The Sequester Has Arrived

So the dreaded "sequester" has gone into effect and we are already dealing with the consequences. If you will remember, the infamous Fiscal Cliff that was in the news last year was a combination of tax hikes and deep across-the-board spending cuts.

Well, the tax issues have been mostly ironed out. Americans will be paying more in taxes, and no one is particularly happy about it. But at least the uncertainty is out of the way, and we know what we're facing. As the old expression goes – better the devil you know to the devil you don't know.

Now it's time for the second half of the Cliff, the deep spending cuts collectively called "sequestration."

Judging by the Dow's recent record-breaking highs, investors don't appear to be all that worried about the cuts. For all the angst and handwringing we've seen over the past year and a half, they seem to have reached the conclusion that it's not a big deal.

So what is the story? Is it a big deal?

To start, most Americans agree that the government spends too much money, a lot of which gets wasted. But slicing $1.2 trillion out of the budget sounds like a big cut. That is, until you look at the details. Only $85 billion is scheduled to take effect this year - in a budget of more than $3.5 trillion – the rest is spread out over the next 10 years. We're talking about spending cuts of less than 2.5%, and that assumes Congress and the administration don't weasel out of it. That's still a real possibility.

If the cuts happen as planned, they will probably take about half a percent off of GDP growth this year. And the effects could be worse if they impact business confidence and hiring.

Still, it's hard to get worked up about spending cuts. Even if the sequester is messy and indiscriminate, it's better than no cuts at all.

The real issue is not the current sequestration cuts, which don't matter in the long run, but entitlements. Social Security and Medicare are already in deficit, now, when the vast majority of Baby Boomers are still in the workforce and still paying into the system. But what happens after 2020, when those Boomers born from 1955-1961, the highest birth years, start to reach retirement age?

If you think we have a deficit problem now, take a moment to think about what's coming.

Actually, I can tell you what's coming - higher taxes along with lower Social Security and Medicare benefits, particularly if you are considered a "high income" retiree. And believe me, what counts as "high income" is probably much lower than you think.

The bottom line is that we cannot depend on government programs to take care of us in our old age. And this means putting the pieces of a retirement plan together today, while there is still time.

Sincerely,

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