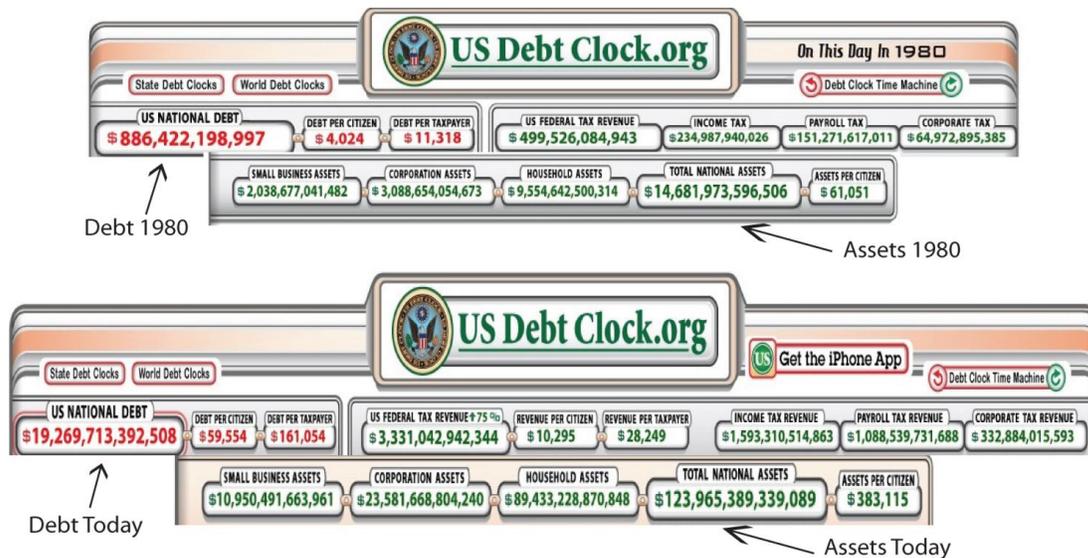




NATIONAL DEBT- BANKRUPTCY OR EXAGGERATION??

Managing portfolios is a tricky business. One of the techniques we use to improve our results is to spend some time looking at the opposite side of a trade. For instance, if we want to buy a stock, we try to build a case against it first. A tendency in our business is to look for evidence to support your opinion and ignore the data that contradicts your investment thesis. Our experience is that we make better decisions when we try to look at every angle, especially the viewpoint that is in conflict with our analysis.

Today there are a lot of scary prognostications about the finances of the United States. What is most interesting is that these fears have been around since we got into the business over 30 years ago, yet things have worked out pretty well over the long term despite some occasional nasty speedbumps. An obvious conclusion is that those initial worries were a tab bit overblown. Why might that be?



The short answer is that the gloom and doom debt figures failed to look at the complete picture. Today the U.S. government has about \$19 trillion of debt. While that is a huge number and is arguably too high it needs to be considered against the asset side of our collective nation’s balance sheet. Using year-end 2015 Federal Reserve figures a recent Yahoo Finance article by Rick Newman estimated that the total net worth of the U.S. is nearly \$100 trillion. Keep in mind that this includes all debt, including the \$19 trillion of debt mentioned above. Investors worldwide are happy to lend the U.S. money at very low interest rates because of this vast source of wealth and the ability to levy taxes to access it.

We need to go one step further in this analysis because politicians like to promise things that don’t need to be paid right away. The two big ones are Social Security and Medicare. Estimating these unfunded liabilities takes a lot of guess work. Not surprisingly there are a wide range of estimates out there. A June 2012 report by the National Center For Policy Analysis estimated that accrued Social Security and Medicare benefits payable to current retirees are about \$13 trillion. It is pretty safe to assume that these benefits will be paid and is therefore a real liability of the government. The study goes on to estimate that if we don’t have policy changes to our benefit structure the government would be liable for another roughly \$50 trillion. The worst-case scenario then based on these estimates is a current net worth of \$37 trillion. The popular website USdebtclock.org shows Total Net Assets of \$124 trillion and U.S. Unfunded Liabilities of \$102 trillion for a net worth of \$22 trillion.

The bottom line is that the United States is not broke and is still extremely wealthy, but our bank account is starting to run dangerously low. The practical implication is that the government will have less flexibility to respond to future economic shocks. Growth over the past several decades has been goosed by the democratization of credit but that tailwind is largely over.

Please contact us if you have any questions. Best wishes.

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