The Weekly Market Update – 5/19/25: U.S. Debt Downgrade Puts Spotlight on Budget

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	5,958.38	5.27%	6.17%	1.30%	18.32%	6,144.15	3.1%
Dow Jones Industrial Average	42,654.74	3.41%	1.55%	0.26%	12.80%	45,014.04	5.5%
NASDAQ Composite	19,211.10	7.15%	11.05%	-0.52%	22.69%	20,173.89	5.0%
Russell 2000	2,113.25	4.46%	5.04%	-5.24%	7.06%	2,442.74	15.6%
MSCI EAFE (USD)	2,549.92	0.78%	6.21%	12.74%	11.81%	2,549.92	0.0%
MSCI Emerging Markets (USD)	1,172.38	2.98%	6.44%	9.01%	12.09%	1,444.93	23.2%
Bloomberg Commodity Index	100.96	-1.76%	-5.12%	2.22%	-0.71%	237.95	135.7%
Barclays U.S. Aggregate Bond	91.20	-0.24%	-1.20%	0.84%	3.65%	112.07	22.9%

Source: FactSet

The U.S. government's debt rating was lowered one notch by Moody's Investors Service to Aa1 from Aaa, due to rising debt levels and fiscal deficits. While the timing of the ratings change was a surprise, the sentiment was not, as it followed ratings downgrades years earlier from both Standard and Poor's (2011) and Fitch (2023). Now, none of three widely used debt ratings agencies give the U.S. a "triple-A" score. Moody's Ratings Action press release highlights concern that "persistent, large fiscal deficits will drive the government's debt and interest burden higher." The ratings change will be digested by financial markets, which can often lead to higher interest rates, all else being equal, as investors demand more yield for lower rated bonds. While the Moody's action includes a "stable" outlook and points out that the "U.S. retains exceptional credit strength," it also serves as a warning that fiscal reforms are needed to limit ever increasing annual fiscal deficits as a percentage of gross domestic product (GDP). Potential reforms include a combination of higher revenue (taxes) and lower spending. Budget deficit challenges are well understood by investors, in our opinion, but the Moody's timing coincides with the U.S. Congress (both the Senate and House of Representatives) being in the process of legislating a 2025 budget bill that contemplates lower taxes and spending cuts. Because the 2017 tax cuts for individuals expire at the end of 2025, the expected action of extending and keeping those tax rates in place will add to annual deficit estimates. Through April (7 months of fiscal 2025), the U.S. fiscal 2025 (year ends September 2025) budget deficit was $1.05 trillion (T), an increase of +23% from the first 7 months of fiscal 2024. This is on pace to meet or exceed last year's $1.8T full-year deficit, and will add to the national debt, which as of 5/15/25 totaled $28.9T (excluding intragovernmental holdings of $7.3T). Last year's deficit represented 6.2% of nominal GDP ($29.7T), well above an average deficit of 3.5% of GDP for the 5-year 2015 to 2019 (pre-pandemic) period. Treasury Secretary Bessent has discussed the Trump administration's second term goal of lowering the deficit to 3% of GDP (and achieving 3% annual GDP growth). Given uncertainty around tariffs and additional tax cuts, the budget negotiations underway will be closely followed by investors.

U.S. interest rates moved higher following the ratings downgrade by Moody's. In early trading on 5/19/25, the U.S. 10-year Treasury yield moved to 4.51%, up from 4.44% on Friday 5/16. This is at the high end of the yield range over the past three months (4.01% to 4.53% since mid-February). This remains below the 2025 high yield of 4.79% in January, but higher interest rates in early 2025 were tied to pro-growth optimism from the incoming Trump administration, whereas now the rate surge is attributed to factors highlighted by Moody's, the annual budget deficit and growing national debt. The Trump plan is to reduce the debt by stimulation growth, with spending cuts a secondary factor. We believe the administration will monitor interest rates closely and could alter policy, especially around tariffs and trade, if bond market volatility increases.

