Weekly Commentary 31 – August 2023

Fitch's Warning and the Continuation of a Bond Bear Market

The big news last week came when Fitch, one of the three top credit rating agencies, downgraded US government debt to AA, from the once enviable status of ultimate creditworthiness - "triple A" standing - which enables US short term treasury securities to be regarded as riskless. That standard has also made US Treasury bills to be used as the ultimate standard against which all financial assets in the world can be properly priced.

There you go. In my brief one paragraph summary of the most important financial news last week above, I have outlined the key problem for the world's financial markets. When US government debt falls off its lofty perch as the ultimate risk free asset, there are many problems that will emerge. The higher cost of borrowing for the US government of its huge financial requirements is the easiest to understand. They borrow nearly a trillion dollars every few months. Any shortfall of lenders will spell disaster for the US government and for the country as a whole. A public finance disaster is looming.

For folks not looking at public finance, there is this bigger and somewhat esoteric matter of pricing all other financial securities. If there is no "risk-free rate" against which the markets can base risk assessment on to then derive an appropriate compensatory return, then markets will go haywire. No proper financial analysis can be carried out on the pricing of securities, including other types of bonds, and even stocks. It makes investing similar to standing on quicksand.

Am I exaggerating? Well remember what happened during the Covid years, when interest rates were brought down to zero? At that time, the risk free rate was in fact ZERO. Having the risk free rate at zero poses a problem contrary to what we are facing today. The so-called "dividend discount model", which is used in finance to price all securities, went bonkers, since the risk free rate appears in the denominator of this model, or equation. That means that the price of securities go straight to infinity, which is exactly what we saw. The stock market went soaring into the stratosphere. Nothing wrong with that of course (if you are suitably long the market) except that when the interest rates went back down, the pricing has to be revised. And reversed…

Since the Big Boys of investment, ie institutional investors, tend to follow the broad pricing principles implied in the dividend discount model, we saw stocks plunging in the following year, which was last year, and this deflated stock markets worldwide by some 30%. If you got hurt in this process last year, you should always remember for the rest of your investing

career that it all started with improper pricing when all investors, except those who understood the math of dividend present value pricing, how it got immeasurably distorted by zero interest rates. Be circumspect for the rest of your life.

The current downgrading of the credit worthiness of US government debt will inject similar uncertainty into the financial markets. It will be in the opposite direction as the covid freebie era…

The logic goes like this. If US treasuries are now considered risky, then investors will need to impose a risk premium on these investments, and as the denominator in the dividend discount model goes up, the value implied in the entire equation goes south. That is why when Fitch made its announcement midweek last week, the US stock market slid from its seven month long rally that has run up 30% so far in 2023.

Will this downturn started last week continue? It depends on whether US treasury prices will continue to factor in the uncertainty created by the downgrading. And will the other rating agencies also downgrade US debt? Already, the benchmark 10 year US treasury is at 4.2 percent, the highest level it has reached in a very long time. In theory, stocks should head down. But investors are clinging on to the hope that inflation is slowing, the interest rate hikes are coming to an end, the job situation is kinda robust, and there will be a soft landing for the US economy. That's why the bull market in 2023 went on for so long, until this Fitch announcement hit.

Janet Yellen was not at all happy with the Fitch assessment of course. As reported by Bloomberg, cited below:

Yellen Calls Fitch Downgrade of US Credit Rating 'Flawed'
Christopher Condon

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(Bloomberg) -- Treasury Secretary Janet Yellen on Wednesday slammed the move by Fitch Ratings to strip the US of its top-tier credit rating, calling it "flawed" and "entirely unwarranted."

"Fitch's decision is puzzling in light of the economic strength we see in the United States," Yellen said in remarks prepared for an event in McLean, Virginia.

In the longer term, the US "remains the world's largest, most dynamic, and most innovative economy – with the strongest financial system in the world."

Yellen's criticism is an echo of predecessor Timothy Geithner's almost exactly 12 years ago, when he blasted S&P Global Ratings for "really terrible judgment" in becoming the first of the three most-cited ratings firms to remove the US from the top, AAA tier. Moody's Investors Service is now alone in keeping the US at the highest grade.

Fitch late Tuesday cut the US to AA+, citing an erosion in financial governance, rising budget deficits and expected fiscal deterioration over the next three years.

Treasuries showed little immediate reaction to the Fitch move, but then slid Wednesday morning in the wake of stronger-than-expected jobs data. They accelerated their selloff following a bigger-than-expected plan for increased US debt issuance.

