Q3 2026 Quarterly Commentary

Growth, jobs, the consumer, the K-shaped economy, the Fed, rising rates, stocks and global risks

October 15, 2026

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Executive Summary: Strong Growth, Narrow Foundations, Rising Rates

Q3 2026: AI spending keeps growth and trade strong, but yields are rising worldwide. Oil is above $100, and fewer buyers are absorbing record debt.

1 Growth and trade

pp. 5–28

Q2 GDP 2.2%; Q3 GDPNow 3.6% (Oct 8), off its 6.2% August peak; no recession signal (Sahm 0.00). The WTO doubled its 2026 world trade forecast to 3.9%; AI goods are 47% of growth.

2 Labor market

pp. 29–36

"No hire, no fire" holds but is fragile: 51k jobs a month in Q3, all from three sectors; revisions cut 116k; unemployment 4.2%.

3 Consumer and housing

pp. 37–45

Real income flat, saving 4.1%. Housing affordability index ~105 vs 170 in 2020; mortgage rate 7.40%, payment +89% since 2021.

4 K-shaped economy

pp. 46–50

The top 10% own 88% of stocks; the bottom 50% owe 52% of consumer debt. Same raises, bigger bills, and thinner cushions at the bottom.

5 The Fed

pp. 51–58

Hiked 12–0 to 3.75–4.00%; after September CPI, an October 28 hike looks likely (futures had priced December). Term premium 0.82%.

6 Global rates

pp. 59–62

10-yr yields up 0.6–1.3 pts since December everywhere but China, half since August. U.S. 10-yr ~5.3%; France highest since 2002, U.K. since 2007.

7 Why rates rose

pp. 63–88

Growth, corporate borrowing, debt, inflation and the war, plus fewer buyers: central banks, pensions and reserve managers step back. Auctions clear only at higher yields.

8 Oil and Iran

pp. 76–77, 101–103

Brent averaged $114 in Sept vs $71 pre-war. Gulf oil is rerouted, but tanker attacks raise costs; emergency stocks cover ~2 weeks of world use.

9 Stocks and co-dependence

pp. 90–114

The S&P 500's earnings yield is below the 10-yr. Foreigners own ~20% of U.S. stocks (~29% with direct stakes), and Asia's AI supply chain depends on U.S. spending.

10 What could tip it

pp. 96, 118–120

10-yr above ~5.5%, a longer war or oil spike, an AI spending slowdown or earnings miss, a yen carry-trade unwind, failed auctions, or post-midterm policy shift

Figures as of Sept 30–Oct 15, 2026; sources on each slide; clickable links in the endnotes at the end of the deck.

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Strong Growth on a Narrow, Borrowed Foundation

A perspective on the third quarter and what it may mean for the months ahead

The U.S. economy enters the fourth quarter looking strong. Growth is tracking 2.5–3.6% this quarter, unemployment is 4.2%, and corporate profits are rising at a pace few expected a year ago. World trade, lifted by spending on artificial intelligence, is beating forecasts; the WTO has doubled its 2026 outlook. By the headline numbers, this is a good economy.

The headline hides three things.

First, growth is concentrated. One theme, AI, drives investment, profits and a large share of growth; three sectors create the jobs, a handful of companies drive the profits, and households at the top of the K-shaped economy do much of the spending. Hiring is stuck, unemployment stays low mainly because the workforce is shrinking, real incomes are flat, and a median family can no longer afford a median home.

Second, growth is borrowed. The U.S. ran a $2 trillion deficit in a year of full employment, and the AI build-out itself now runs ahead of cash flow, with trillions of commitments held off company balance sheets. From Washington to Paris, Tokyo and Beijing, governments spend beyond their means, and too many raise taxes on economies that are not growing fast enough to carry their debt. A productive, well-managed country can live with high interest rates; one that overspends and under-grows cannot.

Third, the world has made one bet. The AI build-out in the U.S. now supports earnings, trade, foreign investment and supply chains across Asia and Europe. The U.S. financial market has become the world's market, which makes the world co-dependent: the gains are shared, and so would be the losses (the full AI story is drawn together on p. 117).

These forces meet in the bond market. Long-term rates have risen almost everywhere, not for one reason but for many at once, and because traditional, price-insensitive buyers of government debt (central banks, reserve managers, pensions) are stepping back just as supply hits records. The Fed has resumed hiking, oil stays above $100 with the Iran conflict managed rather than resolved, and Treasury auctions clear only at higher yields.

None of this means a downturn is imminent; stagflation is not expected in 2026 or early 2027, but persistent inflation or a further spike in rates would slow the economy. The supports are real. But the balance is asymmetric: further gains need everything to keep going right, while a setback needs only one thing to break. The pages that follow present the evidence, an interpretation of what it means, and the signposts worth watching.

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How to Read This Commentary: Nine Questions, One Story

Each section opens with "Perspective": what the data says, what it means, and what would change the view.

Section	The question it answers	Short answer	Pages
1. Growth and trade	Is the economy as strong as the headline says?	*Strong, but concentrated in AI and borrowed*	pp. 5–28
2. Labor market	Is the job market strong, or just stuck?	*Stuck: no hire, no fire, and fragile*	pp. 29–36
3. Consumer	Can the consumer keep carrying the economy?	*For now, by dipping into savings to support spending*	pp. 37–45
4. K-shaped economy	Who is the economy working for?	*Asset owners; that makes it market-dependent*	pp. 46–50
5. The Fed	Will the inflation fight survive the debt math?	*Hawkish words meet fiscal arithmetic*	pp. 51–58
6. Why rates are rising	Why are long rates rising everywhere at once?	*More debt, fewer buyers, and overspending*	pp. 59–88
7. Rates and stocks	Can stocks rise when bonds pay this much?	*Only if earnings deliver; priced for perfection*	pp. 90–96
8. Global risks	How much can the war disrupt the economy?	*A managed war is a persistent supply shock.*	pp. 97–103
9. Co-dependence	If the U.S. stumbles, can the world escape?	*No: diversification is thinner than it looks.*	pp. 105–114

Three threads run through every section:

Concentrated growth
Growth, profits, and spending rest on AI, a few companies, and the top of the K.

Borrowed growth
Deficits at full employment, in the U.S. and abroad, meet fewer buyers for the debt.

One global bet
The world's markets, trade, and capital are tied to U.S. AI spending.

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Perspective: Growth Is Strong, but Concentrated and Borrowed

Section 1: The headline economy is healthy; what carries it is more concentrated in AI and more debt-financed than it looks.

What the data says

- Q2 GDP grew 2.2% and private demand 4.6%; Q3 is tracking 3.6% (GDPNow, Oct 8), down from a 6.2% peak in August
- No recession signal: the Sahm rule reads 0.00 and weekly activity runs near 3%; the WTO doubled its 2026 trade forecast to 3.9%, with AI goods 47% of the growth
- AI is the engine: ~$1 trillion of global AI investment in 2026; computers and software supplied 56% of Q1 growth and about a third over four quarters

Assessment

Growth is real, but it is concentrated and borrowed. One engine, AI investment and the spending of households at the top whose wealth rides on AI stocks carry much of it, financed increasingly with debt, corporate and federal. A $2 trillion deficit in an expanding economy is not recession support; it is spending beyond the nation's means at full employment. That is why strong growth comes with rising prices rather than easing them and why the Fed is hiking rather than cutting. A quarter tracking 2.5–3.6% is healthy by any standard, but it rests on fewer legs than the headline implies.

What would change the view?

- Growth broadens: small-business sales and hiring turn up, and manufacturing strengthens beyond AI equipment
- ISM manufacturing prices paid cools from 77.9 toward 60 (50 = no change) while activity holds: growth without the inflation cost

The question

Is the U.S. economy as strong as the headline says?

The view in one line

Strong, but concentrated in AI and borrowed.

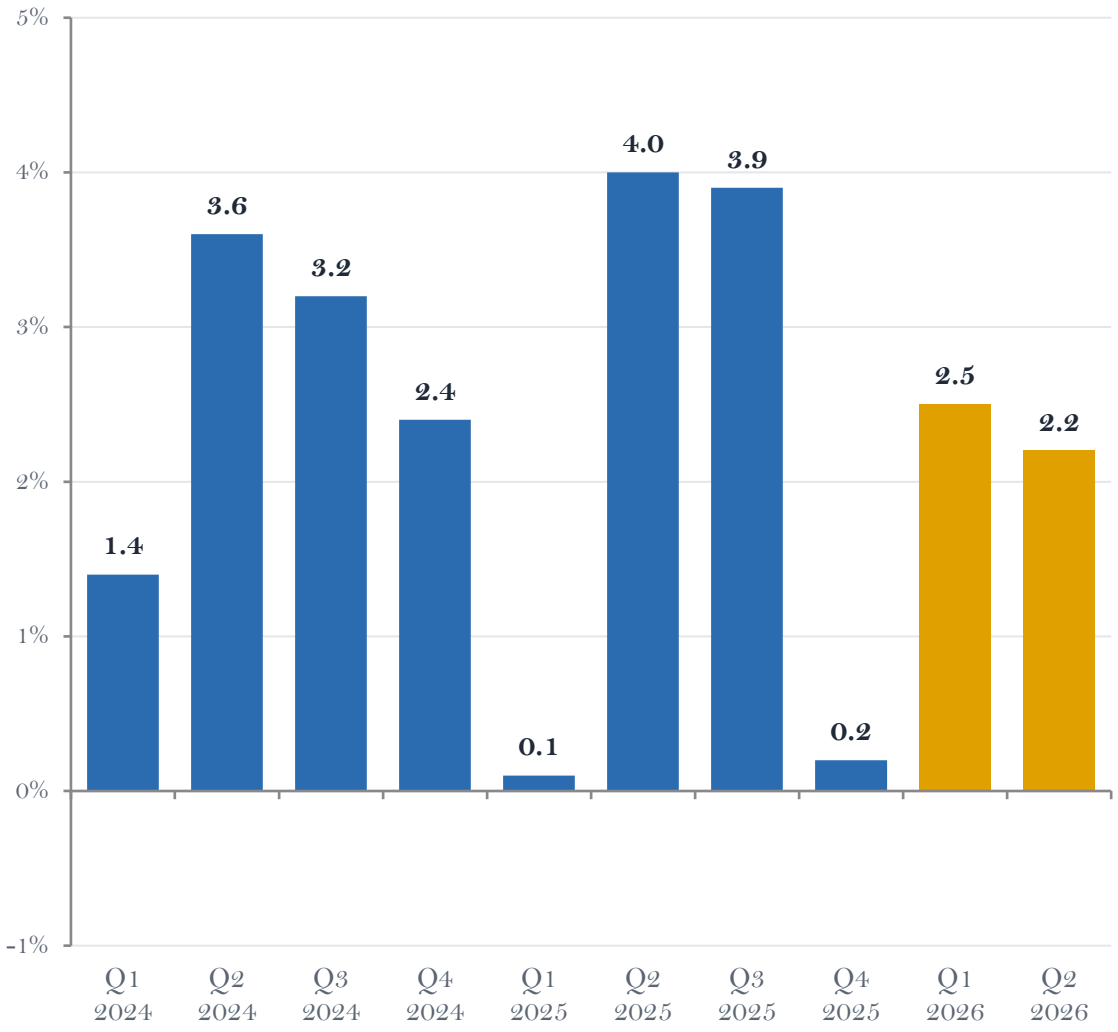
Where to look

p. 6 GDP
p. 9 Q3 nowcasts
p. 10 Private demand
p. 12 The AI engine

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US Real GDP Growth, Q1 2024 – Q2 2026

Percent change from preceding quarter, seasonally adjusted annual rate



2.2% Q2 2026 third estimate, up from 1.5%

Average since 2024: 2.4%

Q1 2025: 0.1%
Imports surged as companies bought ahead of tariffs; revised up from −0.6%

Q2 2025: 4.0%
Strongest quarter in the period after revision

Q4 2025: 0.2%
Oct–Nov government shutdown cut federal spending

2026: 2.5%, 2.2%
Sept 30 annual update revised the whole period

Source: US Bureau of Economic Analysis (BEA). Q2 2026 third estimate with the annual update (Sept 30, 2026); all quarters reflect the revised data.

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Net Trade: Imports Surge on AI Equipment and Energy

Supporting slide to Q2 GDP: the goods deficit widened sharply through August, pointing to a trade drag on Q3 growth.

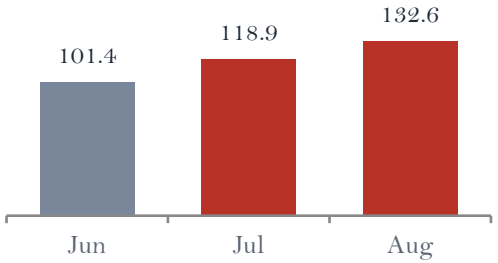
$132.6bn Aug goods deficit (June: $101.4bn)

+5.5% Goods imports m/m (exports +1.9%)

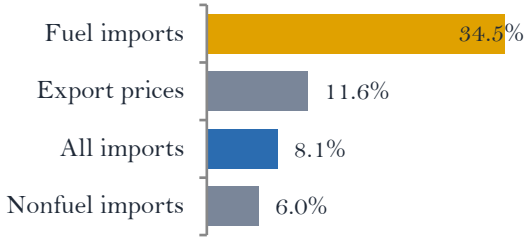
+16% Capital goods imports, Aug vs June

+8.1% Import prices y/y (Sep), most since Jul 2022

Goods trade deficit, $bn (Census)



Trade prices, Sep y/y % (BLS, released Oct 16)



What it means for GDP

Q3 trade drag: Imports subtracted from Q2 growth and the July–August surge points to a larger drag in Q3

Partly offset: Imports are also restocking shelves: wholesale inventories +0.7% and retail +0.3% in August

Price vs. volume: Import prices are up 8.1% y/y (Sep), the most since 2022, so part of the jump in import spending reflects higher prices, not more goods

What is driving imports

AI equipment
Capital goods imports rose from $125.9bn in June to about $145.7bn in August as computer and chip purchases continue

Energy
Industrial supplies imports +16.6% in August vs exports +8.3%; fuel import prices +34.5% y/y (Sep), natural gas +96.5%

Consumer demand
Goods spending led August consumer outlays, pulling in imports and stock-building

Risk to watch: diesel export ban

Under consideration with diesel near a record $6.50/gal and distillate stocks at a 40-year low (EIA). A ban would cut energy exports and widen the deficit further.

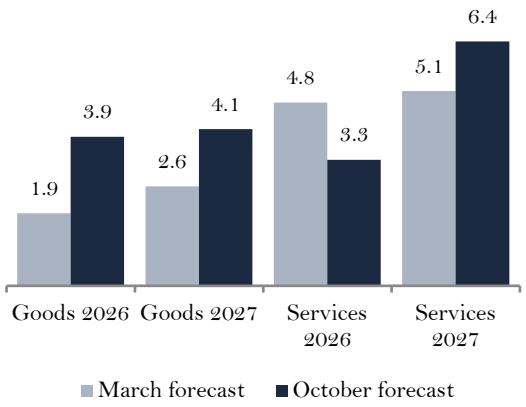
Sources: US Census Bureau, Advance Economic Indicators (July and August 2026); BLS, US Import and Export Price Indexes, September 2026 (released Oct 16, 2026); full sources in the endnotes.

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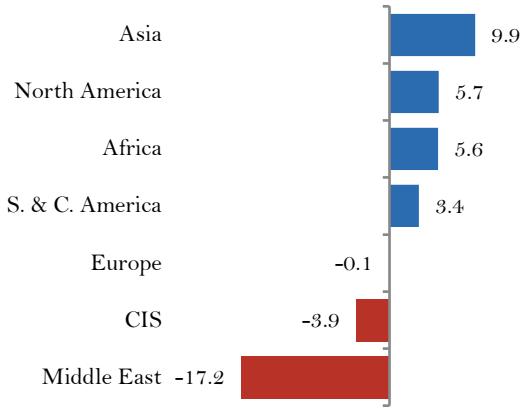
World Trade: AI Goods Carry Global Trade Through the War

The WTO doubled its 2026 goods-trade forecast to 3.9% (Oct 8), but the gain is narrow: AI equipment and Asia, while services and the Middle East shrink.

WTO trade volume growth forecasts, %



Merchandise export volume, 2026 forecast, %



AI goods do the heavy lifting.

- AI-enabling goods (chips, servers) made up 47% of goods-trade growth in H1 2026, up 67% y/y.
- Now 14.8% of world goods trade, vs 8% in 2023; East and Southeast Asia supply ~64% of AI exports.

War bends trade, not breaks it.

- Middle East crude exports –24% and LNG –47% in H1, but global crude only –6% and LNG –1% as others filled the gap.
- Services cut to 3.3% (transport 0.9%, travel 0.2%); WTO raised its 2026 world inflation estimate to 4.7% from 3.7%.

By the numbers

3.9% 2026 goods-trade growth up from 1.9% in March (0.5% a year ago)

4.0 Percentage points of the 3.9% global growth from Asia; rest of world net negative

–29% U.S. imports from China in 2025; China now 9.3% of U.S. imports

~1/5 Semiconductor stocks' share of S&P 500 value, a risk the WTO flags

Why it matters

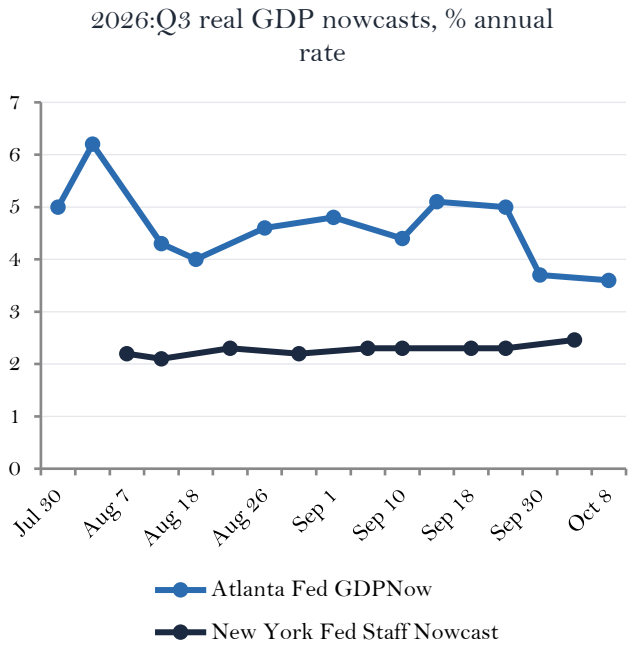
World trade now leans on one engine, U.S.-led AI spending, and one region, Asia. The WTO names the risks: an AI investment slowdown, a stock-market repricing of AI firms, and a longer war (2027 assumes resolution).

