

Fidelity Viewpoints®: Market Sense

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TRANSCRIPT

SPEAKERS:

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Heather Hegedus: Hello and thanks for joining us for Market Sense. I'm Heather Hegedus with Fidelity. The debt ceiling is front and center in Washington right now and it could have big implications on Wall Street. You know, some investors are nervous about a possible U.S. default and the U.S. credit rating being downgraded. But for now, the market on the whole seems to be shrugging it off. So to unpack all of that and what it means for your money and fears of a possible recession. We're joined today as we often are by Fidelity's Director of Global Macro, Jurrien Timmer. We're also excited to welcome back after a little bit of a hiatus, Ashley Tran, a Florida based vice president and branch leader here at Fidelity. Thanks so much to both of you for making the time to be on the show today.

Ashley Tran: Thanks, Heather, happy to be here.

Jurrien Timmer: Yes, great to see you, welcome back, Ashley.

HEATHER: Well, today is May 23rd and you know, the debt ceiling news continues to develop hour by hour, we are all watching this very closely. You know, the negotiations are politically complex, they're high stakes, they're happening behind closed doors. So we want to unpack this all for you today. We want to start off with Jurrien. And Jurrien, if you would, please, could give us just first of all just a quick refresher of what the debt ceiling is and then catch us up on how we got to where we are right now.

JURRIEN: Yeah, so the debt ceiling has been around for a while and invariably the government ends up spending even more money than the debt ceiling allows, and then you get to the debt ceiling, and then you get, you know, to the kind of drama we're seeing play out today. And it's certainly not the first time it's happened. I can assure you it won't be the last time probably. We've seen this movie many, many times, the market has seen it many times.



And probably the most infamous example was the summer of 2011 when the U.S. debt actually got downgraded. The market went down 20% that summer, although the Euro's own debt crisis was also very much in full bloom at the time. I remember when Greece and Italy and Portugal were going to potentially default on their debt. There were other factors going on at the time that caused the market to go down. But so here we are, you know, obviously negotiations are happening. It is in a politically divisive time. It's right, you know, coming up with an election so it's often an opportunity for politicians to score points, and eventually there really is no choice but to raise the debt ceiling for the simple reason that the money has already been spent, right?

So Congress decides how much money to spend and then the Treasury just has to finance the debt that is the result of that spending. So for Congress to say, the Treasury cannot issue debt to fund the money that Congress has already spent is a little bit silly for the lack of a better word. And actually, it's unconstitutional because the 14th Amendment says that it is unconstitutional to default on the debt. So it's a lot of theatrics, it's obviously nerve racking, you can see the market is down by about 0.7% today. So it's not immaterial, it's not that it's not important because what can happen is that the Treasury will run out of cash, probably in the next week or two. June 1st, it's called the X date and so it's not precise, because the Treasury has cash at the Fed, it's receiving tax collections, things like that.²

But at some point, if the debt ceiling deal is not reached, the Government will run out of money. And it will start picking and choosing which bills to pay. And, you know, it may not pay paychecks for its federal employees, it might even have to shut down for a few weeks; that has also happened in the past. But the notion of the Government not paying its debt or interest on the debt would be kind of a doomsday scenario that will be avoided at all costs, and even the parties to the negotiation right now have stated explicitly that defaulting on the debt is not an option.

HEATHER: Let's talk about some of other implications for this quickly, Jurrien, about if Congress does not raise the debt ceiling, what else could happen?

JURRIEN: Well, so what could happen is the markets, of course don't like uncertainty and so it will in all likelihood create some volatility the further we get past the X date. And what you can see is that the Government will stop paying some of its bills because it literally will not have the cash to do it, right? So we've been, for a few months, doing what's called extraordinary measures where the Treasury is just trying to pull a rabbit out of the hat to come up with the money to spend on paying its bills. And, you know, in a way the Treasury has been fortunate that because the Fed has increased its balance sheet so much since the COVID lockdown, that the interest that accrues on that balance sheet actually belongs to the Treasury so its called the Treasury General Account or the TGA, and the Treasury has been able to use its cash balance at the Fed to pay some of the bills but that cash balance which two years ago was \$1.8 trillion is now only at about \$50 billion. We're getting pretty close to the end in terms of how much money there is to be spent. And at that point

the Government will just kind of have to just temporarily not pay, you know, its contractors, maybe it's Federal employees until the debt ceiling is raised again.