Fitch analysts drew attention to medium-term fiscal challenges that they said have been "unaddressed." By contrast, Yellen has expressed optimism about the longer-term debt picture, saying that inflation-adjusted interest costs aren't historically high. (When you read bullshit like this, "inflation-adjusted interest costs are not high, be very careful…)

The Fitch statement also said the firm anticipates the US to fall into a mild recession in late 2023, a projection that's at odds with the assessment of a number of economists. Wednesday morning, Bank of America Corp. scrapped its own forecast for a recession, becoming the first large Wall Street bank to officially reverse its call. (This is called a flip-flop…)

Yellen said the Fitch decision "does not change what all of us already know: that Treasury securities remain the world's preeminent safe and liquid asset, and that the American economy is fundamentally strong." (Oh really? The Russian GDP growth rate is now on par with the US's rate and that country is facing 11 packages of sanctions…)

Earlier Wednesday, one of Yellen's top lieutenants downplayed any risk of forced selling by investors now that Fitch rates the US at AA+.

"We did not see any evidence of that in 2011" with the S&P event, Treasury Assistant Secretary for Financial Markets Josh Frost told reporters Wednesday. "We continue to see robust demand for Treasury securities." (Well, let's see…)

The debt situation, bad as it was in 2011, is much worse today. The debt is now at $32 trillion, about 120 percent of GDP, which is the biggest it has ever been. So Yellen cannot say that Fitch is unjustified in its downgrade. When an individual borrows more and more, lenders will start to cut back on their willingness to provide more loans. The case is the same for countries. Just look at Japan, it cannot seem to be able to reduce any percentage of its debt, not to say get out of its total indebtedness. The same will happen to the US, and this is essentially what Fitch is warning investors about.

There are other implications. With the lowering of the debt rating, investors will seek higher yields to compensate for the risk. The relative interest rates between the US Dollar and other G7 currencies will change in favour of the Dollar. The US Dollar rate has never been a policy objective for the US central bank or the treasury department. And it will likely be left alone to rise without any intervention to contain it. A stronger dollar is likely in the short term until de-dollarization begins to bite.

In addition, there are many analysts who read deeper into what Fitch is trying to do. For one, the Wall Street Journal has carried the article below to say that the US Fed needs to wake up from its claim that there will be a "soft landing". In an opinion piece by David Malpass, a former president of the World Bank, there is a call for change before the shit hits the fan.

Fitch Tells the Federal Reserve to Wake Up

The credit downgrade shows the urgency of rethinking regulatory, fiscal and monetary policy.

By
David Malpass
Aug. 3, 2023 3:10 pm ET

The essence of Fitch Ratings' Tuesday decision to downgrade U.S. Treasury debt: We're experiencing a slow-motion fiscal train wreck, not a "soft landing," and it's draining global capital and endangering the dollar.

The Congressional Budget Office's June 28 report on the long-term deficit shows that the federal government expects to spend $160 trillion between 2024 and 2040, doubling the public debt. Fiscal deficits would average more than 6% of gross domestic product during that period, well above the historical panic button of 3%, pushing average growth below 2%.

The Federal Reserve has been silent about the conflict between its mandate to provide price stability and the continuing fiscal blowout. Its more than $7 trillion in bonds support Washington's deficit spending by holding down bond yields, blurring the line between fiscal and monetary policy. The New York Fed's April Open Market Operations report describes a plan to buy trillions more in U.S. government bonds, apparently without regard to the issuer's fiscal policies or bond rating.

This undercuts the central bank's independence by exposing it to losses when interest rates rise. It also undercuts growth, considering the Fed will have to continue funding its bond portfolio with interest-paying debt. The central bank currently borrows $3.2 trillion from banks and $2.1 trillion in reverse repos from money-market funds, on which it pays 5.4% and 5.3% in interest, respectively. That creates economic inequality by forcing the necessary savings for short-term floating-rate working-capital borrowers—the heart of private-sector dynamism—into long-term bonds. The crowding out has harmed median income growth since the Fed started building its permanent government portfolio in 2010.

