

THE COMPASS



Kabuki

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Important Financial Dates

July 31

- 2nd qtr. payroll tax returns due
- File Retirement Plan Information returns (5500) or extensions

August 15

- 941 deposits due

September 15

- 941 deposits due
- Federal 3rd qtr. estimated taxes due
- All Corporate extension must be filed

October 1

- Deadline to establish SIMPLE IRA retirement plans

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Are those war drums heard across the Potomac? Not exactly. It's the nonstop head banging, foot stomping chest thumping and wailing of Congress, Senate and the White House as they degenerate in the biggest Kabuki dance ever. They have all been drinking too much sake. They just do not get the message. They have the world's largest spending problem to promote their self interests. The US Government spending has gone from 2% GDP one hundred years ago to over 25% of GDP today.

Over the last three years, the current administration has spent \$4.0 trillion beyond revenue on Obamacare, ineffective stimulus, 99 week unemployment and Medicare. This is projected to increase an incremental \$8-\$10 trillion over the next 8 years. The US government is borrowing 42% of every dollar they spend. How long could you live like that? They have a spending problem. Even a class of fifth graders would know that. Most of them just want more revenue to perpetuate their problem. Sorry, wrong answer. You do not give a drunk more booze or a drug addict more drugs. It is time for these spineless turkeys to come out into the cold. Stop the bleeding.

Most of the sane people in DC are over at the Treasury. For months they have been predicting the government was going to run out of borrowing power on August 2nd. It is a basic cash flow analysis that most businesses do. Based on their experience and analysis, Treasury is predicting the collection of \$172 billion revenue from all sources for the month of August. The Treasury also knows its obligation is to pay for \$306 billion in US Government programs for the same period.

The following is a detailed list of all the planned government expenditures for August:

PROGRAM	COST IN BILLIONS
Social Security Benefits	\$49.2
Defense vendor payments	\$31.7
Interest on Treasury securities	\$29.0
Medicare	\$28.6
Medicaid	\$21.4
Department of Education	\$20.2
Federal Aid for College Tuition	\$10.0
Federal salaries and benefits	\$14.2
Unemployment insurance benefits	\$12.8
Food /Nutrition Services & TANF	\$9.3
Health and Human Services grants	\$8.1
HUD programs	\$6.7
Federal Highway Administration	\$4.3
IRS refunds	\$3.9
Department of Energy	\$3.5
Military Active Duty Pay	\$2.9
Veterans Affairs programs	\$2.9
Department of Justice	\$1.4
Department of Labor	\$1.3
Federal Transit Administration	\$1.3
Environmental Protection Agency	\$0.9
Small Business Administration	\$0.3
General Services Administration	\$1.7
Federal Aviation Administration	\$0.7
Department of Homeland Security	\$0.7
NASA	\$1.5
Agency for International Development	\$1.0
Centers for Disease Control & Prevention	\$0.5
Other spending	\$36.7

Remaining payments due \$306.7

Kabuki cont.

If the debt ceiling isn't raised, there is no question that some people will get stiffed. The only question is, which ones? To quote Barrons, "it would be wrong, stupid and unnecessary to stiff the holders of US Treasury paper who are due to receive \$29 billion of interest and principle in August". After paying their obligation, there remains \$143 billion to cover the remaining \$277 billion bills, or approximately 50% to cover all of the government programs. Either cut half of the programs, or cut every program in half. One other option would be to set a priority as to which programs get funded. Now that might be the best answer.

There are three critical dates in August:

August 3 rd	\$49 billion Social Security checks go out to 50 million recipients.
August 4 th	\$100 billion of Treasury Bills mature
August 15 th	Over \$50 billion of interest and principle are due

Based upon most of our sources, do not be surprised if the Kabuki dance crashes and burns with no increase in the debt ceiling. These major risk issues will happen:

1. S&P and Moody's will lower the US credit rating to AA costing over \$100 billion in interest expense for the government
2. Social Security, Medicare, Unemployment, & Medicaid checks will be delayed and reduced
3. Millions of people on government payrolls and millions of citizens working for companies that depend on government payments will not get paid. In fact, don't be surprised if the unemployment rate increases significantly.
4. The stock and bond markets will be very volatile and could retrench quite a bit.

What are we doing at Quest to protect client's investments?

1. Updating tight stop loss collars on all equities.
2. Liquidating mutual funds that have exposure to US & European debt crisis.
3. Use raised cash to take advantage of reduced equities.
4. Overweight in gold and foreign currencies to offset deflating dollar.

