Ropes Wealth Asks What If We Tried Compromise?

The so- called Great Compromise is a hot topic in my house right now, as the focal point of my twins' fifth-grade social studies curriculum about how our country ended up with a dual system of congressional representation. Recall that the fate of the U.S. Constitution hung in the balance in 1787 as delegates meeting at the Constitutional Convention were in a heated dispute: states with larger populations wanted congressional representation based on population, while smaller states demanded equal representation. The good Connecticut delegates Roger Sherman and Oliver Ellsworth forged a compromise of those demands with a proposal for a House of Representatives and a Senate that form the bedrock of our legislative branch.

Now fast forward to 1983. Social Security trust funds were nearly empty and projected to run out of money within 16 years if something wasn't done. Newspapers and television were filled with stories about the impending financial doom facing many aging Americans. President Ronald Reagan and Democratic Speaker of the House Tip O'Neill, bitter enemies, got together and did the work that became the Social Security Reform Act. This package of tax increases and spending cuts would extend the solvency of Social Security payments for 54 years.

Former Chief of Staff and Treasury Secretary James Baker quoted Reagan as saying: "'Jim, I'd rather get 80 percent of what I want than to go over the cliff with my flag flying.'" Speaker O'Neill once famously said, "It's easier to run for office than run the office," and, "Take your job seriously but don't take yourself seriously."

Both moments are vignettes in the fine lost art of leadership and compromise. Today we face a looming debacle as the debt ceiling has become a political football with Democrats wanting a "clean" debt ceiling increase while Republican leadership are demanding any increase be tied to reductions in spending, notably those that are clean-energy related. This week Treasury Secretary Janet Yellen issued a warning the U.S. government could exhaust funds by as early as June 1. The workarounds that have been proposed—issuance of a platinum coin, invoking a provision of the 14th amendment protecting public debt, and prioritizing payments—either bring significant legal uncertainty or are unsustainable solutions. Plus, these unlikely workarounds do not avoid the chaos that is inherent to a debt ceiling binding. The only effective solution is for Congress to increase the debt ceiling without delay or, better yet, abolish it and learn to legislate the issues without hostage politics.

Leadership is also needed desperately in the monetary policy realm right now. As expected, the Federal Reserve opted to raise rates by 25 basis points, lifting the upper bound of the target range from 5.00% to 5.25% and marking the tenth increase in fourteen months. The statement suggested the Fed may be increasingly near the end of rate hikes, depending on the evolution of the data, lagged effects in monetary policy, and financial market developments. While the market welcomed this news of flexibility, the effect fizzled quickly in the backdrop of a continued banking crisis. Though Fed President Jay Powell's statement that Monday's seizure and sale of First Republic to JP Morgan Chase was "an important step toward drawing a line" under the turmoil for regional lenders, by Thursday shares of PacWest, Western Alliance, and First Horizon, among other regional lenders, were trading in distress. For the moment, there is discussion of a special assessment on large banks only to refill the coffers of the FDIC and ease pressure on the smaller regionals. Hedge fund investor Bill Ackman is pounding the table for a systemwide, temporary, unlimited deposit guarantee regime. Unfortunately, that would take an act of Congress, and, well, see above.

We know debt ceiling debates, bank failures, and interest rate increases provide a challenging backdrop for you to maintain conviction in your investment plan. While there is no panacea for any or all of these issues, we ask you to embrace the art of compromise that we wish of our leaders. We can manage short-term anxiety with thoughtful allocations to cash and short-term bonds, and balance that approach with long-term equity allocations to good quality companies and funds of companies. Consider for example a company like Apple, reporting after the close yesterday, that smashed expectations for sales and revenue, noting particular strength in emerging markets performance. That stock had lost close to 30% of its value in 2022's market debacle and was deemed irreparably broken by some market pundits due to supply chain issues and worries that demand for their products had peaked. Risks can be binary and appear just as quickly as they resolve. While there is no downplaying the short-term risks of a debt ceiling impasse or banking crisis escalation, they will not define our economy or the performance of the stock market forever. Therefore, we say lead by example in your belief in the power of progress and long-term thinking that benefits a stock portfolio. But have a very solid backstop set aside for the short-term headwinds that may veer us off course for now, but not forever.

Thank you as always for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

Ropes Wealth Advisors LLC
800 Boylston Street Boston, MA 02199-3600