



Going Out With a Whimper...

Sorry for the short note, but the holidays have me quite disorganized. I'll be out with a full year report on Monday the 31st.

This is normally a slow week for equity markets, but a nice dose of pessimism crept over the markets as politicians decided they were too busy celebrating the holidays to take care of the people's business. The result is an equity market that has sold off 3.5% in just a week.

Uncertainty is Back

Washington never ceases to amaze. Predicting the madness of crowds is one thing. Predicting the madness of politicians is another matter altogether. I had been expecting some sort of agreement in December based on the practical view that politicians would do what was in the best interests of the country and get a deal done before year-end. I also assumed the Republicans would fight for a deal because they lose all negotiating power once the Bush Tax Cuts expire on January 1st. That means the Bush Tax Cuts will become the Obama tax cuts if a new deal is implemented and the Republicans lose any leverage they had over the negotiations. Clearly, it's looking like a January deal is in the works. What that deal will look like is anyone's guess at this point.

This is a big problem for the equity market because of the uncertainty that it brings to the picture. But we've seen this movie before. The market is currently pricing in a very bad outcome for the fiscal cliff. That can't be entirely discounted, but I have a

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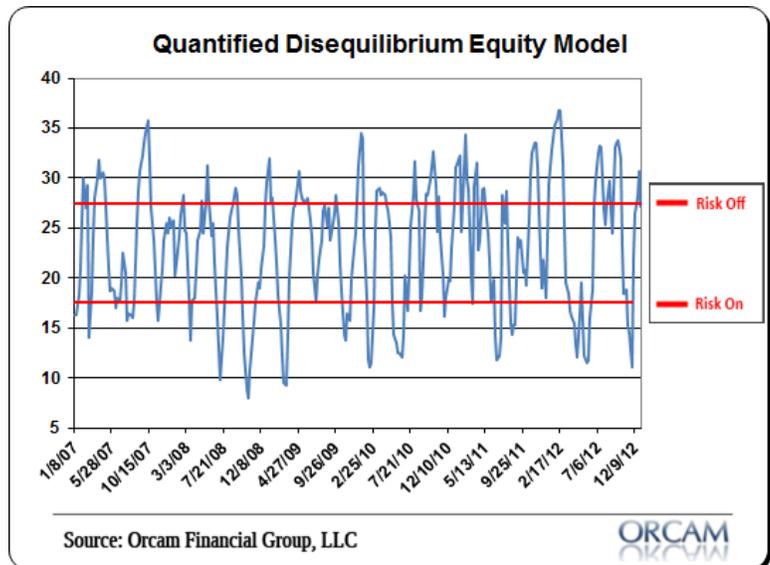
**Long story short—
Uncertainty is
Back....**

feeling we'll look back at this in January and see similarities in the November market declines where uncertainty caused a brief dip and then certainty over the election and the cliff discussions created an environment ripe for a rally. In fact, gauging market sentiment from the Volatility Index shows that investors are much more concerned today than they were back in November despite the much steeper sell-off in November.



Our primary equity model has moved to a much more cautious position and is not firmly in the “risk off” territory. As I reiterated in the last equity strategy update, this reading is consistent with a “hold”. As a risk metric we have to consider this indicator in the larger scheme of things.

The headline risk is simply enormous here. And I think the risk is primarily to the upside as it would take a fantastic policy failure in the next few weeks to prove the bears right at this juncture. That can't be discounted entirely, but I presume there will be a deal sooner rather than later. This will bring clarity to the markets and should be a positive development.



Unfortunately, there are few things madder than trying to predict the madness of politicians. And anyone who tells you what will transpire in the next few weeks is probably lying. I still think the risk lies to the upside here as this feels a lot like the environment from November, but we won't really know the impact of these discussions until we see something on the President's desk.

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