

Our Thoughts on the US Credit Rating Downgrade

On Friday evening, Standard & Poor's took the unprecedented step of downgrading the long-term U.S. credit rating to AA+ from AAA, and Monday is likely to be a wild day in global financial markets. It is difficult to quantify at this point how investors will react to the downgrade. While there may be a knee-jerk reaction in the fixed income markets, we do not expect a lasting surge in borrowing costs as U.S. Treasury markets remain one of the largest and most liquid in the world. Less liquid fixed income markets will be harder hit if riskier assets around the globe are sold on this news.

The issue for equity investors is the impact on the confidence of consumers and businesses to spend and invest. Given several recent events, especially the uncertainty created by the political circus in Washington around the debt ceiling, the probability of economic growth accelerating in the second half of the year has decreased. This will likely have an impact on earnings expectations in future quarters. However, markets come into this week very oversold and valuations are attractive on trailing earnings.

We have taken some modest steps to reduce risk in portfolios over the past several weeks, and have had discussions today about possible impacts on portfolios. Our actions will be influenced by the response of policy makers to the debt downgrade in the U.S., the debt concerns in Europe, and the economic impact of these events. As we write this, the European Central Bank has just announced a plan to support the bond markets in Italy and Spain with open market purchases in a bid to stabilize bond markets across Europe.

We will continue to monitor the situation and potentially take further action as we get better indications on the impacts to global markets and economies.