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**Investment Institute**

# Market Commentary

**Weekly perspective on current market sentiment** **November 20, 2024**

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Last week's S&P 500 Index: -2.1%

## Will fiscal discipline still be lacking?

### Key takeaways

- With annual deficits estimated by the Congressional Budget Office (CBO) to run in the $1.7 to $1.9 trillion range well into the future, more debt will need to be issued to cover spending.
- Ultimately, we expect Congress to acknowledge that the growing share of interest payments crowds out other spending.

With annual deficits estimated by the Congressional Budget Office (CBO) to run in the $1.7 to $1.9 trillion range over the next three years and likely far beyond, more debt will need to be issued to cover anticipated government spending. That also likely adds another $200 to $250 billion in annual interest costs over those same three years according to the CBO. Note that the U.S. paid more than $1.1 trillion in interest on its debt in 2024, a 30% increase from the previous year. This was the third largest budget expenditure after Social Security and health care.

At the time of this writing, the yield on the 10-year Treasury note (TNY) is sitting at 4.43%. At some point down the road, it would make sense that investors could require a higher yield to compensate for the U.S. Treasury's additional debt issuance over time. But we do not believe that investors are demanding that now. For perspective, the yield on the TNY is not high historically when you consider that the average monthly yield from January 1961 through October of this year was 5.8% according to Bloomberg data. That's nearly 1.4 percentage points above the current level. Even the rapid increase from the 3.62% TNY yield on September 16, which was the lowest yield of 2024 so far, is consistent with the economic improvement we foresee in 2025. Domestic and international investors have been steady buyers of Treasury bonds at virtually all of the debt auctions the U.S. government has held so far this year. We do not think this is likely to change any time soon given our dynamic domestic economy and the depth and size of the U.S. Treasury securities market.

Ultimately, we expect Congress to acknowledge that the growing share of interest payments crowds out other spending that Congress wants and, as in the mid-1980s, implement expenditure control. The other dynamic to pay attention to is that the absolute level of debt typically matters less than its share in the economy's annual output. By the 1990s, the budget controls of the 1980s and the economy's growth rate had lowered the share of total debt in the nation's gross domestic product (a standard measure of economic output) by 20 percentage points. To better understand the issues around the federal debt and deficit situation, we would refer you to our "Paying America's Bills" report and the companion "Q&A — Addressing Concerns About Rising U.S. Debt" report just updated in September.

We see in the recent jump in yields as an opportunity to lock in investment-grade yields at a time when money-market rates are coming down. More specifically, as investors consider longer-dated maturities, we favor, first, overweighting intermediate notes (maturities in the three to seven year range) relative to long-term target allocations and making sure that longer-dated allocations match strategic allocations.

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