To Our Valued Clients,

The lone holdout of the big three rating agencies fell into line last week as Moody's Analytics joined peers S&P and Fitch in cutting the U.S credit rating from the highest possible grade of Aaa down to Aa1. The announcement was subtle, released after the markets closing bell on Friday afternoon and competing for attention against the trade policy saga, the budget bill, and a slew of geopolitical headlines. But no matter where it falls in the news cycle, any time the worlds largest economy has its credit rating downgraded, signaling a concern about its ability to repay its future debt obligations, it's worth taking note.

It's been 14 years since S&P announced a credit rating downgrade for the U.S., the first agency to ever do so. The announcement triggered a frenzied response that included a 20% drop in the S&P 500, a sudden, albeit short-lived, selloff in treasury bonds, and the S&P CEO being removed from his post. Maybe because it didn't tell us anything we didn't already know, maybe because it was dampened against a noisy news cycle, or maybe because it's just old hat at this point, but Friday's announcement didn't muster much of a reaction at all. Moody's attributed the downgrade to a growing fiscal deficit, rising interest costs, and a long line of Administrations that have failed to do anything about it—again the persistent gap between government spending and revenues is not telling us anything we didn't already know. So, what are the real implications here? The first thing a textbook would tell you is it could deteriorate investor confidence in U.S. assets, particularly treasuries, leading to increased borrowing costs for the government and consumer alike, and it could increase inflation. However, empirical evidence tells a different story. Following the two prior downgrades in 2011 and 2023 treasury yields and rates on consumer loans actually moved lower in the weeks following the announcement, as did inflation. The early response to this latest downgrade seems to follow a similar pattern, with little disruption.

We are often asked when events such as this occur whether it signals a need to alter portfolio strategy, the answer at this point is no. The signal would be if there is a sudden drop in demand in treasury bond auctions and the structure of the bond market begins to shift, but we just aren't seeing that. None of this is to downplay the U.S. fiscal situation, it needs attention, and continuously kicking the can down the road is only going to get more expensive. However, the Moody's announcement only acted as reaffirmation, not new information. Thanks for reading, and as always, if you have any questions or if we can help in any way, please don't hesitate to give our office a call.

With My Best Regards,

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