As earnings season winds down ahead of the holiday weekend (Memorial Day) many companies are scheduled to appear at investment conferences. Although 92% of S&P 500 companies have released March/April quarter earnings, several high-profile retailers and technology leaders have yet to report. Year-over-year earnings growth is tracking +13.8%, exceeding expectations. Several Wall Street investment conferences will take place this week, and we expect companies to update on tariff impacts, including the tariff pauses announced over the past two weeks. The S&P 500 equity index enters the week at its highest level since late February.

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The Global Industry Classification Standard (GICS) is a four-tiered, hierarchical industry classification system. Companies are classified quantitatively and qualitatively. Each company is assigned a single GICS classification at the Sub-Industry level according to its principal business activity. MSCI and S&P Dow Jones Indices use revenues as a key factor in determining a firm's principal business activity. The 11 sectors are: Communication Services, Consumer Discretionary, Consumer Staples, Energy, Financials, Health Care, Industrials, Information Technology, Materials, Real Estate, and Utilities. Sectors that are called "defensive," are thought to be less exposed to economic cycles compared to "cyclical" sectors, and often attract investor interest during periods of economic weakness.

FactSet is a data aggregation software utilized by D.A. Davidson's Wealth Management Research. The FactSet consensus refers to the aggregate of all analysts' estimates from firms that submit estimates to FactSet for a given financial metric.

The Trump Administration on 2/12/25 announced a framework for its Reciprocal Tariffs, with a link to the memorandum, "Fair and Reciprocal Plan." On 3/26/25 the White House announced tariffs on imported automobiles and certain automobile parts. Here is a link to a Fact Sheet from the President that outlines the action. The President's April 2, 2024 Tariff Announcement is also linked. Also linked is the White House Fact Sheet on the U.K. trade agreement.

The Treasury yield curve displays the market interest rate across different contract lengths for U.S. Treasury securities, indicating the relationship between the interest rate and the time ("term") to maturity. The yields of the 2-year and 10-year U.S. Treasury notes are widely followed barometers of the current U.S. interest rate environment. Treasury security data used in calculating interest rate spreads is obtained directly from the U.S. Treasury Department, through FactSet.

S&P 500 earnings growth reflects the year-over-year change in operating earnings on a per share basis. Earnings data are aggregated for all S&P 500 constituents and are measured according to the relative market capitalization weights for each company. Estimated earnings are the combined FactSet estimates of analysts covering each company included in the index.

U.S. monthly receipts, outlay, deficit, or surplus are reported by the U.S. Treasury at fiscal.treasury.gov. Supporting data is also available from the Congressional Budget Office (CBO). Federal revenue (mostly tax receipts) and outlays is reported on a monthly and annual basis. Current data on the national debt (U.S. government borrowings) is provided by the U.S. Department of Treasury and can be found at fiscaldata.treasury.gov.

In 2025 the U.S. Congress (both the Senate of House of Representatives) will work on a joint budget bill that is expected to include an increase in the debt ceiling and include spending priorities and spending cuts supported by the President. The reconciliation process is a way the expedite bills, as they can be passed by a simple majority vote in the senate as long as certain budgetary rules are followed.

Gross domestic product (GDP) refers to the monetary measure of the market value of all final goods and services produced within a country's borders within a specific time period. Real GDP is adjusted for the impact of inflation. GDP numbers are compiled by the Bureau of Economic Analysis (BEA), a division within the U.S. Department of Commerce. Quarterly GDP is reported as a percentage change from the prior quarter, annualized. The BEA also reports data as a year-over-year percentage change from the same period one year prior. The most recent GDP report can be found at www.bea.gov.

The 2017 Tax Cuts and Jobs Act (TCJA) legislated significant changes in the U.S. tax code, including reducing the top individual tax bracket to 37.0% from 39.6%, lowering the small business pass through tax, and raising the standard deduction. Many of the individual tax changes were scheduled to sunset in 2025 (as part of the budget bill at that time). A summary of the TCJA is linked.

Moody's provides credit analysis on issuers of debt and issues a credit rating on a scale of 21 ratings categories. A credit rated' Aaa is judged to be "of the highest quality, with minimal risk." The next highest category Aa1 is "high quality and subject to very low credit risk". Here is a link to Moody's Rating Scale and Definitions.