will also be faced with renewed discussion about the end of the Federal Reserve’s quantitative easing program, with the likelihood we’ll see moderately higher interest rates by the end of the year. In the very near term, we expect US bonds will maintain their “safe haven” status even as the political process plays out.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Mitch Schlesinger", followed by a long horizontal line extending to the right.

Mitch Schlesinger  
FBB Capital Partners

\* Translation: “*When we thought we had all the answers, suddenly, they changed all the questions.*”