Investment Insight
The Debt Ceiling: Always Under Construction

The Masters — the annual golf tournament in Augusta, Georgia — has promoted itself as A Tradition Unlike Any Other for four decades. It’s great marketing.

While not an annual tradition, the U.S. “debt ceiling” has become Another Tradition Unlike Any Other, minus the great marketing.

The debt ceiling is a legislative limit on the amount of national debt that can be incurred by the U.S. Treasury, thus limiting the risk of a public debt crisis. The challenge is that the debt ceiling is a nominal figure — currently $31.4 trillion — which needs to be continually revised as the size of the economy grows.

If you want a short explainer, you can read Morningstar’s “The Debt Ceiling: A Quick Guide.”

The obvious risk is that a new limit can’t be agreed on, which could lead to a technical default of the U.S. government. Treasury Secretary Janet Yellen said recently that failure to raise the debt ceiling will cause a “steep economic downturn” in the U.S., and she reiterated a previous warning that the Treasury Department may run out of measures to pay its debt obligations by June.

“Steep economic downturn” was only some of the colorful language Yellen used. Additional language included, “financial and economic chaos,” “economic calamity,” and “constitutional crisis.”

Nothing creates urgency and draws viewers in quite like selling fear and outrage. Given that the debt ceiling is a political matter, the media coverage will likely continue in that direction. It’s fair to assume this political process will play out like many others.

In short, a large portion of the process will be political theater.

There’s much that can be speculated about: micro details of the debt ceiling, negotiating tactics, who’s to blame, and what the final resolution might be.

But there’s also an evidence-based approach, looking at historical precedent and examples. This approach won’t provide certainty, but it can provide more clarity.
**Historical Precedent**

Both sides have taken turns putting pen to paper lifting the ceiling. Since 1959, every president has increased the debt ceiling. It has been increased 89 total times since Dwight Eisenhower’s presidency.

**Exhibit 1**

*Increases to the Federal Debt Ceiling by President: 1959 - Present*

![Bar graph showing increases to the debt ceiling by president.](image)

Source: Morningstar.

It’s happened 53 times under a Republican president and 36 times under a Democratic president over the past 60 years. Because of that, we should probably expect number 90 soon.

We call it a debt ceiling, but if the ceiling is under constant construction, it’s not much of a ceiling.

**Recent Parallels**

In 2011, Standard & Poor’s downgraded the U.S. credit rating. It was a major moment.

The below excerpt is from a Reuters article after it happened:

> The United States lost its top-tier AAA credit rating from Standard & Poor’s in an unprecedented blow to the world’s largest economy in the wake of a political battle that took the country to the brink of default.

> S&P cut the long-term U.S. credit rating by one notch to AA-plus on concerns about the government’s budget deficit and rising debt burden. The action is likely to eventually raise borrowing costs for the American government, companies, and consumers.

> The move reflects the deterioration in the global economic standing of the United States, which has had a AAA credit rating from S&P since 1941, and it could have implications for the U.S. dollar’s reserve currency status.
Sounds horrifying, right?

These were the returns of various bond indexes one year after the downgrade:

**Exhibit 2**

**Bond Returns: August 2011 - August 2012**

Source: Morningstar. Indexes shown are unmanaged and not available for direct investment.

Bonds rallied because interest rates fell.

What about stocks?

The U.S. stock market got a lot bumpier after the S&P downgrade. The downgrade was made public on Friday, Aug. 5, 2011, after the market closed. The following week, the stock market went for a wild ride.
Disclosure: Indexes shown are unmanaged and not available for direct investment.

There were big up days and big down days as the market filtered through the news. It was a volatile time to say the least.

But only a year later, the S&P 500 was up nearly 20%. By October 2011, only three months after the downgrade, the S&P had declined 8% but a furious rally followed thereafter.

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$31 Trillion in Context
There’s been an explosion in federal debt. The federal debt level was $15 trillion in 2011. Today, it’s approximately $31 trillion.

Total debt levels in the U.S. have doubled in roughly 10 years. If you only had that data point in isolation, it’s fair to assume the U.S. is a nation stuck inside a debt spiral.

But numbers, especially ones that large, have nuance associated with them. For example, look at the interest the U.S. pays on debt as a percentage of GDP.

Exhibit 5
Federal Outlays: Interest as Percent of GDP

Interest payments on debt are much lower today than the 1980s and 1990s. We can still afford to pay our debts even though the amount of debt has risen substantially.

The debt was lower in the 1980s/90s, but rates were higher—and the size of the economy was obviously much lower as well. In 2011, U.S. GDP was $15 trillion. Today, it’s more than $26 trillion. The simplest observation would be that federal debt will continue to grow as the economy grows. But ultimately, the entire pie will expand.

The debt number is worrisome, but it’s something people have been worried about for 50 years. This was the cover of TIME magazine in March 1973:
The debate will always carry with it the potential for short-term volatility, but that’s nothing new. There is always the chance of short-term volatility.

**Focus on What You Can Control**

Warren Buffett has the concept of a “too hard” pile. In Buffett’s world, if he doesn’t understand a business or industry, he puts it in his “too hard” pile and moves on. In effect, you don’t have to be a master of the universe on every subject.

If people want to follow the political process of the debt ceiling because they enjoy it or find it interesting, of course they should do so. But from an investment perspective, the subject belongs in the “too hard” pile.

Advisors should keep clients focused on what they can control and invite them to ignore the rest. For example, we have no control over politics, tax policy, the economy, or the sequence of market returns. However, we do have control over setting goals, maintaining an asset allocation, controlling costs, and keeping our emotions in check.

Admittedly, it’s more interesting to debate politics than the boring task of focusing on what you can control. But getting the boring decisions right can make a world of difference over time.

Jon Rahm won the 2023 Masters with a short putt—and the U.S. government has a short putt ahead.

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