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Debt Ceiling Q&A

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Q) What is the debt ceiling?
A) The debt ceiling is the maximum limit, set by Congress, that the US is authorized to borrow to meet its obligations, such as Social Security, Medicare payments, government salaries, Treasury debt, and other payments. Since the debt ceiling concept was introduced in 1917, Congress has voted to increase or suspend it more than 100 times, 78 of those times having been since 1960.

Q) When will the Government reach the debt ceiling?
A) The Government technically reached the debt ceiling at the beginning of this year. Since then, the US Treasury has been using extraordinary measures to buy Congress time to raise the debt ceiling. However, Treasury Secretary Janet Yellen recently opined that the Government could be at risk of defaulting on some of its payment obligations as soon as June 1st - or shortly thereafter – if the ceiling is not raised.

Q) Why is the debt ceiling so important?
A) Once the debt ceiling is reached and the Treasury's extraordinary measures are exhausted, the US government will no longer be able to pay all its obligations. This would mean the US would enter technical default. If this happens, the US government will have to decide which obligations to pay until the debt ceiling gets raised. Secretary Yellen has recently said that it would be up to the President to determine which obligations get paid once the debt ceiling is reached and the extraordinary measures are exhausted.

Q) How likely is it be that the US enters technical default?
A) Not likely. The odds do appear greater than previous times the Government approached its debt ceiling, but that's not the base case. If history is any indication, there will be a lot of partisan political bickering until the 11th hour, at which time Congress will likely come to agreement on an increase of the debt ceiling, although likely through a compromise that gives neither party much satisfaction.

Q) Why is this happening now?
A) The current polarized political climate in the US creates risk that these matters requiring compromise and collaboration take longer to address than they otherwise should. The last time we saw similar political posturing was in 2011.

Q) What happened then?

A) In 2011, the debt ceiling was the major topic of discussion. The uncertainty of when/if Congress would raise the debt ceiling caused the stock market to fall about 20% in the two months leading up to the resolution to finally raise the debt ceiling. During that time, one of the major rating agencies downgraded the US debt rating to AA+ from AAA. This does not mean that will happen this time.

Q) Should our clients be concerned about their portfolios?

A) No. The portfolio team has positioned our clients' portfolios to be defensive, which should allow us to capitalize when the markets return to a more favorable risk-to-reward outlook. However, if our clients have any questions or concerns, we encourage them to reach out to their advisor. The peace of mind of our clients is of utmost importance to us.