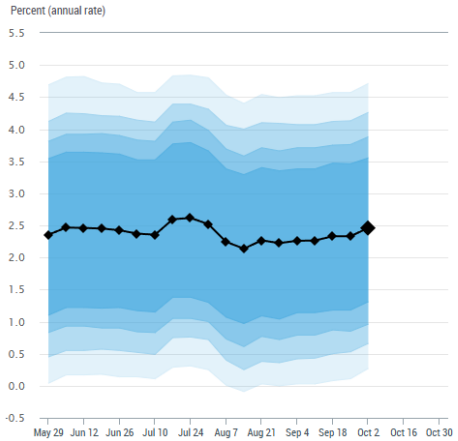
Sources: World Trade Organization, "AI boom and trade resilience to Middle East crisis lift outlook, but gains to be uneven" (press release, Oct 8, 2026) and Global Trade Outlook and; full sources in the endnotes.

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Q3 Growth Nowcasts: Strong but Cooling From Summer Highs

Atlanta Fed GDPNow fell from 5.0% to 3.6% after the Sept 30 data; the New York Fed's model sits near 2.5%. The first official Q3 estimate is due Oct 29.





New York Fed Nowcast with probability bands (as of Oct 2)

By the numbers

3.6% — GDPNow for Q3 (Oct 8), down from 5.0% on Sep 25

6.2% — GDPNow peak (Aug 3)

2.46% — New York Fed Nowcast for Q3 (Oct 2); Q4 2.6% (Sep 25)

Oct 29 — BEA advance Q3 GDP estimate

Why it matters

Late-September tracking near 5% has come down. A 2.5–3.5% quarter still argues against Fed cuts but no longer signals an overheating economy.

Reading the two models

- GDPNow tracks incoming monthly data closely, so it swings: from a 6.2% peak on Aug 3 to 3.6% on Oct 8.
- The New York Fed model weighs a broader data set and has held near 2.1–2.5%; its 80% range runs from about 0.3% to 4.7%.
- Both sit at or above the Fed's 2.3% projection for 2026: growth is solid, but likely slower than the summer suggested

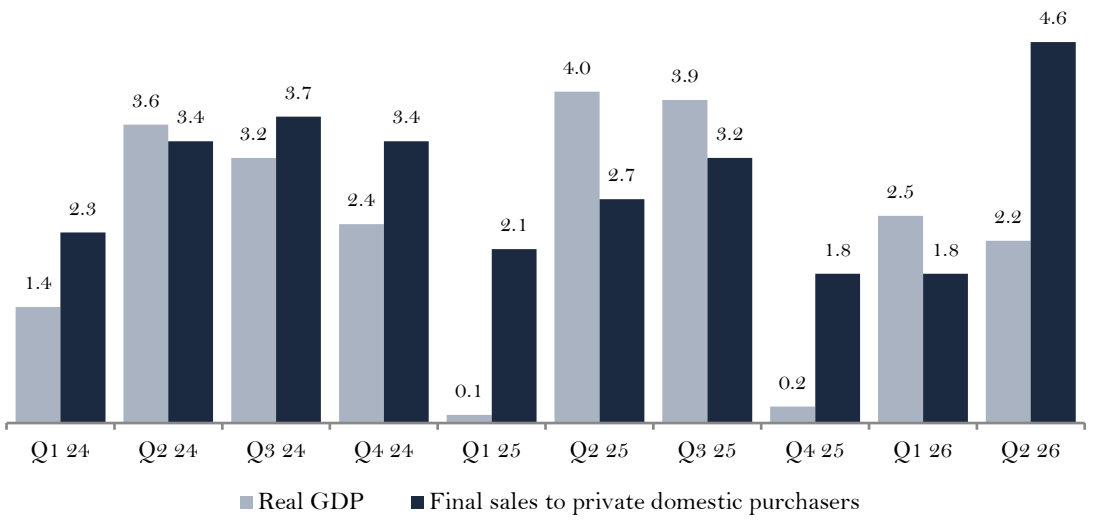
Sources: Federal Reserve Bank of Atlanta, GDPNow (readings Jul 30–Oct 8, 2026); Federal Reserve Bank of New York, Staff Nowcast (chart and Oct 2 reading as captured by the author).

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Underneath GDP: Private Demand Grew 4.6% in Q2

Final sales to private domestic purchasers strip out net exports, inventories, and government, the three most volatile pieces of GDP.

Percent change from preceding quarter, annual rate (after the Sept 30, 2026 annual update)



What it shows

- Q2 2026: GDP grew 2.2%, but private demand grew 4.6%, the fastest in this period, led by consumer spending and AI-related investment.
- Late 2025 and early 2026: private demand slowed to 1.8% during the government shutdown and the start of the Iran war.
- Headline GDP has swung on trade and inventories (tariff front-running in early 2025); private demand has been steadier.

By the numbers

4.6%	Private demand growth, Q2 2026 (calculation from BEA levels)
2.2%	Real GDP growth, Q2 2026 (third estimate)
1.8%	Private demand, Q4 2025 and Q1 2026
~3%	Average private demand growth since 2024

Why it matters

Strong underlying demand is one reason the Fed sees policy as only mildly restrictive. Earlier estimates put Q2 private demand at 3.8%; the annual update revised it up.

Sources: BEA via FRED (A191RL1Q225SBEA; LB0000031Q020SBEA), as of Sept 30, 2026; final-sales growth is calculation from levels (may differ ~0.1 from BEA); full sources in the endnotes.

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Q2 GDP by Component: AI Capex Carries Investment

Real GDP by component, % change from prior quarter at an annual rate: equipment and software kept growing fast while structures, housing and government lagged

Component	Q3 24	Q4 24	Q1 25	Q2 25	Q3 25	Q4 25	Q1 26	Q2 26
Real GDP	**3.2**	**2.4**	**0.1**	**4.0**	**3.9**	**0.2**	**2.5**	**2.2**
Consumer spending	3.7	4.3	0.6	2.1	3.7	1.9	0.7	**3.8**
Durable goods	8.0	12.0	−5.2	3.9	1.6	2.2	1.7	**7.4**
Services	2.8	3.3	1.4	1.8	4.0	2.3	0.7	**3.4**
Business investment	6.0	−0.7	10.7	7.6	3.8	2.1	9.9	**9.0**
Equipment	10.2	−3.0	20.4	7.2	8.9	6.9	15.5	**13.4**
IP products (software, R&D)	3.6	1.4	8.0	16.3	5.7	4.4	15.6	**9.2**
Structures	3.4	−0.3	0.9	−5.3	−7.7	−9.8	−9.4	**0.1**
Residential investment	−4.5	2.7	−2.7	−4.3	−6.3	−1.8	−7.6	**2.8**
Government	5.2	3.6	−0.6	2.3	1.6	−5.7	4.7	**−0.1**
Federal	5.4	3.3	−6.6	−0.4	0.5	−15.7	10.9	**−2.4**
Nondefense	1.1	2.3	−6.5	−3.0	−6.3	−24.5	20.7	**−12.7**
State and local	5.0	3.7	3.0	3.9	2.2	0.5	1.4	**1.2**

■ *Amber: where AI spending shows up (computers, servers, software).* ■ *Blue: consumer durables.* *Red labels: weak lines.*

What the table shows

- Business investment grew 9–10% in each of the last two quarters, led by equipment (13.4%) and IP products (9.2%), where AI spending shows up.
- Consumers rebounded in Q2: durable goods +7.4%, services +3.4%, after a 0.7% first quarter.
- Weak spots: structures fell four straight quarters and housing five before Q2; federal spending swung with the shutdown and fell again.

By the numbers

13.4% Equipment investment, Q2 (15.5% in Q1)

9.2% IP products (software, R&D), Q2

−2.4% Federal spending, Q2; nondefense −12.7%

2.8% Housing: first gain after five straight declines

Why it matters

The investment boom is narrow: machines and software are booming while buildings, housing, and government lag. Growth this concentrated depends on the AI build-out continuing.

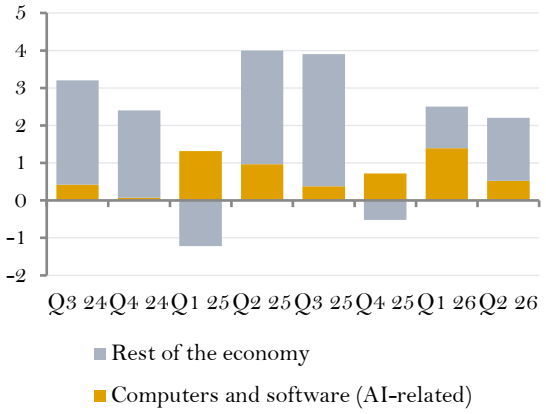
Source: BEA, NIPA Table 1.1.1, Q2 2026 third estimate with the annual update (Sept 30, 2026), as compiled in the client's feed; seasonally adjusted annual rates.

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The AI Engine: One Theme Drives Growth, Markets, and the World

AI spending now powers U.S. investment, profits, and the wealth effect, and ties economies abroad to it; that concentration is strength and fragility at once.

Contributions to real GDP growth, pts



AI investment	2026 estimate
Global AI	~$1 trillion
U.S. AI	~$581bn; 1.8% of GDP
Big-tech capex	~$725–800bn
Share of growth	~1.4 of 2.8 pts (half)

Gross figures; much AI hardware is imported, so the net lift to U.S. GDP is smaller. U.S. share rises to 2.5% of GDP in 2027. BEA data exclude data-center buildings.

1. Build
Data centers, chips, servers, and power

2. Earn
Profits and stock prices of AI leaders

3. Spend
Wealth effect at the top of the K

4. Ripple abroad
Asian chips, Dutch tools, foreign capital

By the numbers

56% Share of Q1 2026 GDP growth from computers and software (24% in Q2)

~⅓ Their share of growth over the past four quarters

47% AI goods' share of world trade growth in 2026 (WTO)

88% Share of U.S. stocks owned by the top 10%

Strength and fragility

The same concentration that powers growth makes the U.S. and the world more dependent on AI investment and revenue. It shows vulnerability, possible fragility, and perhaps brittleness.

Perspective: AI is re-globalizing the world through money

The dependence can only get narrower as investors pile in and countries and industries follow. Whatever people say about deglobalization in trade, AI is re-globalizing the world through tightly connected financial and investment networks. That concentration is a vulnerability: when it breaks, the effect will cascade across markets and countries and reach every part of the K.

Sources: BEA via FRED (Y034RY2Q224SBEA, B985RY2Q224SBEA, A191RL1Q225SBEA); Goldman Sachs (Aug 7, 2026); Bridgewater (Jan 2026); WTO (Oct 2026); full sources in the endnotes.

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AI Concentration Risk: How the Loop Builds and How It Could Break

On the way up, each step feeds the next and more of the world plugs in; on the way down, the same links carry the shock to every part of the K.

THE LOOP: HOW CONCENTRATION BUILDS

1. AI capital spending
~$725–800bn by big tech in 2026; ~$1tn worldwide

→

2. AI revenue and earnings
S&P 500 profits expected +25–32% in 2026

↓

3. Stock prices and wealth
AI leaders lift the index; top 10% own 88% of stocks

←

4. Capital piles in
Global investors, bonds and private credit fund more spending

↑

Self-reinforcing

the more it works, the more money flows in

WHO NOW DEPENDS ON IT

U.S. economy
~⅓ of GDP growth; spending at the top of the K

Asia and Europe
Taiwan and Korea chips, Dutch tools, Mexican assembly

Global investors
Foreigners own ~20% of U.S. stocks; Gulf and Asian capital in data centers

IF IT BREAKS: THE CASCADE

Trigger
AI revenue disappoints, or financing costs jump

→

Markets
Earnings miss; AI stocks and the index reprice

→

Spending
Capex is cut; Asian chip exports and Dutch tool orders fall

→

Finance
Wealth effect reverses; credit losses; foreign selling of U.S. assets

→

Every part of the K
Top loses wealth; bottom loses jobs and hours

Perspective: the dependence can only get narrower as investors pile in and countries and industries follow. AI is re-globalizing the world through money; the same links that spread the gains would spread the losses.

Figures as cited in this commentary (Goldman Sachs, BEA, FactSet, Federal Reserve, Treasury TIC, WTO). Flow and cascade are not a forecast of timing.

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Compute Economics: Scarce Power, Cheaper Chips, Borrowed Money

Power-ready data centers are scarce while older chips get cheaper; leveraged owners renting out fast-aging chips are the weakest link.

How AI computing is rented

1. Owner buys
Hyperscalers and "neoclouds" buy chips, often with debt

▶

2. Customers rent
Time by the hour (~$2–3 for an H100) or 1–3 year contracts

▶

3. Re-rented
Chips stay in the data center; next customer takes the slot

▶

4. Aging chips
Shift to lighter work, resale, then recycling; rarely back to Nvidia

Signal	Latest	Reads as
Data center vacancy, primary U.S. markets	1.4%, a record low (N. Virginia 0.24%)	**Shortage**
Under construction	7,481 MW, 80% leased in advance	**Shortage**
H100 rental rates, smaller providers	Down ~20–50% in 2026	**Glut**
Big-tech capex vs free cash flow	~$800bn; cash flow near zero for most	**Strain**
Debt share of big-tech capex	32%, up from 9% in 2024	**Strain**
Off-balance-sheet commitments	~$3tn: $1.9tn chip and server orders + $1.2tn signed leases not yet started	**Strain**

Where it could crack

- Chips as collateral: many neoclouds borrowed against their chips; falling rental rates thin that cushion
- Accounting vs real life: chips are written off over 5–6 years, but a new generation arrives every 1–2 years, so profits may be overstated.
- Chip gains now come mostly from packaging, memory, and lower precision rather than smaller transistors; each step is costlier, so upgrades should moderate.
- Likely shape: a slower growth rate, not a sudden stop; cracks appear first where financing is thinnest

By the numbers

1.4% — Data center vacancy, primary U.S. markets (H1 2026)

$0.8tn — Big-tech capex guided for 2026, up ~80%

32% — Share of that capex funded with new debt

−20%+ — H100 rental rates this year at smaller providers (down 20–50%)

Perspective

The shortage is in power and permits, not chips. The first cracks would show among leveraged owners renting a fast-depreciating asset, then travel up the chain shown on the previous page.

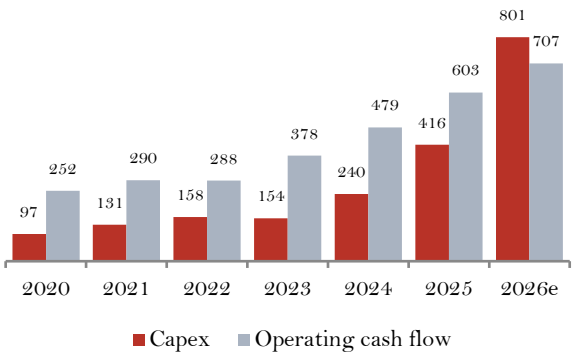
Sources: CBRE H1 2026 (Aug 28) via Data Center Frontier; FactSet (Jul 23, 2026); WSJ analysis of filings via 24/7 Wall St. (Aug 22, 2026); Data Center Knowledge (May 13, 2026); full sources in the endnotes.

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Hidden Leverage: How the AI Build-Out Is Financed

Big-tech capex now exceeds operating cash flow, so a growing share of the build-out is financed in project vehicles and private credit, off company balance sheets

Microsoft, Amazon, Alphabet, Meta, Oracle: $bn



Case study: Meta's Hyperion

Item	Detail
Asset	~$30bn, 2 GW (Louisiana)
Debt	$27bn, A+; largest U.S. IG corporate bond
Debt / asset	~90%
Debt-service cover	1.12x
Cost	6.58%, 1+ pt above Meta's own rate
Leases	4-yr terms + value guarantee

Where the risk sits

- The four largest hold ~$2.4tn of commitments (Alphabet $902bn, 9x a year earlier; Meta ~$700bn); only ~1/5 of data-center obligations is on balance sheets, and leases lift debt from 20% to 48% of capital
- Alphabet and Amazon are now free-cash-flow negative, Meta expected to follow; Amazon says $220bn of 2026 capex still won't meet cloud demand (AWS +37% in Q2)
- Credit is splitting: default-swap spreads widened for all five; AI-linked bonds widened (IG ~75 bp, high yield 150+ bp) while other credit is near its tightest
- The revenue bar: ~$3.55tn a year (8.8% of 2032 GDP) to earn a 10% return, about $6.40 per GPU-hour, close to today's rental rates
- Mismatch: two-thirds of the cost is chips that age in a few years, funded with debt as long as 2049; data-center REITs now move with the market (beta ~1, from ~0.5)
- Circular ties: the IMF counts 14 deals since 2023 (~$300bn equity, $650bn debt) tied to $1.4tn of revenue commitments; Nvidia backs up to $125bn

By the numbers

$800bn Capex in 2026, above $707bn of operating cash flow for the first time

1/5 Share of data-center obligations on balance sheets (four largest)

$450bn AI-related debt issued in 2026 by early Sep, 2x all of 2025 (BOE)

$3.55tn Annual revenue needed to earn a 10% return

Perspective

Not a sign of imminent distress, though the Bank of England now ranks AI among the top risks. The concern is visibility: debt moves off company balance sheets into project vehicles and private credit, where linked exposures are hard to see before a downturn.

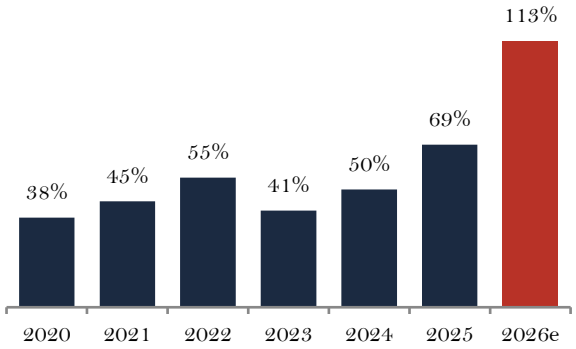
Sources: Van Nieuwerburgh, NBER w35865 (Oct 2026), drawing on filings, S&P, Moody's, WSJ and Morgan Stanley; Bloomberg (Jul 31, 2026); WSJ via DoubleLine (Sep 2026); full sources in the endnotes.

