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It's *always* something.

For the last six months, the world has been bombarded with negative financial news – the Japan earthquake's impact on that country's economy, Europe's debt problems, and now the U.S. debt downgrade. All of these problems – and others being talked about today – have been pretty obvious for some time. It's just that now, it has suddenly hit like a tonne of bricks. What we have is a negative circus environment that has been created by all this uncertainty. And the move by Standard & Poor's (S&P) to cut its U.S. credit rating has just added to the uncertainty.

Before we let misinformation lead us into making rash decisions, let's take a look at some of the key questions some investors are asking.

What happened?

S&P removed for the first time the triple-A rating the U.S. has held for 70 years, saying the budget deal recently brokered in Washington didn't do enough to address the gloomy long-term picture for America's finances. It downgraded U.S. debt to AA+, a score that ranks below Liechtenstein.

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The agency said, "The downgrade reflects our opinion that the fiscal consolidation plan that Congress and the Administration recently agreed to falls short of what, in our view, would be necessary to stabilize the government's medium-term debt dynamics." It also blamed the weakened "effectiveness, stability, and predictability" of U.S. policy making and political institutions at a time when challenges are mounting.

S&P has made it no secret that its downgrade is more about politics and less about the actual health of the credit markets, saying: "The downgrade is not an issue of creditworthiness. The problems are about cash flow and timing, not solvency."

What is the U.S.'s bond rating?

Despite S&P's downgrade, the actual rating of the U.S. is still AAA, which is the average of the three rating agencies: Aaa, AA+ and AAA. It would only be seriously downgraded if the other rating agencies agreed with S&P.

Whenever major sovereign downgrades occur, covenants, collateral haircuts, investment guidelines, risk-based capital charges, etc., all get changed to make sure that nothing happens as a result. Why? Ratings are an opinion, nothing more. No one wants actions to occur on a sovereign because of a downgrade.

Is a downgrade harmful for investors?

When 60 of the top corporations like Berkshire Hathaway, General Electric and Pfizer lost their AAA ratings, investors shrugged off the change; the markets had already rendered their verdict.

Borrowing costs for General Electric and Berkshire actually fell in the weeks after they were downgraded in spring 2009, amid a broader market rally.

What does AA+ mean?

The downgrade from triple-A to AA+ means simply that S&P believes that the U.S.'s ability to make good on its debt is now "very strong," rather than "extremely strong." That's not a huge difference.

And don't forget that the U.S. has the ability to print money and raise taxes, something most other debt issuers are unable to do. In the short term, U.S. Treasuries are still among the safest investments in the world.

Which countries now have AAA ratings?

Only 15 countries (and the very small Isle of Man) now hold the triple-A rating from both Standard & Poor's and Moody's. Canada, France, Germany, Norway, Sweden and Switzerland are among those with the undisputed stamp of approval – as are the Isle of Man, a British crown dependency off the United Kingdom's west coast, and Singapore.

What is China's debt rating?

China, the world's second largest economy, is rated two notches below the United States at AA-.

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If the U.S. isn't at risk of defaulting, what has really changed here?

Not much at this point. Fitch Ratings and Moody's have left their triple-A ratings for the U.S. intact and don't expect to change them, at least not any time soon. On July 27, Fitch went so far as to say that a downgrade by one rating agency would do little to change the fact that market participants will continue to consider U.S. Treasuries a "high-quality credit" for the "foreseeable future."

Are the rating agencies useful?

The investment world has reached the point where the rating agencies are essentially meaningless. Not only is it ridiculous that we are rating the ability of the U.S.A. to pay liabilities denominated entirely in a currency it can print, but between the credit crisis and this latest folly, it's hard to make an argument that these agencies matter.

Warren Buffett was interviewed on Fox Business Network after the U.S. rating downgrade. "I don't get it," he said, In fact, Buffett reaffirmed his belief in the quality of the United States' credit, telling Fox, "In Omaha, the U.S. is still triple-A. In fact, if there were a quadruple-A rating, I'd give the U.S. that."

