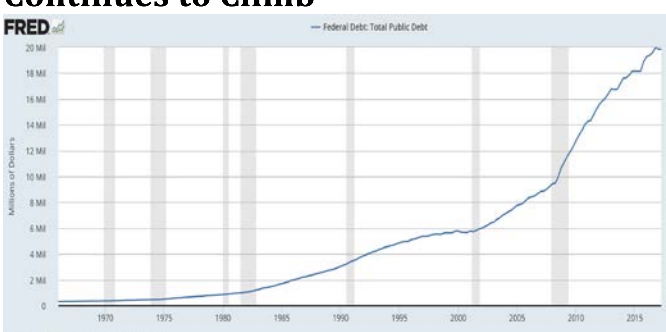
Mitch on the Markets

If Debt Soars Too Far, Will the Market Plummet?

By Mitch Zacks
Portfolio Manager

In October 1981, the United States gross national debt topped the $1 trillion mark for the first time, and as a country we've never looked back. Fast forward to today, and the U.S.'s debt has now crossed $20 trillion for the first time ever, and it's expected to rise to $30 trillion over the next decade.

Total U.S. Federal Public Debt Continues to Climb



Source: Federal Reserve Bank of St. Louis

With the debt load big and getting bigger, many fear that the United States is spiraling out of control. How could the economy possibly continue on a path of sustained growth with so much debt? And, if the economy is on a troubling path, does that mean the market is due for a reckoning too?

3 Reasons Not to Worry about U.S. Debt (For Now)

The U.S. debt is growing, but we do not believe it's time to worry just yet. Here are three reasons why.

1) **The U.S. Remains the Most Credit-Worthy Country in the World –** the United States has the largest and one of the most diverse economies in the world. If 'lenders,' i.e., other countries and central banks that purchase the debt we issue were worried, then a) they would not buy our debt, and/or b) they would require to be paid more than the 2.88% interest rate that is currently offered on 30-year U.S. Treasuries. Yet, central banks across the world continue to buy Treasuries and most see it as the safest investment in the world.
2) **U.S Treasuries are Vital to Global Financial Markets –** this may sound odd, but the world needs U.S. debt. The reason is that

many countries and central banks use U.S. debt as collateral for their own borrowing activities, and oftentimes U.S. debt is used as a reference rate for other debt in the world.

3) **Interest Payments as a Percent of U.S. Revenue are Low –** by historical standards, if you look at how much the U.S. owes each year in interest payments as a percentage of our revenues (tax receipts, other investments), the number is actually quite low. Think of this relationship in terms of your own personal financial situation. If you're making more in revenue than you have at any time in your working career (as the U.S. is today with record GDP and record receipts), you would probably be less worried if you were also accumulating more debt at historically low interest rates. In other words, with such high revenues you would have no problem making your interest payments on time, just as the U.S. does. As you can see in the chart below, the combination of low interest rates and record receipts means our debt is quite affordable relative to other times in history, particularly the beloved 1980's.

Because of High Interest Rates in the 1980's, our Debt was Less Affordable Than It Is Now

Source: Federal Reserve Bank of St. Louis

Expect the Debt to Get Bigger

With tax reform as a top priority in the current Administration, and other spending goals for projects such as infrastructure and border security, it seems likely that the deficit and debt could rise in the coming years. Congress is inching towards a budget plan that allows the government to collect $1.5 trillion less revenue for the next 10 years, even though the number of Americans collecting Social Security and Medicare is set to increase by 15 million over the same time frame. Unless the economy accelerates in a major way – which it could – the debt is likely to grow.

Bottom Line for Investors

As is the case for many households in America, having debt is not necessarily an automatic negative. If there is more revenue being earned each year, and interest rates are near historic lows, one could even make a fair argument that it's a good time to borrow more. We will not make that argument here, but we will say that in our view the debt situation in the U.S. is currently sustainable and should not adversely affect the market. Our advice would be not to let debt worries prevent you from participating in the long-term enterprise value of the U.S. economy, which you can do by owning stocks for the long-term.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

See what Mitch can do for you by visiting our website at ZacksPCG.com

Zacks INVESTMENT MANAGEMENT

DISCLOSURE

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss.

Zacks Investment Management, Inc. is a wholly-owned subsidiary of Zacks Investment Research. Zacks Investment Management is an independent Registered Investment Advisory firm and acts as an investment manager for individuals and institutions. Zacks Investment Research is a provider of earnings data and other financial data to institutions and to individuals.

This material is being provided for informational purposes only and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. Do not act or rely upon the information and advice given in this publication without seeking the services of competent and professional legal, tax, or accounting counsel. The information contained herein has been obtained from sources believed to be reliable but we do not guarantee accuracy or completeness. Publication and distribution of this article is not intended to create, and the information contained herein does not constitute, an attorney-client relationship. No recommendation or advice is being given as to whether any investment or strategy is suitable for a particular investor. It should not be assumed that any investments in securities, companies, sectors or markets identified and described were or will be profitable. All information is current as of the date of herein and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole.

Returns for each strategy and the corresponding Morningstar Universe reflect the annualized returns for the periods indicated. The Morningstar Universes used for comparative analysis are constructed by Morningstar (median performance) and data is provided to Zacks by Zephyr Style Advisor. The percentile ranking for each Zacks Strategy is based on the gross comparison for Zacks Strategies vs. the indicated universe rounded up to the nearest whole percentile. Other managers included in universe by Morningstar may exhibit style drift when compared to Zacks Investment Management portfolio. Neither Zacks Investment Management nor Zacks Investment Research has any affiliation with Morningstar. Neither Zacks Investment Management nor Zacks Investment Research had any influence of the process Morningstar used to determine this ranking.