Stay Calm During the Storm

Don't let S&P's downgrade (or Wall Street's reaction) push you off course

On Friday, Aug. 5, for the first time ever, Standard & Poor's lowered its rating of long-term U.S. government debt one level, from AAA to AA+. The agency also expressed pessimism about the future of long-term federal debt if current government policies don't change. Partly in response, Monday, Aug. 8, saw the stock market continue its recent dive.

For long-term investors in general, and retirement savers in particular, these events underscore a clear message: Stick to your strategy.

In lowering its U.S. debt rating, S&P expressed disappointment in the scope of the budget deficit plan Congress and the Obama administration agreed to early last week, as well as a weakening in the "effectiveness, stability, and predictability of American policymaking and political institutions...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."

> As difficult as it may be to ignore the news and market rollercoasters, keep your perspective and stick to your plan.

Indeed, despite Congress's agreement to spending cuts estimated to reduce the federal budget deficit by approximately $2.1 trillion, Friday's downgrade was not unexpected. Standard & Poor's had previously warned that to maintain its AAA rating, the U.S. should strive to lower the deficit by $4 trillion over the next 10 years.

Yet as difficult as it may be to ignore the news and market rollercoasters, it's important to keep your perspective and stick to your plan. There have been other U.S. debt crises before, and there likely will be others in the future. Stock markets will continue to move up and down based on perception of future economic growth and well-being. Over time, a well-diversified portfolio, regularly rebalanced, remains a wise approach for most investors.

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While a ratings downgrade should not be taken lightly, consider:

- Despite the downgrade, the U.S. Treasury market is still regarded as one of the safest and most liquid in the world. Assets flowed into Treasuries last week as investors moved away from domestic stocks and European markets.

- Treasury yields, which move in the opposite direction of price, decreased last week—the payout on newly issued 10-year Treasury notes fell from 2.8% to 2.6%. This clearly indicates strong demand for Treasuries as investors continued to seek safety in higher quality investments.

- Moody's Investor Service and Fitch Ratings—the other two primary rating agencies—have maintained their highest ratings of U.S. debt.

- In the long run, the downgrade may help spur Congress to address critical issues that effectively reduce federal debt over time.

The S&P ratings downgrade adds to the current uncertainty in today's markets. Lost in the news were better-than-expected numbers released on weekly job claims and the July unemployment rate. While the markets react initially and over time to these announcements, you should continue to focus on your objectives, time horizon and retirement saving goals.

Diversification does not assure a profit or protect against market loss.

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