Past Debt Ceiling Fights & Market Performance

The Treasury announced that the U.S. hit its debt ceiling on January 19th

The latest mess out of Washington is the fight to increase the federal debt ceiling. If this isn't resolved, some fear catastrophe for the markets. Relax. Stocks may dip at first, but a market debacle won't happen.

The debt ceiling fiasco will come and go, market volatility will likely increase and we have to manage our emotions and follow our investment discipline. There will always be drama in D.C. or unexpected announcements on Wall Street.

Long-term financial success dictates that we learn to manage headline generated waves in the market and recognize which ones truly matter and which are just ripples under our boat. Remember, some ripples even offer potential opportunities.

The Debt Ceiling Gets Raised Often

Since 1960, the debt ceiling has been raised 78 times in the U.S., including 20 times since 2001. The Treasury Department has had to use extraordinary measures in six of these standoffs before Congress was able to reach an agreement. And that is what the Treasury Department just announced on Thursday, January 19th.

According to Bloomberg, when looking at the more significant debt-ceiling showdowns of 1995, 2011 and 2013, markets were higher in the 12-month period after the debt ceiling was resolved.

Debt Ceiling Standoffs	Dates	Performance During Standoff	Performance 1 Month Later	Performance 12 Months Later
1995 Debt Ceiling Standoff	Oct 1995 - Mar 1996	10.0%	1.3%	19.9%
2011 Debt Ceiling Standoff	May 2011 - Aug 2011	(5.2%)	(6.9%)	10.4%
2013 Debt Ceiling Standoff	May 2013 - Oct 2013	3.2%	4.5%	8.2%
Average		**2.7%**	**(0.4%)**	**12.8%**

Source: Bloomberg

The Debt Ceiling Explained

Remember this: the debt ceiling does not give Congress the ability to spend more money. It does not hand over a blank check for them to do whatever they please. In the simplest of terms, it approves the check to be written to pay for the spending that lawmakers already approved.

Imagine if you receive a credit card with a limit of $5,000, and then charge $5,000 on it. When the bill comes in the mail, you decide if you'll pay it off or not. That's essentially what Congress is doing, determining: whether they will pay the bill to cover the spending that the House, Senate and president already signed off on.

Seems fairly simple doesn't it? Well, like most things that happen in Washington, both parties attempt to latch special spending items to bills that raise the debt ceiling. The important discussion of how much the U.S. government spends should ideally occur when voting on the actual budget. Without an agreement on this question, we could see a government shutdown.

But even if we do see a government shutdown later in 2023, we will survive and there will be a light at the end of the tunnel – the question is how long it takes to reach the light. After all, did you know that the government has been shut down 22 times since 1976?

For the next few months, discussions of the debt ceiling might slowly crowd out other stories on the newswires. And yes it is a serious issue, but stock market performance is driven much more by economic and earnings fundamentals versus political drama in Washington.