HEATHER: All right, Ashley, I want to bring you in. I'm assuming you're getting a lot of questions right now from consumers about this and what it all means for them? What are they asking you? What are some of the big, most commonly asked questions?

ASHLEY: Yeah, so we absolutely are. And I'm glad that we have the opportunity to talk about this today. I know our branch has been getting a fair amount of calls about this. But it's not just specific to our branch. I think nationally we're hearing a lot of customer concern. And the big concern is really what does this actually mean for me? And, you know, I say there will always be times of uncertainty in the market. But I think what makes right now stick out is that hearing the words like debt ceiling and default all over the headlines, it sounds very daunting. But we like to remind customers that it's times like these when it becomes even more important to take a long term view of your investments and review them regularly to make sure they're in line with your time frame for investing, your risk tolerance, and your overall financial situation.

And ideally your investment mix is one that's going to offer you the potential to meet your goals while also letting you rest easy at night no matter what the environment is since we know it's changing. I like to call that an all-weather approach. So my basic guidance when clients say, you know, what does this mean for me? What should I be doing? I say to not do anything differently. Right now what we're feeling is normal, like Jurrien mentioned, it's happened before it'll happen again. It's complex and likely, we'll hear about resolution at the last minute because these negotiations take time.

But we get that it doesn't feel good. When Jurrien mentioned this has happened before and extraordinary measures, actually since 1985, the Treasury has acted and resorted to taking extraordinary measures like we are now 11 times. And each time that has happened, Congress has acted to forestall default.³ But that announcement came at the very last minute through a lot of high stakes wrangling. But if you are feeling fearful, I would start with reflecting on what you're feeling fearful about. And many people's response would be, well, I'm afraid of losing money. And I would challenge that further and ask, what is the real impact of losing that money? Does that mean you're losing income that's covering your essential expenses? Does that mean you're losing out on money you had hoped to pass down to heirs? Defining that real impact of the market volatility or potential for loss is the first step in building out a plan for the all-weather portfolio to help you prioritize how to meet the goals. And if you have questions about that or want to talk to a financial professional through your goals and plans, you can do that for free by giving us a call.

HEATHER: All right, that's good to keep in mind, Ashley. You both mentioned that this has happened before so what do we know from history being our guide about how this could impact the markets. Jurrien, let's ask you that question.

JURRIEN: I mean, in a way I think of it—I mean it's already—it's already very much in the rear-view mirror. But remember Brexit? That was one of those things that everyone was really worried about and that's not to say that Brexit didn't have implications of course back over in the UK. But when it finally was resolved, you know, there was some short term volatility, the market went down for a few days, and then it recovered. And everyone sort of went along about their business.

I mean, by that, I don't mean to minimize what's happening, of course. It's very serious business to not pay bills, whether you're a person or the Government. And it's extremely serious business if you're a sovereign country that has a lot of debt to not pay back that debt. But, you know, as Ashley said, when it really push comes to shove and you look at your portfolio, it's good to ask like, what would actually happen, right? Let's say you have a portfolio of stocks and bonds. Stocks ultimately are—or stock prices ultimately follow earnings. So how would a shutdown or a default affect corporate earnings? You know, I'm not so clear that a temporary shutdown where the country can't pay its bills would have a lasting impact on that and the same on bonds. Obviously if the Government were to default on the debt, that would have a very, you know, immense implication. And we can think of episodes in other countries, third world countries, you know, emerging markets where countries have defaulted and their currency went down, and they never recovered.

But the U.S. is hardly in that category. It is the reserve currency of the world. And so if there was, God forbid, a default, it would likely be very temporary, maybe spanning a few weeks. Let's say interest doesn't get paid on T-bills, and then when the debt ceiling does gets raised which it always has and there really is no alternative then to raise it, because like I said earlier, the money has already been spent. Then once the debt ceiling is raised, those T-bills or whatever securities are will be paid in arrears. So it's not fun, it might cause some disruption, some volatility. Maybe the dollar gets more volatile but ultimately these things tend to be resolved because there literally is no other alternative.

ASHLEY: Yeah, Heather, can I actually add to that thinking about what Jurrien mentioned and how historically stocks have moved higher after past debt crisis. And I would just be remiss not to mention the importance of discipline and staying invested. So, like Jurrien mentioned, the markets tend to bounce back after a resolution regarding debt ceilings. I think there's an important message here to remind clients that you can make up for downside loss over time. But if you miss the upside, that's not something you can't make up or get back or create. And when the markets fall and we see the volatility it's natural to feel stressed. But sometimes those feelings will tempt you to pull your money out of the market entirely. However, not being invested can come with its own set of risks particularly if and when the markets rebound.

