

Buena Vista Investment Management, LLC

Creative Investment Solutions

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Should Investors Be Concerned With Political Showdown Federal Reserve Bank Providing Needed Liquidity to Offset Market Volatility

In September the Federal Reserve surprised the financial markets with their decision to continue their easy money policy. In that announcement the Fed indicated that it will continue with its monthly purchases of treasury bonds and mortgages (Quantitative Easing) and would begin tapering those purchases at some point, possibly later this year.

Initially, both the stock and bond markets rallied on this news. Interest rates would remain low for the foreseeable future, providing more reason for investors to remain in stocks. But as we moved toward the end of the quarter the stock market reversed itself and has since been moving south. The primary reason for this change of heart by market participants was not only a fear of slow economic growth but also the uncertainty created by the government shutdown, and more importantly, the looming October deadline for raising the debt ceiling.

How concerned should investors be about the debate over expenditures and the debt ceiling? Of the two, the debt ceiling is a far more serious issue. Having said that, it is likely that both of these events will add to short-term market volatility, but neither should have a long-term effect on the markets. We make the last comment based on our belief that it would be totally irresponsible to allow any default on US debt instruments and we do not believe that either political party wants that to happen. So we begin our investment assumptions with the belief that the debt limit will be raised.

With respect to short-term volatility we only need to look back to 2011 to look at how markets reacted during the last debate over the federal debt ceiling. As that debate raged the stock market dropped almost 20%. Should we expect the same market reaction this time? We believe that this time is different.



In 2011 there were numerous events buffeting the global equity markets at the same time, in addition to the chaos in Washington. There were the concerns over a meltdown in Europe. Greece was in turmoil. There were potential defaults in Portugal and Spain and there were concerns about whether or not the Euro was even going to survive.

As the chart to the left shows, the stock market is up 17% this year and over 50% since the last time the debt ceiling was discussed. The reason for the move up is due to a much improved situation in Europe and the improvement in the US economy.

We remain of the opinion this is not 2011 revisited.

(OVER)

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Federal Reserve Bank Providing Needed Liquidity to Offset Market Volatility

As such, any market volatility leading up to the debt ceiling should be manageable from an investment perspective. We expect to retain current investment holdings in client portfolios, but we remain ready to increase cash holdings if necessary.

While the government shutdown and debt ceiling discussion is now dominating the financial and national networks, the bigger and the more important long-term topic for investors is how and when the Federal Reserve Bank will end its accommodative policies.

Normally, the Federal Reserve Bank controls short-term interest rates through its Fed fund activities and the open markets set intermediate and long-term interest rates. But beginning in 2009/2010 the Federal Reserve Bank took the unusual step of buying billions worth of Treasury notes, bonds and mortgages, artificially pushing interest rates down to encourage economic growth.

We are of the opinion that the easy money policies of the Fed over the last few years has helped set the stage for a substantial rebound in the industrial and manufacturing segments of our economy. They have also helped fuel the incredible renaissance of our oil and gas industry. Our current environment of low interest rates coupled with improved corporate productivity and new export opportunities have led many economists to forecast 3%+ GDP growth here in the US in 2014.

If they are right and we do see higher economic growth and in turn higher equity prices in 2014, the Fed will likely begin to curtail its bond buying activities. Intermediate and long-term interest rates will begin to rise and barring some unique or unusual occurrence, we will probably be able to say that we have seen the generational lows for interest rates.

For investors, an increase in interest rates from abnormally low levels should not be an immediate detriment to equity prices as higher rates will indicate the economy is creating more jobs and better economic activity. But it is likely that improved economic activity will lead to higher interest rates and that is when the real fun will begin. If we think the current battles in Congress are fun, wait until interest on our \$16 trillion national debt is running at 6% rather than 3%. For now we expect that cooler heads will prevail and our elected officials will increase the debt limit and then hopefully they will begin to address the really important issue of reducing our national debt.

BUENA VISTA INVESTMENT MANAGEMENT LLC

LONG-TERM MARKET INDICATORS

Buena Vista Conservative Buy/Sell Discipline:	Bullish (turned positive 1-2012)
Leuthold Major Trend Index	Bullish (turned positive in 7-2013)
InvesTech Negative Leadership Composite:	Neutral (turned neutral in 9-2013)
S&P 500 Stock Index:	1,681 (17.84% thru 9-30-13)
Dow Jones Total Market Index	17,781 (19.44% thru 9-30-13)

Important Disclosure – The performance numbers contained on this page are provided for informational purposes only. Returns may vary depending on personal objectives and timing of invested dollars. The performance numbers contained on this page are net of Buena Vista management fees and are based on investments held in a composite of accounts with like investment strategy. Contact Buena Vista Investment Management LLC for more specific information concerning performance and market data. Do not rely on this information to make investments.

