SILVERCREST
ASSET MANAGEMENT GROUP

AGONY BUT NO ECSTASY!!

The evil-doers in Washington have reached a temporary agreement to raise the debt ceiling which would allow the government to reopen for business, but only on a temporary basis. Given the intensity of the conflict between the two political parties, a quick long-term resolution is in doubt. As a result uncertainty will persist.

By our estimate, the government shutdown may cause a reduction of 0.6%-0.7% in December quarter GDP with a small carry-over into early 2014. There are many potholes on the road to a comprehensive agreement that would cover the budget, healthcare, defense outlays and other major spending programs. As it is, housing, employment and consumer spending have already been adversely impacted.

There are other negative consequences that cannot be easily quantified. At the top of the list is a growing sense that the United States has become as dysfunctional as many other less stable but important global players. The annual budget spectacle lends credibility to such a claim.

For the stock market, the impact of current fiscal jockeying can become a drag if both sentiment and fundamentals cause the public to lose faith in the country's governance, thus turning cautious in their spending at the same time that foreign lenders demand higher returns to compensate for the added political risk.

In our recent reports, which have been uniformly optimistic about U.S. equities, we tended to be conservative in our macro earnings projections, recognizing already elevated profit margins, the slow growth in personal income, and continued pressure on Washington to contain spending. Accordingly, we find no new justification for a reduction in our earnings estimates for the S&P 500 which are $107.00 for 2013 and $110.00 for 2014. Based on these and other metrics, we continue to view the U.S. stock market as undervalued, with a potential return in excess of 15% within the next 12-18 months. These expectations are derived from a P/E ratio of 17X, a level which had been exceeded, often widely, in all but one of the post-war market cycles.

The fixed income sector provides limited attraction, particularly on the long-end of maturity, even though we now believe that persistent timid growth would persuade the Fed to continue its policy of Quantitative Easing well into 2014.

Stanley A. Nabi, CFA
Vice Chairman

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