PRIVATE CLIENT SOLUTIONS

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Market Commentary

The Debt Ceiling: Tempest in a Teapot?

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The Debt Ceiling: Tempest in a Teapot?

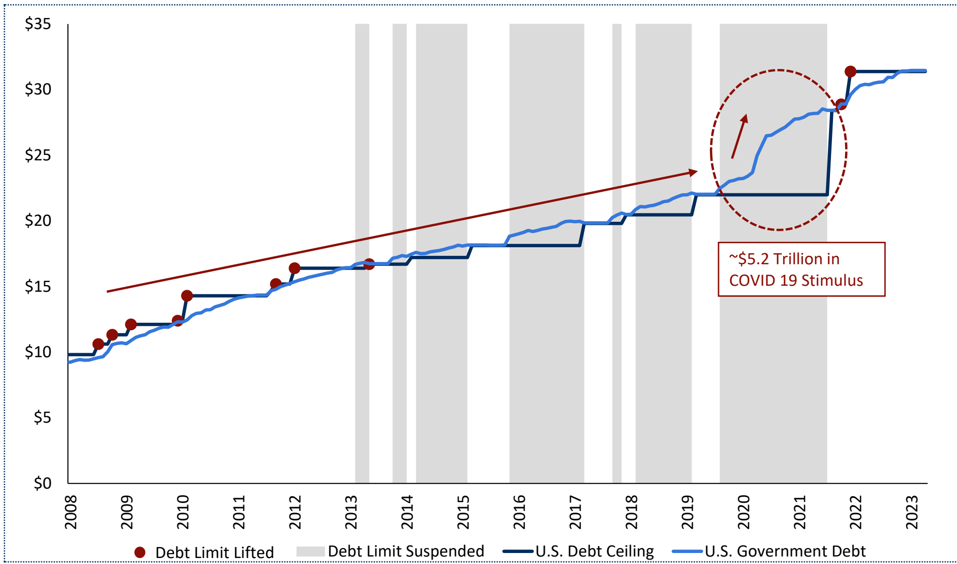
It's difficult to get through an hour of business (or political) news lately without hearing about the U.S. debt ceiling. While the prospect of the U.S. government running out of cash to repay lenders and make other payments would obviously be a dire and globally impactful event, it would also be an entirely self-inflicted wound. Negotiations are not about if the debt ceiling should be raised, but rather what type of spending constraints the government should be subject to over the next few years and revisions to some previous programs and initiatives. As such, we expect the two sides of the House to reach a compromise and raise the debt ceiling before any significant harm falls on the U.S. (and the global) economy, and importantly, before voters endure any material hardship that might impact their support for their respective elected representatives.

The most recent comments from Treasury Secretary Janet Yellen suggest June 5 as the deadline to effect the ceiling increase. With a tentative deal seemingly moving to both houses of Congresses for approval, by the time this report is published on June 1, the deal may be reached or there may be a temporary solution to continue paying bills for a short period while details on a more permanent deal are hammered out. Irrespective of these outcomes, it is worth noting why the U.S. seems to be going through this process on an almost annual basis and why investors should try to cut through this type of noise and remain committed to well-established long-term investment plans.

How Did We Get Here?

Perhaps a quick history lesson could be useful at this point. In 1917, Congress enacted the Second Liberty Bond Act, which set a limit on how much the U.S. Treasury could borrow. Prior to that, each bond issuance had to be approved with a legislative act. Since then, the debt limit has been increased over 90 times, including 78 times since 1960, or roughly once a year or so, as the country's borrowing needs grew. Most occurred without much fanfare, but with remarkable flair a few times in the recent past.

U.S. Government Debt Is About to Hit Its Limit for the 79th Time Since 1960



Source: Bipartisan Policy Centre; FactSet; Raymond James Ltd.; Data as of April 30, 2023, in trillions of U.S. dollars.

What Is the Comparison to 2011 and 2013?

In 2011, similarly to 2023, Republicans refused to approve a debt limit increase without concessions on government spending. A bitter bipartisan negotiation ensued, with an agreement coming only hours before the deadline. In 2013, a deal was struck with just one day to spare. The 2011 event was so dramatic that it prompted S&P, one of the top rating agencies, to lower the credit rating of the United States from AAA to AA+. Now, in 2023, another agency, Fitch Ratings, has warned of a potentially similar move.

