S&P Rating: Your money in a AA-rated U.S.

Money

Paul Lim, Susie Poppick, and Angela Wu, On Saturday August 6, 2011, 12:16 pm EDT

United States bonds are no longer officially rated Triple-A, at least in the eyes of Standard & Poor's.

And while Moody's and Fitch, the other leading rating agencies, have affirmed the top rating, they too have worried about the long-term prospects for the United States.

None of this necessarily means disaster for your money. The United States has not been downgraded to "junk" status, like say, Greece. The rating is still very high -- just not tops.

Still, there could be ripple effects. Here's where.

Your stocks

Bad news for the economy generally means tough times for stocks. But history shows that when a country loses its AAA credit rating, it's not necessarily terrible news for that nation's stock market.

When Canada lost its AAA rating in April 1993, for instance, the country's stocks gained more than 15% in the subsequent year. The Tokyo stock market climbed more than 25% in the 12 months after Moody's downgraded Japan in November 1998.

S&P rating downgrade: FAQ

At the very least, a downgrade could add more fear and uncertainty to an already sluggish economic recovery, market strategists say. As a result, they advise investors to dial down risk in their equity portfolios by gravitating toward shares of larger, stable companies -- but not just any large caps.

Mark Luschini, chief investment strategist for Janney Montgomery Scott, favors "boring blue chip stocks with pristine balance sheets and that are globally diversified and therefore benefit from faster growth outside the U.S., especially in the emerging markets."

Why not just go directly to emerging market stocks? For starters, U.S.-based multinationals are a safer bet than volatile emerging market shares, especially in times of economic uncertainty. Long-forgotten U.S. multinationals are trading at much more attractive values than emerging market stocks, which have been on a tear for the past decade. And large-cap multinationals tend to pay big dividends, which come in handy during periods of slow growth.

Your bonds

In the year following Canada's downgrade in 1993, yields on 10-year Canadian bonds jumped from 7.6% to 8.1%. So there could be an uptick in U.S. bond yields, but experts didn't think it would be big.

That's because Treasuries, unlike Canadian securities, are considered a default investment for global investors seeking safety.

"There isn't a fund that owns Treasuries just because they're rated AAA," says Ben Inker, head of asset allocation for the asset management firm GMO. "They own Treasuries because, well, they're Treasuries."

That said, a downgrade would likely force investors to look at bond issuers with balance sheets, unlike the U.S.'s, that are improving.

"If you're a bond holder, you want the most credit-worthy securities," says Anthony Valeri, fixed income strategist for LPL Financial. That would mean high-quality corporate bonds and emerging market debt, he says.

After deleveraging over the past three years, U.S. corporations are sitting on nearly $2 trillion in cash.

As for emerging market countries, their ratio of debt-to-GDP is falling as the same ratio rises in the U.S. and Europe.

Plus, Americans who buy emerging market debt could see their investments rise simply because emerging market currencies are strengthening against the U.S. dollar.

Your cash

The relative safety of the different vehicles in which you might stash your cash -- FDIC-insured accounts, money market funds or short-term Treasuries, for example -- wouldn't be so affected by a downgrade that you'd need to shift your money around, say experts.

Skittish investors who wouldn't want to park their cash in downgraded Treasuries might feel more secure by putting that money into an FDIC-backed bank account instead, since it would be protected by deposit insurance, says FPA New Income manager Thomas Atteberry.

But the increased sense of security would be little more than psychological, says Peter Crane, president of Crane Data, which tracks the money-market fund industry; after all, like Treasuries, FDIC-insured accounts are ultimately backed by the same entity: the U.S. government.

As for money market mutual funds, which are not insured, the effect of a downgrade is not expected to be dramatic, since those funds generally invest in short-term debt, and discussion of a downgrade has so far been limited to long-term U.S. bonds, says Mike Krasner, managing editor of imoneynet.com, which monitors the money fund industry.

Despite a downgrade, U.S. debt would still be considered a safe haven. "Double A will become the new triple A," says Crane, "because there simply isn't a viable competitor to Treasuries."

Your borrowing

The price of consumer credit would be pegged less to a Treasury downgrade than it would be to bond investors' overall confidence, says Scott Hoyt, senior director of consumer economics for Moody's Analytics.

Because yields -- and corresponding interest rates -- move inversely to price, rates that track shorter-term Treasuries are more likely to see a bump.

Rates on car loans, which follow shorter-term rates like the two-year Treasury or LIBOR, the London Interbank Offered Rate, could go up -- but not enough to really hit consumers, says Paul Cuevas, director of auto finance at J.D. Power & Associates.

Most mortgage rates, however, track the 10-year Treasury yield, which continues to fall. Adjustable rate mortgage holders could be slightly more vulnerable, because ARMs are typically tied to shorter-term interest rate movements, says Lawrence Yun, chief economist for the National Association of Realtors.

For students and parents who rely on private student loans, any jump in borrowing costs for lenders would be passed on to borrowers, says Mark Kantrowitz, publisher of FinAid.org and Fastweb.com. Federal student loan rates would remain fixed.

Credit card rates are pegged to the prime rate, which moves with the federal funds rate. If the prime rate goes up, consumers could be hit with credit card rate hikes, says Beverly Blair Harzog of Credit.com. Even if the rate doesn't go up, she says, card issuers spooked by a credit downgrade could raise your interest rates anywhere from 1% to 5% -- but only if you've had your card for more than a year.

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