Pacific Crest Financial Advisors, LLC

The US Credit Rating Downgrade

As you likely know, Standard & Poors (S&P) announced Friday evening that it was downgrading the US sovereign credit rating from AAA to AA+. The other two primary credit agencies (Moody's and Fitch) continue to maintain their AAA rating for the US. Naturally, this unprecedented step has triggered immense debate, interest and concern.

As these are really uncharted waters, it is of course difficult to be precise and accurate about the movements in specific markets. The constant remains that these are markets where you do not want to be forced into transactions unless there is a changed view in the fundamentals or an emergency liquidity need. Instead, the key is to remain diversified. Looking forward, we would anticipate markets to be volatile due both to the downgrading and the continued worry surrounding the European debt crisis.

Longer-term the impact may lead to weakening the effectiveness of the US as the global economic support. While this may play out over time some of the immediate impact may be delayed due to the fact that no other country is able and willing to replace the US as the core of the global system. Thus, other than the expected general increase in risk premiums and volatility, it is hard to predict with a high degree of conviction how the global system will react. Will it come to a new normal (with AA+ as the core) or will further structural changes be inevitable?

While all of this seems glum, this downgrading may also hold a silver lining. It may serve as a wakeup call for the policymakers and send a loud signal regarding the country's eroding economic strength and global standing. Ultimately, it points to the need for a stronger initiative through focused economic policymaking and more coherent governance. Hopefully this will lead to a longer-term solution that will put the US back on a path to economic prosperity. A large portion of S&P's reasoning for the downgrade was the current state of the US government and their seemingly widening party gaps (not just the financial figures behind the current economy). Below are two key points that S&P stated in their downgrade:

- The downgrade reflects our opinion that the fiscal consolidation plan that Congress and the Administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term debt dynamics.
- More broadly, the downgrade reflects our view that the effectiveness, stability, and predictability of American policymaking and political institutions have weakened at a time of ongoing fiscal and economic challenges to a degree more than we envisioned when we assigned a negative outlook to the rating on April 18, 2011.

So, while there will continue to be various opinions abounding and fingers being pointed due to this downgrade and the future expectations, we hope that this alarm will ring loudly enough in Washington to prompt leaders to work with a consensus in dealing with the economic pressures we are facing.

At the close of the markets on Monday we were effectively set back roughly 10 months for the Dow, S&P 500 and the Nasdaq indexes. Here is a little more information on each:

- The Dow closed Monday at 10,810 (with a 52 week range of 9,916 to 12,929).
- The S&P 500 closed Monday at 1,119 (with a 52 week range of 1,011 to 1,371).
- The Nasdaq closed Monday at 2,358 (with a 52 week range of 2,099 to 2,887).

Do remember that most of our clients retain a sizable fixed income allocation where we have not seen the volatility of the equity market. Ultimately, regardless of what happens in Washington, Europe and globally, we will do our utmost to continue to deliver to you the investment management and financial/life planning quality that you have come accustom to.

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