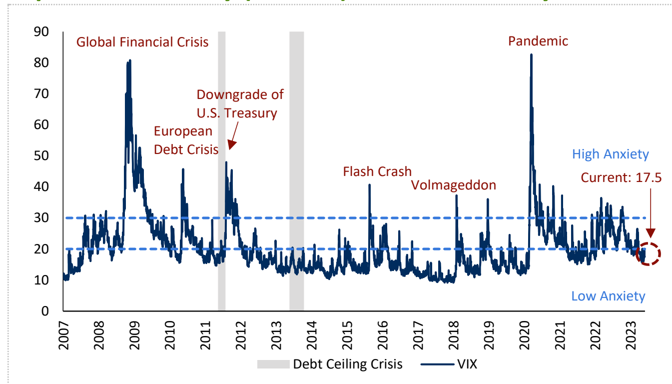
What Would Happen Without a Deal?

The question has not really been if they would reach a deal, but rather how close to the wire negotiations run. Even if discussions run past the dreaded x-date, the Treasury can still employ "extraordinary measures" to keep cash flowing for the short term. Suspending the ceiling, functionally allowing the Treasury to exceed its debt limit, has actually been invoked seven times in the last 10 years.

How Have Markets Reacted So Far?

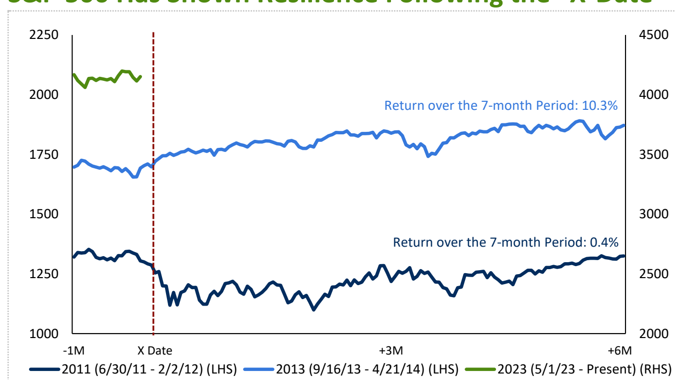
As we saw in 2011 and 2013, the primary assets impacted by these near misses are short-term treasury bills, as investors worry about how repayments could be impacted. For the most part, equity markets have been shrugging off the potential dire consequences of a default, as evidenced in the VIX, which we can use to gauge expectations of anticipated volatility or negative reactions. We are currently sitting below 20, which is generally a level of low anxiety, versus the high anxiety benchmark of 30 expected during periods of more serious concern. If politicians stay true to form, expect negotiations to run right down to the wire. There is always the potential for a short-term negative reaction in times of uncertainty, but we would expect any ensuing recovery to be relatively swift.

Expected Volatility (the VIX) Is Still Relatively Low



Source: FactSet; Raymond James Ltd. Data as of May 30, 2023.

S&P 500 Has Shown Resilience Following the "X-Date"



Source: FactSet; Raymond James Ltd. Data as of May 25, 2023. "X-Date (2011)": August 2, 2011. "X-Date (2013)": October 17, 2013. "X-Date (2023)": June 5, 2023.

The Final Word

Despite the headline-grabbing noise around the debt ceiling, remember that there are multiple and more fundamental issues that support/impact asset valuations. Investors should remain committed to their well-established long-term plans.

