

MARKET ANALYSIS | MAY 2023

THOUGHTS ON THE DEBT CEILING

Philip Blancato
CHIEF MARKET STRATEGIST, ADVISOR GROUP





Overview:

The U.S. government has bills to pay. These bills come from its responsibility to meet its existing legal obligations, including Social Security and Medicare benefits, military salaries, interest on the national debt, tax refunds, and other payments. Unfortunately, the U.S. Government doesn't have enough revenue (mostly generated through taxes) to cover those expenses. Therefore, the government must borrow money, and it does that by issuing bonds (a.k.a. accumulating debt).

The debt limit is a cap on the total amount of money that the United States is authorized to borrow to fund the government and meet the aforementioned financial obligations. The U.S. hit that limit, \$31.4 trillion, on January 19, 2023.¹

Therefore, we are now in a situation where the U.S. Government either raises the debt ceiling or defaults on its debts. Raising the debt ceiling allows the federal government to continue issuing Treasury bonds that bring in revenue and help it pay its bills. But the government can only borrow money if Congress authorizes them to do so

(Note: Congress instituted the limit in 1917 to rein in the Treasury and the Federal Reserve, which were basically spending whatever they wanted and ignoring potential consequences).

Has the Debt Ceiling been raised before?

Since 1960, Congress has raised the debt ceiling 78 times, and in the vast majority of cases, Congress extended it without hesitation or drama. Two recent exceptions were the showdowns in 1995-1996 and 2011.

- The government shut down twice between 1995 and 1996. Over a million government workers were furloughed for a week in late November 1995 before the debt limit was raised.¹
- In 2011, an agreement was made just days before the deadline. As a result, S&P downgraded the U.S. credit rating from AAA to AA+ for the first time. This delay cost the government an estimated \$1.3 billion in extra costs that year.¹

The most important thing to note is that the US Government has NEVER DEFAULTED on its debt.

Why we do not believe the government will default on its debt and the “Crisis” will soon be resolved:

The U.S. dollar is still the king and preferred currency utilized in global markets, and we do not believe it will be replaced anytime soon. The greenback accounts for nearly 60% of all foreign exchange reserves, which is over twice the percentage of total international reserves of the next closest currency.² Similarly, as we mentioned, the nation’s debt has reached \$31.4 trillion. Of that amount, about \$24.5 trillion, or 78%, was debt held by the public — representing cash borrowed from domestic and foreign investors.³ Given the reliance of the global financial system on U.S. Treasury bonds and U.S. dollars, a default could broadly lead to a loss of confidence in the U.S. government and financial markets — an outcome so distasteful to lawmakers that most view it as nearly impossible.

Earlier this month, the Congressional Budget Office (CBO) highlighted the economic severity of a potential, protracted U.S. debt default. The key takeaways from their worst-case scenario forecast are an immediate sharp recession and GDP to fall 6.1% in Q3. In addition, unemployment would increase by 5% with over 8 million jobs lost in Q3 alone.⁴ Not to mention that there will be no cash to pay the military, millions of federal pensioners, or beneficiaries of Social Security, Medicare, Medicaid, or other entitlement programs. We think that Congress will not allow this sort of economic turmoil, and therefore believe a resolution on the debt ceiling will ultimately be reached, even in the 11th hour.



Economic Definitions

Federal Reserve (Fed): The Federal Reserve System is the central banking system of the United States of America.

10-year Yield: The 10-year Treasury yield is the yield or interest paid to investors who purchase 10-year Treasury notes. It rises and falls based on myriad factors, including inflation, monetary policy, and investor confidence. The 10-year Treasury yield helps investors track the cost of capital and financial market health.

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

Congress: Congress is the legislative branch, which makes our laws, and has two parts: the U.S. Senate and the U.S. House of Representatives. Each state has two U.S. Senators and at least one U.S. Representative; the more residents a state has, the more U.S. Representatives it is allowed.

Index Definitions

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Disclosures

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance cannot guarantee future results.

The statements provided herein are based solely on the opinions of the Advisor Group Research Team and are being provided for general information purposes only. Neither the information nor any opinion expressed constitutes an offer or a solicitation to buy or sell any securities or other financial instruments. Any opinions provided herein should not be relied upon for investment decisions and may differ from those of other departments or divisions of Advisor Group or its affiliates. Certain information may be based on information received from sources the Advisor Group Research Team considers reliable; however, the accuracy and completeness of such information cannot be guaranteed. Certain statements contained herein may constitute "projections," "forecasts" and other "forward-looking statements" which do not reflect actual results and are based primarily upon applying retroactively a hypothetical set of assumptions to certain historical financial information. Any opinions, projections, forecasts and forward-looking statements presented herein reflect the judgment of the Advisor Group Research Team only as of the date of this document and are subject to change without notice. Advisor Group has no obligation to provide updates or changes to these opinions, projections, forecasts and forward-looking statements. Advisor Group is not soliciting or recommending any action based on any information in this document.

1 <https://www.visualcapitalist.com/rise-of-americas-debt-ceiling/>

2 <https://www.imf.org/en/Blogs/Articles/2022/06/01/blog-dollar-dominance-and-the-rise-of-nontraditional-reserve-currencies>

3 <https://www.pgpf.org/blog/2023/05/the-federal-government-has-borrowed-trillions-but-who-owns-all-that-debt>

4 <https://www.whitehouse.gov/cea/written-materials/2023/05/03/debt-ceiling-scenarios/>

Securities and investment advisory services are offered through the firms: FSC Securities Corporation, Royal Alliance Associates, Inc., SagePoint Financial, Inc., Triad Advisors, LLC, Infinex Investments, Inc., and Woodbury Financial Services, Inc., broker-dealers, registered investment advisers, and members of FINRA and SIPC. Securities are offered through Securities America, Inc., American Portfolios Financial Services, Inc., and Ladenburg Thalmann & Co., broker-dealers and member of FINRA and SIPC. Advisory services are offered through Arbor Point Advisors, LLC, American Portfolios Advisors, Inc., Ladenburg Thalmann Asset Management, Inc., Securities America Advisors, Inc., and Triad Hybrid Solutions, LLC, registered investment advisers. Advisory programs offered by FSC Securities Corporation, Royal Alliance Associates, Inc., SagePoint Financial, Inc., Securities America Advisors, Inc., Triad Advisors, LLC, and Woodbury Financial Services, Inc., are sponsored by VISION2020 Wealth Management Corp., an affiliated registered investment adviser.