Russell's view:

Partial government shutdown and debt ceiling

OCTOBER 1, 2013

Unable to reach an agreement on the federal budget, the U.S. government started the new fiscal year on October 1, 2013 with a partial shutdown – the first in 17 years. We asked our Chief Economist, Mike Dueker, and our Chief Investment Strategist, Erik Ristuben, for their views on the potential impact to the markets and economy.

Historically, government shutdowns have effectively been a nonevent for markets. According to analysis by the Washington Post, the average decline in the S&P 500® Index during a shutdown lasting 10 days or more is about 2.5%. For shutdowns lasting five days or fewer, the average decline is 1.4%.[1]

Of course, the impending debt ceiling debate is an additional wrinkle this time. According to latest estimates by the U.S. Treasury, the government will hit the debt ceiling on October 17 this year.[2] So even if the government shutdown is resolved relatively soon, the debt ceiling awaits.

The U.S. government has raised the debt ceiling 79 times since 1940[3] but the process hasn't always involved as much political brinksmanship as it has in recent memory. In the debt-ceiling showdowns in 2011 and 2012, each side was satisfied to extract a bit of pain from the other side, such as defense cuts or tax increases on high-income earners. Even still, the August 2011 debates were followed by a U.S. debt rating downgrade. This time, it appears that Republicans see the fight over Obamacare as a paradigm shift on which compromise could prove difficult.

Regarding the impact to the U.S. economy, a provisional run of the Business Cycle Index model[4] (which might have a longer shelf life than normal if the shutdown prevents release of a payroll employment report this Friday), still shows a very constructive view of 2014. However, it has a downgraded view of job gains in the fourth quarter of 2013, which might see monthly jobs gains average less than 150,000 jobs per month.

Part of the reason for the decline in projected job growth is the recent decrease in the 10-year Treasury yield, which many attribute to the Federal Reserve's recent decision to delay tapering its pace of asset purchases. Arguably, the

[1] Source: http://articles.washingtonpost.com/2013-09-27/business/42453331_1_shutdowns-stock-market-debt-ceiling

[2] Source: http://www.bloomberg.com/news/2013-10-01/shutdown-confrontation-may-rob-momentum-from-debt-debate.html

[3] Source: White House Office of Management and Budget; http://www.whitehouse.gov/omb/budget/Historicals/

[4] Created by Russell's Chief economist for North America, Mike Dueker, the Business Cycle Index (BCI) forecasts the strength of economic expansion or recession in the coming months, along with forecasts for other prominent economic measures. Monthly updates are available at http://www.russell.com/Helping-Advisors/Markets/BusinessCycleIndex.aspx

drop in the benchmark bond yield might have occurred regardless of the Fed. Anticipated fiscal policy tumult in the fourth quarter of 2013 may be leading to expectations of weaker growth and lower bond yields.

Overall, Russell expects this shutdown to be resolved and the debt ceiling to be raised – but the politics will likely continue to cause volatility in the markets. For long-term investors, the dips may present buying opportunities. We will be watching the situation closely.

The S&P 500® Index is a free-float capitalization-weighted index published since 1957 of the prices of 500 large-cap common stocks actively traded in the United States. The stocks included in the S&P 500® are those of large publicly held companies that trade on either of the two largest American stock market exchanges: the New York Stock Exchange and the NASDAQ.

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First used: October 2013

RFS 11445