Rather than sound the alarm over this fiscal drain, regulators have protected the status quo. Their power has ballooned since the days of the "Greenspan put" in the 2000s, when Wall Street expected the central bank to pause or cut interest rates to protect stock-market valuations. The Fed can now do much more: by buying huge amounts of bonds, mortgages and repos outright and paying top interest rates to U.S. and foreign banks and money-market funds. The regulators can also back large depositors after bank failures, as they did with

Silicon Valley Bank in March. These powers risk moral hazard—and each payment comes at taxpayers' expense without the accountability of Congress's appropriations process.

Fitch's downgrade won't change Washington's embedded antigrowth policies, but it is a reminder that the numbers don't add up and that financial markets worldwide still have to divide up the losses from months of rising interest rates.

Yet it's still possible to salvage the U.S. growth model. On the fiscal side, Congress needs to rewrite its debt-limit law so that it forces spending restraint—not debt default. Regulators need to put additional onus on the financial system and capital markets to assess risk rather than avoid such assessments by imposing a blanket increase in capital requirements. The latter course, which regulators have charted since SVB's failure, will further reduce dynamism without making the financial system safer.

On the monetary side, the Fed should protect the dollar and recognize its major influence on the economy's productive capacity. The central bank should pivot from its bond-heavy balance sheet, which distorts capital flows, favors the wealthy and creates a conflict of interest with the Fed's primary regulatory and monetary responsibilities.

The downgrade is a clarion call to rethink fiscal, monetary and regulatory policies. With Europe, Japan and China nearly stagnant, the most important swing factor in the global growth outlook is U.S. private-sector innovation. To reach its potential, that ingredient can no longer be stalled by regulatory mandates and government's passion to grow and pick winners and—mostly—losers.

Mr. Malpass served as president of the World Bank, 2019-23, and undersecretary of the U.S. Treasury, 2017-19.

But that's not all. The Financial Times also weighed in and published an article on the political ramifications of the downgrade.

FT Opinion: Fitch Ratings Inc - There is political logic to Fitch's downgrading of US debt

A divided Congress is in no position to tackle America's serious fiscal problems

GILLIAN TETT

Sometimes the gods of finance deliver choreography that might make future historians chuckle. This week in America provided one such moment.

On Tuesday, the special counsel Jack Smith announced a blistering new indictment against former US president Donald Trump for allegedly launching "an unprecedented assault on the seat of American democracy".

And on the very same day, the credit rating agency Fitch stripped America of its hallowed AAA tag, echoing a similar 2011 move by Standard & Poor's. This means two out of the

three big rating agencies have now downgraded treasuries — never mind that these supposedly define the "risk-free" benchmark for global finance.

At first glance, these two announcements might not seem linked — and they were certainly not co-ordinated. But the coincidence is symbolic. For what they collectively signal is that America's political economy is heading into uncharted waters, with an alarmingly wide range of potential outcomes. Investors should take note, regardless of their views on the wisdom behind the move by Smith — or indeed Fitch.

To understand why, it pays to peruse the details of Fitch's announcement. In decades past, rating agencies have assessed the creditworthiness of America primarily by analysing its economic and financial fundamentals. For as any student of finance knows, one difference between emerging markets and developed countries is that the former have traditionally been deemed more prone to political risk, and developed countries less so.

In Tuesday's announcement, Fitch analysts did duly cite some statistics. "We expect the general government deficit to rise to 6.3 per cent of GDP in 2023, from 3.7 per cent in 2022, reflecting cyclically weaker federal revenues, new spending initiatives and a higher interest burden," they noted, predicting "a further widening to 6.9 per cent of GDP in 2025".

Meanwhile "the interest-to-revenue ratio is expected to reach 10 per cent by 2025 (compared to 2.8 per cent for the 'AA' median and 1 per cent for the 'AAA' median") and the "debt-to-GDP ratio is projected to [reach] 118.4 per cent by 2025 . . . two-and-a-half times higher than the 'AAA' median of 39.3 per cent of GDP." In plain English: America's debt data is far worse than any other top-rated country, and likely to deteriorate.

Of course, as many economists angrily retorted, America is not exactly a "normal" country. Since it enjoys the (in)famous "exorbitant privilege" of printing dollars, it can always repay its debts — if it chooses.

Moreover, Fitch itself noted that some of those debt statistics have actually improved recently: debt-to-GDP, say, is slated to be "only" 112 per cent in 2023, down from 122.3 per cent in 2020. No wonder that Janet Yellen, Treasury secretary, dismissed the downgrade as "arbitrary and based on outdated data".