These clowns in Washington just do not understand the ramifications of their selfish political inaction.

1. Increase spending and deficit
2. Increase unemployment
3. Increase interest rates of government, states and all citizens
4. Risk of recession

If the debt ceiling is not increased by August 2nd with all of the above ramifications, the current administration will be "one term". The pompous trifecta should do the right thing for the country.

A Kabuki dance is defined as chaos with a planned outcome. Unfortunately, this dance is not going to end with their planned goal. The result is predicted to end with a congressional squadron of kamikazes blinded by their biased political convictions. They do not have a "Plan B". The answer will be in the 2012 election.

If the current administration does not want to deal with that outcome, there are two suggestions that follow this article that can provide a solution to the US Government problem. The first one was the product of the Simpson Bowles Commission. As an alternative, the second plan was suggested by this office starting in our May News-letter.

Simpson Bowles Overview

We propose a six-part plan to put our nation back on a path to fiscal health, promote economic growth, and protect the most vulnerable among us. Taken as a whole, the plan will:

- Achieve nearly \$4 trillion in deficit reduction through 2020, more than any effort in the nation's history.
- Reduce the deficit to 2.3% of GDP by 2015 (2.4% excluding Social Security reform), exceeding President's goal of primary balance (about 3% of GDP).
- Sharply reduce tax rates, abolish the AMT, and cut backdoor spending in the tax code.
- Cap revenue at 21% of GDP and get spending below 22% and eventually to 21%.
- Ensure lasting Social Security solvency, prevent the projected 22% cuts to come in 2037, reduce elderly poverty, and distribute the burden fairly.
- Stabilize debt by 2014 and reduce debt to 60% of GDP by 2023 and 40% by 2035.

The plan has six major components:

- 1) Discretionary Spending Cuts:** Enact tough discretionary spending caps to force budget discipline in Congress. Include enforcement mechanisms to give the limits real teeth. Make significant cuts in both security and non-security spending by cutting low-priority programs and streamlining government operations. Offer over \$50 billion in immediate cuts to lead by example, and provide \$200 billion in illustrative 2015 savings.
- 2) Comprehensive Tax Reform:** Sharply reduce rates, broaden the base, simplify the tax code, and reduce the deficit by reducing the many "tax expenditures"—another name for spending through the tax code. Reform corporate taxes to make America more competitive, and cap revenue to avoid excessive taxation.
- 3) Health Care Cost Containment:** Replace the phantom savings from scheduled Medicare reimbursement cuts that will never materialize and from a new long-term care program that is unsustainable with real, common-sense reforms to physician payments, cost-sharing, malpractice law, prescription drug costs, government-subsidized medical education, and other sources. Institute additional long-term measures to bring down spending growth.
- 4) Mandatory Savings:** Cut agriculture subsidies and modernize military and civil service retirement systems, while reforming student loan programs and putting the Pension Benefit Guarantee Corporation on a sustainable path.
- 5) Social Security Reforms to Ensure Long-Term Solvency and Reduce Poverty:** Ensure sustainable solvency for the next 75 years while reducing poverty among seniors. Reform Social Security for its own sake, and not for deficit reduction.
- 6) Process Changes:** Reform the budget process to ensure the debt remains on a stable path, spending stays under control, inflation is measured accurately, and taxpayer dollars go where they belong.

Quest – Ten Steps to Fiscal Stability

Entitlements

1. Medicare – increase from 1.45% to 3.0%
2. Social Security
 - a. Increase contribution from 6.2% to 7.0%
 - b. Remove income ceiling
 - c. Raise early retirement from 62 to 65 over 10 years
 - d. Raise full retirement age from 67 to 70 over 10 years
3. Medicaid
 - a. Increase look back 5 to 10 years immediately
 - b. Raise look back to 15 year over 10 years
 - c. Tax credit for LTC insurance premiums up to \$5000/yr

Income Tax

Abolish the current 55,000 pages of income tax code . Implement Value Added Tax.

4. Switch income tax to an 18% value added tax
All goods and services except food, medicine, clothes, energy, rent or cost of primary residence
5. Corporate income tax to 18% of net operating revenue
6. Tax credit for charitable contributions

Structure

7. Required Budget \leq 20% of GDP, (Exception = War declared on US), No Budget = government shutdown
8. Eliminate all earmarks, criminal if attached
9. Term limits of \leq 12 years, House and Senate
10. Tax increases only by Constitutional Amendment