

Carl P. Sherr & Co., LLC – Addressing the S&P downgrade

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As you know, the ratings agency Standard & Poor's announced Friday evening that it was downgrading the credit rating of the United States from AAA to AA+ and it also assigned a negative outlook to this new rating. This unprecedented step has naturally raised many questions. To help our clients better understand the announcement and the implications, we have compiled a list of frequently asked questions.

Should I be worried?

It's a natural reaction to be concerned—but don't panic. We think the downgrade is a critique of the U.S. political system rather than a default probability. According to S&P: "*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.*"

Are U.S. bonds safe?

Yes. According to Warren Buffet, our debt is still AAA but our currency and our government are not AAA.

Will this cause interest rates to go up?

In theory, a downgrade will force interest rates higher to compensate for added risk (i.e. Greece). However, even after the downgrade, U.S. treasury bonds are still considered a safe haven and that will keep our interest rates low in the near term.

How will this affect stocks?

The downgrade will have an immediate impact on confidence which will cause stock markets to be volatile. Sentiment will also be impacted by what is taking place in Europe. What's hard to measure is the ability of our leaders in Washington DC to fully address the issues and restore confidence in the markets.

How accurate are these ratings?

Ratings are based on economic assumptions and models. Therefore a rating is an opinion and not a fact. It's important to note that Moody's and Fitch (the other two major ratings agencies) have not issued downgrades and still maintain the U.S. with a AAA rating. It's interesting to note that during the housing bubble, ratings agencies like S&P assigned AAA ratings to mortgage backed bonds that in hindsight should not have been rated on par with U.S. treasury bonds. It was a huge error that impacts their overall credibility.

In closing, while the ratings change is a historical event that will be with us for years to come, we hope it will be a 'wake up call' to our elected leaders to come together and make the tough decisions that will put us on a path to economic prosperity. We are maintaining our portfolio allocations but rest assured that we are closely monitoring the situation and we are here to answer any questions. Please do not hesitate to call or email.
