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FUSCO FINANCIAL ASSOCIATES

Market Commentary

To Our Valued Clients,

In a surprise move, major credit ratings agency Fitch Ratings cut its U.S. debt rating last week from the highest rank of AAA, one notch lower to AA+. The announcement came almost exactly twelve years after rival agency, S&P Global, became the first to downgrade U.S. debt back in August of 2011. Fitch attributed “an erosion of governance” with respect to U.S. debt as the primary reason for the downgrade. This type of language in conjunction with the downgrade may elicit concern for some investors, but will it have any kind of material impact?

In 2011, S&P’s ratings downgrade prompted a significant selloff in the stock market, which fell by nearly 20% following the announcement. Conversely, it sparked a rally in treasury bonds. While this last point may seem counterintuitive, after a brief selloff, investors were enticed by the higher yields they could now attain from what they believed to be one of the safest borrowers in the world. In short, the treasury bond market shrugged at the downgrade and posted one of its strongest years on record. So, if markets had such strong reactions back in 2011, why were they so benign in the week following this announcement? For starters, this announcement didn’t communicate anything investors weren’t already aware of regarding the level and governance of U.S. debt. It also didn’t reference any of the macroeconomic factors that are most likely to influence the decisions of bond investors, namely inflation and growth prospects. And lastly, the largest owners of U.S. Treasuries are the Federal Reserve, U.S. Commercial Banks, and foreign Central Banks; the announcement will have very little influence on their decision to own U.S. debt.

In summary, while no one wanted to see the downgrade, it doesn’t add up to a whole lot from a practical standpoint. Most would agree that the current level and future trajectory of our country’s debt is important, and the governance structure surrounding it isn’t always efficient, but still the Fitch announcement didn’t offer us any unique or additional insight into these issues. This likely explains the relatively muted stance that the market has taken to this point. Thanks for reading, and as always, if you have any questions or if we can help in any way, please don’t hesitate to give our office a call.

With My Best Regards,

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