Unfortunately, these rating agencies wield a big stick. While downgrades could lead to forced selling and a potential short-term overreaction, we think Buffett has the exact right perspective. This downgrade is 100% meaningless and any panic that could ensue could be a buying opportunity.

Could we have a double-dip recession?

Just like the last summer, talk of a "double dip" recession in the U.S. is back. It has been three decades since the United States has suffered a recession that followed on the heels of the previous one. Although it could be happening again, there remains more evidence to the contrary. As an example, consider all of information that is provided by the Institute for Supply Management (ISM), which surveys 300 manufacturing firms to measure the business world's appetite to buy stuff and hire people (economic refresher: any number above 50 suggests the economy is expanding while any number below 50 means the economy is contracting). The index slowed to 52.7 from 53.5 in June – still above 50.

There must be some risk, right?

Absolutely. The U.S. has never been downgraded. So we are in very uncertain territory. However, all parties are focused on the issues now.

The uncertainty will lead to volatility in the equity markets, and the U.S. dollar will continue to be of concern until politicians get their act together and concrete decisions on debt reduction are made. What will help mitigate the volatility is a diversified portfolio that includes fixed income.

Why the volatile reaction in the markets?

Perhaps one of the reasons investors have had such trouble digesting a tsunami of daily market information and balancing their perspective is something called the Recency Effect. Because the wounds of 2008's market meltdown are still so fresh, investors might be more prone than usual to mistakenly believe a benign economic slowdown is the next big financial calamity taking shape.

Where is the bottom?

In the most general sense, what we're seeing today is broad de-risking. In short, investors are running from risk, and in the flight from risk, not all stocks are viewed equally. The "where is the bottom" question is not one that anyone can answer with any certainty. However, we'll do our best to shed some light. Let's deal with the "how low can it go" question first.

No one can state with any certainty that we've reached a bottom until after the bottom has passed. But every market drop does have a bottom. Even the much more serious 2008 financial crisis, which did involve corporations, had a bottom on March 9, 2009.

While there is no telling at this juncture how far stock prices could fall in the near term, we think there are sound arguments to support the notion that many stocks are trading well below what they would be selling for if the macroeconomic outlook were better. Therefore, unless you believe we are destined to slog through bad macroeconomic times forever, there are quite likely equities that can be accumulating today that will produce substantially better than market returns in the long term.

How do you get away from this relentless onslaught of bad news?

Keep an eye on what really matters, what you are invested in – that is, corporations and their profits. Lost in the headlines were corporate earnings. Second-quarter earnings season showed profits had yet another double-digit increase. Earnings per share are up more than 18 per cent from a year ago, marking the seventh straight quarter of double-digit growth. Seven out of 10 companies that have reported have turned in better-than-expected results so far. The majority of S&P 500 firms have reported second-quarter results and 72 per cent have beat analysts' expectations. In a typical quarter since World War II, only 62 per cent, on average, exceed estimates.

Another thing that is comforting in the historical data on the Dow's losing streaks is that many of them have occurred near major bear-market bottoms. For example, before February 1978, the most recent time the Dow declined for nine straight sessions was in October 1974. That came just two months before the end of the punishing 1973-74 bear market.

The one thing you can say about investors is that they have very short memories. It doesn't take much to turn them on a dime because when it comes to fear and greed, this is the best mechanism in the world and you can see fear turn to greed pretty quickly.

Periods of extreme price volatility have occurred for as long as there have been markets and they will continue to occur periodically as long as humans are involved. It's normal for this to happen from time to time. Don't get constantly drawn into this short-term focus. When you have a short-term focus on the market, emotions hold sway and they distort your decisions.

The bottom line is, fear has been and will always be part of the market equation. This is a very stormy relationship. Investors break up with the market and then get back together again. And they will come back.

Please keep in mind that most investors today have lived through the dot-com bubble, the 2008 banking crisis and the 2010 Flash Crash.

Back in 2008, Warren Buffett wrote:

"A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now…

"In short, bad news is an investor's best friend. It lets you buy a slice of a corporation's future at a marked-down price. Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497."

You can expect strong volatility, much rhetoric and media discussion in the coming weeks. Our advice is to remain rational in this irrational world.

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