Martone Capital Management: Weekly Investment Commentary (12/16/2013)

In a rare act of negotiation and bipartisanship, leaders in the House of Representatives and Senate agreed last week to fund discretionary spending for the next two years. The deal moderately increases government spending and scales back the previously planned "sequester" cuts. The increased spending will be covered by increasing some government fees and changing pension contribution plans, as well as via some vaguely defined future spending cuts.

Assuming the deal is ratified by the Senate (and we believe it will be), it will accomplish two things. First, it will mitigate fiscal drag associated with the sequester. Second, it will remove a lingering uncertainty - the possibility of another government shutdown - that had the potential to undermine both business and consumer confidence. We would view the spending deal as a modest positive, with initial estimates suggesting it may add approximately 0.2% to gross domestic product in 2014.

While any agreement is better than none, there is a lot that this deal does not tackle. It does nothing to address the debt ceiling, tax reform, long-term entitlement reform or the pending expiration of previously extended unemployment benefits. At the very least, we expect political wrestling over the debt ceiling to continue into 2014 - especially as next year brings with it the backdrop of the midterm elections.

Outside of news from Washington, last week also saw some important developments in the consumer sector of the economy. Specifically, U.S. household debt increased at a 3% annualized pace in the third quarter, the largest increase since the first quarter of 2008. Consumers' willingness to take on more debt is being driven by several factors, including a marginally better jobs market, rising household net worth and a low-interest-rate environment that makes borrowing more attractive.

Should this trend continue, we believe it could help support economic growth in 2014. Although we expect interest rates to increase next year, we are forecasting only a modest rise, and believe borrowing trends will continue to stabilize. To at least some extent, higher borrowing levels will help mitigate the impact of slow income growth and promote some increase in consumer spending. From an investment perspective, this would be a positive for stocks, but arguably a negative for bonds.

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