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MARKET SIGHT LINES

U.S. Fiscal Challenges: Growing Spotlight on an Unsustainable Path

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For several years, my team and I have been discussing the increased debt across our economy since the Great Recession, fueled in good part by low interest rates in the wake of that crisis. As interest rates began rising in 2022, we have focused on the need for a *Fiscal Transition*, or the idea that participants in our economy — most notably the U.S. government — must adjust their use of debt going forward, improving their fiscal practices. In this Sight|Lines, we discuss how industry leaders are expressing these concerns, the political dynamic driving the worrisome Fiscal Trajectory, and the implications for individual investors when the problem comes to a head in the future.

THE TAKEAWAY: AN UNCHECKED FISCAL TRAJECTORY WILL SPELL TROUBLE

Our Fiscal Trajectory is on an alarming path, and more and more industry leaders are calling for an increased focus on the problem. In summary:

- U.S. government debt has grown significantly, with the cost of that debt – the interest payments – eating into the government's discretionary spending.
- Congress is debating the incremental costs of the latest omnibus tax-and-spending proposal, but the trajectory – with or without tax cuts – is unsustainable.
- Various industry leaders, including Jamie Dimon and Warren Buffett, are calling for a focus on the problem.
- The necessary fiscal discipline is described as politically unappealing, raising the question of what would have to happen to bring the needed change into focus.
- Perhaps recognizing that the U.S. taxpayer ultimately owes the debt will help.
- If the U.S. ever defaults on its debt, individual investors may be severely impacted.
- A significant increase in taxes to try to solve the problem will impact individuals too.
- Some talk about "printing" money to pay off the debt, but that will fuel inflation.
- We believe the problem can be solved with government attention within the next five years.

IN-DEPTH: UNLESS OUR GOVERNMENT CHANGES OUR FISCAL TRAJECTORY, INVESTORS WILL EXPERIENCE TROUBLE – LOWER VALUES AND/OR INFLATION – DOWN THE ROAD

U.S. debt and interest rates have risen in recent years, and our Fiscal Trajectory is on an alarming path, with more and more industry leaders calling for an increased focus on the problem. Going deeper:

- U.S. government debt and the cost of debt have grown significantly:
  - The debt has grown from $9 trillion in 2006 to $36 trillion today.
  - The cost of debt – interest payments – equal about 50% of the remaining discretionary budget.
- Both sides of Congress' debate on tax and spending are unsustainable:
  - Congressional Budget Office forecasts considering the latest tax bill project debt to be around $61 trillion in 2034, but without the proposed tax cuts the level is estimated to be $56 trillion.
  - Both are at alarming levels.
- Various industry leaders are calling for greater focus on the problem:
  - Jamie Dimon (JPMorgan Chase) – "The rising U.S. national debt is a … a real problem. … I don't know if it's six months or six years, but one day, the bond markets will crack."
  - Warren Buffett (Berkshire Hathaway) – "We're operating at a fiscal deficit that is unsustainable over a very long period of time."
- The necessary fiscal discipline is described as politically unappealing:
  - Elected officials don't focus on meaningful change, and many industry leaders describe investor pain – an erosion in portfolio value – as a potential catalyst for them to refocus.
  - Government debt is U.S. taxpayer debt – maybe an increased understanding of this will help.
- The "math" of the problem is in some ways simple: we must either raise taxes, cut spending, "print money," default on the debt, or grow GDP to solve the debt problem:
  - As mentioned, cutting spending remains politically unappealing…for now.
  - A significant increase in taxes can help to solve the problem but impacts individuals.
  - Some talk about "printing" money to pay off the debt, but that will fuel inflation.
  - A U.S. default will severely impact individual investors, as we all are invested in these bonds.
  - We believe the problem can be solved within the next five years with focus on:
    - Significantly reduced government spending.
    - Increased tax revenues through economic growth supported by regulatory changes and balanced tax policies that protect revenue but support private investment.

CONCLUSION

My team and I remain focused on the increasing U.S. government debt. Our country is on an unsustainable Fiscal Trajectory, in need of a *Fiscal Transition* to improve its fiscal practices. More and more industry leaders are expressing these concerns, and yet the political dynamic driving this trajectory seems unchanging. Absent a shift toward improvement, individual investors should expect to see a decline in their investment portfolios, increased inflation, or both, sometime down the road. The questions are, when and how much?

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