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Rich on Paper, Tight on Cash: Why Profitable Giants Are Borrowing

The old businesses still earn record profits, but AI spending now absorbs all of their cash and more, turning a flexible budget into fixed commitments.

Capex as % of operating cash flow (Microsoft, Amazon, Alphabet, Meta, Oracle)



Where the cash goes

Five companies, $bn	2020	2026e
Operating cash flow	252	707
Capex	97	801
Left after capex	155	−94

How the pieces fit

- Profits come from the old businesses: ads, software, and cloud fund the build-out; AI's own revenue is still small next to the spending.
- Profit and cash are diverging: spending leaves as cash now but reaches earnings slowly through 5–6 year depreciation, so earnings look strong while free cash flow nears zero.
- Cash once returned to shareholders now goes to AI: buybacks, dividends, and deals compete with capex, and debt fills the gap
- Spending is turning into fixed costs: ~$3tn of signed chip orders and leases must be paid whether or not AI revenue arrives; only unsigned projects can be cut cleanly.
- Everything rests on the cash machine: an ad slowdown, AI taking share from search, or regulation would force less buyback, more borrowing, and fewer new projects.
- The weakest links have no cash machine: smaller cloud providers carry commitments and debt without old businesses behind them, so they crack first.

By the numbers

113% 2026 capex as a share of operating cash flow, from 38% in 2020

~$3tn Signed chip orders and leases not yet on balance sheets (nine firms)

$784m Meta's Q2 free cash flow, down 91% from a year earlier

5–6 yrs Chip write-off period, vs a new generation every 1–2 years

Perspective

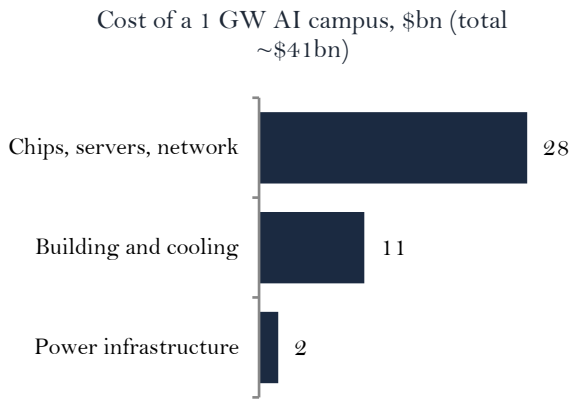
The giants can absorb a setback by cutting buybacks and new projects. The economy built around their spending cannot: that cut is the AI slowdown on the list of what could tip the balance.

Sources: Van Nieuwerburgh, NBER w35865 (Oct 2026), from company filings; WSJ analysis via 24/7 Wall St. (Aug 22, 2026); Reuters (Jul 30, 2026); full sources in the endnotes.

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What a Gigawatt Costs: The Build-Out Is Bidding Up Prices

A 1 GW AI campus costs tens of billions, and the race to build them is pushing up prices for chips, power equipment, land, materials, and skilled labor.



Van Nieuwerburgh (NBER); a 1 GW Abilene, Texas campus ~$30bn (C&W, BI). Scale: 1 GW ≈ one large nuclear reactor ≈ average use of ~850,000 U.S. homes (EIA).

Inputs the boom is bidding up

Input	Change
Memory chips	>5x a year ago
New gas power plants	~3x cost to build
Generators	2.5–3 yr wait
Power equipment	Backlogs past 2030
Powered land	$584k/MW, +51%
Construction per MW	+21% since 2024
Skilled labor	~+6% (2025)

Why it matters for growth and inflation

- Meta, Amazon, Microsoft, and Alphabet expect ~$750bn of capex this year: more than the GDP of Ireland or Belgium, ~$5,500 per U.S. household.
- The build-out competes with the rest of the economy for copper, steel, electricians, and power equipment, one reason costs are rising upstream (p. 75).
- Capacity added by 2032 (~188 GW) would use about as much power as all U.S. homes today; ~43% of announced capacity is expected never to be built.
- Delays are real: Oracle declared force majeure on a New Mexico campus in September after a key gas pipeline stalled in permitting.

By the numbers

$41bn Cost per GW; about two-thirds is chips and IT

5x Data-center memory prices vs a year ago

+21% Data-center construction cost per MW since 2024

60 GW+ U.S. capacity in four years, ~3x today; ≈ 50m homes

Perspective

AI is a source of cost pressure as well as demand. Until supply of power equipment, chips, and skilled labor catches up, the build-out adds to inflation even as it adds to growth.

Sources: Van Nieuwerburgh, NBER w35865 (Oct 2026); Bloomberg (Oct 2026), citing Cushman & Wakefield and Bloomberg Intelligence; EIA; full sources in the endnotes.

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The AI Stack: AI Exposure Reaches Far Beyond Chips

AI exposure in a portfolio includes the chips plus the software, cloud, networks, buildings, power, materials, and money the build-out needs.

CORE AI: where models are built, run and sold		
Applications	AI features in software, search, ads and devices	*Microsoft, Alphabet, Meta, Salesforce, ServiceNow*
Cloud and models	Rent computing power and build the large models	*Amazon (AWS), Microsoft (Azure), Google Cloud, Oracle, CoreWeave*
Chips and memory	Processors and high-speed memory that do the math	*Nvidia, AMD, Broadcom, Micron, SK Hynix*
Chipmaking	Foundries and the machines that make chips	*TSMC, Samsung, ASML, Applied Materials, Lam Research*
AI-ENABLED BUILD-OUT: what AI needs in the physical world		
Networking and servers	Switches, optical fiber and server assembly	*Arista, Cisco, Corning, Dell, Super Micro*
Data centers and cooling	Buildings, racks, power distribution, cooling	*Equinix, Digital Realty, Vertiv, Schneider Electric*
Power and grid	Generation, turbines, transformers, grid builders	*GE Vernova, Siemens Energy, Eaton, Constellation, Vistra, Quanta*
Materials and financing	Copper, uranium, natural gas; bonds and private credit	*Freeport-McMoRan, Cameco; banks and private-credit lenders*

Companies are examples of each layer, not recommendations; many span several layers.

Local exposure: data centers fund 39% of Loudoun County, Virginia's budget ($1.2bn, FY2026); new applications were paused in September.

By the numbers

$9.0tn — AI build-out 2025–32: ~3.2% of GDP a year vs ~2.2% for railroads (NBER)

4.4% — U.S. power used by data centers in 2023; 6.7–12% by 2028

~2x — Global data center power use by 2030, to ~945 TWh (IEA)

9 of 11 — S&P sectors with companies in this stack (Morningstar)

Perspective

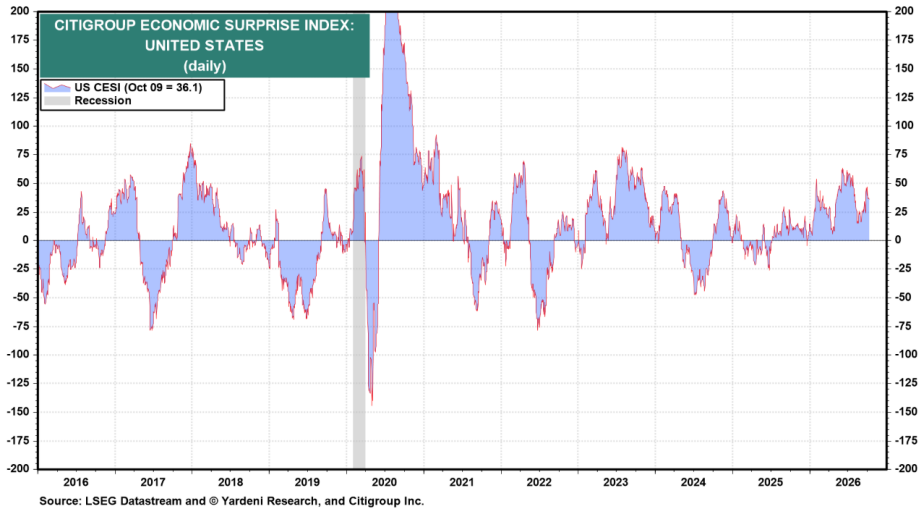
AI is a theme, not a sector. A portfolio with no chip stocks can still lean on AI through software, utilities, industrials, real estate, and credit; holdings with different labels may share one driver.

Sources: Van Nieuwerburgh, NBER w35865 (Oct 2026); U.S. DOE/LBNL (Dec 2024); IEA, Energy and AI (Apr 2025); Loudoun County (FY2026 budget); NBC Washington (Sep 2026); company filings.

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October 15, 2026

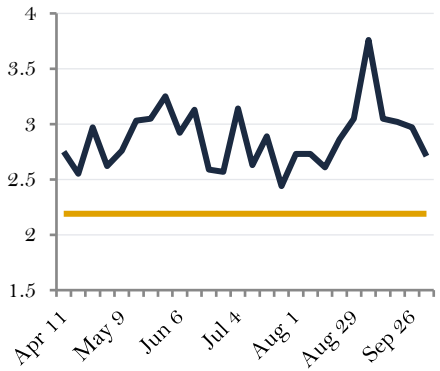
Real-Time Gauges: Weekly Activity Near 3%, Data Still Beating Forecasts

The Dallas Fed's weekly index points to growth near 2.7–3.0%; Citi's surprise index (36.1 on Oct 9) shows data still beating forecasts.



Citi Economic Surprise Index, U.S., daily, as of Oct 9, 2026

Dallas Fed WEI vs 4-qtr GDP growth (2.19%)



How to read them

- WEI combines 10 daily and weekly series (consumer spending, jobs, production); a reading of 3 means activity consistent with 3% annual growth.
- Citi's index measures whether data beat or miss economists' forecasts; it has stayed positive all of 2026 and rebounded to 36.1 after a late-summer dip.
- Together: the economy is still growing at or above trend, and data keep beating forecasts even as weekly activity cools.

By the numbers

2.71%	WEI, week ended Oct 3
2.88%	WEI 13-week average
3.76%	WEI high this year (week of Sep 5)
36.1	Citi surprise index, Oct 9: data beating forecasts

Why it matters

High-frequency data agree with the nowcasts: solid growth. Weekly activity has cooled from its September high, but data still beat forecasts, which supports the Fed's case for staying tight.

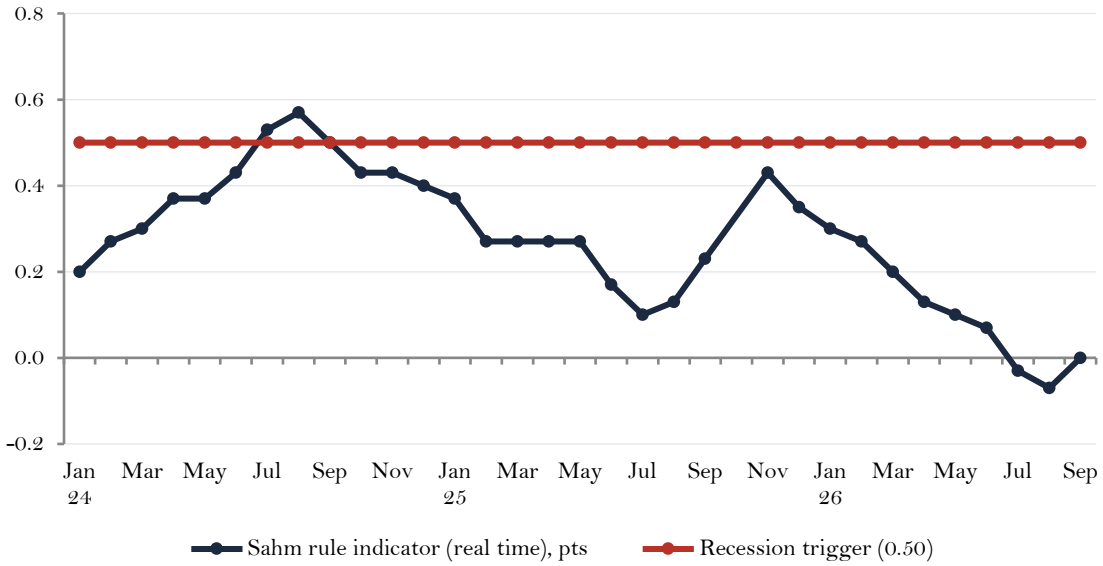
Sources: Dallas Fed, Weekly Economic Index (FRED: WEI; week ended Oct 3, 2026; 13-week avg. from Dallas Fed); Citigroup Economic Surprise Index via LSEG Datastream and Yardeni Research; full sources in the endnotes.

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Recession Watch: The Sahm Rule Says No

The real-time Sahm indicator was 0.00 in September, far below the 0.50 trigger, as unemployment held near 4.2%.

Sahm rule recession indicator, percentage points (Oct 2025 not published: shutdown)



How it works

- Signals a recession when the 3-month average unemployment rate rises 0.50 point above its low of the prior 12 months.
- It crossed 0.50 in mid-2024 (0.57 in Aug) without a recession, a reminder it is a rule of thumb, not a forecast.
- Today unemployment (4.2%) is at its 12-month average: low hiring, but no rise in joblessness.

By the numbers

0.00	Sahm indicator, Sep 2026
0.57	Aug 2024 reading: a false alarm
4.2%	Unemployment rate, Sep 2026
9.5	Sahm peak in 2020 (3.9 in 2009)

Why it matters

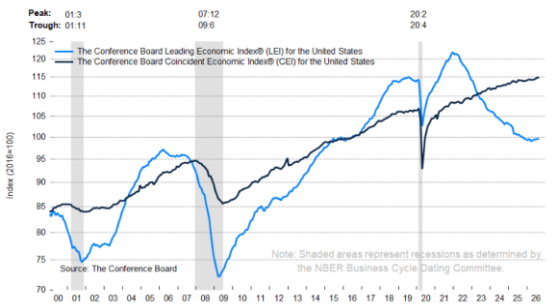
No recession signal from the labor market today. The risk is the "low hire" side: if layoffs rise, there is little hiring to absorb them, and the indicator can move fast.

Sources: St. Louis Fed, FRED: SAHMREALTIME (Claudia Sahm), updated Oct 2, 2026; BLS unemployment rate (UNRATE). October 2025 not published due to the government shutdown.

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Leading Indicators: Slipping, but No Recession Signal Yet

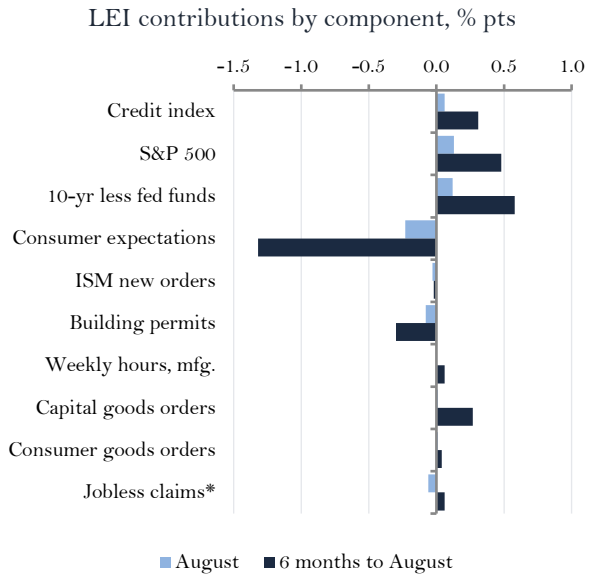
Conference Board LEI, August 2026: down 0.1% to 99.5; six-month change −0.1%, with diffusion above 50, so the 3Ds rule did not signal a recession.



Leading (blue) vs coincident (black) index, 2016=100, to Aug 2026



LEI six-month growth, annualized, with 3Ds signals, to Aug 2026



**Inverted series. Components need not sum to the LEI change (trend adjustment).*

Reading the 3Ds rule

- Duration and depth: six-month LEI growth, annualized, below −4.3%
- Diffusion: half or fewer of the 10 components rising over six months
- Both together signal a recession. August met neither: growth just below zero, diffusion above 50
- The rule flashed for much of 2022–24 with no recession: a guide, not a forecast

By the numbers

99.5	LEI, Aug 2026 (2016=100): −0.1%, after +0.2% in July
−0.1%	Six-month change, Feb–Aug (−0.6% in the prior six months)
>50	Diffusion: most components not weakening
−4.3%	Recession threshold, annualized: not breached

Why it matters

Stocks, the yield curve and credit supply the gains; consumer expectations are the biggest drag. Markets look better than households feel, the K-shape in a single index.

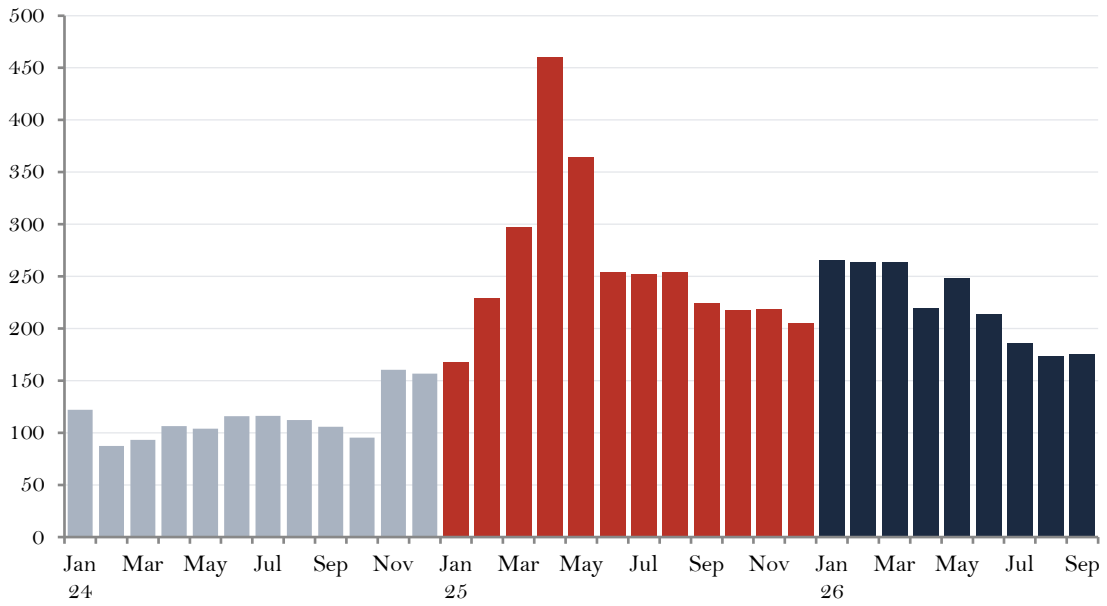
Source: The Conference Board, US Leading Indicators, August 2026 (charts and contribution data reproduced from the Conference Board release as compiled in the client's feed).