For Long-Term Oriented Investors: Stay Invested and Well Diversified

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD
Em.Mkt Equities 43.5%	Canadian Equities 17.6%	US Bonds 10.4%	Em.Mkt Equities 16.5%	US Equities 41.3%	US Equities 23.9%	US Equities 21.6%	Commodities 23.0%	Em.Mkt Equities 28.3%	US Bonds 9.1%	US Equities 24.8%	US Equities 16.3%	Commodities 36.1%	Commodities 16.5%	Int'l Equities 11.8%
Canadian Equities 35.1%	Commodities 14.5%	Canadian Bonds 9.3%	Int'l Equities 16.2%	Int'l Equities 29.5%	US Bonds 15.5%	US Bonds 20.5%	Canadian Equities 21.1%	Int'l Equities 16.9%	US Equities 4.2%	Canadian Equities 22.9%	Em.Mkt Equities 15.0%	US Equities 27.6%	Cash 1.7%	US Equities 7.9%
Commodities 29.0%	Em.Mkt Equities 10.4%	US Equities 4.6%	US Equities 13.4%	Balanced Portfolio 14.7%	Balanced Portfolio 12.4%	Int'l Equities 18.7%	US Equities 8.1%	US Equities 13.8%	Cash 1.3%	Int'l Equities 15.9%	Balanced Portfolio 9.3%	Canadian Equities 25.1%	Canadian Equities -5.8%	Canadian Equities 7.2%
Balanced Portfolio 12.1%	US Equities 9.1%	Commodities 4.6%	Balanced Portfolio 8.4%	Canadian Equities 13.0%	Canadian Equities 10.6%	Balanced Portfolio 9.3%	Em.Mkt Equities 7.0%	Canadian Equities 9.1%	Canadian Bonds 1.0%	Balanced Portfolio 14.4%	Canadian Bonds 8.6%	Int'l Equities 10.5%	US Bonds -6.7%	Balanced Portfolio 5.8%
Int'l Equities 7.8%	Balanced Portfolio 8.0%	Cash 0.8%	Canadian Equities 7.2%	US Bonds 4.6%	Canadian Bonds 8.3%	Canadian Bonds 3.3%	Balanced Portfolio 6.4%	Balanced Portfolio 8.9%	Balanced Portfolio -0.3%	Em.Mkt Equities 12.2%	Int'l Equities 5.7%	Balanced Portfolio 10.1%	Int'l Equities -8.1%	Canadian Bonds 3.4%
US Equities 7.4%	Canadian Bonds 6.1%	Balanced Portfolio 0.4%	Canadian Bonds 3.4%	Commodities 4.2%	Em.Mkt Equities 4.7%	Em.Mkt Equities 0.5%	Canadian Bonds 1.3%	Commodities 3.8%	Int'l Equities -6.0%	Commodities 10.3%	Canadian Equities 5.6%	Cash 0.0%	Balanced Portfolio -9.6%	Em.Mkt Equities 3.1%
Canadian Bonds 5.2%	Int'l Equities 2.5%	Canadian Equities -8.7%	US Bonds 1.5%	Em.Mkt Equities 2.8%	Int'l Equities 2.3%	Cash 0.5%	Cash 0.5%	Canadian Bonds 2.4%	Commodities -7.4%	Canadian Bonds 7.3%	US Bonds 5.6%	US Bonds -2.6%	Canadian Bonds -11.7%	US Bonds 2.8%
Cash 0.4%	US Bonds 0.8%	Int'l Equities -10.1%	Cash 0.8%	Cash 0.8%	Cash 0.8%	Canadian Equities -8.3%	US Bonds -1.1%	Cash 0.6%	Em.Mkt Equities -7.7%	US Bonds 3.0%	Cash 0.5%	Canadian Bonds -2.8%	US Equities -12.2%	Cash 1.6%
US Bonds -12.6%	Cash 0.4%	Em.Mkt Equities -16.8%	Commodities -2.0%	Canadian Bonds -1.3%	Commodities -27.8%	Commodities -10.7%	Int'l Equities -2.1%	US Bonds -3.2%	Canadian Equities -8.9%	Cash 1.6%	Commodities -7.8%	Em.Mkt Equities -4.4%	Em.Mkt Equities -14.8%	Commodities -11.6%

Source: FactSet, Raymond James Ltd. Data as of May 15, 2023. All returns are in CAD. Asset classes are represented by: S&P/TSX Composite TR Index (Canadian Equities); iShares Core Canadian Universe Bond Index ETF (Canadian Bonds); S&P 500 TR Index (US Equities); iShares Core U.S. Aggregate Bond ETF (US Bonds); iShares MSCI EAFE ETF (International Equities); iShares MSCI EM ETF (Emerging Market Equities); iShares Premium Money Market ETF (Cash); SP GSCI Commodity Futures (Commodity). The asset allocation of the Balanced Portfolio is 20% Canadian Equities + 20% US Equities + 10% International Equities + 10% Emerging Market Equities + 20% Canadian Bonds + 20% US Bonds.

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