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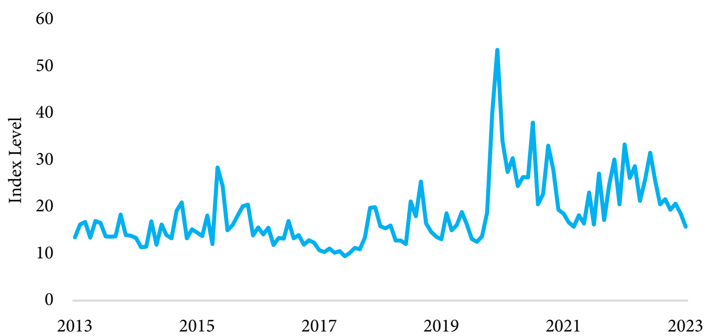
MAY 2023 DEBT CEILING UPDATE

The US is quickly approaching the point at which the Treasury Department will not be able to meet our nation's financial obligations. The Treasury, which has been operating on extraordinary measures since it hit the debt limit in January, estimates it will run out of funds as soon as next month. The government's wrangling over raising the debt limit, currently at $31.4 trillion, is likely to result in heightened stock and bond market volatility.

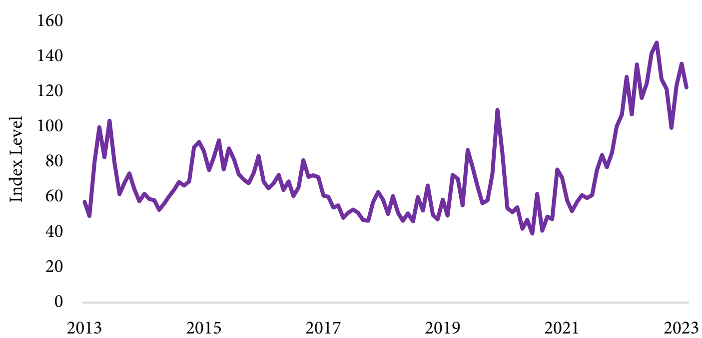
Equity and fixed income markets are reacting differently to the growing uncertainty. Equity market volatility is muted and below its 5yr and 10yr averages, while interest rate volatility is elevated. Yields on short-term Treasury bills that mature next month have also risen, reflecting investor concerns of a potential default.

Muted Equity Market Volatility - CBOE Volatility Index (VIX)



Source: FactSet May 2023

Elevated Interest Rate Volatility - ICE BofA MOVE Index



Source: Bloomberg May 2023

The debt ceiling crisis is a self-inflicted wound. The Council of Economic Advisors (CEA) suggests the current brinksmanship will negatively impact 3Q23 GDP by -0.2%. If an agreement is not reached in time, the economic costs balloon. A technical default would significantly impair short-term (and potentially longer-term) economic growth prospects and raise interest rates. The CEA predicts a short default would detract -0.6% from 3Q23 GDP and -6.1% in the event of a protracted default. A default also risks damaging the credibility of the United States and could increase borrowing costs for an extended period.

Estimated Economic Effects of Debt Ceiling Standoff: Q3 2023

Measure	Brinksmanship	Short Default	Protracted Default
Jobs, millions	-0.2	-0.5	-8.3
Real GDP, % annualized growth	-0.3	-0.6	-6.1
Unemployment, % points	0.1	0.3	5.0

Source: CEA Analysis May 2023

The U.S. must pay its debts on time and in full, as we always have. Leaders in both parties seem to understand the severity of defaulting, but longer-term resolutions are difficult to craft as neither party wants to give up their leverage. Markets largely anticipate that political posturing will ultimately give way to compromise and a new debt ceiling will be established. However, with just over two weeks to go, the chance of a technical default is not zero.

Should the U.S. default, the repercussions would be severe and recession risks would increase considerably. However, if history is any guide, an agreement will be reached in time to avert disaster. Investors should continue to focus on longer-term prospects for economic growth and returns. We believe high-quality companies with strong growth profiles and sound balance sheets should weather this storm.

Investment Oversight Committee
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