

August 4, 2011

Standard & Poor's Downgrades Long-Term U.S. Credit Rating to AA+

On August 5, Standard & Poor's announced that it has lowered its long-term sovereign credit rating on the United States of America to 'AA+' from 'AAA' and affirmed the 'A-1+' short-term rating. The outlook on the long-term rating is negative.

The AAA rating remains on short-term bonds, which are those that mature in 12 months or less.

According to its website, a Standard & Poor's rating outlook assesses the potential direction of a long-term credit rating over the intermediate term (typically six months to two years).

Standard & Poor's has indicated it will release more information on August 8 "concerning affected ratings in the funds, government-related entities, financial institutions, insurance, public finance and structured finance sectors."

Moody Investor Services and Fitch Ratings have affirmed their AAA credit ratings August 2nd, the day President Obama signed the bill that ended the debt-ceiling debate.

There are numerous potential implications from this downgrade and it is impossible at this point to predict the repercussions, this being the first time the U.S. has ever experienced a downgrade, since 1941 when S&P first began rating sovereign debts. However, from numerous pieces we have read this weekend, we will share a few things that caught our attention:

- While the first concern is that interest rates will rise, making it more expensive for our government to finance debt and increasing costs for taxpayers, history has demonstrated that some past credit downgrades made on large nations, such as Japan in 2002, actually resulted in little, if any, rise in interest rates.¹
- Most money markets should not be impacted by this credit downgrade since they own very short-term treasury bonds, which still own the AAA rating.
- Although many holders of Treasury bonds, such as insurance companies, mutual funds, and private pensions have investment objectives to hold only the safest investments, U.S. still will be considered among the safest and most liquid investments, so it is possible there will be little action taken among those holders.
- The Federal Reserve, which holds 14 percent of U.S. government debt¹ will not sell. In fact, if some sales do result because of the downgrade, the Fed could step in and buy those Treasury bonds.

- Foreign bond holders, which represent the largest holders of U.S. debt, will have to ask themselves whether U.S. government bonds are still the safest and most liquid securities that exist and the likely answer is yes. They simply don't have many other practical alternatives, so it is very possible there will not be a mass exodus from U.S. bonds. It is important to know though that there are now 18 countries still rated AAA by S&P, such as Canada, Australia and the U.K
- There are actions the Fed could take as a result of the downgrade. They are already scheduled to meet Tuesday morning and that meeting will now be watched even more closely that it already would have been.

The impact on financial markets is likely to be more psychological than anything. Since there is already a concern about the slowdown our fragile economy has experienced in recent months, this will add fuel to the fire of the bear argument that we may be sliding back into recession. We still believe that the economy is more likely to grow at a slow pace, rather than slip back into recession, but we will be paying close attention as economic data comes out. The jobs numbers on Friday, for example, was much more positive than many expected and that was a hopeful sign, if only we can continue to add jobs.

More information about ratings is available at standardandpoors.com, moodys.com and fitchratings.com.

While the immediate effects of these actions are currently unknown, we will continue to monitor the situation and the markets. To view updates and commentary as they are available, please visit raymondjames.com.

In the meantime, please feel free to contact me with any questions or concerns.

Sincerely,

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¹ *Implications of a US downgrade* appearing on CNBC.com, written by John Carney

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