So when someone pulls their money out of the market and goes to cash they're usually scared but they often plan—or forget to plan for the other side of that. And that is what is my plan to get back into the market? When and how will I actually do that. If we take—

ASHLEY: Go ahead.

JURRIEN: No, go ahead, Ashley, sorry.

ASHLEY: No, that's okay, I was just going to say if we move when we feel good or bad, it's possible you're not going to feel comfortable getting back into the market until the volatility slows down and you feel good. And by that time, you could miss out on some very significant days. What do you add to that Jurrien?

JURRIEN: Yeah, no, I was just going to highlight what you just said. Rather than having volatility be your enemy where you make knee jerk reactions and sell when things get a little bit scary, you can actually use them to your advantage and say, okay, we're having a volatility event. The market's down 10% or what have you. You can use that as a rebalancing opportunity and so, one person's pain could be another investor's gain.

HEATHER: Good perspective from both of you there. I did want to talk about what this means for the Fed's plan as well and whether this uncertainty could impact the Fed's course. Jurrien, you know I'm curious to get your take on whether you think this could make it more likely that the Fed posits or pivots now even.

JURRIEN: Yeah, so the expectations from the market of the Fed is that the Fed is pretty much done raising rates. And of course, it has raised them quite a bit from zero a little over a year ago to about 5–5.25% right now. And the expectation, I think probably unrealistically from the market is that the Fed will start cutting rates soon. And I don't think that that's in the card because the inflation, even though it's improving, has not improved enough, I think for the Fed to give the all clear.

So, again, I think the Fed is probably looking at this in a similar way that we're talking about this saying, you know, if the Government were to shut down for a week or two, and, again, that has happened in the past. So basically, Federal employees are told to come to work because they can't get paid. They basically got furloughed for a few weeks. Contractors are not getting paid. And if that's all just temporary, a week or two until a deal is reached, I don't think it will sway the Fed in one way or the other.

And think of it almost like a natural disaster, although this is a self-made disaster, if it is one, that if there's like a hurricane and the economy stops for a week and then reopens, it's not really going to change the long term course of economic growth. But if the economy closes and stays closed for six months or three months like we saw with COVID, of course, that's a different story. So the Fed, I think, would look at it in the same way. And I think it would be extremely unlikely that if—even if there is a shutdown that it would last more than a few days or a few weeks, because at some point all the politicians that are at the impasse of this fiscal cliff are going to

start getting calls from their constituents. And that—if that doesn't motivate them, basically nothing well.

HEATHER: What about the potential for a looming recession? You know, we talk a lot about that here on Market Sense, could this be the final straw that tips the U.S. in a recession?

JURRIEN: I mean, it's always possible, it could be a catalyst. But I think there are bigger forces at play, and again, it comes down to whether this would be a short term situation or a longer term. I think the bigger narrative, though is, you know, there's a reason we're having a debt ceiling conversation. That's because there's a lot of debt and there's a lot of debt at the same time that the Fed, because inflation is a problem, is raising rates a lot. And high rates and high debt do not mix very well. And we've seen this, of course, with some bank headlines over the past few months. So if there's going to be a recession, it might get sped up by this, it might be a catalyst. But ultimately, the problem that the debt ceiling is addressing is probably the more important thing than the debt ceiling itself.

HEATHER: Well, another thing that we haven't talked about that I know is also a concern on a lot of people's minds, Jurrien, is the possible that the rating agencies could downgrade the U.S. credit rating because of all of this. How real in your view is the possibility of that happening? And if that were to happen, what would that mean for the U.S.?

JURRIEN: Well, our debt got downgraded in 2011 which of course is already a long time away. So we're at double A. You know, all of these issues are known issues, right? We already know that the debt level is very high. COVID certainly had a lot to do with it but even beyond COVID, the country is running pretty big deficits. And those deficits are approved by both sides of the aisle, right, so this is not really a partisan issue.

And so that is the bigger issue so if the Government's debt would get downgraded by a rating agency, I don't know that it would be because of the current debt ceiling impasse, but it would just be because there's just a lot of debt. And the Government is not running a fiscally sound ship, and so obviously the debt ceiling is a manifestation of that. But I haven't heard anything that a downgrade is imminent or would be triggered. Again, there's only been one downgrade despite, you know, as Ashley said, 11 of these episodes. And so but ultimately, it's still the U.S., it's still the reserve currency, we're still the largest economy. So if the debt goes from AA to AA minus, it's not good. You know, nobody wants to get their debt downgraded but I don't know that it would actually change very much around the world.