But what many critics failed to realise is that this downgrade has less to do with economics than with politics — or "governance", to use the polite euphemism the rating agency repeatedly cites. For even if Washington can theoretically pay its bills and cut its debt, that does not mean it actually will; or not with 100 per cent probability. There is a new ripple of policy risk.

One sign of this is that bitter Congressional battles keep exploding over the debt ceiling. And while the last such stand-off was resolved in June, the shouting — and threats about a government shutdown — may return this autumn when negotiations restart over the 2024 budget.

The broader issue, however, is that the political ecosystem is so polarised that it is hard to imagine Congress taking the sensible steps needed to tackle America's fiscal problems. These include hammering out a bipartisan bill to overhaul social security, reviewing spending

and reforming the tax system. There have not been any serious initiatives along these lines since the 2010 Simpson-Bowles commission — and that failed.

That is why this week's accidental choreography matters. If Smith's legal onslaught knocks Trump out of the 2024 election race in a way that enables centrist political forces to prevail, it is possible to imagine a future scenario where sensible bipartisan fiscal policies might emerge in Congress to tackle that debt.

But right now Trump is leading the Republican field, by some way, and the indictments are energising his base. At best, this will ensure that the 2024 race is bitterly polarised, making bipartisan initiatives impossible. At worst, if Trump wins back the presidency (which cannot be discounted), this will unleash profound policy uncertainty.

This is a populist, after all, who has vowed to take revenge on his enemies by gutting the civil service. The last time he was in office he threatened the independence of the Federal Reserve, delivered big unfunded tax cuts and failed to trim spending. More recently, he has pledged to block reforms of social security or Medicare, and pledged to extend expiring tax cuts.

So while it might seem fair to question some of the economic logic — as well as the timing — of Fitch's move, the rating agency's fears about rising policy risk looks spot on. What the loss of that AAA tag really reveals is that America is being judged less like a developed country, and more as an emerging market. Uncle Sam should weep.

gillian.tett@ft.com

The FT article can be read to be very bearish about American public finance. Given the deep divisions in the country, there is very little hope that the two sides – Democrats vs Republicans – can come to agree on anything. Certainly not how to spend money, or worse still, find the means to pay for it.

An astute investor among our shareholders asked me last week if this is the end of America. Will this end in a Soviet Union type collapse or a sterling collapse at the least?

Based on the materials I have highlighted above, especially the FT article, the US debt crisis certainly indicates ominous trends going forward. As Tett at the FT says, there is no semblance of policy governance in existence. Imagine any company in which the board or the management team is divided like that…bankruptcy is guaranteed. I will elaborate as follows:

1) US lawmakers and in fact most US politicians are not attuned to the current economic situation in the country. Yellen is a good economics practitioner but nobody ever listens to her, and both the Administration and Congress simply ignore her when she tries to hem

in spending. All that the US political class want to do is to spend money without restraint. They continue to think that it is an American privilege to pay all its debts by printing money, incurring an interest rate of zero. Those days are coming to an end, as the world starts to de-dollarise (meaning countries don't want to be paid in dollars) and as interest on US debt rise inexorably and significantly.

2) America cannot seem to refrain from incurring exorbitant military expenditures. It imagines enemies everywhere where none exists. It seems to have deep fears of its own inadequacies. The Ukraine war is an example. The country is steeped in Russiaphobia since McCarthyism, when there is no need to be since Russia phased out communism as a ideologically opposite form of government. As for the "authoritarianism" pronounced by the Biden Administration to be so abhorrent, if the Russia people don't mind it, who is Uncle Sam to complain about it? Russians have just as much right to choose their form of government as Americans have in their own country. As such, for the last thirty years, the US has had the attitude that it was a victor in the cold war and therefore did what all conquerors do since time immemorial – bully the vanquished and dictate terms to its sole benefit. In the Ukrainian case, it kept taking on more NATO members, contrary to commitments made in 1989, and extending the eastern boundary of NATO to the borders of Russia. Well, the US didn't tolerate Cuba being in the Russian camp in 1962 either, right? The reaction to Russia over the use of Ukraine as a proxy to challenge its existence is just the same. This means that the US has actively created the circumstances to spend a lot of its national budget to support yet another war. A couple of trillion here and there a year, and over 20 years, it all adds up. Let's not also forget how it is also gearing up militarily to take on China, arguably the largest economy in the world on PPP terms, some 20-30 percent larger than the USA in real spending terms.

