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The Debt Ceiling Distraction

A Manufactured Crisis

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In 1917 the United States Congress first established a limit on government borrowing to finance the country's involvement in World War I. The current debt ceiling is set at $31.4 trillion[1] and has been raised to accommodate the government's growing debt obligations over time. In fact, it has been raised 78 times[2] since 1960 as a part of regular business for Congress. Historically this budgeting statute has been more procedural than material. However, recent rising debt-to-GDP levels and partisan politics have turned procedure into brinksmanship. Sadly, the 2023 debt debate is not the first of its kind.

In 2011 a prolonged debate in Congress over raising the debt ceiling led Standard & Poor's to downgrade the United States' credit rating and market volatility ensued with the S&P 500 [3]dropping nearly 17% in just 11 trading days[4]. In 2013, another impasse over the debt ceiling led to a 16-day government shutdown. We are quickly approaching a similar scenario unless Congress comes to a resolution.

On January 19 the U.S. once again hit its debt ceiling[1] and the Treasury Department enacted "extraordinary measures" to avoid or delay technical default. Early measures often include drawing from cash and other emergency reserves. More dramatic measures include the suspension of social security or other trust payments, delaying federal employee retirement payments, or even shutting down portions of the federal government. According to Treasury Secretary Janet Yellen's estimations, the U.S. government may exhaust these measures and potentially default on its obligations as early as June 2023[1].

A default on U.S. debt would be unprecedented in modern times. With the U.S. dollar largely regarded as the reserve currency of the world and the Treasury market one of the deepest and most secure, a default would likely have wide-reaching effects. Equity markets, currency markets, credit markets and commodities (which are priced in U.S. dollars) would likely be impacted and perhaps adversely. It would be wise to learn from the turmoil in the United Kingdom last fall on how political decisions can have a material impact on financial markets. Ultimately, this is a scenario best not to test.

That said, we believe the debt ceiling is more distraction than anything else for long-term investors. Why?

Resolution – Recent actions from politicians have done more to shake confidence in bipartisan resolution than it has to establish it. This is the primary reason we believe this issue could persist or even escalate as summer draws near. However, if market volatility, delayed tax refunds, missed social security payments, government furloughs among other issues occur, it will be felt by voters of both parties creating an incentive for resolution.

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[1] *Secretary Yellen Debt Limit Letter to Congress January 19, 2023*

[2] *U.S. Department of the Treasury January 24, 2023*

[3] *Use of Indices and Benchmark Return Indices cannot be invested in directly. Index performance is reported gross of fees and expenses and assumes the reinvestment of dividends and capital gains. Past performance does not indicate future performance and there is a possibility of a loss. See disclosure page for indices representing each asset class.*

[4] *FactSet as of January 25, 2023*

Manufactured Crisis – Ability and willingness are very different things when it comes to a debt crisis. Questioning the ability of a debtor to pay has far wider implications than questioning willingness. Debt ceiling brinksmanship for most investors leaves a question of when, not if, payment will be received. Ultimately, such actions erode faith in the U.S. Treasury system and may have long-term implications, but it is less likely to evolve into a systemic risk as if the U.S. government were truly insolvent. Moreover, the resolution to the crisis is, in theory, easily and quickly attainable.

While it is in the country's best interest to resolve the debt ceiling, we believe it is in the best interest of investors to avoid the noise from these manufactured crises and focus on things that matter to the long-term outcomes in markets.

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Brad joined Fiducient Advisors in 2012. He is chair of the firm's Investment Committee and a member of the firm's Discretionary Committee, Research Forum, Capital Markets Team and Mission-Aligned Investing Committee. In 2019, Brad was name named a "Rising Star" in City Wire's annual Professional Buyer publication for his contributions in the investment manager research industry. Prior to joining the firm, Brad worked in various research capacities at Citigroup and Wells Fargo in New York. He received a Bachelor of Arts in Finance and Minor in Economics from The University of Colorado and is a CFA® charterholder and member of the CFA Society of Chicago and CFA Institute. Additionally, he is active with Greenhouse Scholars, a nonprofit providing financial and personal support to under resourced college students. In his free time, Brad loves cooking and spending time with his wife and young sons.

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***The S&P 500 Index** is a capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*