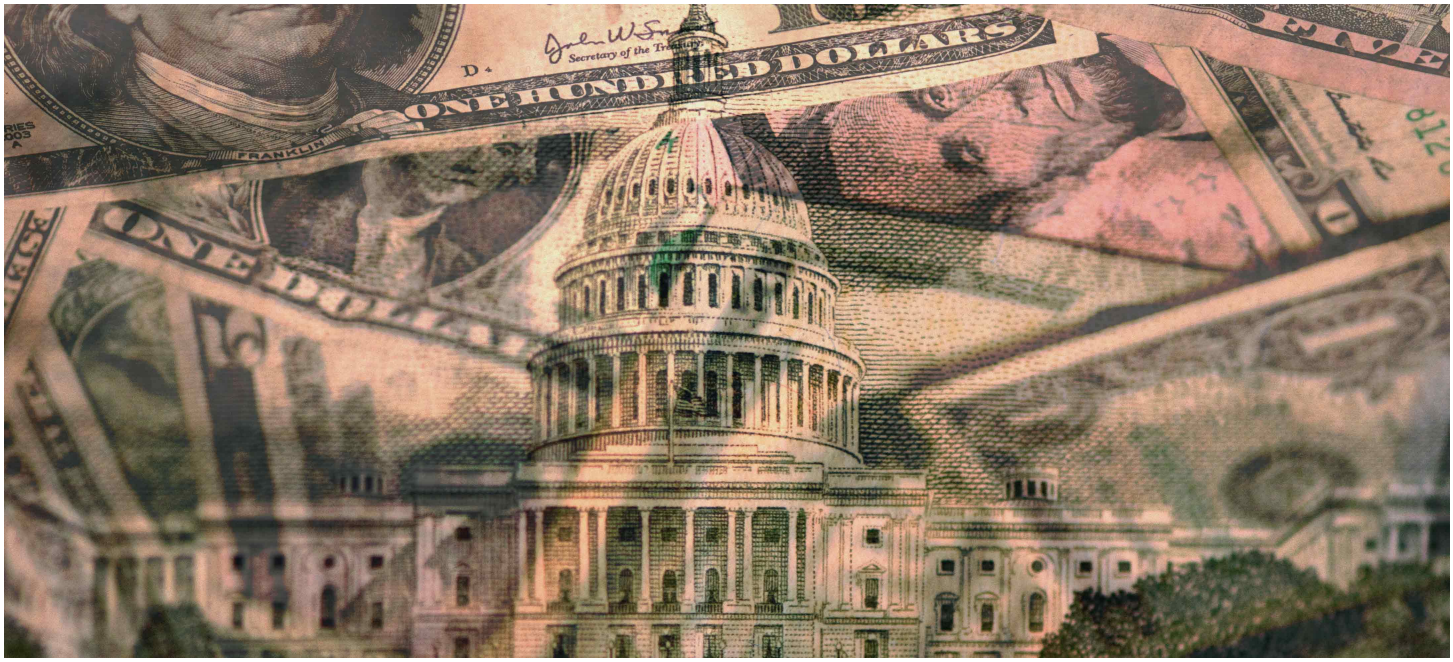


An Update on the Debt Ceiling

The U.S. is one of only two industrialized nations that separate the governmentâ??s ability to spend from its ability to borrow (the other is Denmark). In 1917, Congress instituted a maximum debt limitâ??often referred to as the *debt ceilingâ??*to protect the government and its citizens against a blank-check mentality that could lead to unbridled spending.

While the debt ceiling worked well as a fiscal balancing tool for nearly 100 years, it has recently become a point of contention.

What is clear is that the U.S. government has experienced unsustainable debt growth, accumulating debt far greater than what it earns in any given year. And, while most people agree that the government needs to bring its budget deficit under control, building consensus behind the best approach seems full of political potholes.

