Russell Investments' Chief Investment officer – Client Investment Strategies, Erik Ristuben comments on the S&P downgrade of U.S. Treasury debt

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On August 8, 2011, Russell Investments' Chief Investment officer – Client Investment Strategies, Erik Ristuben provided Russell's views on the S&P downgrade of U.S. Treasury debt and its viewpoint on the impact for fixed-income and equity markets globally:

And now this: Can the market's psyche handle the downgrade?

As markets open for Monday trading on August 8, 2011, investors' eyes will alternate focus between global bond and equity markets to gauge reaction to Friday's announcement by S&P that U.S. Treasury debt is no longer among the safest investments in the world.

Our view is that recent negative market volatility reflects a drop in confidence in response to a spate of negative headlines – not a global economic collapse. Our analysis of the facts leads us to believe that although the economy has been weakened, a "double-dip" recession still remains unlikely.

Eyes fixed on fixed-income

We've been watching reactions to the downgrade through the weekend, and we don't think the bond market is looking to S&P to determine what U.S. Treasuries are worth. In fact, last week's drop in Treasury yield – which reflected a flight to safety – gives us a good indication that there is no significant concern about America's ability to service and repay its debt. Our current thinking is that the bond market reaction to S&P will likely be muted.

The downgrade does raise technical concerns regarding capital requirements for banking, insurance, derivatives and money funds, but the Fed, other regulators and governments in Europe and Asia have strongly stated that the risk weighting for U.S. Treasuries in capital structures "remains unchanged." Although it's impossible to be completely certain how yields will react there is reason to believe, based on recent history, that Friday's downgrade will not necessarily prolong the current weak patch in the U.S. economy. Russell still forecasts roughly 2.5% in U.S. GDP growth in the back half of this year.

Equities

The wildcard is the equity market. As of this writing on Sunday, however, the announcement is two days old and many nations have come out in support of the value and safety of U.S. Treasuries. We've seen a measured response in the U.S. futures market, and early futures activity in the Asia Pacific market indicates a negative open to the markets but not full-out panic.

Russell is cautiously optimistic that we will not see an emotional reaction in the equity markets on Monday. Certainly the S&P downgrade won't do anything to help speed the economic recovery, which has been weaker and slower than we would have hoped, and we anticipate that traumas such as those experienced last week will be a regular "companion" of the recovery.

For more information, see the latest posts on Russell's blog: http://conversation.russell.com/. Erik Ristuben and Russell's team of investment strategists are also available for interviews to provide more colour around these perspectives.

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