Mimosa Investment Management

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D.C. Dysfunction

It remains a constant in the D.C. bubble that very few lawmakers function well. Democrats and Republicans, not to mention the extremes in both parties, have dug in solidly to their respective ideologies. As of press time for this memo, two major economic hurdles have surfaced: the government shutdown and the fast approaching debt ceiling.

Shutdown

Seemingly a mild shutdown of some government agencies has involved furloughs for non-essential workers. However, witness the pain felt by visitors to some National parks which have been closed. Or what must be the disappointment felt by families foregoing the $100,000 benefit resulting from the loss of a family member in combat action.

National Debt

Speculation has it that Congress must raise the ceiling on our total national debt. Otherwise, the U.S. will default and bond credit ratings will suffer. World leaders have admonished the U.S. not to default as to do so would wreak havoc on the world economy.

Both these two issues need fixing and soon. But the impasse in our nation's capital presents a decided encumbrance to solutions. What is the impact on the investor?

Investor Outlook

The D.C. dysfunction clearly impacts investments. Look no further than at the DJIA which hit 15,677 on September 18. Then it immediately fell to below 14,800 by October 10. It is no coincidence that investor confidence has been impacted. As for bonds the yield curve has maintained a positive trajectory over time. In other words more yield can be found in longer maturities as shown below:

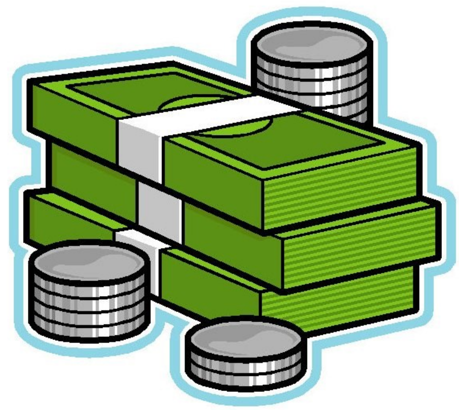
Yield and Maturities

Security Types	2 Year	5 Year	10 Year
U.S Treasury	0.472%	1.514%	2.762%
Aa Rated Corporates	0.503	1.767	3.424
Aa Rated Municipals	0.806	1.580	2.890

Enter the Fed

Complications face investors in the very short maturities, with the corresponding lack of yield. Such investor quandary, it can be argued, mostly results from Federal Reserve monetary policy. Back in 2007 the Fed funds rate of just over 5.0% reflected more "normal" times. Through a series of fairly rapid Fed Funds rate cuts by 2009, the rate had dropped to 0.25%, and there it has stayed since.

Once Bernanke and the Fed exhausted interest rate cuts, they next turned monetary action to quantitative easing. It appeared that the $85 billion per month that the Fed investments in Treasurys and mortgage-backed securities was coming to a gradual tapering. But at its September 18th meeting, the Fed made clear that tapering will be delayed. The reason for this action reflects the concerns that the economy has not responded and recovered as strongly as hoped.



Now that Lawrence Summers has taken himself out as the next Fed chair beginning in 2014, Janet Yellen has become the front runner for that post and has President Obama's approval. Early indications appear as if she will continue Bernanke's bond buying policies. This appointment should bode well for equity and bond markets.

The Fix

Yet, for markets to fare well, Congress and the President must "get their act together". The indications appear to be more favorable now for fixes to the shutdown and debt ceiling. However we've been close before.

As of October 3 this year, a Fox poll showed a staggering 81% of Americans disapprove of Congress. 45% had a favorable view of Democrats and 35% viewed Republicans favorably. We may soon see many new faces in the D.C. bubble.

Breaking Now

Late on October 16, both houses of Congress passed measures to end the Shutdown and extend the Debt Limit, but for only a couple of months. The same, tired Congressional arguments will be rehashed, this time over the year-end holidays.