



# Caprin Asset Management, L.L.C.

1802 BAYBERRY COURT, SUITE 202, RICHMOND, VA 23226

804.648.3333

WWW.CAPRINBONDS.COM

April 18, 2011

## S&P Revises U.S. Credit Outlook to Negative

While reaffirming their “AAA” rating on the United States, S&P this morning revised its outlook to “Negative.” S&P cited rising budget deficits and debt levels and provided a two year time frame over which they might lower their ratings on U.S. government debt. Stocks and Treasuries immediately sold off on the news, though Treasuries have largely recovered as of this writing.

### Highlights:

- S&P REVISED U.S. CREDIT RATING OUTLOOK FROM STABLE TO NEGATIVE
- EQUITIES AND TREASURIES SOLD OFF QUICKLY FOLLOWING S&P'S REVISION
- REVISION SHOULD SERVE AS A WAKE-UP CALL TO U.S. POLICYMAKERS; QUICK AND DECISIVE ACTION IS REQUIRED NOW

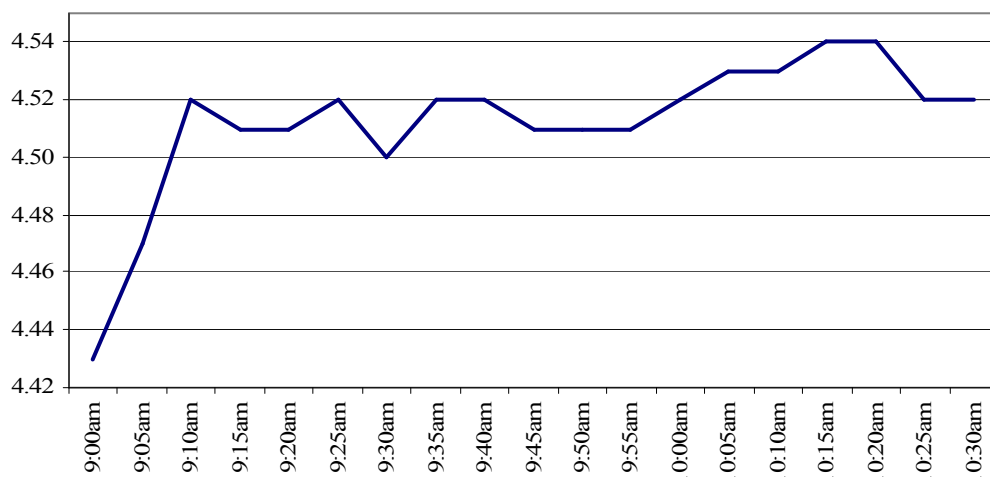


Figure 1. 30-Year U.S. Treasury yields from 9-10:30am on 4/18/11

Source: Bloomberg

## Market Summary

**Equities:** The S&P announcement generated a sharp selloff in equities, which were already set to open lower on news out of Europe and OPEC. Our interpretation is that the fiscal remedies needed to stabilize the budget and debt situation would be contra-growth, impairing longer term earnings and equity appreciation. If inadequate remedies result and the U.S. Government is downgraded, equities will likely languish in a challenging credit environment.

**Treasury Market:** After having traded stronger earlier in the morning, longer maturity Treasuries quickly sold off on the news, while short maturities remained relatively stable. Losing the “AAA” rating clearly would impact the Treasury market's position as the worldwide “flight to quality” option. Global demand for Treasury debt would likely suffer in the event of a downgrade, resulting in lower prices and higher yields.

The outlook for Treasuries depends on a budget resolution that addresses the deficit and debt to the satisfaction of S&P, and Moody's should they follow suit. If viable fiscal solutions emerge and the AAA status is maintained, we are likely confronted with an environment of overall slower growth (less fiscal spending, higher taxes) and lower interest rates. However, if no meaningful (at least in the eyes of S&P) resolution can be achieved and a downgrade results, Treasuries would sell off dramatically.

(Continued on Page 2)

## Caprin Asset Management, L.L.C.

---

### Caprin Outlook

While the deteriorating Federal budget situation is not *new* news, the move by S&P definitely caught the markets off guard. This outlook change is not simply tied to uncertainty over raising the debt ceiling. This move is a challenge to the broader tax and spending policies out of Washington, with a clear warning that “something needs to change, or else.”

Caprin believes this move by S&P may actually be a strong incentive for meaningful change from Washington. We believe that ratings pressure in the Muni Market helped promote real budget and structural reform, and we are seeing the result across the nation. Likewise, this shot across the bow may help similarly motivate the President and Congress.

Clearly, the possibility of a downgrade will be a major political issue among the parties and the branches of government. As we enter the next phase of the perpetual election cycle, there is the risk that rhetoric overtakes substance. Thus far, enacted spending cuts have been largely cosmetic, with little bipartisan support for meaningful reform. The Republican message has been “tax increases are off the table,” while Obama’s response to a Republican reform plan implies class warfare. The outlook downgrade by S&P shows the credit markets are beginning to lose confidence in the Government's ability to manage its affairs. We were able to dodge a similar circumstance 15 years ago, but the cumulative effect of mountains of debt and escalating deficits suggests that real change must happen now.

---

*“We believe there is a material risk that U.S. policymakers might not reach an agreement on how to address medium- and long-term budgetary challenges by 2013; if an agreement is not reached and meaningful implementation does not begin by then, this would in our view render the U.S. fiscal profile meaningfully weaker than that of peer 'AAA' sovereigns.”*

Standard & Poor’s, April 18, 2011 report

---

---

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this piece, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion of information contained in this piece serves as the receipt of, or as a substitute for, personalized advice from Caprin Asset Management. To the extent that a reader has any questions regarding the applicability to their situation of any specific issue discussed above, they are encouraged to consult with the professional advisor of their choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.