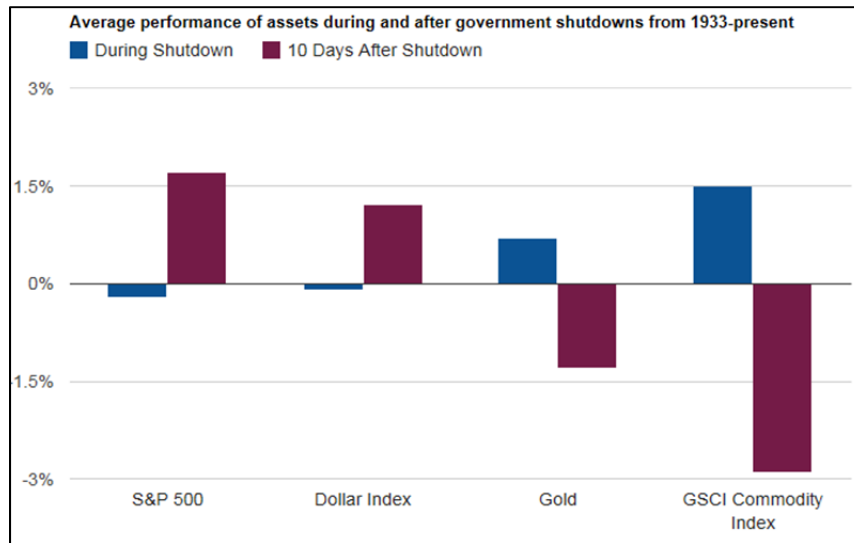


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Capital Markets during Government Shutdowns

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It has been 17 years since the federal government last faced a partial shutdown. In 1995-1996 the government came to a halt over funding for Medicare, education, the environment and public health, and for 21 days, non-essential employees of the federal government did not have jobs. However, if history is any guide to the current budget debate, stocks, bonds and the U.S. dollar will be largely unaffected.



Between December 16, 1995 and January 6, 1996 (the last shutdown), the S&P 500 actually gained 0.1%, while treasury yields dropped 10 basis points, and the U.S. Dollar weakened by 0.1%. These numbers are not far from the historical averages judging by the past 17 shutdowns. Even though the temporary impact may be mild, the dooms-day-investors often find gold or commodities as ways to hedge their risk against a deepening crisis.

What should be noted is that a government shutdown is temporary, and the economy/capital markets will recover. To put this into perspective, ten days after a shutdown, the S&P 500 is usually up (+2%). Twelve months after a shutdown, the S&P 500 is usually up even more (+11%). Gold and commodities typically move inversely to the S&P 500.

While the impact of a U.S. government shutdown may be low, the looming U.S. debt default could be a catastrophic event, given that the 10-year treasury yield has been regarded as a global benchmark. However, investors must separate systematic risk and non-systematic risk.

Government intervention and shutdowns are systematic risks, which are not diversifiable as both stocks and bonds may be impacted. A U.S. debt default is considered a non-systematic risk (sovereign risk), which investors can mitigate by diversifying into foreign investments to minimize U.S. exposure. But, where else would you invest?

We may never be able to predict the future, but if there is one lesson learned through the past debates, it is to be patient.

Source: Bloomberg, International Business Times.

