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Memorandum

Date: May 25th, 2023

To: Joseph Rinaldi

From: Michael Huber

Re: Debt Ceiling and Markets

10 questions answered on the debt ceiling negotiations

Expectations and takeaways
- Our base case is for an agreement to materialize in Congress to raise the debt ceiling.
- While the debt ceiling represents a near-term uncertainty, significant budget cuts add to risks of below-trend growth and remove cash available for markets.

What it could mean for investors
While talks are ongoing we expect increased volatility for markets which should be resolved when an agreement is reached.

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1. Is there any flexibility in the U.S. Treasury's X-Date?
The Treasury's X-Date represents the date the treasury runs out of cash. Janet Yellen has warned policymakers that the U.S. The Treasury will run out of sufficient cash as early as June. We suspect that the true X-Date is closer to September. With that said disappointing tax revenue and rising interest costs have put strain on Treasury funds.

2. Once a deal is reached how long will it take for Congress to pass it?
There is a rule in the House requiring a 72-hour reading period between the bill's presentation and the House and a vote. We believe a presidential signature on a deal is possible for early June.

3. How might Congress extend the time to work out an agreement?
A short-term debt extension covering a couple weeks could be passed first to allow time for a more comprehensive agreement to be finalized.

4. Would interest be paid on existing debt even during a technical default?
The U.S. The Treasury could prioritize paying principal and interest on existing debt over other outlays in order to avoid technical default. In 1979, there was a blip in payment processing that caused some delays in interest payment of some specific T-bills. After some legal battles, the Treasury made investors whole.

5. What are the potential market implications of a technical default?
As negotiations draw out, volatility could increase. Yields on ultra-short term Treasuries that mature in a number of weeks could rise sharply. An agreement that includes significant budget cuts could weigh on equities in the coming months, while a more moderate agreement is unlikely to have significant effect.

6. What type of impact could money market funds experience if the danger of default grows?
The implications of a technical default are complicated, but we do not believe that MMF's will be forced to liquidate their Treasury holdings.

7. Is another downgrade of the U.S. credit rating likely? Implications for fixed-income pricing?
In the unlikely event of a technical default credit rating agencies would most likely adjust their rating downward. Implications would be negative for **fixed-income pricing**, as U.S. Treasuries are considered risk-free and all risk-assets are priced as a spread to the U.S. treasury curve.

8. What should equity investors do?
We favor looking through near-term volatility and to overlay a risk-management program to generate extra-income and minimize volatility in client portfolios.

7. How might different debt ceiling solutions aggravate or ameliorate the economic slowdown that is developing?
In our opinion, we are already in a mild recession. Austerity can be expected to contribute to diminished growth. The deficit is already above 12% of projected revenue, and rising. Historically, interest expense above 14% has previously triggered austerity.

8. What are the potential global implications if concerns of a U.S. default intensify?
Even a short-lived disruption of Treasury interest and debt payments would impact the smooth flow of global financing and pricing of other securities in the U.S. and abroad. A debt default may also lift spread sector interest rates.