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Policy Uncertainty: Well Below the 2025 Tariff Peak, Still Elevated

The Economic Policy Uncertainty index fell to about 175 in September 2026 from 460 in April 2025, but remains ~50% above its 2024 average.

U.S. Economic Policy Uncertainty index, monthly (Sep 2026 preliminary)



What the index measures

- News coverage of economic policy uncertainty in 10 large newspapers (the main component)
- Federal tax provisions set to expire, from CBO lists, weighted by dollar value
- Disagreement among professional forecasters on inflation and government spending (Philadelphia Fed survey)

By the numbers

460	April 2025 peak (tariff announcements)
~265	Jan–Mar 2026, as the Iran war began
175	September 2026 (preliminary)
115	2024 average

Why it matters

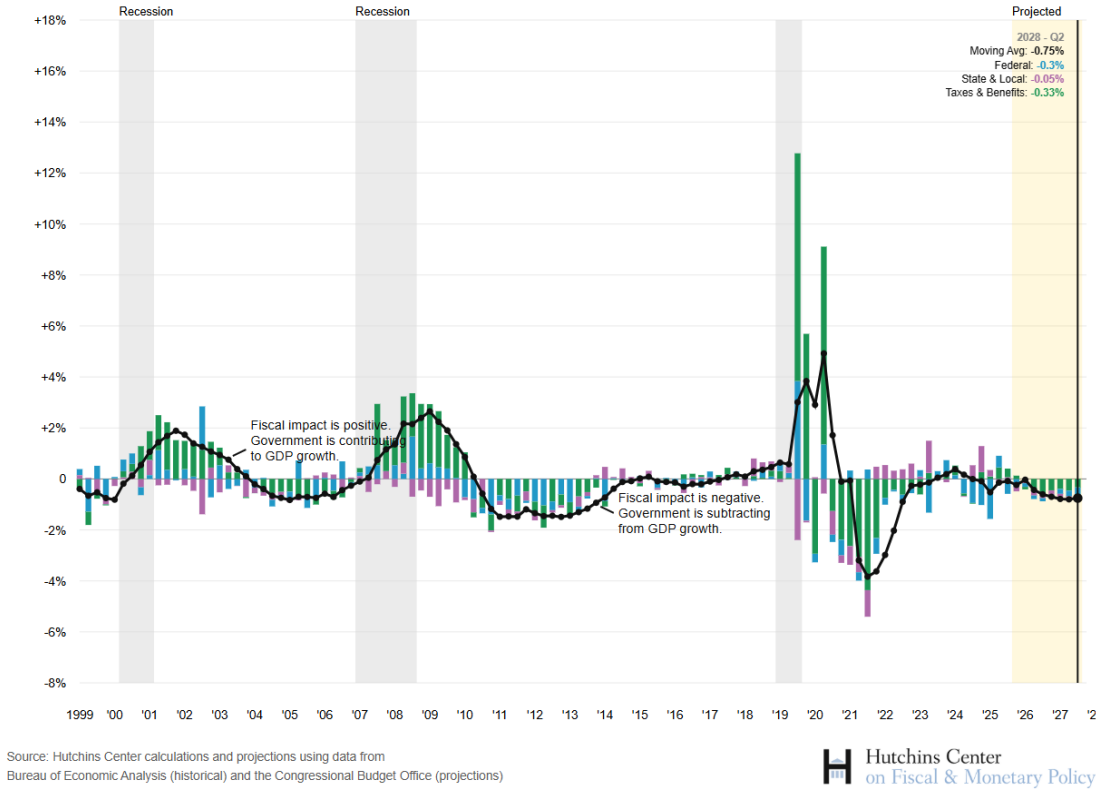
Uncertainty has eased from crisis levels, which supports hiring and investment plans. It remains high by historical standards: war, tariffs, and a hiking Fed keep it there.

Sources: Baker, Bloom and Davis, Economic Policy Uncertainty Index, via FRED (USEPUINDXM), updated Sept 30, 2026; September value may be revised.

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Fiscal Policy: A Small Drag on Growth Now, a Bigger One Ahead

Brookings' Fiscal Impact Measure: government taxes and spending subtracted 0.1 point from Q2 growth; the drag is projected to widen into 2027.



Hutchins Center Fiscal Impact Measure, quarterly contribution to real GDP growth (chart as captured by the author)

- Q2 2026: fiscal policy subtracted 0.1 point; federal purchases −0.4 and state and local −0.1, partly offset by the One Big Beautiful Bill Act tax cuts and transfers
- Rest of 2026: "moderately restrictive," with tax cuts only partly offsetting weak government purchases and tariffs; the drag grows in 2027

By the numbers

−0.1 pt	Fiscal impact on Q2 2026 GDP growth (Sept 30 update)
−0.4 pt	Federal purchases, Q2
2.2%	Q2 real GDP growth (third estimate)
2027	Drag projected to grow

Why it matters

Despite a $2 trillion deficit, fiscal policy is not adding to growth: interest costs and transfers, not purchases, drive the deficit. Growth is coming from private demand and AI investment.

Sources: Brookings, Hutchins Center Fiscal Impact Measure (updated Sept 30, 2026); chart reproduced from the Hutchins Center as captured by the author (may predate the Sept 30 update).

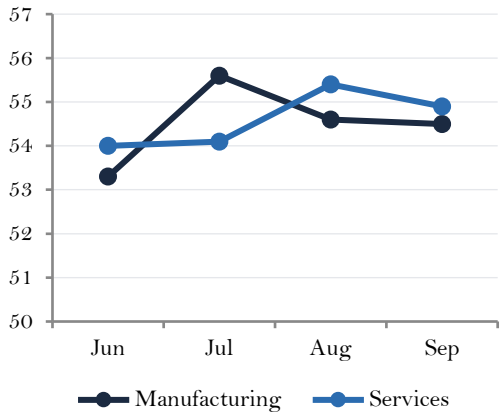
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Purchasing Managers: Expansion Continues, Prices Run Hot

ISM manufacturing (54.5) and services (54.9) grew in September; prices paid in the mid-70s show the oil shock spreading.

ISM index (50+ = expansion)	Mfg Sep	Mfg Aug	Services Sep	Services Aug
Headline PMI	54.5	54.6	54.9	55.4
New orders	55.3	53.7	59.8	60.9
Production / business activity	56.7	58.3	56.5	61.7
Employment	52.7	51.2	50.1	47.8
Prices paid	**77.9**	71.1	**74.0**	72.6
Supplier deliveries	59.0	59.3	53.2	51.3
Backlog of orders	56.4	51.8	56.6	n/a

Headline PMIs, 2026



Reading the survey

- Manufacturing has expanded for nine straight months, helped by AI equipment and data-center orders.
- Prices paid jumped to 77.9 in manufacturing: input costs are rising faster than at any point this year.
- Hiring is barely growing: services employment just crossed 50.

By the numbers

54.5 ISM manufacturing PMI, Sep (9th month above 50)

54.9 ISM services PMI, Sep

77.9 Manufacturing prices paid, up from 71.1

50.1 Services employment, from 47.8

Why it matters

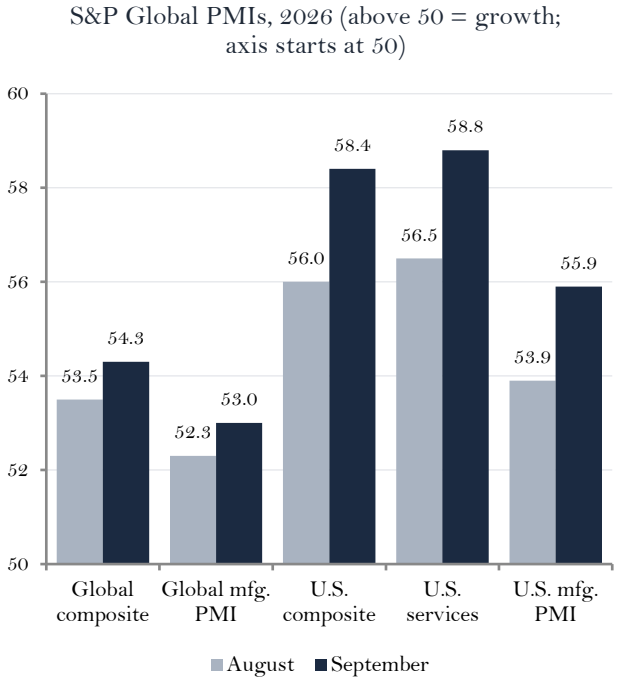
Businesses are busy, but their costs are surging. Hot price indexes support the Fed's view that inflation risks lean higher, even as hiring stays soft.

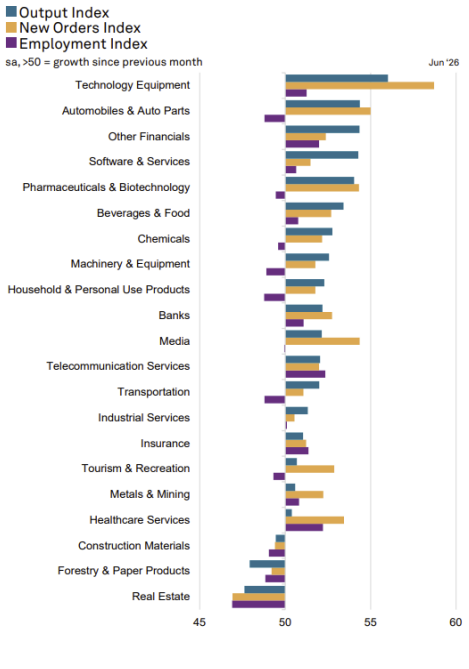
Sources: ISM, Manufacturing and Services Reports on Business (Sept 2026; released Oct 1 and 5); component detail via First Trust; Jun–Jul headlines via Trading Economics (secondary).

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Global PMIs: Fastest Growth in 40 Months, Costs Re-Accelerate

S&P Global PMIs for September 2026: global output, orders, and hiring at multiyear highs, led by the U.S.; input-cost inflation is climbing again.





Source: S&P Global PMI.

Global sector PMI, June 2026 (stale; latest in the feed)

By the numbers

54.3 J.P.Morgan Global Composite, Sep (53.5 Aug)

53.0 Global manufacturing PMI, highest since Feb 2022

58.4 S&P Global U.S. composite (56.0 Aug)

51.9 Global employment index, fastest since May 2023

Why it matters

The upturn now spans services and hiring worldwide, with the U.S. and tech goods out front: the global co-dependence on one engine. Rising price gauges echo the ISM survey.

What the September surveys say

- Global: composite up for a sixth month to 54.3, a 40-month high; new orders fastest since Feb 2022; 12 of 15 countries grew, led by the U.S., Spain and India
- U.S.: manufacturing 55.9, strongest since May 2022; services 58.8; supplier delays the longest in over four years
- Prices: global cost inflation near a four-year high; selling-price inflation picked up again
- Sectors (June): technology equipment led output and new orders; real estate ranked last

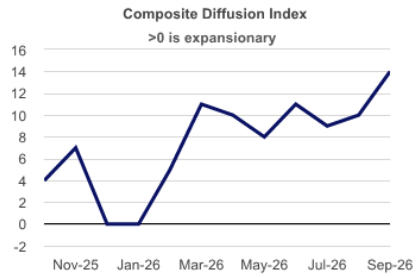
Sources: S&P Global and J.P.Morgan, Global Composite and Manufacturing PMIs (Oct 5, 2026); S&P Global US Manufacturing (Oct 1) and Services PMIs (Oct 5); Sector PMI (June).

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Regional Factory Surveys: Mixed Activity, Prices Running High

September 2026: Kansas City and California strengthened, New York cooled, and Richmond contracted; prices paid rose almost everywhere.

Kansas City Fed: composite 14



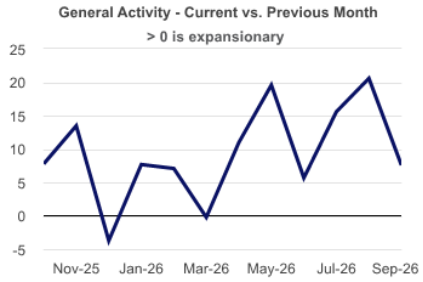
Rose from 10; new orders 24, the year's best. Hiring flat; raw-material costs outpace selling prices

California purchasing managers



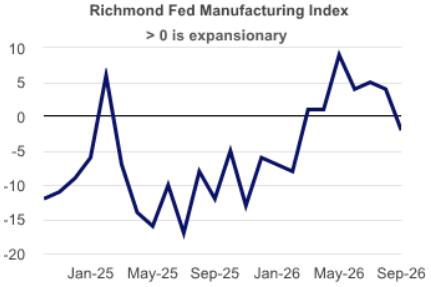
Quarterly; not a Fed survey. Q3 at a three-year high; orders, jobs and inventories up; steel prices still rising

New York Fed (Empire State): 7.6



Down from 20.6; new orders 2.0, shipments −3.2. Prices paid 63.1, the highest since mid-2022

Richmond Fed: composite −2



Down from 4, first negative since February; new orders −6. Prices paid at a one-year high

Common thread: costs. Energy from the Iran war, steel, and tariffs push input prices up faster than firms can raise their own, squeezing margins even where orders are strong.

By the numbers

14	Kansas City Fed composite, Sep
7.6	Empire State conditions, Sep (20.6 Aug)
−2	Richmond Fed composite, Sep (4 Aug)
63.1	Empire State prices paid, highest since mid-2022

Why it matters

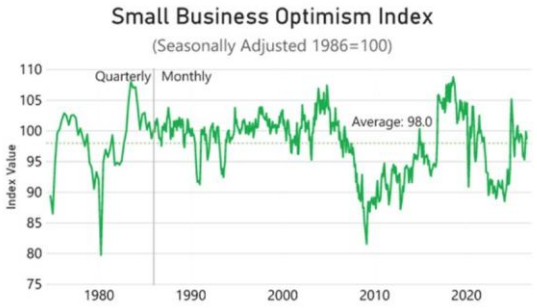
Factory momentum is uneven by region, but cost pressure is broad. Margins are being squeezed, which can show up later as higher prices or slower hiring.

Sources: Federal Reserve Banks of Kansas City, New York and Richmond, Sept 2026 surveys; California composite and charts via Moody's Analytics (client feed).

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Small Business: Optimism Slips, Uncertainty Stays High

NFIB, August 2026: optimism fell to 98.7, just above its 52-year average; uncertainty eased to 89 but remains far above normal.



NFIB Small Business Optimism Index



NFIB Uncertainty Index

Single most important problem	Share
Labor quality	23%
Taxes	16%
Inflation (up 2 pts)	16%
Poor sales (up 2 pts)	10%
Labor costs (lowest since 2021)	7%

Other signals, August

- Expected business conditions: net +10%, down 5 points (average +4%)
- Sales: net −9% saw higher sales, the lowest since Nov 2025
- Earnings trends: net −19%; hiring plans 17%, down 3
- Credit: net −2% expect easier conditions, the best since Dec 2024

By the numbers

98.7 Optimism Index, Aug (July 99.8; average 98.0)

89 Uncertainty Index (average 68)

28% Net share planning price increases

62% Owners affected by supply-chain disruptions

Why it matters

Small firms are holding up, but sales are slipping and inflation is climbing their list of worries. September data is due around Oct 13.

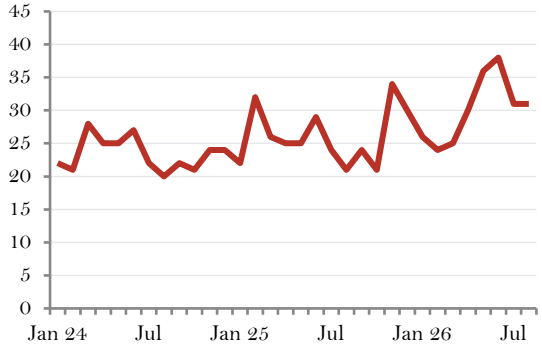
Sources: National Federation of Independent Business, Small Business Economic Trends, August 2026 (charts reproduced from the NFIB report as captured by the author).

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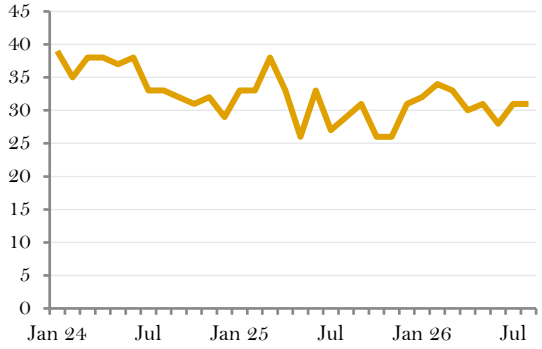
Small Business Detail: Prices Rising, Sales and Hiring Softening

NFIB survey, net percent of owners reporting actual changes, January 2024 – August 2026 (seasonally adjusted)

Actual price changes, net % higher
(Aug: 31)



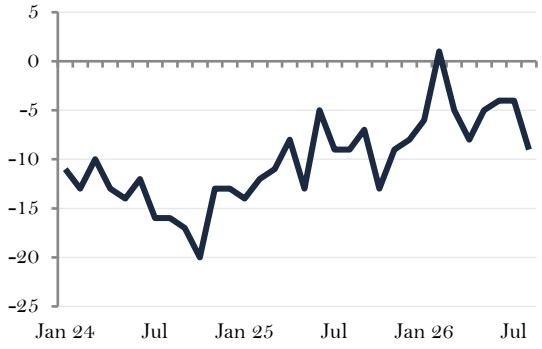
Actual compensation, net % higher
(Aug: 31)



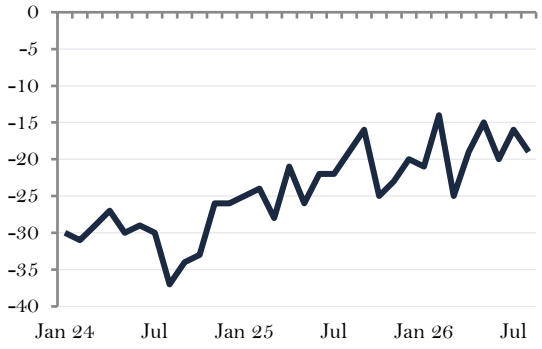
Job openings unfilled, % of owners
(Aug: 35)



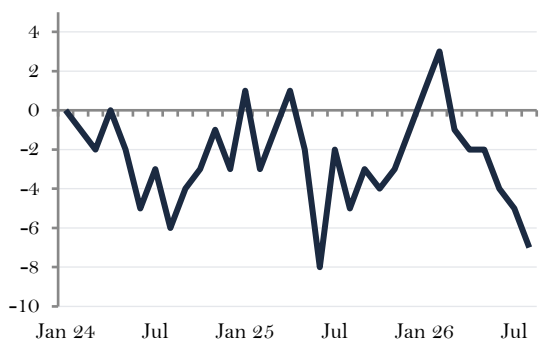
Actual sales changes, net %
(Aug: −9)



Actual earnings changes, net %
(Aug: −19)



Actual employment changes, net %
(Aug: −7)



Takeaway: more owners are raising prices (net 31%, up from ~22% in early 2025) while sales, earnings, and employment changes have turned weaker this summer.

