The Crescent Group

(214) 775-6401
us.rbcwm.com/thecrescentgroup

© 2022 RBC Wealth Management, a division of RBC Capital Markets, LLC, registered investment adviser and Member NYSE/FINRA/SIPC.

RBC Wealth Management

The Crescent Group

Carsten Frederiksen, CFP®
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6401
NMLS#: 1321563 City National Bank

Paul Hendershot
Senior Vice President
Financial Advisor
Senior Portfolio Manager
Portfolio Focus
Direct: 214-775-6430
NMLS # 1370978 City National Bank

Lindsey Vickers, MBA
Senior Registered Client Associate
Direct: 214-775-6458

The Crescent Group website

Continued on page 2

August 2023 Crescent Commentary

What happens to your wealth if U.S. global dominance declines?

This month, the United States credit rating was lowered for the second time in twelve years, this time by Fitch Ratings. Fitch is an organization that assigns ratings to the debt of corporations, governments, and other institutions. Fitch's decision means that it believes the U.S. government has a lower capacity to continue to pay interest and principal on its debt. Why does Fitch believe this? Some of the key reasons were: continued political standoffs over the debt ceiling, which have nearly led the U.S. to default on its debt, as well as the ratio of U.S. debt as a percent of GDP reaching the highest levels since the 1940s.(1)

Financial markets and pundits had a mixed reaction to the downgrade, with opinions ranging from it doesn't matter at all to it matters a lot. And although there was some short-term reaction by financial markets, with bond yields rising, market conditions appear to have leveled off since that time.(2)(3)

It's true that the U.S. remains the world's most powerful financial entity. The U.S. can always print dollars to pay debt principal and interest, although doing so too freely would likely reduce the attractiveness of U.S. bonds as an investment. It's also true that the U.S. had similar debt ratios in the 1940s and was able to reduce them to reasonable levels over the following decades. And it's possible we could do the same thing again. We also know that debt rating agencies such as Fitch have a mixed track record with ratings. For example, leading up to the Financial Crisis, these agencies issued their highest ratings to mortgage bonds that eventually defaulted.(4)

If the U.S. is able to successfully manage its debt levels going forward, our economy will likely continue to gradually progress over time, albeit punctuated by the inevitable boom and bust cycles. But with any analysis, you want to ask what happens if things go right and things go wrong. So, what happens if the U.S. does face a debt crisis in the future, reducing the global influence of our government and currency?

The best example we can point to in modern history is the experience of the British empire, which held the status of the world's largest empire beginning in the mid 1800s through the 1920s. Over that time period, the pound was the world's reserve currency. This came to an end in the 1940s when Britain faced a debt crisis as a result of the cost of the two world wars.(5)

Investment and insurance products offered through RBC Wealth Management are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, or guaranteed by, a bank or any bank affiliate, and are subject to investment risks, including possible loss of the principal amount invested.

The U.S. dollar replaced the pound as the world's reserve currency beginning in the 1940s. What happened to the U.K. economy following the collapse of its empire and the loss of its currency's reserve status? The answer is that U.K. GDP growth has continued at a mid-single-digit rate since then, with the same temporary recession setbacks that we've experienced in the U.S. U.K. companies and brands that dominated their industries in the 1800s continue to do so today and have gotten stronger over time. There are many other examples of globally dominant businesses that have continued to get stronger over time, even though they are domiciled in countries whose influence has faded over time.[4][6]

So although no one can know what the coming decades hold for U.S. global dominance, we can look to the above precedents to understand that even if the U.S. and the dollar were to experience a decline in global influence, geographically diversified U.S. businesses and brands that dominate their industries are likely to continue to do so and to continue to get stronger over time. The implication for investors is that if you're concerned about a decline in U.S. influence as a result of its debt levels or other factors, you should own a geographically diversified portfolio of investments that doesn't depend on the U.S. market alone.

From a fixed income standpoint, if you believe the U.S. government could face a debt crisis in the future, you'd want to own the bonds of the same types of businesses described above – globally dominant, geographically diversified companies not tied exclusively to the U.S. Given the current popularity of short-term T Bills and municipal bonds, that would likely mean a significant reconfiguring of a lot of investment portfolios.

Government benefit programs such as Social Security and Medicare are a final point to mention regarding any potential future decline in the U.S. government's fiscal strength. Such programs would likely get scaled back in some way, and we might experience higher tax rates to pay for them. We've seen some of the impact of this in France this year when there were protests as the government raised the state pension age from 62 to 64. The U.S. government has already made adjustments to Social Security to increase the age required to receive your full benefit, and additional adjustments are likely over time. We don't see this impacting individuals currently in or near retirement, but younger generations would see some impact from this. The only way for consumers to weather a potential decline in government benefits or increase in taxes is the old-fashioned way of spending less and saving more.[7][8]

The Crescent Group
Paul Hendershot | Carsten Frederiksen, CFP® | Lindsey Vickers, MBA

Sources:

(1) Fitch Ratings
(2) The Wall Street Journal
(3) CNBC
(4) Board of Governors of the Federal Reserve System
(5) Social Science Research
(6) Company Reports
(7) Reuters
(8) CNN

The views presented herein are solely those of The Crescent Group, and do not necessarily represent the views Of RBC Wealth Management. Current status of issues discussed in this letter is subject to change based upon Market conditions and industry fundamentals. Clients should work with their Financial Advisor to develop Investment strategies tailored to their own financial circumstances. Past performance is no guarantee of Future results.

Wealth Management

© 2023 RBC Wealth Management, a division of RBC Capital Markets, LLC, registered investment adviser and Member NYSE/FINRA/SIPC.