

## **Under The Hood**

It is New Year's Eve and like many Americans I am watching the political theatre today surrounding the fiscal cliff. The press is enjoying the drama, as it gets people to tune in. However, there is a chance that people listening to the press and the spin are hearing something different than what is unfolding for me. To me there appears to be a melting resolve of the American people to tackle tough issues.

Writing this newsletter is actually fun the vast majority of the time. Many of the recipients are people I cherish, so it is like a conversation with wonderful people I know. It is often a chance to help folks with ideas and concepts that can make them more financially secure and free. Encouraging, positive and even uplifting messages are always more enjoyable and fun.

In this issue we'll take a little more serious look under the hood of the financial workings of the government, so that you can judge for yourself how you think we are doing as a country and as a society. If this generates questions please feel free to reach out to me. Your questions, comments and reactions are all welcomed, pro and con. If you elect not to read this issue, it would be very understandable!

### **Uncle Sam Spends Differently**

Though the workings are intricate beyond my understanding, the principles can be boiled down to a few basics. The US Congress over a couple of centuries has enacted legislation that was signed into law by the President. These laws include programs and departments of the government that require funding. The Congress authorizes this spending, and then money gets dispersed from the US Treasury for all of these purposes authorized by law.

Each payday Americans send a portion of their hard earned money to the US Treasury for a variety of taxes, not just income taxes. If in April you "owe" more money to the government (kind of makes you wonder who serves who) your check gets made out to the "US Treasury". It is the payday for the government so to speak. It is one of many, as we are taxed in dozens of other ways most folks don't count, as they are hidden in the cost of gas, communications, travel and a host of other tax nicks we are subjected to every day.

However when all of these taxes are not enough to satisfy the government's appetite to spend your money, the Treasury simply issues bills, bonds and notes. It borrows money and spends that money, just like you might on a credit card, only this borrowing is back by the "full faith and credit" of the government. In essence, it is backed by an unlimited ability to tax you and your fellow citizens in the future.

### **How Do These Bonds Work?**

Here's where it gets a little tricky. When a government or corporation goes to issue bonds.... other people, companies and even other governments buy these bonds. Bond buyers judge bonds based on how secure they feel about receiving their interest payments and their

investment back at the end. The more secure buyers feel, the more valuable the bonds are and the lower the interest rate the buyer will demand to make the investment. The bond market will let demand set a natural price and interest rate for a bond being issued. The riskier the bond, the more interest buyers will demand. At some high enough level of risk, almost no one is willing to buy particular bonds, just ask the Greek government.

One of a couple of buyers of bonds that can upset the natural balance of this process is our private banking system, the Federal Reserve Bank, headed by Chairman Ben Bernanke. The Federal Reserve has the power to create “new” dollars and “give” them to the government, by buying new Treasury Bonds. On 3/28/12 Lawrence Goodman of the Center for Financial Stability was quote as estimating that the Federal Reserve was buying 61% of the Treasury bonds being issued. You may recognize this as the so called “Quantitative Easing” or “QE” as it has become known. This manufactured demand for Treasury Bonds can keep their rates artificially low.

If the Federal Reserve did not buy such a large percentage of the new bonds it is possible that the interest rates would go up for Treasury Bonds. It is also possible that not all the bonds would sell, so the Treasury would not receive all of the money it needed to cover the spending of the government.

### **Is There A “Credit Limit”?**

No one I’ve talked to or listened to seems to have an idea what the credit limit might be for this excess spending by our government. The “debt ceiling” that caused so many problems in the summer of 2011 is one such limit, but after much posturing, it was raised, as it always seems to be. No one in government seems to want to have to live just on the revenue the people pay in taxes, they want to spend much, much more. They even mandate this spending by law.

Though no one has mentioned a limit, there is a general sense that this process of printing money (with no economic backing) and giving it to the government to spend has a limit somewhere. All of these people also feel that the higher the US debt goes, the bigger the problem we will face when “the music stops”.

### **Tackling Tough Issues**

Unfolding for me, (from the election results in November to the failure to reach an agreement today) is the proof that America will not face and will not cause its government to face the reality of too much spending and too much debt. That would take a majority of Americans being willing to live with lower government benefits and higher taxes. Somehow we only like the idea of “other people” paying higher taxes and “other people” living with lower government benefits. We just don’t have the resolve as a people to participate in the solution together.

### **Bottom Line**

As government debt continues to rise at a dizzying rate (just check [usdebtclock.org](http://usdebtclock.org)), it is unlikely that our elected politicians will find solutions. This is natural because all of the solutions require mutual sacrifice by all, not exactly the stuff that election success is built on these days. Expect the drama to play out for several more years and for there to come a time when we encounter some difficult years. Diversification, securing sources of income, reducing debts and making the most of life are all important ways to prepare for 2013 and what lies beyond. Tasia and I are here to help in any way that we can.

*Post Script: The tax deal that averted the "fiscal cliff" delayed spending cuts and increased taxes on a small group of people. The result is higher deficits in this New and future years. Though this postpones the difficulty the "Cliff" presented, it only causes the magnitude of the difficulty to grow in the future. By the way, because the government is spending so much money so quickly, we'll hit the debt limit approved in 2011 in just a couple of months. Expect the next episode of this drama to begin gaining the attention of the press in the next month or so. If the debt limit was not to be increased the Treasury could not borrow beyond the existing limit forcing the Congress and the President to live within the means of just the taxes Americans pay, a novel concept don't you think!*

## **Your Feedback**

I would love feedback on this newsletter. Future issues may include a host of good ideas, insights, specific steps to take financially, life insights and of course "Wit and Wisdom". Most importantly, I'd like it to be of value to you and to encourage an exchange of great ideas and insights. Please send your feedback to:

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