3) The US government is incapable of ever considering broad based taxes to pay for its expenditures. Since "read my lips" Bush Sr, raising taxes is considered anathema for a successful political career. It is not part of the qualification of running public finance. Since all American politicians are like that, the corollary is that nobody in government in the US is qualified to run government finance. Imagine that!

This Fitch downgrade is almost entirely the fault of the politicians. In the US, they play games such as fighting each other until the last moment, as they take budget battles into brinksmanship and pretend as though lenders will tolerate their games forever. Well, now Fitch has represented the investor class to tell the political class that there is a limit to their tolerance. Enough is enough, and the penalty for mismanaging the debt (ie the bond market) is that the Treasury will have to pay more to borrow. Therefore, we have not seen the end of higher borrowing rates yet. Not by a long shot.

With the gradual eclipse of the banks, "shadow banking" has emerged as a major part of the financial system. At $240 trillion, this system is now far bigger than its conventional counterpart. The bond market is its main component, taking money from investors who can

easily yank it away at short notice and funnel it into other investments. The bond market, boring as it may seem, is at the center of all financial markets and the way of life in the 21st century in capitalist societies, where people are always willing to leverage capital to make more resources available to spend on current wants and desires… To hell with the future. Savings is not a desirable behavioural trait in modern America. The existence of the bond markets and its perpetual growth is testimony to this uniquely American phenomenon.

The problem of how to tame shadow banking – the epitome of leverage to extract more resources for meeting current wants - is one of the toughest problems in finance today. For the financial system as a whole, it is arguably better that these borrowing risks are spread across a vast decentralized web of international investors, rather than concentrated in a narrow clutch of banks compliant to the wishes of central banks. In this new balance of financial power, the lenders via the international bond market are in control. The importance of the bond markets has been demonstrated for decades. During the 1980s there was Michael Milken who took junk bonds to a new zenith when he controlled the M&A market. Then Lew Ranieri created mortgage securities which as everyone remembers almost crashed the global economy in 2008. The fundamental idea of both these creative financiers was to package smaller loans into bigger bonds and thereby bringing together more people who needed money to match up to those who had it. It wasn't a bad idea. It made the banks shift risks away from themselves and into markets. The problem is that the tail is now wagging the dog. The bond markets should never be considered to be compliant to the whims of the political class. And in America today, until Fitch said otherwise, the politicians thought they were in control. Hell no, suckers, you are not. The bond markets now control you…

During the covid crisis, the US government led all G7 countries into a zero interest rate environment, thinking this will remove the risk of collapse of their economies. This led to 10 year bonds being priced at ½ percent in yields. Imagine what that means. You lend money to the US treasury for ten years, and they will pay you just ½ interest per year for ten years. For many months, people thought it was a great deal and bought bonds at that yield to their heart's content. By 2021, they woke up and realised it was a shitty idea.

When the pandemic was over, those who bought those bonds suffered massive losses. It was a case of government incompetence that led to the rise and fall of the gigantic global bond market, and till today, bonds are still sliding. Yet, in this incredibly tenuous aftermath of policy mistake after mistake, the Democratic White House is fighting with a Republican Congress as though the country is in good financial shape. It is ignorance and hubris combined together that threatens the well-being of the country.

The bond market, as represented by the 10 year US treasury, is now touching 4.2 to 4.25 for the third time over the course of the past one year. This is the third time we are here – at 4.2 percent yield. And I think this time, it will break. Once it breaks, the bond market will be headed into new bear market territory.

This humble view of mine is reinforced when I read in the Wall Street Journal article that has the following headline, and much of the story is not so different even though there are those sentences that try to provide some balance and redeeming features in American government public finance governance.

Fitch Downgrade Won't Break Washington's Tax, Spending Habits

Republicans and Democrats aren't likely to cut entitlements or raise taxes, leaving debt problems untouched

By
Andrew Duehren

The Biden administration criticized Fitch's decision to downgrade the U.S. credit rating, which the rating agency said was based on political dysfunction. WSJ Asia Markets Editor Matthew Thomas outlines reaction to the decision. Photo: Saul Loeb/AFP

Fitch Ratings chastised Washington policy makers this week for fighting too much, spending too much and cutting taxes too much.

