

## Investment Policy in Light of Debt Crisis

A world leader of dubious reputation once said *"We are standing on the edge of the cliff but we are ready to make a decisive step forward [1]."* Unfortunately, as you read this, our government is locked in a battle over the debt ceiling and it feels like the entire economy might take one of these "decisive steps" forward that lead to the abyss. We are very optimistic that the best interests of the country and its citizens will prevail over political affiliations, yet we still feel the need to explain how we plan to react to this situation.

First, we need to explain the significance of the debt ceiling which must be agreed upon by Aug. 2nd to avoid significant disruption to gov't services and potentially payments to US Gov't debt obligations. If the US Gov't - as the largest consumer in the economy [2] is not able to finance its purchases, the demand for a variety of goods and services will likely be depressed. What is more, the compensation of millions of gov't employees will potentially be affected along with the recipients of gov't programs like social security. In other words, the effect can be deep and far reaching and could be felt by the entire economy.

The US economy is the largest in the world [3] and much of the world holds US Gov't debt along with other denominated securities [4]. That is why the effect of the uncertainty in the US is felt heavily abroad. While experts differ on their view whether the failure to raise the debt ceiling will result in gov't default on debt obligations, it appears to us that all markets nationally and abroad are watching the debates in congress with a sense of nervousness. Given the far reaching effects of the debt ceiling discussion, we must evaluate the effect these events will have on our investment strategy. We must perform the evaluation in a thoughtful and careful manner. A good place to start is with our investment philosophy.

For the vast majority of our portfolios, regardless of who manages them, our underlying philosophy is that investing in the US economy and its various sectors will generally provide us with the best combination of risk and return. We compliment that core investment with international investments as appropriate.

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1 Quote attributed to Nikita Khrushchev – former Soviet leader 2 The US Gov't budget is \$3.7 trillion according to Wikipedia; [http://en.wikipedia.org/wiki/United\\_States\\_federal\\_budget](http://en.wikipedia.org/wiki/United_States_federal_budget) 3 [http://en.wikipedia.org/wiki/List\\_of\\_countries\\_by\\_GDP\\_\(nominal\)](http://en.wikipedia.org/wiki/List_of_countries_by_GDP_(nominal)) 4 [http://en.wikipedia.org/wiki/United\\_States\\_public\\_debt#Foreign\\_holders\\_of\\_U.S.\\_Treasury\\_Securities](http://en.wikipedia.org/wiki/United_States_public_debt#Foreign_holders_of_U.S._Treasury_Securities) 5 Using diversification as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions.

It is critical to note that we do not create portfolios and strategies that "emigrate" financially from the US. Considering the impact the US Gov't debt could have on the global economy, it will likely be impossible to "hide" fully from the potential effects of this decision.

Outside of cash, we believe all assets will be affected by the decision that Capitol Hill and the White House ultimately will make. Every market and security (*including commodities*) will likely feel the effect the debt ceiling discussion and will therefore go through a period of uncertainty and volatility with unpredictable results. We feel that choosing cash as a "safe harbor" in a potential crisis can be as much of a risk as staying invested in our current portfolio. Cash may be safer, but only if we do not have to re-invest in the market in the future. What we learned in October 2008 and March 2009 (*the darkest days of the crisis*) still reigns true: leaving the market at the wrong time can be even more devastating than the worst damage of the crisis!

It is important to understand that in our view, the current market pricing may already incorporate the "majority" view of what will happen. We are not the only investors asking ourselves what will happen and what the impact may be. The market has probably already priced in the probability of NOT reaching an agreement and those consequences. Markets continuously reprice as more information becomes available.

Finally, liquidity is an entirely different perspective for evaluating the portfolio. It is very likely that the future may bring increased volatility in the face of uncertainty, which can make it difficult to raise cash for distributions or other needs. If you anticipate needing significant cash outlays in your portfolio in the next year, please talk to us so that we can adjust our strategy. As always, we want to emphasize that we are not economic forecasters and we do not believe in economic prognosis or market timing. We are investing in the US economy and its best companies and sectors in a long-term strategy that also implements diversification [5] and careful examination of the risks. We would be pleased to discuss this further with you.

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