Sources: National Federation of Independent Business, Small Business Economic Trends, August 2026 (monthly tables); charts are a reconstruction from NFIB's published tables.

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Perspective: The Job Market Is Stuck, Not Strong

Section 2: employers are neither hiring nor firing; that looks stable, but stability built on inertia is fragile.

What the data says

- Payrolls averaged 51,000 a month in Q3, almost all from three sectors (health care and education, construction, manufacturing); revisions cut 116,000
- Unemployment 4.2%, layoffs 1.0%, quits 1.9% and hires 3.3%: little movement in any direction
- 7.1 million openings, yet hiring is slow: information posts 4.3% openings but hires only 1.6%; job searches average ~25 weeks

Assessment

Stuck, not strong. Employers are not firing because they remember how hard it was to hire, and they are not hiring because they are unsure about demand, costs, and how much AI will change the work. Workers sense it and stay put. Openings stay posted while few are filled. The result looks stable, but with hiring this slow, even a modest rise in layoffs would push unemployment up quickly, because there is little hiring to absorb those who lose jobs. Low unemployment also reflects a shrinking labor force, down about 1 million people in a year, not abundant opportunity.

What would change the view

- Hiring revives: the hires rate climbs back toward 3.6%+ and openings in information and professional services start being filled.
- The warning sign: layoffs rise above ~1.3% and the Sahm indicator moves off zero.

The question

Is the job market strong, or just stuck?

The view in one line

No hire, no fire: calm on the surface, fragile underneath.

Where to look

p. 30 JOLTS
p. 31 Jobs by sector
p. 34 Unemployment and payrolls
p. 36 Job searches

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Labor Market: "No Hire, No Fire" Holds in August

BLS Job Openings and Labor Turnover Survey (JOLTS), August 2026: little movement in hiring, quitting or layoffs

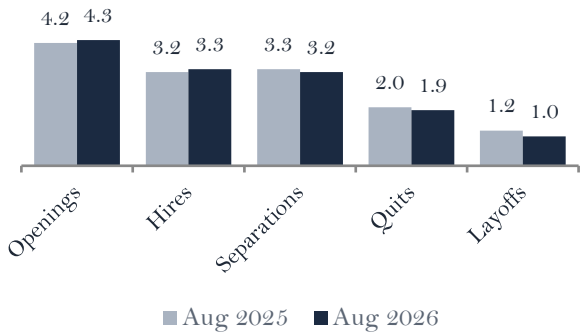
7.1m Job openings (4.3% rate), vs 6.9m a year ago

3.3% Hires rate (5.2m), unchanged on the year

1.9% Quits rate (3.1m), down from 2.0%

1.0% Layoffs rate (1.6m), down from 1.2%

Rates, % (Aug 2025 vs Aug 2026)



How to read it

Low hire
Firms keep openings posted but hire at a slow 3.3% pace

Low fire
Layoffs rate 1.0%, lowest of the five months BLS reports

Staying put
Quits at 1.9% show workers see few better jobs

What it means

Stable, not strong: Hires beat separations by only ~120k: slow net job growth
Job security: Few layoffs fit the Fed's full-employment view
Wage pressure capped: Low quits usually mean smaller pay gains
Openings ≠ hires: Openings are jobs posted; hires are jobs filled. A wide gap points to picky employers, skill mismatches, roles on hold while firms test AI, and fewer quits to replace
Read openings with care: About a third of firms answer the survey (high 60s a decade ago) and many postings are never filled; hires and quits are better gauges

Where the openings are

Job openings rate, Aug 2025 → Aug 2026

Durable goods mfg.	3.1% → 4.6%
Finance & insurance	3.5% → 5.0%
Retail trade	3.8% → 4.7%
Accommodation & food	6.2% → 4.7%
Real estate	3.6% → 2.0%
Information	4.7% → 4.3%

Also notable

- Information: 4.3% openings but 1.6% hires, lowest of any private industry
- Retail hires up 19% y/y (562k → 667k)
- July openings revised up to 7.3m

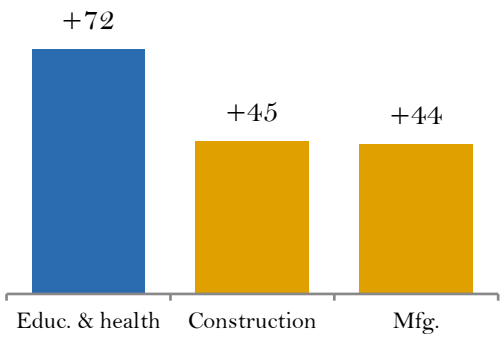
Source: US Bureau of Labor Statistics, Job Openings and Labor Turnover – August 2026 (USDL-26-1547, Sept 29, 2026), seasonally adjusted; BLS JOLTS response rates; full sources in the endnotes.

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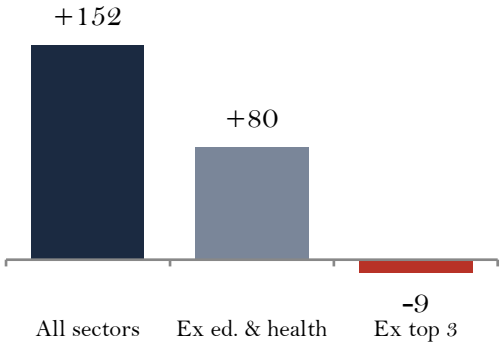
Jobs: Health Care and Blue-Collar Work Are Carrying Hiring

BLS payrolls, July–September 2026: three sectors added 161,000 jobs; the rest of the economy lost 9,000

Top 3 sectors, jobs added Jul–Sep (000s)



Total payroll change, Jul–Sep (000s)



Inside the leaders

- Health care: hospitals and outpatient care added ~48k from July to September; nursing homes lost ~7k
- Construction: nonresidential specialty trades +18k since July, while residential trades fell
- Manufacturing: up 72k since its December 2025 low

Where jobs are shrinking

- Financial activities –26k (down 129k since May 2025, mostly insurance)
- Information –24k; professional and business services –20k
- Government –11k; temp help –21k over the three months

Sector detail compares July and September levels.

The split: hands-on jobs are growing; office jobs in finance, tech, and business services are shrinking.

By the numbers

51k Average monthly job gain, Jul–Sep

27k Average without education and health

+87k Goods-producing jobs (construction, manufacturing, mining), 3 months

4.2% Unemployment rate, Sept

Why it matters

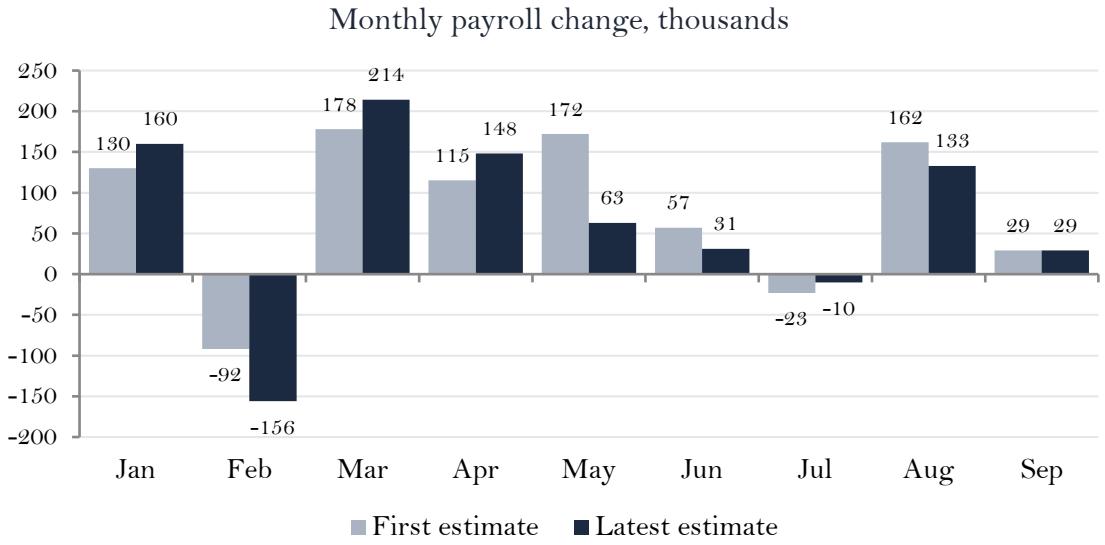
Job growth is narrow. Strip out the top three sectors and payrolls fell over the quarter, consistent with the "no hire, no fire" picture in JOLTS.

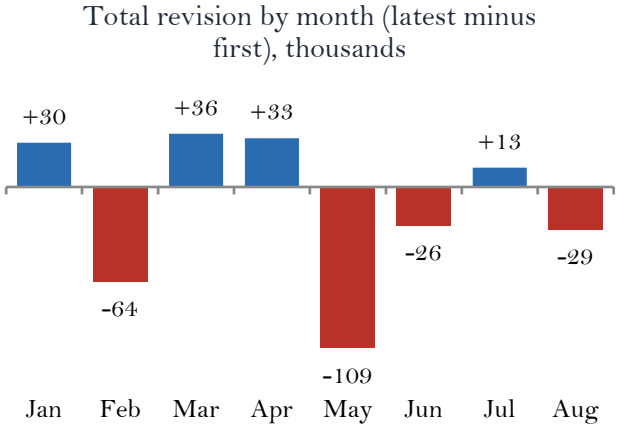
Source: BLS, The Employment Situation – September 2026 (USDL-26-1549, Oct 2, 2026), Summary table B and Table B-1, seasonally adjusted; August and September are preliminary; full sources in the endnotes.

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Payroll Revisions: 2026 Job Growth Was Weaker Than First Reported

First-reported vs. latest monthly payroll change, January–September 2026: revisions have cut 116,000 jobs from the first prints.





What stands out

- May was cut from +172k to +63k, the largest revision
- February's loss deepened from –92k to –156k
- Four months were revised up, but the cuts were larger

Latest = third estimate for Jan–Jul, second for Aug, first for Sep.

By the numbers

728k Jobs added Jan–Sep, as first reported

612k Jobs added Jan–Sep, latest estimates

–116k Net revision, about 16% of first-reported gains

68k Latest monthly average, vs 81k first reported

Why it matters

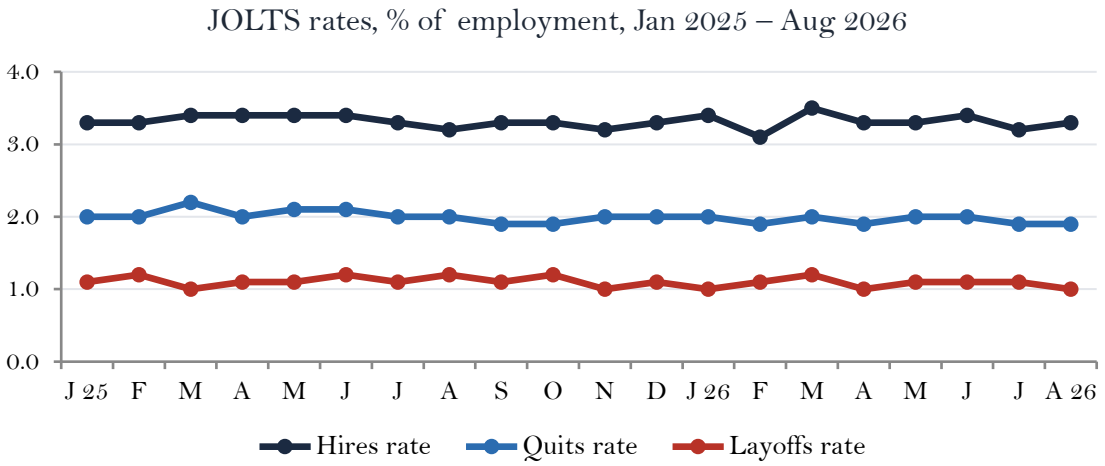
Downward revisions are a classic sign of a cooling job market. August and September can still change, and the annual benchmark revision comes in early 2027.

Source: BLS, CES net revisions to total nonfarm over-the-month change, seasonally adjusted (bls.gov/web/empsit/cesnaicsrev.htm), and Employment Situation – September 2026; full sources in the endnotes.

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Labor Market Verdict: "No Hire, No Fire" Holds, but It Is Fragile

JOLTS and payroll data agree: hiring and quitting are flat, layoffs are low, and stability rests on a shrinking labor force.



Signal	Evidence	Reading
Hiring	Hires rate 3.1–3.5% for 20 months; Q3 payrolls +51k/mo	● Low
Firing	Layoffs 1.0–1.2%; Aug 1.0%, tied for the year's low	● Low
Job switching	Quits 1.9% vs 2.0–2.2% in early 2025	● Falling
Breadth	Three sectors made all net gains; Sept diffusion index 49	● Narrowing
Revisions	2026 first prints cut by 116k	● Weaker
Labor supply	Participation 61.8% vs 62.5% a year ago	● Shrinking

The verdict

"Low hire" is confirmed. Hires have barely moved in 20 months, and payroll growth is narrow and being revised down.

"Low fire" holds in aggregate, but finance, information and business services are cutting jobs.

Why unemployment stays low: fewer people are in the labor force, partly from slower immigration, so weak hiring does not show up as higher unemployment.

The risk to watch

If layoffs rise from 1.0%, there is little hiring to absorb them, and the consumer's job security goes with it.

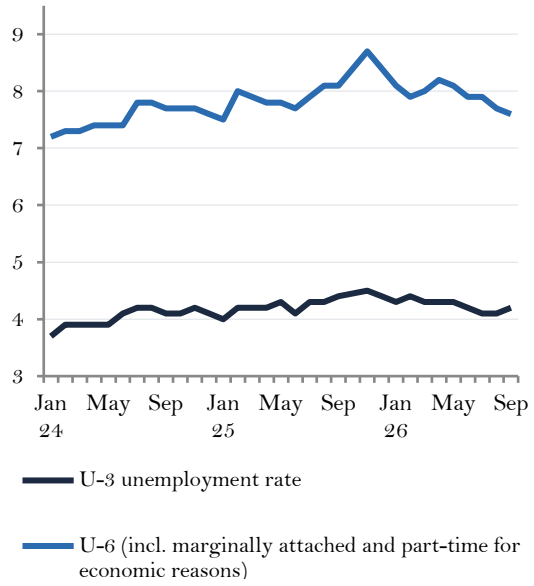
Sources: BLS Job Openings and Labor Turnover Survey via FRED (JTSHIR, JTSQUR, JTSLDR), seasonally adjusted; BLS Employment Situation – September 2026; BLS CES revisions; full sources in the endnotes.

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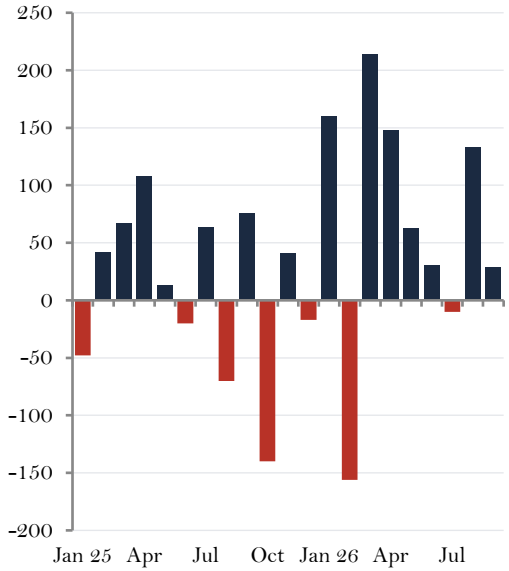
Unemployment and Payrolls: Steady Jobless Rate, Slow Hiring

September: payrolls +29,000 and unemployment 4.2%; broader underemployment (U-6) fell to 7.6%, the lowest this year.

Unemployment rates, % (Oct 2025 not collected: shutdown)



Monthly payroll change, thousands (latest)



What it shows

- Hiring is slow: payrolls averaged 51,000 a month in Q3 2026 and about 32,000 a month over the past 12 months.
- Yet unemployment has drifted down from 4.5% (Nov 2025) to 4.2%, partly because fewer people are entering the labor force.
- U-6 fell to 7.6%: fewer people working part time involuntarily, a sign of underlying stability.
- Layoffs stay rare: initial jobless claims 197,000 (week of Oct 3); continuing claims 1.72 million, the lowest since early 2025.

By the numbers

+29k	Payrolls, September
4.2%	Unemployment rate (U-3), September
7.6%	U-6 underemployment, lowest of 2026
51k	Average monthly payroll gain, Q3

Why it matters

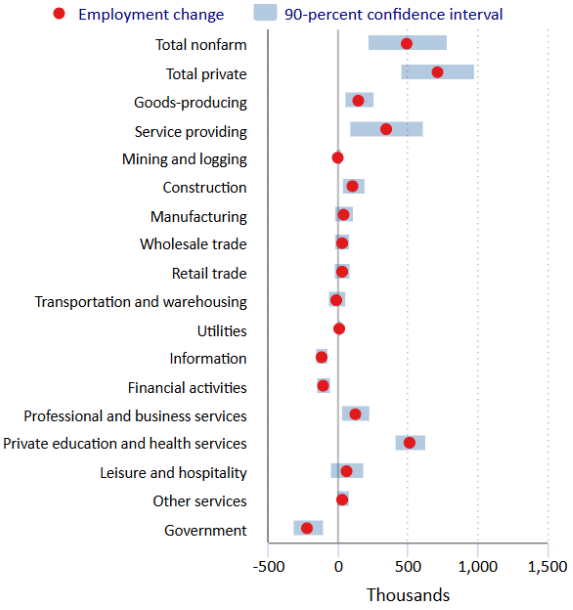
A labor market with low hiring and low layoffs: unemployment is steady, so the Fed sees full employment and stays focused on inflation.

