# Columnist Sees “Crescendo of Errors” in Washington

By Randy Myers

The political divisiveness that has characterized Washington, D.C. over the past few years reached new highs in October 2013, first when Congress allowed the federal government to shut down, and then when it came perilously close to allowing the U.S. to default on its debt. To Michael Barone, syndicated columnist and senior political analyst with the *Washington Examiner,* those developments stemmed from “a crescendo of errors” on both sides of the political aisle.Addressing the 2013 SVIA Fall Forum, Barone said one reason for the nation’s political differences is that there are genuine disagreements between the Republicans and Democrats on important issues of public policy. But he also argued that both sides have made political mistakes and miscalculations, including over-interpreting the mandates they received from voters in the 2012 elections, and failing to understand the needs or views of the other side.

President Obama, Barone said, came to office believing that in a time of economic distress, Americans would be more supportive of, or at least more amenable to, government. But Barone characterized that as a misguided interpretation of what happened in the 1930s, when Franklin Roosevelt won four successive terms as president in part on a platform of expanding government to help the poor. Roosevelt also led the country through World War II, though, and his third and fourth reelections, Barone contended, can more properly be attributed to him being a strong leader in extreme times.

Barone also called Obama’s decision to push national healthcare reform through a Democratic Congress during his first two years in office a partisan gamble for which Democrats have been paying a price ever since—including, in 2012, the biggest gain of seats in the House of Representatives by Republicans since the late 1940s.

But Republicans have miscalculated too, Barone suggested. For example, he said, they failed to recognize that when Democrats earlier this year called for a “clean” continuing resolution to keep the federal government open past September 30, with no material changes to government spending, the Democrats were actually making a concession; they didn’t ask for higher taxes nor did they insist on reining in the sequestration spending cuts. Yet instead of accommodating the Democrats, a minority of House Republicans refused to vote for a continuing resolution unless it defunded Obamacare, the president’s signature legislative achievement. Polls showed that voters liked the idea of delaying Obamacare, but not defunding it. Republicans ultimately lost the showdown, but only after forcing the federal government into a much-maligned partial shutdown.

“In my view, both sides were blundering,” Barone said. “There were a critical number of Republicans under the delusion they could rally the country to defund Obamacare or get the Senate to cave.” Their stance, he theorized, may have had more to do with the politics of 2016—the year of the next presidential election—than the politics of 2013 or 2014.

Meanwhile, Barone said he thought a critical number of Democrats were under the delusion that the Republican tactics would prove suicidal for that party. “I think Republicans are hurt, but that’s exaggerated,” he said. “Most polls show Republicans doing worse than Democrats, but by a small margin. I’m not inclined to think there will be huge changes in Congressional numbers as a result of these things.”

Barone also ascribed some of the blame for Washington’s gridlock to the nation’s founding fathers, who devised a system of checks and balances by creating three separate branches of government. “I also blame the American people,” he said, “for electing a divided government and expecting them all to get along.”

While having different parties control different parts of the government has actually been quite common over the past several decades, Barone said the trend has been exacerbated of late not just by an influx of Latin American immigrants to the U.S., but also by the migration of affluent Americans to “culturally congenial” locales, where like-minded communities can deliver big majorities for one party or another. When Jimmy Carter was elected president in 1976, for example, he narrowly carried the San Francisco Bay area by a 51 percent to 49 percent margin, Barone said. Obama, by contrast, won the Bay area with 73 percent of the vote in 2012.

Having supporters clustered in central cities, liberal suburbs, and college towns “gives Democrats a huge advantage in the electoral college,” Barone said, leaving fewer “target states” in

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## Building an Optimal Lineup

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plans, since having too many options could confuse plan participants. Sponsors also should consider whether they want to offer funds that are actively or passively managed; the latter are generally cheaper. One bad idea, he said, is to offer funds that invest in a specific industry; they concentrate risk and can be highly volatile.

In choosing specific investment options, Blanchett recommended that plan sponsors look for investments that are high quality with reasonable risk, and make sure that any funds of funds, such as target-date funds, follow similar criteria when selecting the funds in which they invest. All funds should be analyzed relative to asset allocation targets and performance benchmarks, he said. In terms of quantitative screening, sponsors should look at performance and style consistency, manager tenure and expenses. But they should also perform a fundamental analysis, looking at things like the people and processes behind a fund. Target-date funds merit special scrutiny, he said, requiring not only all the normal due diligence, but also a review of other factors, such as the “glide path” they follow as they become more conservative over time. SVIA

# Potential Regulatory Changes Cloud Outlook at Front End of Yield Curve

By Randy Myers

The front end of the yield curve—home to conservative investments such as money market funds, short-term investment funds (STIFs), and even stable value—has been challenging for the past few years, not just for individual investors, but for institutions as well, including corporate sponsors of defined contribution plans. Corporations have record amounts of cash on their balance sheets, but the yields available to them at the front end of the curve have been languishing at or near historic lows. Meanwhile, proposed regulatory reforms could soon change the way money market funds operate.

"People are struggling with what's going on," Laurie Brignac, senior portfolio manager and co-head of North American Global Liquidity for Invesco Fixed Income, said at the 2013 SVIA Fall Forum. "Where do you put your money? Corporate treasurers are asking us all the time, 'What's the next step?'"

The answers aren't entirely clear. The Federal Reserve has indicated that it plans to keep short-term interest rates at extraordinarily low levels until unemployment falls to 6.5 percent, which many economists don't anticipate happening until late 2014 or early 2015. But there are some bright spots on the horizon, Brignac said.

Perhaps most intriguingly, the Fed announced in September that it is going to start testing a new tool—fixed-rate, full allotment, overnight reverse repo facilities—that should help establish a floor on money market rates. And the U.S. Treasury, Brignac noted, has announced that it will hold its first floating-rate note auction in January 2014, creating securities that could provide extra yield to investors when interest rates move higher.

"In this low-rate environment, everybody is pushing for yield and looking for new places to invest money," Brignac said. "We're seeing a lot of clients max out as much as they can in money market funds, but where are they putting (the excess)? We're getting record requests for separately managed accounts."


From the left: Stephen Kolocotronis, Fidelity Investments; Laurie Brignac, Invesco; Gina Mitchell, SVIA; Timothy Keehan, American Bankers Association

Meanwhile, government regulators are considering changes in the way money market funds operate, particularly with respect to maintaining a constant net asset value of $1 per share. As Brignac explained, the Securities and Exchange Commission has proposed three alternative approaches. In the first, institutional prime money market funds and tax-exempt money market funds would have to allow their net asset values to float daily with market values, out to four decimal places, rather than hold constant, as is currently done. Government funds and funds catering to retail investors would be exempt from the change. Proponents argue that a floating NAV would give institutional investors a truer picture of the value of their money market holdings. "It sounds deceptively

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presidential elections. Republican supporters, by contrast, are dispersed more widely across the country, giving the GOP more of an advantage in House elections. Both George W. Bush in 2004 and Barack Obama in 2012 won the popular vote for the presidency, Barone noted, but Obama got many more electoral votes in his race. It was the opposite story in the House, he said, with Bush carrying 225 Congressional districts but Obama only 209.

Despite all that has happened, Barone said he thinks Democrats will face an uphill battle to regain the House in 2014, noting that only 17 Republican House districts were carried by Obama in 2012.

"Blame the government shutdown on the incompetence of both parties, but spare some blame for the framers of the Constitution and the American people as well," he concluded. "We have met the enemy, and he is us." SVIA