

Client's Corner

“The Terrible, Horrible, Terminal, Apocalyptic National Debt Crisis”

Editor's note: The title that you see in quotes above is that of a previous Client's Corner essay that appeared in June 2016, and that you are about to read below. I hope you will find therein a lesson of sorts, or at the very least a certain amount of dark humor.

JUST THE OTHER DAY, I WAS AT A LOVELY CLUB IN downtown Jacksonville, Florida, waiting to speak at a luncheon meeting of about a hundred financial advisors.

Suddenly, one of the advisors came bursting out of the room where the audience was finishing their lunch, and accosted me. “One question,” he said, “and I want your honest answer.” (As if I ever give anyone any other kind—maybe he was thinking of himself.)

“The United States is bankrupt,” he began. I was constrained to stop him there, and to report, in no particular order, that (a) I was unaware that the United States was, is currently, or is about to go bankrupt, and (b) that wasn't a question.

He babbled on—I couldn't follow most of it—until I simply had to excuse myself on the grounds that I was preparing a talk to a hundred people. As he wandered away, I thought, “Wow. This is getting pandemic. Now it's not just the investors who are getting the Debtageddon phobia; the disease is spreading to advisors who should know better.”

Hence this little essay.

To begin, let's see if there's anything about this situation that we can all agree on. I propose three stipulations. (1) The total federal debt is just now crossing \$19 trillion, counting what the government owes itself in things like the totally misnamed Social Security Trust Fund. (2) The debt has about doubled in the last dozen years, and now exceeds U.S. GDP. (3) It continues to grow at a rate in excess of U.S. GDP growth, a trajectory which must at some point become unsustainable.

I don't think any reasonable observer denies any of these three statements. I would, however, draw your attention

to three words in the third stipulation: *at some point*. The questions before us all, it seems to me, are (1) when and in what form will that point arrive, and (2) how does the individual investor make rational investment policy out of these three stipulations in the meantime.

We must, first of all, not shrink from the fundamental idea that, on its current trajectory, the growth of the debt will become unsustainable at some point. *But that point isn't here yet, nor is it immediately visible on the horizon*. And how does any clear-eyed observer of the situation draw that conclusion? Why, simply by looking at the world's continuing willingness—nay, eagerness—to finance our debt at negligible interest rates.

On the afternoon that I write—indeed, at the very moment—the interest rate on the U.S. Treasury's 10-year note is precisely 1.8490%. (Can we call it 1.85%, just for simplicity's sake?) That is, when the whole world woke up this morning, the blended outlook of all the investors on the planet was that the U.S. is so overwhelmingly likely to make timely payments of principal and interest in today's dollars over the next decade that they were willing to lend us money at a paltry 1.85%.

The implications of this factoid for Debtageddon catastrophists seem especially foreboding.

You see, to hold the view that America's sovereign debt is about to hit a wall, and to incinerate us all in a fiery crash, is to say that *you know something that the consensus of the whole world's wealth clearly does not*. This certainly doesn't, in and of itself, make you wrong. But it does oh-so-gently suggest that you may be somewhat overconfident in your assessment of the situation.

(However anecdotally, let me interject here the personal observation that every single time in my half-century career as an investor that I was convinced I was right and the whole world was wrong, I was sadly and sorely mistaken.)

Next, we must face the fact that Debtageddon—or indeed any economic extinction theory—is premised

on an extrapolation. It is undeniable that on its current trajectory—growing at a rate in excess of our country’s GDP—the debt must become unsustainable at some point. The critical assumption is implicit in the phrase “on its current trajectory.” But as Herbert Stein, Chairman of Presidents Nixon and Ford’s Council of Economic Advisors, famously said: if something cannot go on forever, it will stop. Debtmageddon holds that Stein’s Law does not obtain here—that this time is different. In this view, the particular thing that currently can’t go on forever will not stop. Instead, we will drive over the cliff, never braking nor turning the wheel.

It’s a theory, I guess, but it’s totally unsupported by the historical record. For while granting that democracies don’t usually make the hard decisions until the spaghetti is hitting the fan, we Americans do seem ultimately to make them. No less acerbic an observer than Winston Churchill noted that about us when he said that one can always count on America to do the right thing—after we’ve tried everything else.

Third, for this longtime student of investor psychology, there is the problem that Debtmageddon is the ultimate Known Unknown. And in my experience, it’s never the known unknowns that get you.

Think back—if you can even remember some of these incipient “crises”—to all of the things everybody was sure were going to derail the markets, if not the economy, if not human life on Earth, just since the turn of this century: Y2K, 9/11, the SARS quarantine (a billion Chinese wearing surgical masks on TV every night), the inevitable stock market crash when the baby boomers hit retirement age and started selling, bird flu, the debt ceiling crisis/government shutdown, swine flu, the implosion of the eurozone, the fiscal cliff, Ebola, ISIS. These were the quintessence of known unknowns: they were all anybody talked about, because they were universally seen as heralding The End of Economic Life on the Planet as We Have Known It.

And when existential financial/economic crisis finally did show up, from whence did it come? Why, from the American single family home—where no one was looking for it. It was the ultimate Unknown Unknown.

Finally, there is the overriding issue, for the individual investor, of how to make investment policy out of Debtmageddon—if, when and in whatever form it

eventuates. Since you’re not going to be able to postpone your retirement until you can make a clear assessment of this situation and get your portfolio in shape for it, what do you do today, tomorrow or next week?

This is not at all a rhetorical question—it’s where the rubber meets the road—and I will cheerfully leave it to you and your financial advisor to explore together.

I simply ask: is your financial planning going to be based on the realities of your life—hopes, dreams, goals, retirement date—or on an apocalyptic speculation?

Editor’s Note, continued: It was true in June 2016, and remains true today, (a) that the rate of growth of the national debt exceeds that of U.S. GDP, and that (b) therefore one would have to assume that at some point this trend would become unsustainable. Said debt is currently about twice the amount it was in June 2016, yet that seemingly inevitable reckoning has somehow still not arrived.

On June 1, 2016—the day this essay was published—the S&P 500 stood at 2,100. As I write, it’s 6,900. In the full calendar year 2016, the earnings of the S&P 500 were \$109, and they paid out \$45 in dividends. In the year just ended, the comparable figures were \$271.52 and \$78.50. The Index compounded from 6/1/16 to 12/31/25 at a bit more than 15% annually; \$100,000 invested grew to \$380,000, just shy of quadrupling.

Perhaps most ironically, even as the nation seemed forever to be teetering on the brink of insolvency, the Nominal Broad U.S. Dollar Index—the trade-weighted dollar—went from 113 to 120. Forgive me for belaboring this: the national debt doubled but the dollar grew even stronger relative to the currencies of our trading partners. One might have thought that borderline impossible.

But there had to be some price to be paid for our profligacy, and indeed there was: in mid-2016, the interest rate on our 10-year Treasury note was 1.85%. Today, the world is demanding 4.16% to hold that same debt. We’re a riskier credit, after all.

What if that was the reckoning, and we missed it, while we were waiting for Armageddon?

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