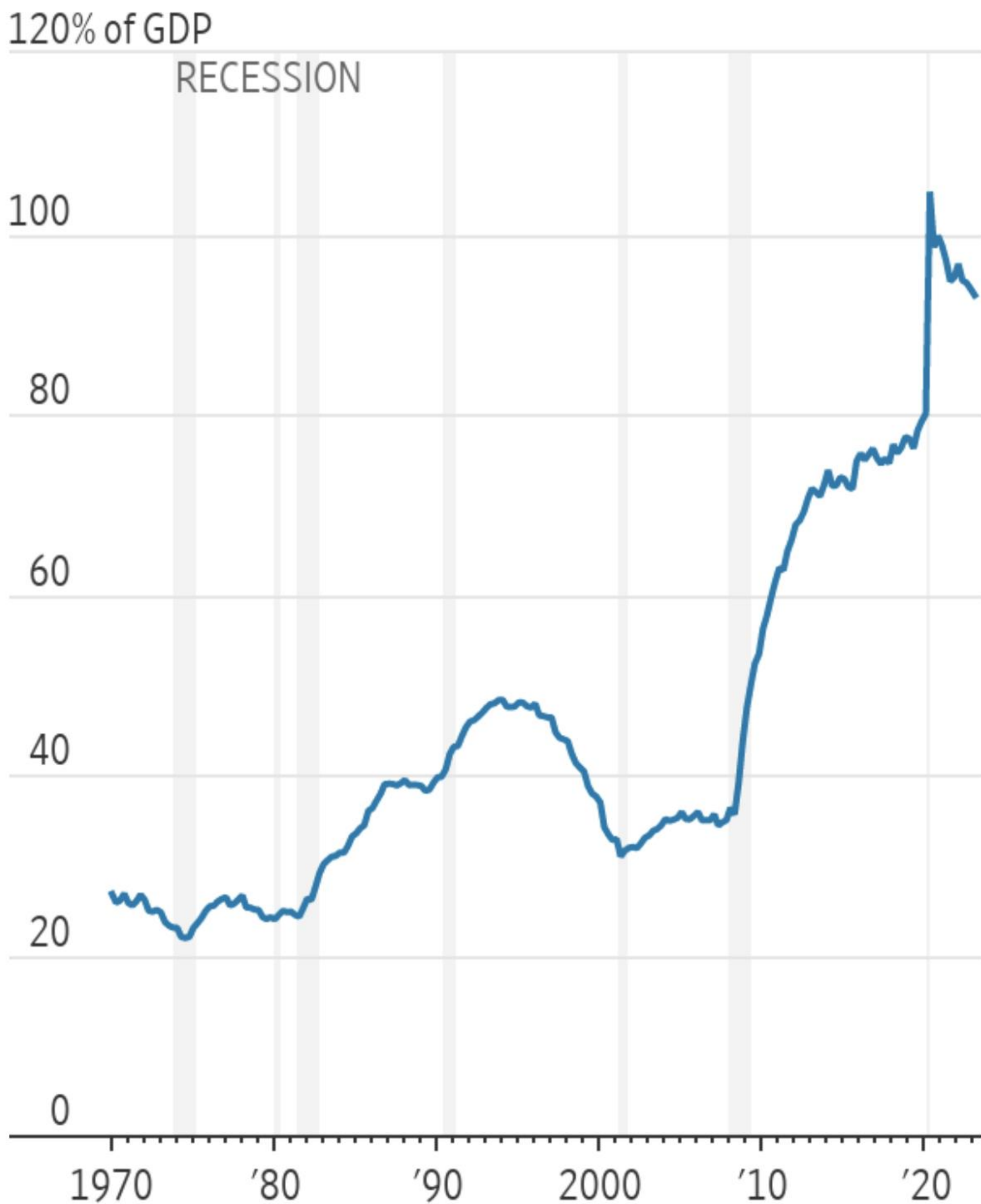
Republicans and Democrats are likely to keep doing all three.

Fitch's downgrade of its U.S. government debt rating Tuesday only fueled more of the partisan bickering that the firm said was raising concerns about America's ability to tackle its swelling budget deficits. And as Congress prepares to hash out spending for next fiscal year, the two parties aren't considering the policies that could meaningfully address the problem: raising taxes or cutting spending on major programs such as Medicare or Social Security.

"There's no imminent signs of Congress having the political will to address our entitlement programs or the revenue that funds them and the rest of the government," said Shai Akabas, executive director of economic policy at the Bipartisan Policy Center. "It's a sign of worse things to come if we don't get our fiscal house in order."