Sources: BLS, Employment Situation – Sept 2026 (Oct 2), via FRED (UNRATE, U6RATE, PAYEMS); DOL claims (ICSA, CCSA); payroll changes calculated from latest-vintage levels; full sources in the endnotes.

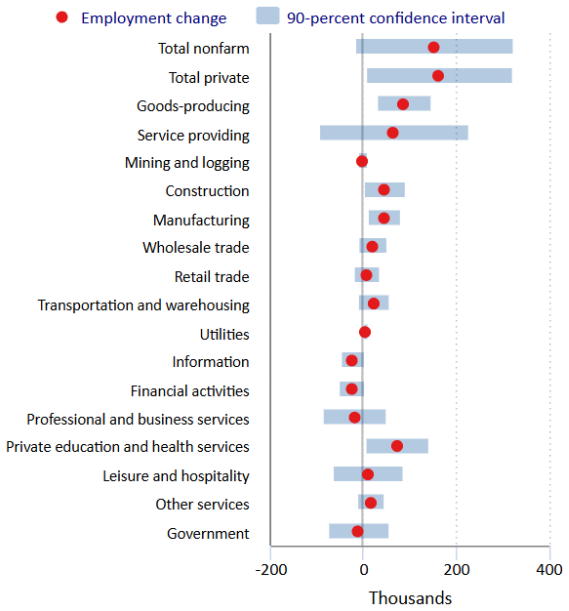
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Job Changes by Industry, With BLS Confidence Intervals

Trailing 12 months (left) and 3 months (right), September 2026: where the blue band crosses zero, the change is within sampling error.



Trailing 12 months



Trailing 3 months

What it shows

- Red dots are the estimated change; blue bars are 90% confidence intervals.
- Over the past 3 months, most industry changes are within sampling error: the band crosses zero.
- Health care, construction, and manufacturing account for the gains (see p. 31).

By the numbers

+152k Jobs added Jul–Sep, all sectors

+72k Education and health, Jul–Sep

+89k Construction and manufacturing, Jul–Sep

−9k All other sectors combined, Jul–Sep

Why it matters

Job gains are narrow: outside education and health, construction and manufacturing, all other sectors combined lost 9,000 jobs in Jul–Sep.

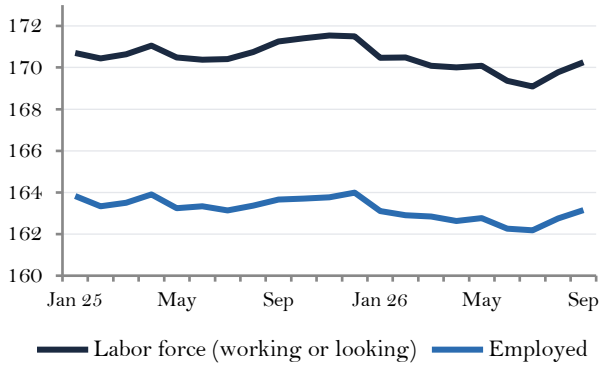
Sources: BLS, Current Employment Statistics, 90% confidence intervals (charts reproduced from BLS as captured by the author); sector totals: BLS Employment Situation, Sept 2026.

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Labor Market Detail: A Shrinking Workforce Keeps Unemployment Low

"No hire, no fire" is half the story; the other half is a labor force that has shrunk by about 1 million people in a year.

Labor force and employment, millions



Change, Sep 2025 to Sep 2026, millions



*Household survey, seasonally adjusted. *Oct 2025 not collected (shutdown), interpolated. January figures include annual population adjustments.*

Two halves of the labor market

- **Demand, no hire, no fire:** hiring at 3.3%, ~25-week job searches, about one unemployed person per opening
- **Supply, a shrinking workforce:** participation fell from 62.5% to 61.8% while prime-age participation held near 83.7%, pointing to retirements and lower immigration. Unemployment eased from 4.4% to 4.2% because fewer people were looking, not because more found work; employment fell 0.5 million.
- **Why 51,000 jobs a month is enough:** with little labor force growth, the pace needed to hold unemployment steady has fallen.
- **Wages:** hourly earnings (+3.0%) look soft partly on a shift to lower-paying jobs; switchers' raises rebounded to 4.7% from 3.7% in May. Supply losses are concentrated in immigrant-heavy trades (construction, agriculture, care, hospitality), where pay and prices rise; in fields like engineering, supply is little changed, and AI is softening demand, so no added wage pressure.

By the numbers

−1.0m Labor force, Sep 2025 to Sep 2026

61.8% Participation rate, down from 62.5%

~5.2% Unemployment rate if participation had held at 62.5% (illustrative)

4.7% Pay growth for job switchers, vs 3.4% for stayers (Sep)

Perspective

A stable 4.2% rate on a shrinking workforce means fewer people working: a smaller base for growth, spending, and taxes. Growth must come from productivity.

Sources: BLS household survey via FRED (CLF16OV, CE16OV, UNEMPLOY, CIVPART, LNS11300060), Employment Situation Sep 2026; BLS hourly earnings (CES0500000003); full sources in the endnotes.

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Perspective: Consumers Are Dipping Into Savings to Keep Spending

Section 3: spending is outrunning income, and higher rates have pushed housing out of reach for the typical family.

What the data says

- Real spending rose 0.6% in August while real disposable income was flat; the saving rate fell to 4.1% from ~5.3% in February.
- Real average hourly earnings are down 0.7% from a year ago (Sep CPI 3.7%); Michigan sentiment is 48.1, below every recession start.
- Housing affordability index ~105 vs 170 in 2020; the mortgage rate is 7.40%, and the monthly payment is up 89% since 2021.

Assessment

For now, yes, but by drawing down savings rather than earning more. Spending is outrunning income, and the gap is being filled from cushions that are thinning, especially for households without assets. Housing tells the story most clearly: higher rates have pushed homeownership out of reach for the median family, freezing mobility and shifting the cost of the rate cycle onto younger and lower-income households. Spending is likely to slow toward income growth; the question is whether it glides or stops.

What would change the view

- Real wages turn positive and the saving rate stabilizes, which would make spending self-sustaining.
- The warning signs: layoffs above ~1.3%, the saving rate below 4%, or delinquencies spreading beyond student loans into cards and autos

The question

Can the consumer keep carrying the economy?

The view in one line

For now, by dipping into savings to support spending

Where to look

p. 38 Spending vs. income
p. 39 Wages vs. prices
p. 44 Housing
p. 45 Dashboard

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Consumers Spend Faster Than They Earn

BEA Personal Income and Outlays, August 2026 (released Sept 30): strong spending, flat real income, sticky core inflation

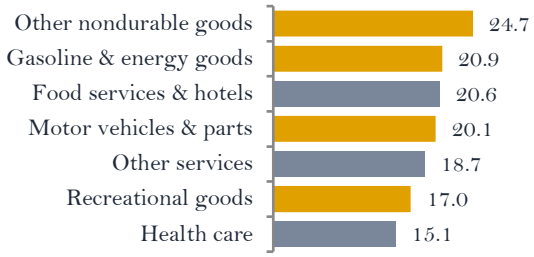
+0.6% Real consumer spending m/m (nominal +0.9%)

0.0% Real disposable income m/m (July +0.3%)

4.1% Personal saving rate, down from ~5.3% in Feb

3.0% Core PCE inflation y/y (headline 3.4%)

Aug spending change, $bn (annual rate)



Goods +$114.1bn · **Services** +$76.7bn
Recreation services −$10.3bn

What stands out

Goods-led surge
Goods were $114bn of the $191bn rise, led by gasoline, vehicles and recreational goods

Saving drawn down
Spending +0.9% vs income +0.2%; real disposable income flat

Inflation sticky
PCE +0.3% m/m, core +0.2%; core PCE 3.0% y/y vs core CPI 2.4%

How it fits the Q3 story

Trade link: Goods demand explains the import surge and the ~3ppt trade drag on Q3 GDP
Durability: Spending funded by lower saving, not income; hard to repeat into Q4
Fed & rates: Core PCE at 3.0% supports the September hike and further tightening.

The Fed's preferred gauge

PCE price index, August 2026

3.4%	3.0%	+0.2%
Headline y/y	Core y/y	Core m/m

- Core PCE runs about 0.6 points above core CPI (2.4%), so the Fed's own measure looks stickier than the headline CPI story.
- Energy is the gap between headline and core: gasoline and energy goods spending +$20.9bn in the month.
- Fed funds at 3.75–4.00% after the Sept 16 hike; this data gives no reason to stop

Data caution

Annual update revised figures back to Jan 2021, so compare against revised, not previously published, numbers.

Source: US Bureau of Economic Analysis, Personal Income and Outlays, August 2026 (BEA 26-43, Sept 30, 2026); core CPI from BLS, August 2026. Next release Oct 29, 2026.

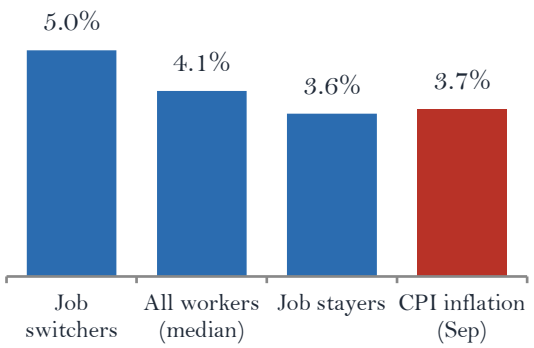
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Paychecks vs. Prices: Pay Slips Behind Inflation

September 2026: most workers' pay has slipped just below inflation, and consumers feel worse than the data suggests.

3.6%	Pay growth, job stayers (Atlanta Fed, Aug)
3.7%	CPI inflation, y/y (BLS, Sep)
–0.7%	Real avg hourly earnings, y/y (BLS, Sep)
4.1%	Personal saving rate (BEA, Aug)

Wage growth (Aug) vs inflation (Sep), y/y %



Why the measures differ

Median worker
The Atlanta Fed tracks the same people over a year: their pay is up 4.1%.

Average paycheck
BLS average hourly pay lags 3.7% inflation, so real pay is down 0.7%.

Few switchers
Switching pays (5.0%), but the quits rate is only 1.9%.

What it means

Pay now trails prices: Job stayers' 3.6% raises fall just short of 3.7% inflation.
Energy is the swing: Gasoline and diesel costs decide whether real pay rises or falls.
Savings take the strain: With real income flat, spending growth relies on saving less.

How consumers feel

University of Michigan, Sept 2026 (final)

48.1
Sentiment index (51.7 in Aug)

4.6%
1-yr inflation expectations

- Below the level at the start of each of the last six recessions
- Long-run inflation expectations rose to 3.4%, vs a 2.33% 10-yr inflation breakeven
- Sentiment has been a weak guide to spending since the pandemic, but the gap with the data is widening

Watch

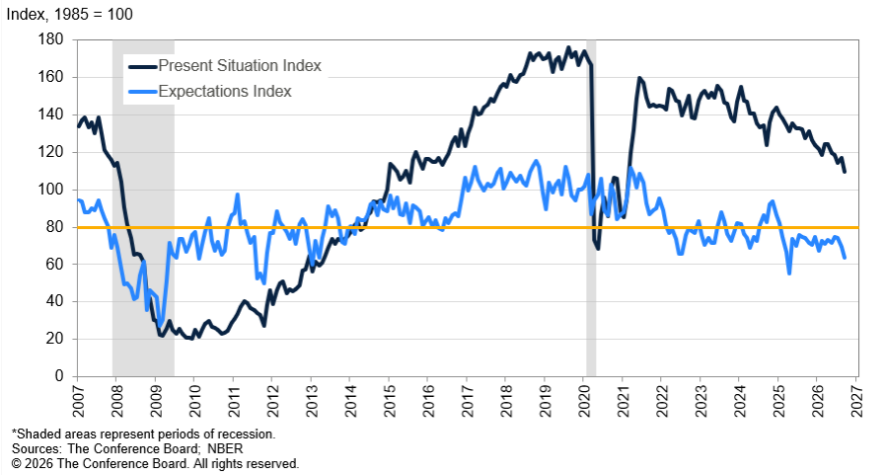
Job-stayer pay (3.6%) has slipped below inflation (3.7%): real incomes are turning negative for most workers, so the saving cushion shrinks faster.

Sources: Atlanta Fed Wage Growth Tracker (Aug 2026); BLS CPI and Real Earnings (Sep 2026); BEA (Aug 2026); U. of Michigan (Sept 2026).

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Consumer Confidence Drops to 81.9 as Fuel Costs Surge

Conference Board, September 2026 (released Sept 29): the expectations gauge fell for a third month and sits well below 80, a level long read as a recession signal.



Present Situation and Expectations indexes (1985 = 100), 2007 to Sept 2026; gold line = 80. Chart: Conference Board.

September 2026	Level	Change	Note
Consumer Confidence Index	**81.9**	−6.7	*From 88.6 in August*
Present Situation Index	**109.3**	−7.9	*Conditions today*
Expectations Index	**63.6**	−5.9	*Third straight fall*
Business conditions now, net good − bad	**−1.9%**	−3.4 pts	*More say "bad"*
Jobs plentiful − hard to get	**+1.7%**	−2.5 pts	*23.6% vs 21.9%*
Expected business conditions, net	**−9.5%**	−3.2 pts	*6 months ahead*
Expected jobs, net	**−14.4%**	−3.1 pts	*6 months ahead*
Expected income, net	**+2.5%**	−3.0 pts	*Still positive*
Median 12-month inflation expected	**5.1%**	**+0.3 pts**	*Mean 6.1%*

By the numbers

81.9 Confidence Index, down from 88.6 in August

63.6 Expectations Index: third monthly fall, below 80

+1.7% Jobs "plentiful" minus "hard to get", near zero

5.1% Median inflation expected over 12 months

Why it matters

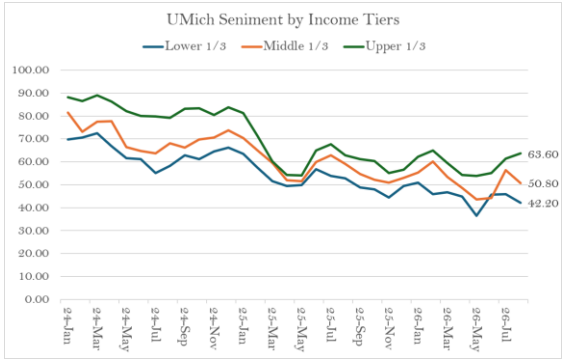
Write-ins on prices, oil. and gas hit new highs; war, politics. and tariffs eased but stayed common. Michigan sentiment (48.1, Sept) tells the same story: prices, not layoffs, are driving the gloom.

Source: The Conference Board, Consumer Confidence Survey, September 2026 (Sep 29, 2026; cutoff Sep 23), via client feed; NBER recession shading. Next release Oct 27.

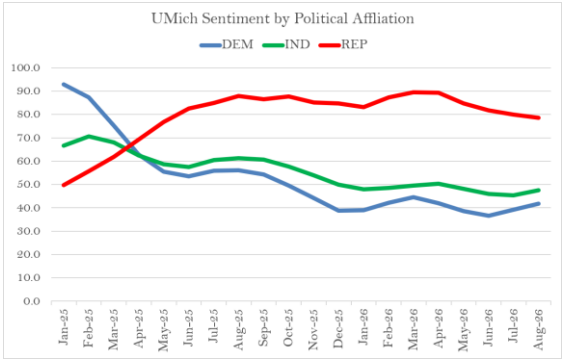
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Sentiment Splits: Upper Third Recovers, Lower Third Slides

University of Michigan detail: sentiment diverges by income and by party, and the October preliminary reading slipped to 46.3 as lower-income sentiment fell steeply.

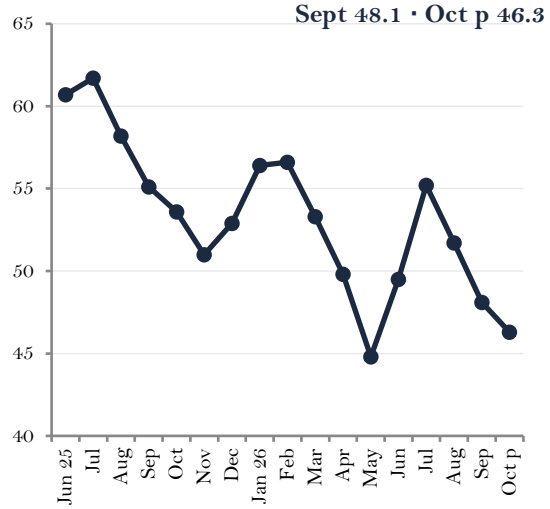


Sentiment by income third, Jan 2024 to Aug 2026

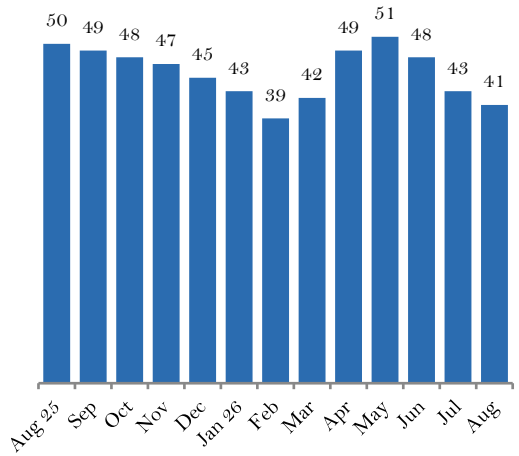


Sentiment by party, Jan 2025 to Aug 2026

Consumer sentiment index, Jun 2025 to Oct 2026 (prelim.)



Share expecting prices to rise 5% or more next year, %



Charts rebuilt from the client's feed (UMich data). Oct p = preliminary (final Oct 23); the 5%+ share is through August.

By the numbers

21 pts — Gap in Aug: upper third 63.6 vs lower third 42.2

37 pts — Party gap in Aug: Republicans ~79 vs Democrats ~42 (read from chart)

46.3 — Sentiment, Oct preliminary (48.1 in Sept)

4.7% — Year-ahead inflation expected, Oct prelim (3.4% in Feb)

Perspective

The top third, cushioned by stocks, has climbed since May; the bottom third has not. Party colors the level, but the income split is the signal: the lower K feels prices first. Draft view.

Source: University of Michigan, Surveys of Consumers: charts via client feed (data through Aug–Sep 2026) and October 2026 preliminary results (sca.isr.umich.edu); full sources in the endnotes.

