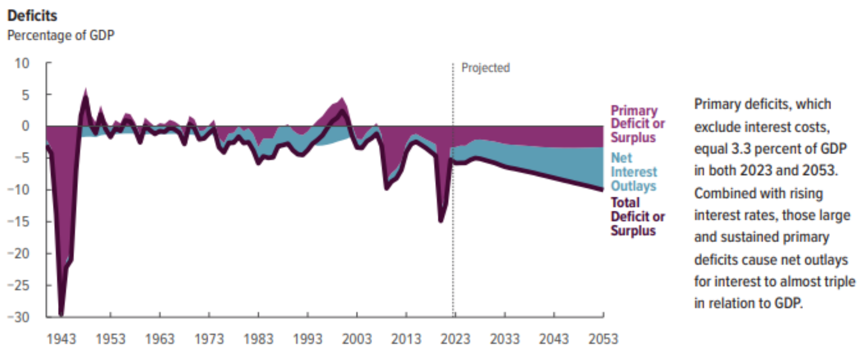
Fitch Downgrades U.S. government debt rating from AAA to AA+

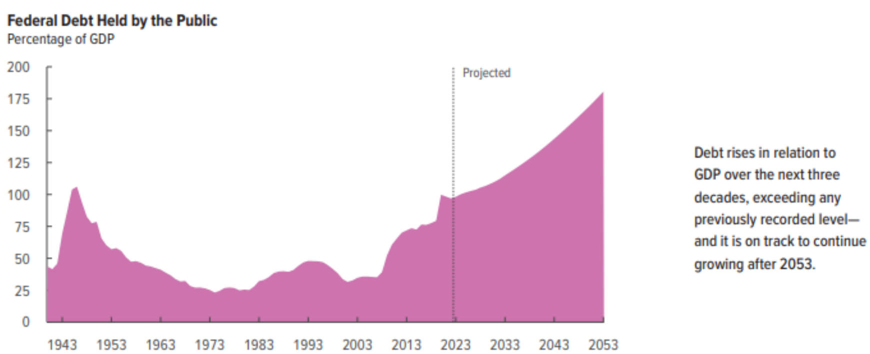
Fitch Ratings downgraded the U.S. government's debt rating on the afternoon of August 1, 2023, taking the debt rating from AAA to AA+. The move impacts all U.S. Treasury securities. We anticipate this will also impact U.S. agencies, particularly Fannie Mae and Freddie Mac due to their reliance on the Treasury, however no action has been taken at the time of this writing. This is the second debt downgrade with Standard & Poor's shifting ratings to AA+ back in 2011.

In short, the move was deserved and long overdue yet entirely inconsequential for investors.

Fitch took the action, unsurprisingly, due to the runaway debts and deficits that have plagued our fiscal picture for more than 20 years and shows no signs of improving anytime soon. The below graphics from the Congressional Budget Office illustrate the problem at hand: debt is accelerating and increasingly being used to pay for interest on outstanding debt and funding current consumption through entitlement programs and the massive stimulus efforts during the pandemic.



See Figure 1-1 on page 6.



If the problem is real, and it is, why do I characterize this as entirely inconsequential for investors? The characterization stems from the simple concept that the U.S. Treasury controls the issuance of currency to pay off issued debt and, as we have seen in the past, the Federal Reserve is expected to continue to support the Treasury in times of market turmoil. Therefore, we fully anticipate the U.S. Treasury to make good on their debt. I expect the challenge for investors to not be ratings or default risk but rather stem from continually increased issuance needs to fund expected spending which should, all else equal, pressure yields higher and put downward pressure on the U.S. dollar given the large projected deficits relative to major trading partners. As always, please reach out if you would like to discuss further.

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