Biden administration officials lambasted the Fitch decision, blaming the Trump administration for destabilizing the political system and pointing to their own deficit-reduction efforts. Republicans said Democrats' spending plans had knocked the economy off the track, doubling down on calls for cuts that the White House has rejected.

U.S. debt held by the public as a share of gross domestic product



Note: Seasonally adjusted.

Source: U.S. Office of Management and Budget via St. Louis Fed

Helping enable Washington's deadlock is the markets' muted reaction to the downgrade—and global investors' seemingly bottomless appetite for U.S. government debt. Gone are the days when so-called bond vigilantes stalked the Treasurys market demanding lower deficits. Even this spring's debt-ceiling fight had only a limited impact on trading in the roughly $25 trillion market.

In its report this week, Fitch pointed to projections for rising U.S. deficits as a sign of the country's troubled fiscal outlook. After dropping sharply last year, the gap between spending and revenue has grown by 170% in the first nine months of this fiscal year, according to Treasury data through June.

Factors driving the deficits' growth include higher net interest costs, a product of the Federal Reserve's interest-rate increases aimed at fighting inflation. The U.S. has spent $131 billion more on interest payments so far this fiscal year, a 25% increase from the prior year. Tax revenue has also dropped by 11% after surging last year.

Net interest costs are expected to reach an amount equivalent to 3.7% of U.S. gross domestic product in fiscal year 2033, according to the Congressional Budget Office. If investors drift away from Treasurys over the long term because of Fitch's lower rating, borrowing costs could rise further.

Social Security, Medicare and Medicaid—which together account for roughly two-thirds of all federal spending—will also continue to get more expensive over time as the population ages. CBO expects spending on Social Security to grow from 5.1% of GDP in 2023 to 6.0% in 2033. Spending on Medicare, Medicaid and other mandatory health programs will rise from 5.8% of GDP to 6.6% over the same period, per CBO.

While some lawmakers have floated ways to overhaul Social Security and Medicare, the topic largely remains a third rail for both Republicans and Democrats.

During this year's debate over raising the debt limit, for example, both parties shied from considering cuts to Social Security or Medicare. The programs, which benefit elderly and disabled Americans, are hugely popular across the political spectrum. A lower credit rating isn't likely to change that fundamental political calculation.

"I don't think it should shape how people feel about debts and deficits. We've known we've had a long-term imbalance for decades and this doesn't change anything," said Ben Harris, a former top economist at the Biden Treasury Department.

Congress will have to act eventually, though lawmakers tend to wait until moments—not years—before a potential disaster to address it. Social Security's trust fund will run out in 2034, meaning the government won't be able to pay the full amount of promised benefits, the government estimates. And Medicare's hospital-insurance trust fund will be able to cover all benefits until 2031.

Lawmakers will be forced to act on taxes far sooner, in 2025, when many of the most popular of the Trump-era tax cuts are set to expire. Fitch expects Congress will simply extend the tax cuts, reducing revenue and raising deficits.

Democrats might try to raise taxes to bargain with Republicans over extending the cuts—but that could be difficult. Democrats attempted unsuccessfully to peel back less popular

provisions of the Trump tax cuts in 2021, when they controlled Congress and the White House.

The Biden administration's plans to raise the corporate tax rate, as well as the top capital-gains and income rates, fell apart after moderate Democrats opposed them. The party ultimately settled on alternative, less conventional ways to increase corporate taxes.

Legislative deadlines might eventually spur Washington to try to address its debt problem. But with the dollar as the world's reserve currency and financial markets' enduring reliance on Treasurys, Fitch's rating downgrade isn't likely to jolt policy makers out of long-running patterns.

"The U.S. is in a really strong position, and that's an appropriate judgment on the part of investors. I worry that judgment is breeding really problematic complacency on the part of elected officials," said Michael Strain, the director of economic policy studies at the American Enterprise Institute, a conservative think tank.

In my assessment, the US bond market will enter into a prolonged bear market because this market is the consequence of the breakdown of discipline in running proper public finance by its own government. Fitch has just reframed that reality into a double A rating, a catastrophic failure for a government that needs triple A rating to be able to finance a $34 trillion debt growing at $1.5 trillion a year.

As such, if you like bonds, wait, because you can buy it at much higher yields after it has collapsed. If you don't like bonds, stay the hell clear.

The worst is yet to come.

By:

Yeong, Wai-Cheong, CFA

Fintech Entrepreneur, Money Manager and Blogger

Un-Influencer in a World full of Hubris