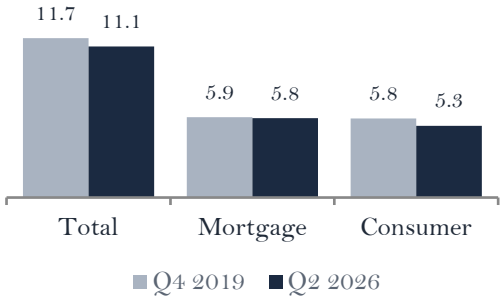
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Consumer Credit: Stretched at the Edges, Not Breaking

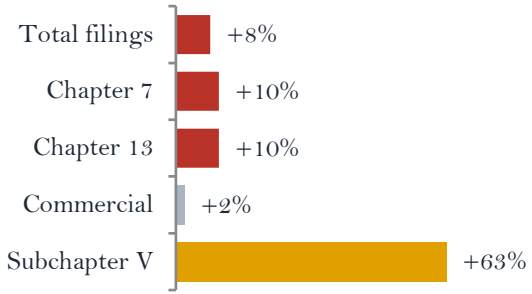
Household balance sheets look healthy in aggregate; stress is concentrated in student loans and rising bankruptcies.

$1.26tn	Credit card balances, +$54bn y/y (Q2)	**2.85%**	Bank card 30+ days late (3.04% a year ago)
3.82%	Card charge-off rate (4.19% a year ago)	**11.1%**	Debt payments / income (11.7% in Q4 2019)

Debt service, % of disposable income



Bankruptcy filings, Aug 2026 y/y %



How to read it

Aggregate is solid: Debt payments take a smaller share of income than before the pandemic.
Rising from a low base: Individual filings are up 9% y/y, but bankruptcy levels remain below pre-pandemic norms.
Watch the flow: New card delinquencies are steady but elevated; a rise there would be the early warning.

Where the stress is

Student loans
10.6% of balances 90+ days late, up from 10.3% in Q1

New card delinquencies
6.97% of card balances moved into serious delinquency, vs 6.93% a year ago

Bankruptcy notations
~137,000 consumers in Q2, a small rise on Q1

Bank lending
A modest net share of banks tightened card standards; auto loan demand weaker

Headline 12.8% card "90+ delinquent" figure is inflated by old charged-off debt staying on credit reports longer (NY Fed).

Sources: NY Fed Household Debt and Credit Report Q2 2026 and Liberty Street Economics (Aug 2026); Federal Reserve charge-off and delinquency rates, Household Debt Service Ratios (Q2; full sources in the endnotes.

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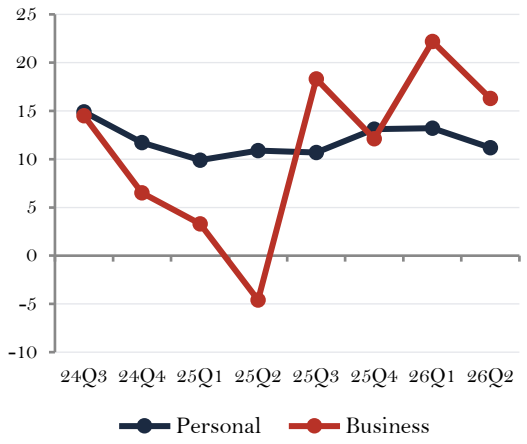
Bankruptcy Filings: Business Cases Climb Faster Than Personal

Filings remain low by historical standards but have risen at double-digit rates for two years, Moody's data through the second quarter of 2026.

% change, y/y	26Q2	26Q1	25Q4	25Q3	25Q2	25Q1	24Q4	24Q3
Total personal	**+11.2**	**+13.2**	**+13.1**	**+10.7**	**+10.9**	**+9.9**	**+11.7**	**+14.9**
Chapter 7	**+13.3**	+16.4	+15.3	+14.1	+16.0	+13.8	+18.2	+20.6
Chapter 11	**−5.0**	+11.6	+9.4	+24	+23.7	+63.3	+28.6	+30.1
Chapter 13	**+7.5**	+8.1	+9.7	+5.6	+2.9	+4.1	+2.8	+7.2
Total business	**+16.3**	**+22.2**	**+12.1**	**+18.3**	**−4.6**	**+3.3**	**+6.5**	**+14.5**
Chapter 7	**+16.8**	+14.5	+13.4	+15.7	+10.3	+13.1	+17.2	+17.7
Chapter 11	**+19.3**	+38.2	+13.2	+26.5	−19	−5.5	−7.1	+15.0
Chapter 13	**−5.8**	+11.5	−4.6	+3.2	−27	−19	−13	−5.7

Three months ending in each quarter, not seasonally adjusted; quarters newest first. Some business figures are rounded in the source.

Total filings, % change y/y



Moody's read (Jul 30)

- Pressure: soaring energy costs, high prices, depleted savings and far fewer job openings
- Gasoline ~40% above a year ago hits lower- and middle-income households hardest.
- Past rate hikes still feed through as fixed-rate loans (80%+ of debt) roll over.
- Wealth cushions some, but stress is building: the question is how far filings rise, not whether.

By the numbers

+11.2% Personal filings, 3 months to June, y/y

+16.3% Business filings, same period

+19.3% Business Chapter 11 (reorganizations)

7 of 8 Quarters since 24Q3 with personal filings up 10%+

Why it matters

Epiq's August count (+8% y/y) shows the rise continuing into Q3. For consumers, Chapter 7 liquidations are rising faster than Chapter 13 repayment plans.

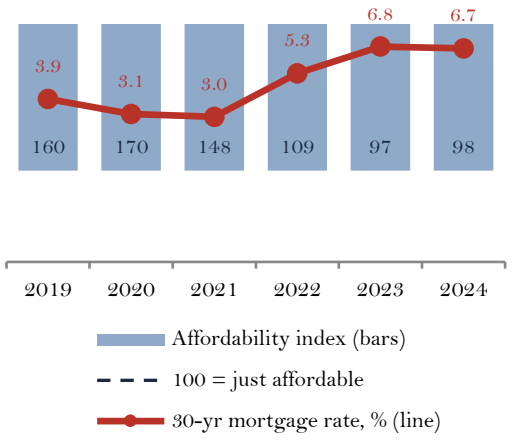
Source: Moody's Analytics, bankruptcy filings, 2026 Q2 (Jul 30, 2026), via client feed; Epiq AACER (Aug 2026). Q2 is the latest quarter in the feed.

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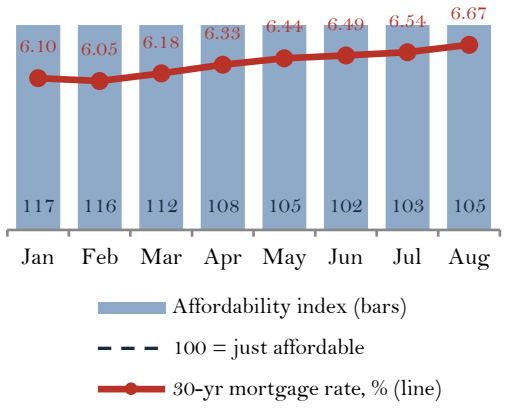
Housing Affordability: Higher Rates Put Homes Out of Reach

A median-income family could afford 1.7x the median home in 2020; today barely 1.05x, and the 30-year mortgage rate is back above 7%.

Annual, 2019–2024



Monthly, 2026 (rate now 7.40%, Oct 8)



How to read the bars: 100 means a median-income family earns exactly enough to qualify for a mortgage on the median-priced home (20% down; payment no more than 25% of income). 170 in 2020 meant it earned 70% more than needed. Below 100 (dashed line), as in 2023–24, it no longer qualifies. Bars falling as the red rate line rises = rates pushing homes out of reach.

Median-priced home	Price	Mortgage rate	Monthly payment*	Share of income
2021	$357,100	3.01%	**$1,206**	16.9%
2024	$412,400	6.81%	**$2,153**	25.5%
June 2026	$440,600 (record)	~6.5%	**~$2,274**	~24.6%

**Principal and interest. June 2026 payment and share derived from NAR's qualifying income and index; 2025 annual index not yet published.*

By the numbers

7.40% — 30-yr mortgage rate (Oct 8), vs 2.96% in 2021 and 5.98% at the Feb low

+89% — Monthly payment on a median home, 2021 to mid-2026

21% — First-time buyers' record-low share; their median age, 40, a record high

3.98m — Home sales pace (Aug), ~35% below 2021

Why it matters

Mortgage rates follow the 10-year Treasury. When rates dipped to ~6% early this year, affordability improved; at 7.4%, it is slipping again. Half of mortgages are below 4%, so owners stay put and supply stays tight.

Sources: NAR, Housing Affordability Index (FRED FIXHAI, through Aug 2026), Existing-Home Sales and 2025 Buyer Profile; Freddie Mac PMMS (Oct 8, 2026); FHFA via Wolf Street; full sources in the endnotes.

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Consumer Health Dashboard: Where the Cycle Stands

Ten signals to anticipate the consumer's next move, latest official data as of October 14, 2026

Indicator	Latest	Context	Signal
Layoffs rate (JOLTS)	**1.0%**	Down from 1.2% a year ago	● Healthy
Quits rate (JOLTS)	**1.9%**	Fewer job switches, slower raises	● Watch
Pay of job stayers vs CPI	**−0.1 pt**	3.6% vs 3.7% (Sep): now negative	● Stress
Personal saving rate	**4.1%**	Down from ~5.3% in February	● Watch
Debt payments / income	**11.1%**	Below 11.7% pre-pandemic	● Healthy
Bank card 30+ delinquency	**2.85%**	Lowest since Q2 2023	● Healthy
Student loans 90+ late	**10.6%**	Rising: 10.3% in Q1	● Stress
Bankruptcy filings	**+8% y/y**	Rising from a low base	● Watch
Michigan sentiment	**48.1**	Below every recession start	● Stress
Household net worth	**$195.9tn**	+$12.8tn in Q2, led by stocks	● Healthy

Read: 4 healthy, 3 watch, 3 stress. Jobs and household balance sheets are holding; income growth, savings, and mood are where the cycle is turning.

A two-speed consumer

Asset owners

- Stocks added $10.7tn to household wealth in Q2.
- Wealth gains keep higher earners spending.
- Exposed to a stock-market correction

Paycheck-to-paycheck

- Real pay flat; energy and food costs bite hardest
- Student loan and bankruptcy stress rising
- Little saving cushion if layoffs pick up

Late-cycle tell: spending that depends on stock prices and falling saving, with layoffs as the trigger to watch.

Sources: BLS (JOLTS Aug; CPI Sep 2026); Atlanta Fed; BEA (Aug 2026); Federal Reserve (DSR, delinquencies, Z.1, Q2 2026)

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Perspective: Asset Owners Carry the Cycle

Section 4: the economy works best for those who own stocks and homes, which makes overall spending market-dependent.

What the data says

- The top 10% of households own 88% of stocks; the bottom 50% owe 52% of consumer debt.
- Household net worth reached $195.9 trillion; the wealth effect keeps the top spending.
- The Fed's 2025 survey: older and wealthier families pulled furthest ahead after the pandemic.

Assessment

The economy is working best for those who own assets. Rising stock prices and home values keep the top spending, and that spending props up the national numbers. The bottom half gets the same raises but has bigger bills and thinner cushions. This matters beyond fairness: overall consumption now leans heavily on the stock market, so a market correction would hit spending harder than in past cycles. Keeping rates high rewards savers and squeezes borrowers, widening the gap further.

What would change the view

- Wage gains at the bottom outpace inflation for several quarters, broadening the spending base.
- A 15%+ stock correction in which top-tier spending holds up would show less market dependence than assumed.

The question

Who is the economy working for?

The view in one line

Asset owners; that makes the cycle market-dependent.

Where to look

p. 47 Who owns, who owes
p. 48 The lower K
p. 49 The upper K
p. 50 Fed survey 2025

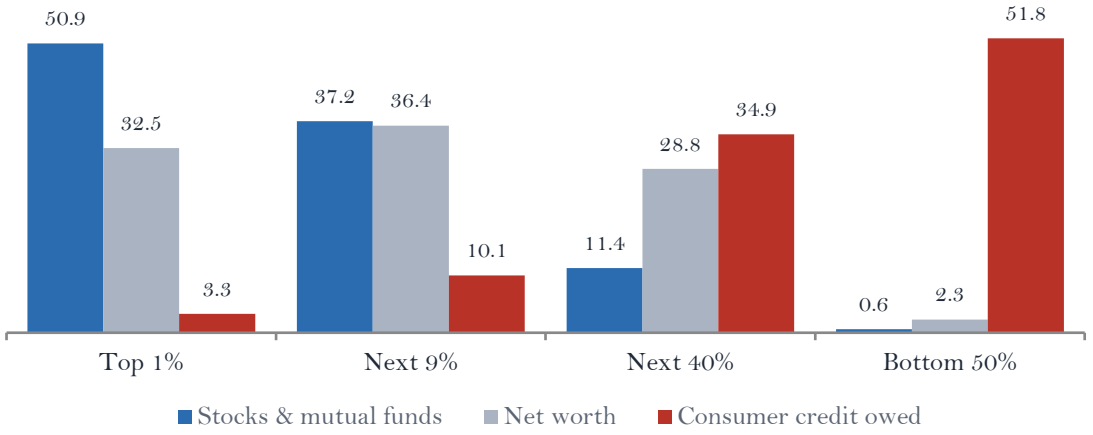
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The K-Shaped Economy: Who Owns the Gains, Who Owes the Debt

Federal Reserve Distributional Financial Accounts: the top 10% hold most of the stocks, the bottom 50% hold most of the consumer debt.

88%	Stocks held by the wealthiest 10% (Q2)	**2.3%**	Share of net worth held by the bottom 50%
52%	Share of consumer credit owed by the bottom 50%	**+$10.7tn**	Household stock gains in Q2 alone (Fed Z.1)

Share of U.S. total held by each wealth group, %



Why it matters: Rising stock prices flow almost entirely to the top 10%. Higher interest rates land mostly on the bottom half, which owes more than half of all credit card, auto, and other consumer debt.

The K's two channels

Assets: the upper K

- S&P 500 up 12.9% this year (total return, Sept 29)
- Stocks now 48% of household financial assets, a record
- Cash also pays: T-bills yield about 4.2–4.3%

Debt: the lower K

- Credit card rates average about 21% (Fed, May)
- Fed funds now 3.75–4.00% and still rising
- Bottom half has 2.3% of the wealth to absorb it

Groups are ranked by wealth, not income; the two overlap heavily but are not identical.

Sources: Federal Reserve Distributional Financial Accounts (stocks and net worth Q2 2026; consumer credit Q1 2026, latest available), Financial Accounts Z.1 (Q2 2026), G.19 Consumer; full sources in the endnotes.

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The Lower K: Same Raise, Bigger Bills, Thinner Cushion

Pay growth is similar across the wage scale; inflation, interest costs, and savings buffers are not.

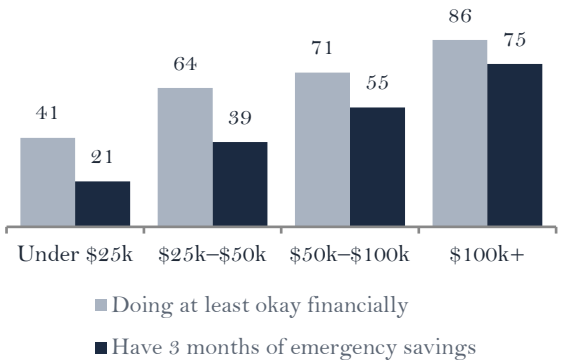
3.7% vs 3.8% — Pay growth, lowest vs top wage quarter

33% vs 6% — Income spent on food, lowest vs top fifth

+34.2% — Gasoline prices, y/y (BLS CPI, Sep)

21% vs 75% — 3-month savings cushion, <$25k vs $100k+

Financial resilience by income, % of adults (Fed)



How the squeeze works

Essentials inflate fastest
Energy +16.3% y/y; food and fuel take a far bigger bite of low incomes

Rates hit borrowers
Card balances cost ~21%; bottom half owes 52% of consumer credit

Missed-payment risk
Expected odds of missing a debt payment rose most for incomes under $50k (NY Fed, July)

The point

Lower-wage workers are getting the same raises as everyone else. The K comes from the cost side: their budgets are heavy in food, fuel, and borrowing, which is exactly where prices and rates have risen most, and they have the least savings to absorb it.

Signs of strain at the bottom

10.6% student loan balances 90+ days late (NY Fed, Q2)

+10% Chapter 7 bankruptcy filings, y/y (Epiq, Aug)

4.1% saving rate, down from ~5.3% in Feb (BEA)

41% of adults under $25k say they are doing okay (Fed)

If the Fed hikes again

Variable-rate card and auto costs rise within weeks for the lower K, while the upper K earns more on cash.

Sources: Atlanta Fed Wage Growth Tracker by wage quartile (12-mo avg, Aug 2026); USDA ERS food spending share (2024); BLS CPI (Sep 2026); full sources in the endnotes.

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The Upper K: AI Capex and Stocks Keep the Top Spending

The AI build-out drives corporate spending, stock gains and wealth at the top, and it has further to run in 2026.

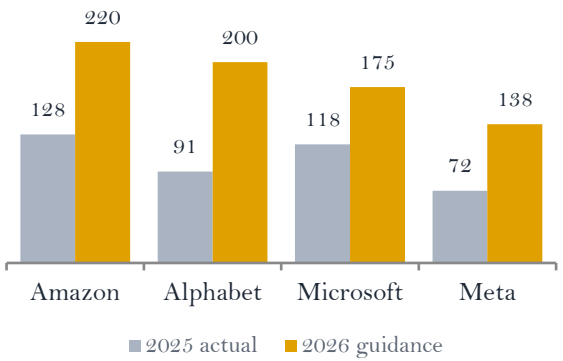
~$725bn 2026 capex guidance, top 4 hyperscalers

+77% vs about $410bn spent in 2025

+12.9% S&P 500 total return, year to date (Sept 29)

$195.9tn Household net worth, record high (Fed, Q2)

Capital spending, $bn (company guidance)



How it reaches the top

Capex → earnings
Chips, data centers and power lift profits across the AI supply chain

Earnings → stocks
Stocks added $10.7tn to household wealth in Q2; 88% goes to the top 10%

Wealth → spending
Higher-income households drive a large share of spending (Moody's est. ~45% for the top 10%)

Why it can continue

The 2026 capex plans are already committed, funded by cash flow and record bond issuance. As long as AI spending and earnings hold up, the wealth effect keeps the upper K spending even as higher rates squeeze the lower K.

