LPL Financial

9785 Towne Centre Drive
San Diego, CA 92121-1968

One Beacon Street, 22nd Floor
Boston, MA 02108-3106

July 27, 2011

Dear Valued Investor:

The clock continues to tick towards the August 2, 2011 deadline when the United States debt ceiling limit will be reached. This limit is a key element of U.S. Government financial management. The U.S. Government is expected to receive about $175 billion in tax revenues for the month of August, but has $310 billion in monthly obligations that it needs to meet. As a result, the $135 billion in monthly shortfall is usually borrowed via the issuance of U.S. Treasury bonds. However, once the debt ceiling is met, the U.S. Government will not be able to issue new debt and will therefore, have to make significant decisions as it relates to what $135 billion or 44% of its "bills" it will delay payment on. That is, of course, if the debt ceiling limit is not raised by Congress and signed into law by the President.

While the rhetoric coming out of Washington has certainly transitioned from compromise to contention, it should not be overlooked that the divided parties are aligned on a few very important criteria that should bring a resolution closer to happening—namely that spending cuts should be enacted and that a more responsible government spending policy should be put in place to get a handle on the nation's soaring national debt. In addition, both sides seem to now understand that the polarizing political view of revenue increases (the Democrats' wish) and significant entitlement reform (the Republicans' wish) are too significant a gap to overcome over the short term and are now virtually off the table.

Now, the only (and it is a big "only") things that the two sides have to work out are: where the cuts in spending should come from, how long they will take to implement, and how much money they will save. The reality is that the two divided sides are not as far apart on the terms of a deal as they are from an ideological and political posturing perspective. Said another way: the two sides sound and act a lot further apart than their competing plans actually are.

We expect that the debate in Washington will continue over the next few days as the game of political ideological "chicken" plays out. However, our base case is that a compromise will be forged over the coming days and will result in either a short-term extension of the debt limit or, more likely, an agreement to raise the borrowing capacity of the United States Government until well into next year.

More importantly, even if a bill is not agreed upon and signed into law to raise the debt ceiling by August 2, we do not foresee the United States Government defaulting on its obligations. A default will occur if the government failed to pay the interest due on its debt. For the month of August, the interest due on Treasury bonds accounts for only $29 billion, which is easily met by the $175 billion in tax revenues that are expected. However, while a default would be avoided, the significant impact of dialing back $135 billion that could not be borrowed for other Federal services and obligations would have serious economic impacts.

While the debt ceiling debate has grabbed the headlines and is currently the most significant risk to the market, the underlying strength of the global economy remains solid. Moreover, several of the open-ended issues that have lingered for months are finally getting substantively addressed, including a plan for a second bailout of Greece, a stabilizing European debt crisis, and the re-emergence of Japan's economic infrastructure from its terrible natural disaster in early spring. In addition, company earnings continue to be very strong as corporate America continues to benefit from a resurgent business reinvestment climate and a resilient consumer.

In the meantime, the current conditions support a cautious stance as the market is singularly focused on Washington. We expect that a resolution on extending the debt ceiling will ultimately be agreed upon, but not until the deeply divided government drags the nation and the market even further through the mud. But, on the other end of this self-imposed crisis stands an economic climate where businesses are earning near record profits, employment is improving, housing has stabilized, and consumers are once again revisiting the malls to spend. While the turmoil in Washington will invariably offer up several more nervous days as the debate lingers on, we believe that a relief rally for the market is around the corner once compromise replaces contention and unity trumps division. As always, if you have questions, I encourage you to contact your financial professional.

Best regards,

Burt White
Chief Investment Officer
LPL Financial