The result has been a series of emotional debt-ceiling showdowns and warnings that the country may soon default on its debt. While the past few days have brought signs of optimism, a solution remains elusive. However, it is worth noting that there is an enormous gap between reaching the debt ceiling and defaulting on our debts.

When will the Treasuryâ??s coffers run out? Answering that question is not so easy. As Treasury Secretary Janet Yellen told Speaker of the House Kevin McCarthy, â??It is impossible to predict with certainty the exact date when [the] Treasury will be unable to pay the governmentâ??s bills.â?•

But the truth is that the timing doesnâ??t matter. The core of the issue is that while a debt-ceiling resolution this week might delay the need to face debt problems, it does not solve the larger issue.

For a moment, letâ??s imagine what could happen if the debt ceiling is not raised in time. In that case, the U.S. Treasury would continue to collect tax revenue and, of course, roll over the nationâ??s existing debt, keeping total debt under the debt ceiling. But if access to new debt is cut off, the U.S.â??like any other consumerâ??would be forced to reprioritize its expenses and find items to eliminate to ensure that costs do not exceed the collected revenue amounts.

We are confident that paying the interest on national debt and fulfilling Social Security obligations are at the top of the governmentâ??s priority list. These payments will be maintained, even if other, lower-priority programs are cut.

Consequently, even if the debt ceiling is not raised, the odds of default are exceedingly low. While this logic avoids a technical debt default by the federal government, it does nothing to provide job or income security for most federal employees.

But the U.S. does not need an actual default to undermine investor confidence. Following the first debt-ceiling tug-of-war in 2011, S&P Global Ratings downgraded U.S. government debt. Itâ??s important to understand that this downgrade was not a reflection of the governmentâ??s true ability to service its debt, but rather a reflection of *concerns* about the government and its ability to service debt.

As former Federal Reserve Chair Alan Greenspan stated, â??This is not an issue of credit rating. The United States can pay any debt it has because we can always print money to do that.â?• In other words, it is a matter of will.

The U.S. has the enormous privilege and responsibility of maintaining the *reserve currency* for most global trade. This brings an unrivaled level of stability to the U.S. economic landscape, insulating us from sudden swings in currency valuationsâ??but exposing other countries to those same swings. As John Connolly, former U.S. Treasury Secretary under Richard Nixon, said in 1971 to his international counterparts, â??The dollar is our currency and your problem.â?•

While losing this reserve status would require many more years of reckless federal spending behavior, the status is being targeted by our economic competitors and potential enemies. Any decline in confidence in the dollar or the governmentâ??s ability to service its debt adds fuel to this competitive fire.

With that in mind, should investors look for ways to reduce risk as the country approaches its debt-ceiling deadline?

There is no doubt that the market could experience heightened volatility as this debate intensifies and the media weighs in at an increasingly high pitch. However, this is not a short-term issue that can be solved by holding additional cash.

There are four key points to consider in deciding how to prepare.

1. As a firm, we continue to hold U.S. Treasury bills, notes, and bonds and believe they represent the peak of credit quality and the basis for price discovery for all other fixed income assets.
2. The U.S. Treasury will prioritize interest payments and continue to service the existing debt of the federal government.
3. The noise surrounding the debt-ceiling debate may create some uncomfortable moments for investors, but these discomforts will most likely prove temporary.
4. The global equity markets are not focused on the debt ceiling. Instead, they remain focused on interest rate levels, the Federal Reserveâ??s fight against inflation, and the chances of an economic recession.

Despite the sense of urgency that typically surrounds debt-ceiling conversations, this is not a problem that can be solved quickly. It is a longer-term challenge to the primacy of the U.S. in the global economic hierarchy. And solving it will require disciplined focus on behalf of the U.S. Treasury.

From an investment perspective, if the federal government does not begin to bring its total debt under control, then we expect to consider changes regarding how we and our investors should approach long-term asset allocation. But at this moment, the situation remains under study and review.

Have questions? Need help? Call the CAPTRUST Advice Desk at 800.967.9948, or schedule an appointment with a retirement counselor today.

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