Answering Your Questions About the Fitch Downgrade

Presented by Warren Wealth Associates

On August 1, Fitch Ratings—*one of the top three international credit rating agencies*—downgraded its credit rating for the U.S. government from AAA to AA+, and although this may seem like bad news for U.S. markets, this isn't likely to have a long-term effect. To better understand why this may not be cause for concern, it's important to take a look at the reasoning behind this decision as well as the U.S.'s history with downgrades.

What's Our History?

The U.S. has been downgraded only once before in 2011, when S&P rated the government AA+, bringing it down from AAA. S&P has maintained the AA+ rating for the U.S. ever since and currently has a stable outlook for its rating, matching Fitch. S&P downgrade was due to concerns over the willingness and ability for Congress to pay the country's debts on time following a politically charged debt ceiling standoff.

S&P downgrade echoes the current downgrade from Fitch, as both rating agencies cited rising political dysfunction as a primary cause for their downgrades following contentious debt ceiling standoffs. In both cases, the standoffs were resolved, and the federal government did not default.

The one major difference between these two downgrades is in the initial market reaction. Markets sold off immediately following the 2011 announcement, with S&P, Dow Jones Industrial Average, and Nasdaq Composite all down between 5 percent and 7 percent on the first market day following the downgrade. But we haven't seen sell-offs of that magnitude with this current downgrade.

Although markets were down modestly yesterday, investors largely shrugged off the recent downgrade. And why shouldn't they? The U.S. has already had one AA+ credit rating for more than a decade with no major repercussions, and the Fitch downgrade didn't tell investors anything they didn't already know.

Why Another Downgrade?

Our past downgrade sets the stage for the current one. Fitch cited a "steady deterioration in standards of governance over the last 20 years," as a key factor of the current downgrade. Although it also cited fundamental reasons for its downgrade, including rising deficits, tighter monetary policy, and its expectation for a recession by the end of the year, those factors alone have never led to a U.S. downgrade in the past.

Economists and investors have questioned the timing of the downgrade announcement from a fundamental perspective, as the economic reports released since May have shown signs of a healthy economic expansion and hopes for a soft landing have increased. It's possible that we'll enter a recession at some point in the short- to intermediate-term, but the ability for the U.S. to pay its debts in the short term is not at question. Recent threats to payments have come from the political side—not the economic.

So, What Now?

We don't anticipate any major market volatility or uncertainty due to the recent downgrade, as rising political dysfunction and the state of the U.S. economy is not news to investors. We'll of course continue monitoring the situation, but for the time being, we remain fairly optimistic about the state of the U.S. economy.

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