CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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The Debt Ceiling and Your Portfolio

- The debt ceiling has been reached, and the clock is ticking before the U.S. will miss payments on its obligations.
- Market fluctuations will likely worsen as political brinkmanship could last until the last second.
- Positioning your portfolio based on the headlines is not advised. Your advisor can help you focus on your long-term risk and return objectives.

The United States hit the debt ceiling in January and now the United States Treasury Department is using what they call "extraordinary measures" to continue paying government operations. It estimates that these measures may not be sufficient to continue paying obligations as early as June. You have probably heard about this in the news and conversations, but what exactly is the debt limit and what does this mean for your investments? This is a very politicized topic as both Republicans and Democrats publicly debate this contentious issue. We will attempt to take the politics out of this debate and discuss this topic as it relates to your investments.

What is the Debt Ceiling?
The debt ceiling is the maximum amount of debt the U.S. government is authorized to borrow by law. While Congress has already authorized spending commitments, the U.S. government is spending more than it receives in tax revenues, creating a budget deficit. To pay for this deficit, the government must issue more debt (Treasury bonds), but the maximum amount of debt written into law has been reached. Approaching the debt limit is not unprecedented and the Treasury Department points out that "since 1960, Congress has acted 78 separate times to permanently raise, temporarily extend, or revise the definition of the debt limit." This time does feel different, however, as COVID stimulus spending caused debt to GDP to surpass World War II levels and congressional divisions seem deeper. Defaulting on the debt and not making payments on commitments, however, is more unprecedented.

Why is the Debt Ceiling Important?
The debt ceiling is so important because failing to raise the debt could cause the government to not meet legal obligations such as paying Social Security, Medicare, and interest on the debt. If Congress disagrees on a debt limit, that could lead to a default on U.S. Treasuries, making countries less willing to buy America's debt (Treasury bonds). In 2011, a credit rating agency downgraded the U.S. from AAA to AA+ partly due to a debt limit battle.

If a default did occur, the government would likely delay payments to bondholders, but it would pay a steep price. The ramifications would be huge – potential downgrades by rating agencies, elevated levels of market volatility, and a worsening economic situation. Furthermore, what cannot be measured is the indirect effect from businesses. With uncertainty in Washington and its potential effect on the economy, business leaders may be reluctant to increase capital expenditures or hire additional workers – both clearly not a good sign for the economy.

Should I Make Changes to My Portfolio?
It is possible, but in our view not probable, a fight over the debt ceiling could cause a U.S. default. There is often a lot of political brinkmanship, but a default would not be desirable for either party. If we look back to 2011, there was another contentious debt ceiling debate after the financial crisis, and while it came down to the wire, the debt limit was raised.

Overall, we are entering a potentially volatile period for the financial markets. Increased uncertainty combined with below-trend economic growth will likely lead to sharp market fluctuations. To mitigate the risk of volatility, we remain committed to increased diversification. Please continue working with your financial professional to help you align your portfolio with your long-term investment objectives. It is easy to get distracted by the noise and sensational headlines. Creating a financial plan that you can monitor and follow helps to avoid the distractions and to stay focused on what you can control.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

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