

The Debt-Ceiling Saga: Bluster and Blunder

Politicians are playing a dangerous chess game of brinksmanship and bluster. Ultimately, the risk of a blunder will bring an end to their silliness.

Pete Chiappinelli, CFA, CAIA, Chief Investment Officer

“The blunders are all there on the board, waiting to be made”.

- Savielly Tartakower, renowned chess player and recipient of the first International Grandmaster title

If history is any guide on the debt-ceiling saga playing out currently, a few things are likely to happen in the coming days, weeks, and months. We wrote (see [“Thinking The Unthinkable, Again”](#)) about the debt-ceiling saga back in January of this year, but the issue is heating up again.

First, gamesmanship, brinksmanship, and political chess will mean that this could be a nail-biter, and it will be great fodder to feed the media fear mongers. However, the debt-ceiling impasse will ultimately be resolved, with the ceiling getting raised. The odds of a U.S. default are so infinitesimally small that even saying the words seems like a waste of breath. No doubt, some behind-the-scenes deals about the future budgets are already getting done, and we will never know about them. We have heard, however, that for both procedural and calendar-driven reasons, wrapping up talks by early June may be a stretch.

Therefore, if an agreement won't or cannot be reached soon - the Speaker of the House has an appointment with the White House on May 9th specifically to address the issue - the higher likelihood is that a stop-gap agreement will be created, or even a series of them. The net effect of this is kicking the can down the road. There is precedent for such a scenario. The practical effect is that it buys more time for both sides of the table to continue their game of political chess, but now with higher stakes and urgency. However, it will also be a time where politicians get a taste of the danger of playing such a game.

They, and we, should expect volatility in both stock and bond markets to increase markedly. We are already seeing volatility in the bond market at its highest since the Great Financial Crisis of the 2008, due in large part to this political posturing. While the U.S. stock markets have been rallying through much of 2023 and during debt-ceiling handwringing (the S&P 500 was up over 9.0% through the end of April and growth stocks are up double digits), Wall Street's focus has been on the very encouraging earnings and revenue surprises related to the first quarter. This generally sanguine mood could change rapidly if rhetoric about default takes a notch upwards. There is nothing like a stock market scare, however short-lived, to get negotiators back to the negotiating table with sharpened pencils.

Either way, though, our strong – very strong — belief is there is going to be a negotiated extension into the fall. And by fall, markets and voters will tire of scare tactics and will demand a deal; the threat of Social Security cuts or a humiliating default would lead to an agreement by the second half of the year.

As it relates to an investment strategy, this is what we are doing, and more importantly, what we are not doing:

- First and foremost, we are not doing anything in the coming days, weeks, and months believing we can dodge and weave around this likely volatility. Trying to perfectly sidestep this short-term, politically driven volatility is truly a fool's errand for anybody, and excruciatingly truer for taxable investors as each trade, in and out, has a tax toll.
- Second, should volatility increase markedly, we would recommend using this opportunity to harvest losses and bank them for future use. For many in high-tax states that are staring at short-term capital gains tax rates as high as 56.8% — hello, Massachusetts—these bankable tax offsets are extremely valuable.

For our clients that are currently engaged in dollar-cost-averaging programs, increased volatility would trigger our recommendation to accelerate deployment of cash, to take advantage of cheaper prices.

- Volatility also presents opportunities for tax-efficient strategic rebalancing.
- Finally, we are recommending clients move to money market funds instead of rolling T-bills, especially if they think they have some large cash flow needs in the coming three to six months.

As the quote above indicates, both parties may have all sorts of creative strategies to play, thinking they can “win.” However, the risks of serious political and economic blunders multiply with each passing day, and the markets will tell them so in no uncertain terms. And they will ultimately listen, resolving their differences, raising the debt ceiling, and calming the markets.



Pete is Chief Investment Officer at the firm. He is focused primarily on Asset Allocation in setting strategic direction for client portfolios. Pete has 30 years of experience in research, investment strategy, and thought leadership regarding the management of multi-asset class portfolios, inclusive of equities, fixed income, and alternatives. His work has been featured in leading financial publications such as *The Wall Street Journal*, *The New York Times*, *Barron's*, and others in Canada, Europe, and Asia. His market commentaries have been featured at major industry conferences, in TV documentaries on capital markets history, and on social media outlets. Prior to joining Ballentine Partners in 2022, he was a Senior Portfolio Strategist on GMO's Asset Allocation team. Prior to that, he was an Institutional Portfolio Manager at a specialized unit within Fidelity Investments and was the Managing Director of Institutional Investment Strategy & Research at Putnam Investments. He is a graduate of Carleton College and holds his MBA from The Wharton School at the University of Pennsylvania. Pete holds the Chartered Financial Analyst (CFA) designation, is a member of the CFA Institute and CFA Society Boston, and he holds the CFA Institute Certificate in ESG Investing. He also holds the Chartered Alternative Investment Analyst (CAIA) designation and was the founding President of CAIA Boston. Pete lives in Hingham, MA with his wife, Cheryl, and enjoys travel, cooking (definitely not a "foodie" but a "foodie wannabe"), sourdough breadmaking, and conjuring up ways to embarrass his three children.

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