HEATHER: Okay, well, Jurrien hasn't heard anything about that yet. But Ashley, you know, what would a U.S. credit rating getting downgraded mean for investors? Is there anything that investors would want to consider if we were to be in that kind of situation?

ASHLEY: Sure, so just some points of awareness that it could drive some volatility because it doesn't feel good, right? And it going to sound like I'm repeating myself here a little bit but we really encourage customers to not make impulsive decisions based on the headlines. And reasons for that being for one, like we've been saying, the default is unlikely. And secondly, it's not going to change anyone's portfolio.

What it could do however is create some temporary dislocation, which I'm going to revisit what Jurrien brought up earlier could be used as a really good opportunity to rebalance. A quick reminder on rebalancing; rebalancing is just adjusting the weightings of the different asset classes in your portfolio. That could be industry or sector specific or a combination of both but that is going to be key to what can help you remain properly invested as the market shifts and experiences that volatility. Because when dislocation happens, sometimes the market stress can cause disruption. It can be tough to price assets correctly in absolute and relative bases. And that may actually alter the risks you're taking on with your current mix. So we use the term diversification a lot, meaning having that intentional mix of stocks, bonds, and short term that aligns with your horizon and risk tolerance but that's not just a one time ask to diversify.

You need to keep that on track with periodic checkups so we do encourage investors to monitor their portfolios and periodically evaluate changes. Do I need to go in and rebalance? Take a look at relative performance and risk. And there's different ways you can do that, for example, consider rebalancing if any part of your asset mix moves away from a certain target percentage but a full time job, something to always consider as we see the markets moving up and down.

HEATHER: All right, good perspective, Ashley. You know we're about nine days away from June 1st. All eyes on Washington. And Jurrien, I just wanted to end things by asking you what you going to be watching in the week ahead.

JURRIEN: Well, obviously we're going to be watching this drama. But again, it's a movie that we've seen before and it's always ended the same way. And that is with another increase in the debt ceiling. And think of it this way, you know, when you're standing over the cliff, the easiest thing to do is to build more land and that's ultimately what the government has always done. And I'm not—I expect that that will happen again.

HEATHER: All right, a nice analogy there. Great conversation. Thank you, both, Ashley and Jurrien. We know you're going to continue to monitor the very latest for us on this front. And we also know that staying on track during uncertain times can take discipline. We talked about how it can feel a little bit uncomfortable to be where we are right now. But Fidelity does have a lot of resources that can help you. So we encourage you to scan the QR code right there on your screen right now. Or type in the URL there. To sign up for our free weekly Viewpoints Newsletter where a team of financial writers help us all sort through the headlines and lay out what you need to know in order to make informed, educated decisions. As a reminder, if you have questions about

making a financial plan or staying on track, Fidelity can help with that. So call us, go online, or download Fidelity's app to learn more.

And before we go just a quick programming note, we will be off next Tuesday but we're back the first Tuesday in June with the first of two mid year shows actually. We're diving into money moves that you might want to consider making as we take our pulse halfway through the year. As well as a mid-year check up on the economy. And it's pretty wild to think that we're midway through the year already but here we are. So we're working on those two big shows for you so mark your calendars for June 6th and June 13th. We're going to be watching the situation in Washington so stay with Fidelity for the latest. I'm Heather Hegedus on behalf of Jurrien Timmer and Ashley Tran. Hope you have a great week.

HEATHER: We're going to miss you, but you will be with us after your maternity leave, right?

LEANNA: Yes, come fall.

HEATHER: All right, that sounds great. All right, wish you all the best. Thank you so much for joining us today, everybody, for Market Sense and we'll see you right back here next week. Have a great day.

¹NPR, April 29, 2023: <https://www.npr.org/2023/04/29/1172894580/congress-has-revised-the-debt-ceiling-78-times-since-1960-a-financial-historian->

²NBC News, May 1, 2023: <https://www.nbcnews.com/politics/white-house/treasury-says-us-will-hit-debt-limit-early-june-1-sooner-expected-rcna82323>

³Fidelity May 2023: <https://www.fidelity.com/learning-center/trading-investing/debt-ceiling>

⁴Aug. 5, 2011 CNN: https://money.cnn.com/2011/08/05/news/economy/downgrade_rumors/index.htm

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