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\$SPX S&P 500 Large Cap Index INDX

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21-Oct-2013 12:27pm

Open 1745.20 High 1747.79 Low 1741.71 Last 1744.08 Chg -0.42 (-0.02%) ▼

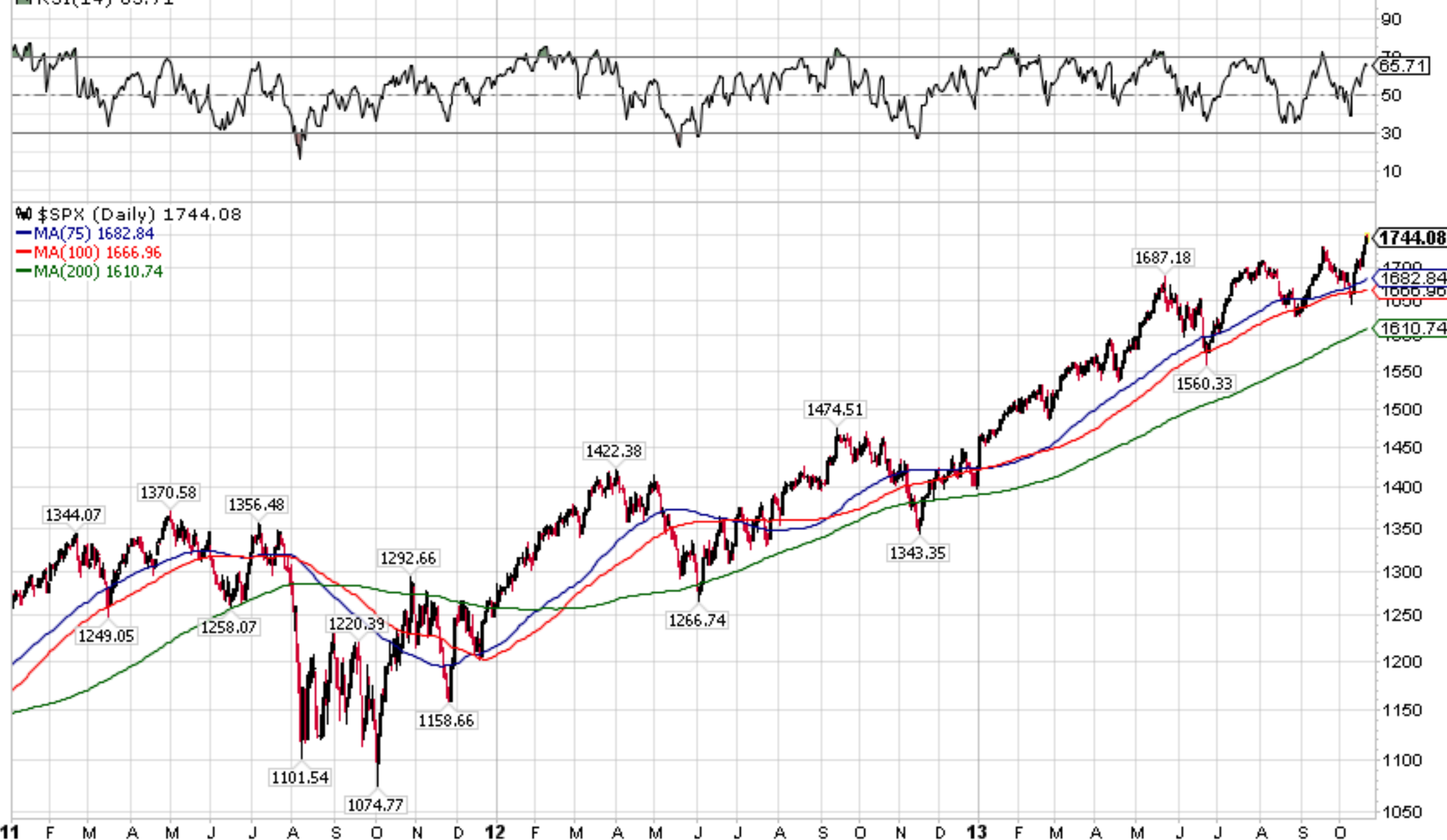
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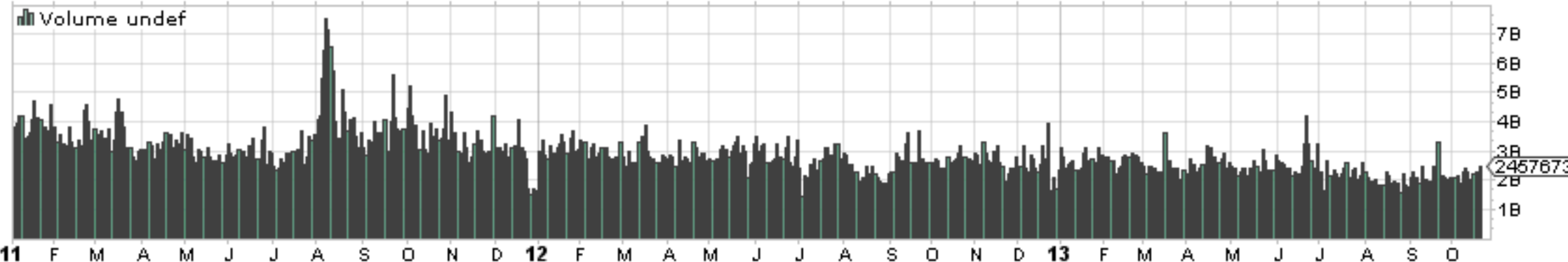
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Volume undef



\$SPX S&P 500 Large Cap Index INDX

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Open 1678.79 High 1687.97 Low 1677.33 Last 1687.97 Chg +9.31 (+0.55%) ▲

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