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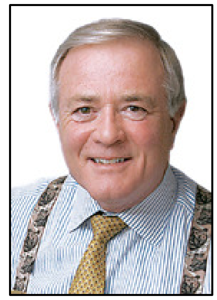

William Rutherford

Budget crisis freezes government, markets and maybe the Fed

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Just as his approval numbers reached an all-time low for his presidential term, Barack Obama was rescued again. He painted himself into a corner with his “red line” in Syria that he couldn’t or didn’t want to back up. Vladimir Putin bailed Obama out.

Now, with Obama’s approval rating at 49 percent, the Tea Party Republicans have contrived to make the president look good. With no apparent ability to count votes, or knowledge of how government works (clue to Tea Party: there are three branches of government, and you control none), the Tea Party blunders on, bringing the operation of government to a halt.

The Republicans, who had a shot at improving their numbers in the midterm elections, once again see defeat snatched from the jaws of victory. The Tea Party has stymied the Republican Party, and all Republicans will be tarred. Like Don Quixote, they see themselves on a great crusade, while in reality they are tilting at windmills.

The Tea Party wants Obama to concede to the loss of his signature legislation, the Affordable Care Act. No matter whether the legislation is good or bad, it is the law of the land; Obama is not going to give it up, and, as president, he has the power of veto. Of course, the Tea Party does not have the votes to send a bill to the president anyway. It is all a simple numbers game, and the Tea Party does not understand that it doesn’t have them.

The markets are generally down from their all-time highs since the government shutdown began, but in an orderly way. The S&P 500 fell on seven of the last eight trading days of the quarter, coinciding with the impasse, with losses continuing into the new quarter. Of course, we don’t know how long this impasse will continue, and the markets may yet crumble if the crisis lasts too long, but for the time being they have stood up well.

The debt ceiling is another matter, but I believe a way will be found out of this mess too. The Republican house leader has said he will not let the debt ceiling cause a default. Perhaps a grand coalition will occur with the Tea Party on the fringe. Also, President Obama believes he has the power to ignore the debt ceiling. But the exercise of that power would no doubt precipitate a constitutional crisis.

The U.S. might find it difficult to sell bonds when its authority to do so is being challenged. With some members of Congress saying that a default might not be so bad, it is hard to be optimistic. Central to the whole debate is the desire by the Tea Party to defund Obamacare. No matter the strength of their efforts or the merit of their arguments, it will not happen. They don't have the votes, which is what counts in a democratic system of government.

John Boehner's job is on the line. His caucus is fractured between moderate Republicans and Tea Party members. The latter do not think Boehner represents them well and would prefer he be replaced by one of their own ilk. If that happens, the Republican Party could go the way of the Whigs and Know Nothings.

For months, the markets have overcome obstacles and crises to march higher. This pause is well needed because of the big run-up the markets had in September. The economy needs time to recover further before the markets continue into what is expected to be a robust year end. Short interest positions in the S&P 500 are touching record lows as large investors expect a market increase into year end. Betting against the markets has been a losing game that large investors do not want to play.

The Russell 2000, a gauge of the small cap equity universe, has hit an all-time high. This bodes well for the markets in general.

Washington's upheaval may cause the Fed to delay interest rate increases in an effort to buoy the economy. After a long delay that caused market uncertainty, the president's appointment of Janet Yellen as the next Fed chairperson, buoyed the markets. Yellen is expected to focus on unemployment and keep interest rates low.

The Institute for Supply Management factory index, a key gauge of the economy, hit a two-year high, indicating that the economy is gaining steam. This was the fourth straight monthly increase for the index, which rose to 56.2 – the highest level since April 2011. Readings over 50 signify that the economy is expanding. The Chicago business barometer jumped in September, as did the Dallas fed's general business activity index.

Big three automakers are working at full production. GM reports that nine of its 17 plants are working three shifts compared with just three plants in 2008. The company has plans to operate more factories at full capacity as the average age of cars on the road reaches 11.4 years, a record high.

A contrary indicator, however, is a bull on the cover of Time magazine. Also, the IBD/TIPP index of economic optimism plunged to its lowest level since August 2011 on the news of the Washington stalemate.

The six-month outlook on personal finance also dived to two-year lows. The survey found that 58 percent of those polled believe the U.S. is still in a recession. This has caused many people to look to 2011, the last shutdown, for a guide. However, a big difference in the two occasions is that central banks were tightening monetary policy in 2011, but now they are all accommodative.

Investors would be wise to use this market pause to consider careful additions to their portfolios at marked down prices. Be selective and be diversified.

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