Retirement News Highlights

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Fitch credit downgrade isn't worrying institutional investors; seen as political warning

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Fitch Ratings on Tuesday announced it had downgraded the U.S. long-term credit rating to AA+ from AAA, citing government dysfunction related to the debt ceiling.

Institutional investors see no immediate negative consequences, seeing it more as a warning regarding the political environment to the U.S.

"The ratings downgrade itself is largely inconsequential, other than the reminder it serves that fiscal profligacy has consequences," said David G. Eichhorn, CEO and head of investment strategies at NISA Investment Advisors, in an email. "Most notably, whether through future fiscal policy of relative austerity or monetary reaction to the continued disregard of deficits, the bill will eventually come due that will inherently be a drag on U.S. growth."

"My concerns are regarding the 'sovereign ceiling rule,' which stipulates that a corporation's debt rating cannot exceed that of the country where it is incorporated," said Charles Van Vleet, assistant treasurer and CIO of pension investments at Textron Inc., Providence, R.I., who oversees $13 billion in retirement plan assets, in an email. "Currently, the ratings agencies have not made their stance clear on whether they intend to enforce the sovereign ceiling rule in the U.S."

Fitch later on Wednesday issued a release that said the downgrade of U.S. debt "will not trigger negative ratings actions for U.S. non-financial corporates, since there are no direct linkages to the sovereign rating."

Alec Phillips, Washington-based chief U.S. political economist in the U.S. economics group within Goldman Sachs' global investment research unit, wrote in a Wednesday note that Fitch's downgrade "mainly reflects governance and medium-term fiscal challenges, but does not reflect new fiscal information."

As such, Mr. Phillips noted, the downgrade should have "little direct impact" on financial markets since it is unlikely that there are "major holders of Treasury securities who would be forced to sell based on the ratings change."

He also said that when ratings agency S&P downgraded the U.S. sovereign rating in August 2011, it led to a "meaningfully negative impact on sentiment," but resulted in "no apparent forced selling at that time."

Goldman Sachs had about $2.7 trillion in AUM as of June 30.

George L. Ball, Houston-based chairman of Sanders Morris Harris, an investment firm with $4.9 billion in assets under management, said by email that the downgrade will have no important impact on yields or the role of U.S. debt, either domestically or internationally. "It is a warning to politicians, not a meaningful market mover," he added.

Treasury Secretary Janet L. Yellen criticized Fitch for the downgrade. In a statement, she said she strongly disagreed with Fitch's decision and said it was "arbitrary and based on outdated data."

Fitch's quantitative ratings model declined markedly between 2018 and 2020, Ms. Yellen added, and "yet Fitch is announcing its change now, despite the progress that we see in many of the indicators that Fitch relies on for its decision."

Some of these measures, including those related to governance, she noted, "have shown improvement over the course of this administration, with the passage of bipartisan legislation to address the debt limit, invest in infrastructure, and make other investments in America's competitiveness."

Ms Yellen asserted that Treasuries "remain the world's preeminent safe and liquid asset, and that the American economy is fundamentally strong."

Harry Richards, investment manager, fixed income at Jupiter Asset Management, agreed that the 2011 downgrade should serve as a playbook, noting it "did not generate any material sell-off in Treasuries, while risk assets saw some volatility."

"We expect a weaker U.S. economy, and we think that is ultimately going to have repercussions on the path for monetary policy, leading to lower yields on U.S. Treasuries," he said in an emailed statement. "While we acknowledge external credit ratings, our views on default risk are based on our own research and thinking. In our opinion the U.S. remains extremely unlikely to default and given where rates have moved, we believe treasuries offer great value at these levels given their ability to provide protection in an economic downturn."

Jamie L. Patton, Los Angeles-based managing director and co-head of global rates at TCW Group, said that the downgrade will have no "meaningful impact" on bond markets or on portfolios.

"This was not really a surprise since Fitch had been warning for a while that they would be downgrading the debt," she said in an interview.

Any impact from the downgrade would have been manifested by forced selling of Treasuries, but that is unlikely to occur, she noted.

Treasuries remain a high-quality investment, she added.

TCW had $210 billion in assets under management as of June 30, 2023.

"We don't believe Fitch said anything particularly surprising so we don't believe the downgrade alone will have a long-lasting effect on markets" said Rhys Williams, Bryn Mawr, Pa.-based chief strategist at Spouting Rock Asset Management, by email. "We do think it does serve as a reminder that all is not perfect in the world and that long term the U.S. government faces structural budget issues and a political system that has shown little interest in solving long-term issues."

Mr. Williams added that earnings this week from tech giants Apple and Amazon will be even more important now that the market mood has become more apprehensive. "But we think if those stocks respond well to earnings, that the Fitch downgrade will recede into memory," he said.

Spouting Rock has about $3.1 billion in AUM.

Brian Mulberry, Denver-based client portfolio manager at Zacks Investment Management, said the impact of this downgrade will likely mean that the U.S. Treasury will need to boost its offering yields to attract buyers across maturities, which will increase the interest burden paid by the Treasury.

"Bottom line here is that government spending has accounted for a lot of the growth recorded this year (including job creation), and if those resources will be redirected to cover the growing interest burden, then it will likely negatively impact growth," he said by email. "Will this cause the Fed to lower interest rates? Not in the very near term, but based on the Treasury Department's statement in response to Fitch, there will certainly be pressure there, but that is mainly a political issue at the moment and the Fed is likely to remain focused on prices/inflation."

Zacks has $13.9 billion in AUM.

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