How defensible is the K?

Strong evidence

- Wealth, stock ownership, and debt (Fed DFA)
- Savings buffers and financial well-being (Fed SHED)
- Budget exposure to food, fuel and credit

Weaker evidence

- Wage growth is similar across the wage scale
- Spending data conflict: BLS survey showed lowest-income spending grew fastest in 2024
- Minneapolis Fed (Mar 2026): data "do not align to tell a clear, K-shaped story"

The risk to the upper K

If AI returns disappoint, a stock correction would hit the group now carrying consumer spending.

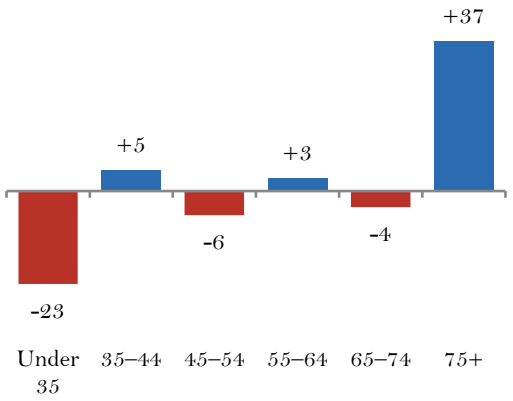
Sources: company capex guidance compiled by ValueAdd VC (2026; ranges shown at midpoint); S&P Dow Jones Indices via ChartRow; Federal Reserve Z.1 and DFA (Q2 2026); full sources in the endnotes.

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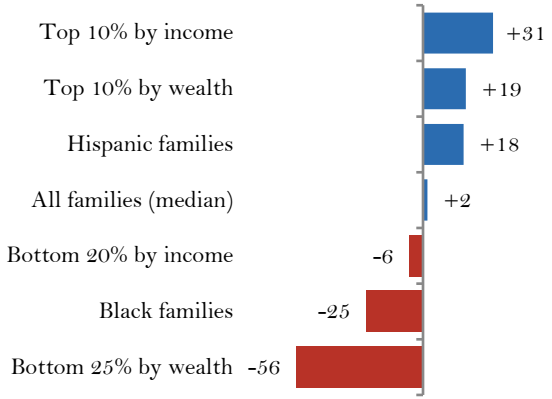
Fed Survey 2025: The Old and the Wealthy Pulled Ahead

Survey of Consumer Finances, 2022–25, after inflation: median wealth +2%, but +37% for families 75+; the young and the bottom fell back

Median net worth by age, % change 2022–25



Median net worth by group, % change 2022–25



Financial stress and stocks	2022	2025
Families behind on any payment	12.2%	**19.6%**
60+ days late	4.9%	**8.2%**
Debt payments above 40% of income	6.5%	**8.6%**
Own stocks (directly or in funds)	58%	**56%**
Median stock holdings, if owned	$56,900	**$77,400**

Context: wealth jumped 37% in 2019–22, the survey's biggest gain; 2022–25 slowed to +2% even as the S&P 500 rose 78%. Families without a high-school diploma: –55%, the largest drop on record. Behind on payments: most since 2010.

By the numbers

$215,900 Median family net worth, +2% (mean $1.24m, +7%)

$504,900 Median for families 75+, now the richest age group (+37%)

$33,000 Median for families under 35 (–23%)

$1,700 Median for the bottom 25% by wealth, down from $3,800

Why it matters

Older families once spent their wealth down; "This is totally reversed now" (NYU's Edward Wolff). Stock owners gained while the young and the bottom fell behind: the K-shape, in the Fed's most detailed data.

Sources: Fed Board, Changes in U.S. Family Finances from 2022 to 2025 (SCF, Oct 9, 2026; 2025 dollars; 4,367 families; income groups use usual income); Wall Street Journal (Oct 9).

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Perspective: Hawkish Words Meet Fiscal Arithmetic

Section 5: the Fed's commitment to price stability is credible today; the debt math is what will test it.

What the data says

- The Fed hiked 12–0 to 3.75–4.00% in September; 12 of 18 officials see one more hike this year (median 4.1%).
- Officials project core PCE inflation of 3.4% for 2026; futures price a December hike and more in 2027.
- The term premium is 0.82%, a 12-year high: investors want extra pay to hold long bonds.

Assessment

Chair Warsh has made price stability the centerpiece; whether the hawkish tone is conviction or signaling, September's inflation pickup makes another hike at the October 28 meeting likely. But tightening into a ~$40 trillion debt and a ~$2 trillion deficit raises the government's own interest bill, and a third of marketable debt reprices within a year. The harder the Fed pushes, the more the fiscal arithmetic pushes back. And because today's inflation is mostly supply-driven, a few more hikes will not tame it; only a recession-sized tightening would, which is not expected under this administration. Whether rhetoric remains policy is the central question for 2027.

What would change the view

- Core PCE inflation moves back toward the Fed's 2% target without further hikes, letting the Fed declare victory.
- Deficits narrow meaningfully, easing the conflict between monetary and fiscal policy.

The question

Will the Fed's inflation fight survive the debt math?

The view in one line

Hawkish words, meet fiscal arithmetic.

Where to look

p. 52 The Warsh Fed
p. 54 Fed projections
p. 57 Market expectations
p. 58 Term premium

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Reading the Warsh Fed: What Drives the Next Move

September 16, 2026, FOMC press conference: no forward guidance, but a clear framework for anticipating policy

3.75–4%	Fed funds after +25bp hike (unanimous)	**4.1%**	Median fed funds, end 2026 and 2027 (SEP)
3.7→2.3%	Median PCE inflation, 2026 → 2027 (SEP)	**2029**	Median year inflation reaches 2% (SEP)

The test for action: *"We must be confident that underlying inflation is moving to our objective clearly and at sufficient speed."*

What the Committee watches

Inflation trends
6- and 12-month trends; how many categories still run above 3%

Spread of price shocks
Whether energy and food price jumps broaden into other prices

Financial conditions
"Hard pressed" to call them restrictive; hike removed "a dose of accommodation"

Inflation expectations
Market inflation compensation stays low; expectations stay anchored

Economic strength
Hiring, earnings, capex, productivity; ~4.1% jobless rate = full employment

Geopolitics & commodities
Energy, crops, refining margins; peers abroad also facing price pressure

What it downplays: single data releases ("data-point dependence is a dangerous preoccupation"), forward guidance, neutral-rate estimates, market pricing, and political pressure. Warsh sees no need to weaken the job market to cut inflation.

Reading the next move

Inflation risks to the upside; labor risks balanced (SEP)

Points toward another hike

- Core categories still above 3% on 6- and 12-month basis
- Commodity and input prices keep rising
- Financial conditions stay easy
- Inflation expectations or inflation breakevens drift up

Points toward holding

- Underlying inflation falls clearly and quickly
- Energy shock stays a relative-price change
- Higher long yields tighten conditions for the Fed

Since the meeting

August PCE came in at 3.4% (core 3.0%), below the ~3.6% (core ~3.2%) Warsh estimated. Modest relief, but still well above 2%.

Sources: Federal Reserve, Transcript of Chairman Warsh's Press Conference, Sept 16, 2026, and Summary of Economic Projections (medians); BEA, Personal Income and Outlays, August 2026.

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September 2026 FOMC Minutes: Debate and General Leaning

A unanimous hike, with most officials expecting another by year end; the debate is over why, and how restrictive policy really is,

General leaning: Hawkish. The Committee voted 12–0 to raise the target range ¼ point to 3¾–4%, and most participants judged another increase likely appropriate by year end. The statement pledged that the Committee "will deliver price stability."

Where participants broadly agreed

- Inflation remains elevated, with insufficient recent progress (staff est. August PCE 3.8%, core 3.4%)*
- Labor market near maximum employment; risks to it now broadly balanced
- Growth solid, led by AI-driven investment and resilient consumer spending
- Inflation risks skewed to the upside; longer-term expectations still anchored.
- Financial conditions supportive despite a roughly 35bp rise in 2- to 10-year yields

Where views diverged

- Rationale: many cited risk-management insurance; a number saw the hike as needed on their baseline outlook.
- Stance: several viewed policy as not or only mildly restrictive; a couple raised neutral-rate estimates.
- Signals: falling 3-month core PCE versus its seasonal bias; BEA revision lowers inflation about 0.2 pt.
- AI: future productivity gains versus demand outpacing supply in the medium term.
- Households: wealth gains support high earners while energy costs strain lower-income households.

Path ahead: Year-end 2026 projections show 12 of 18 participants expecting one more increase, 4 expecting two, and 2 expecting none (median 4.1%). Decisions remain data dependent; next meeting October 27–28.

*Staff estimates before the meeting; BEA's official August PCE (Sept 30): 3.4% headline, 3.0% core (p. 38). Sources: Federal Reserve, FOMC Minutes and SEP (Sept 15–16, 2026); BEA.

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Fed Projections: Higher Rates and Inflation, Lower Unemployment

Summary of Economic Projections, September 16, 2026: median forecasts of Fed officials, compared with June

Median projection, %	2026	2027	2028	Longer run
Real GDP growth	**2.3** June 2.2	**2.4** June 2.3	**2.2** June 2.2	**2.0** June 2.0
Unemployment rate	**4.1** June 4.3	**4.1** June 4.3	**4.1** June 4.2	**4.2** June 4.2
PCE inflation	**3.7** June 3.6	**2.3** June 2.3	**2.1** June 2.0	**2.0** June 2.0
Core PCE inflation	**3.4** June 3.3	**2.5** June 2.5	**2.2** June 2.1	—
Federal funds rate	**4.1** June 3.8	**4.1** June 3.6	**3.9** June 3.4	**3.2** June 3.1

How to read: the top number is the September 2026 median projection; the small number below is June 2026. Red = revised up since June; blue = revised down.

Growth and inflation are Q4-to-Q4 changes; unemployment and the fed funds rate are fourth-quarter or year-end levels. The ranges of projections, September vs June, are on page 55.

What changed since June

- Growth up and unemployment down: the Fed sees a stronger economy through 2028
- Inflation slightly higher, reaching 2% only in the longer run
- Every interest-rate projection moved up: higher for longer, not cuts

By the numbers

4.1% Median fed funds, end-2026: one more hike

3.4% Core PCE projected for 2026

3.2% Longer-run neutral rate, up from 3.1%

2.3% 2026 growth, above the 2.0% trend

Why it matters

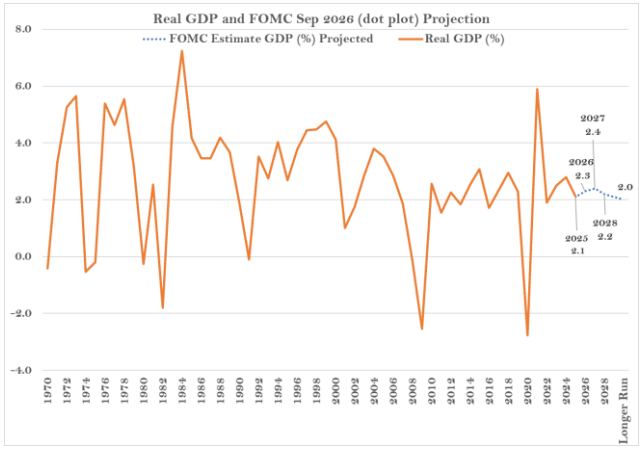
Every rate projection moved up: the Fed expects to hold rates higher for longer, not cut. Inflation is projected to stay above 3% this year and reach 2% only in 2028–29.

Sources: Federal Reserve, Summary of Economic Projections, September 16, 2026 (Table 1), and June 17, 2026.

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Fed Growth Outlook: Above-Trend Growth Rests on Productivity

September projections lift the growth range for 2026–27 and the long run; with slow labor force growth, AI-driven productivity must do the work.



Real GDP growth, 1970–2025, and Fed median projections (Sept 2026)

The growth arithmetic

Potential growth = labor force growth + productivity growth

- Labor force growth is likely subdued under current immigration policy
- So growth above the 2.0% trend needs productivity, largely AI, to do most of the work

Range, %	2026	2027	2028	Longer run
GDP growth	**2.2–2.4** June 2.0–2.3	**2.2–2.6** June 2.0–2.4	**2.0–2.2** June 2.0–2.3	**2.0–2.2** June 1.8–2.0
Unemployment	**4.1–4.2** June 4.3–4.4	**4.0–4.2** June 4.2–4.5	**4.0–4.2** June 4.1–4.3	**4.0–4.3** June 4.0–4.3
PCE inflation	**3.5–3.7** June 3.5–3.7	**2.2–2.5** June 2.2–2.5	**2.0–2.2** June 2.0–2.1	**2.0** June 2.0
Core PCE	**3.3–3.4** June 3.2–3.5	**2.3–2.6** June 2.2–2.5	**2.0–2.2** June 2.0–2.1	—
Fed funds rate	**4.1–4.4** June 3.6–4.1	**3.6–4.4** June 3.1–3.9	**3.1–4.1** June 3.1–3.6	**3.1–3.6** June 3.0–3.5

Top = September 2026; below = June 2026. Red = moved up, blue = moved down. Ranges exclude the three highest and three lowest projections (the "central tendency").

By the numbers

2.6% Top of the 2027 growth range, up from 2.4% in June

2.2% Top of the long-run growth range, up from 2.0%

3 yrs Growth seen above the 2.0% trend median, 2026–28

4.1% Low end of 2026 unemployment range (4.3% in June)

Perspective

The Fed is betting on productivity. If AI gains arrive, above-trend growth can coexist with easing inflation; if they lag, the same growth would mean more inflation and higher rates. Growth rests on AI.

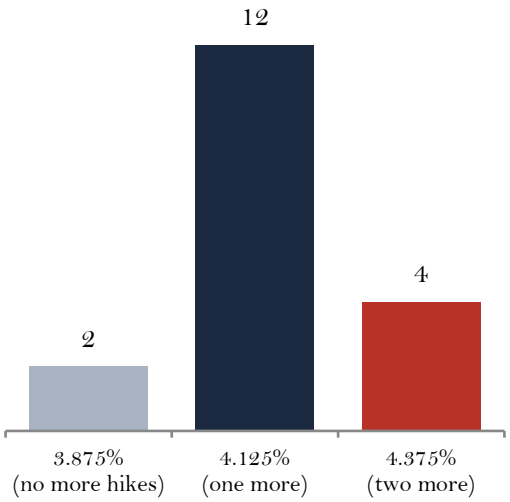
Sources: Federal Reserve, Summary of Economic Projections (Sep 16 and Jun 17, 2026), Table 1.

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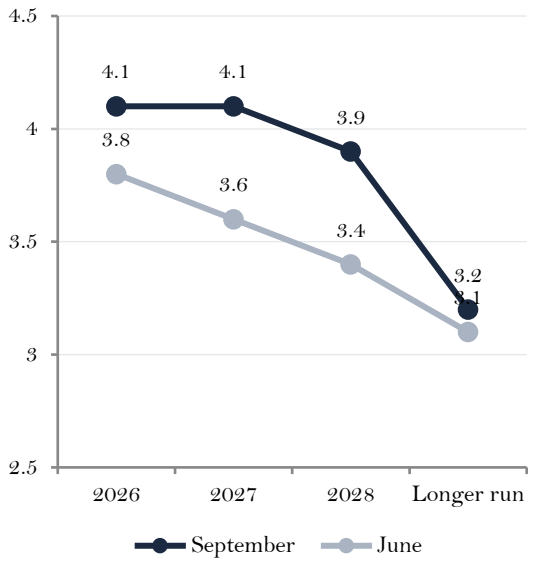
Dot Plot: 12 of 18 Officials See One More Hike This Year

Projected federal funds rate at end-2026, and the median path, September vs June

End-2026 fed funds projections (18 participants)



Median fed funds projection, %



What changed since June

- June: the median path pointed to cuts in 2027–28. September: rates stay near 4.1% through 2027.
- Only 2 of 18 see no further hike this year; 4 see two more.
- One participant did not submit a projection (19 members, 18 dots).
- Rate path stays above the 3.2% neutral estimate through 2028: policy stays restrictive.

By the numbers

12 of 18 — Expect one more 25bp hike in 2026

4.1% — Median end-2026 and end-2027

+0.5 pt — Rise in the 2027 median since June

3¾–4% — Current target range (Sept 16)

Why it matters

The Fed has removed the cuts it pencilled in for 2027. Markets agree a December hike is likely (next page).

Sources: Federal Reserve, Summary of Economic Projections, September 16, 2026 (Figure 2 dot plot and Table 1) and June 17, 2026.

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Markets Expect a December Hike and More in 2027 (CME FedWatch)

Futures-implied probabilities for the federal funds target range at each meeting, as of October 2, 2026; current range 3.75–4.00%

Meeting	3.75–4.00	4.00–4.25	4.25–4.50	4.50–4.75	4.75–5.00	5.00–5.25	5.25–5.50	5.50–5.75
Oct-26	**77.9**	22.1						
Dec-26	14.8	**67.3**	17.9					
Jan-27	9.0	**46.8**	37.2	7.0				
Mar-27	2.4	19.1	**44.2**	29.1	5.1			
Apr-27	1.4	12.3	34.0	**35.3**	14.9	2.1		
Jun-27	0.8	7.3	24.0	**34.7**	24.3	8.0	1.0	
Jul-27	0.6	6.1	21.0	**32.8**	26.2	10.9	2.2	0.2
Sep-27	0.5	5.2	18.4	**30.7**	27.3	13.6	3.7	0.5
Oct-27	0.5	5.0	17.8	**30.2**	27.5	14.2	4.2	0.7

Percent probability; highlighted = most likely outcome at each meeting.

How expectations moved

- July 1: futures priced rates at 3.75–4.00% through mid-2027 (i.e., one hike and done)
- Oct 2: the most likely path is 4.00–4.25% by December and 4.25–4.50% by March 2027, two more hikes
- Oct 8 (press reports): ~82% chance of no move on Oct 28; ~80% chance of a hike by December

By the numbers

67% — Probability of 4.00–4.25% after the December meeting (Oct 2)

~18% — Chance of an Oct 28 hike (Oct 8), down from ~50% before the weak jobs report

44% — Most likely range by March 2027: 4.25–4.50%

Oct 28 — Next FOMC decision

Why it matters

Markets now price more tightening than the Fed's own median (one hike). Any upside inflation surprise would validate that; a weaker job market would pull it back.

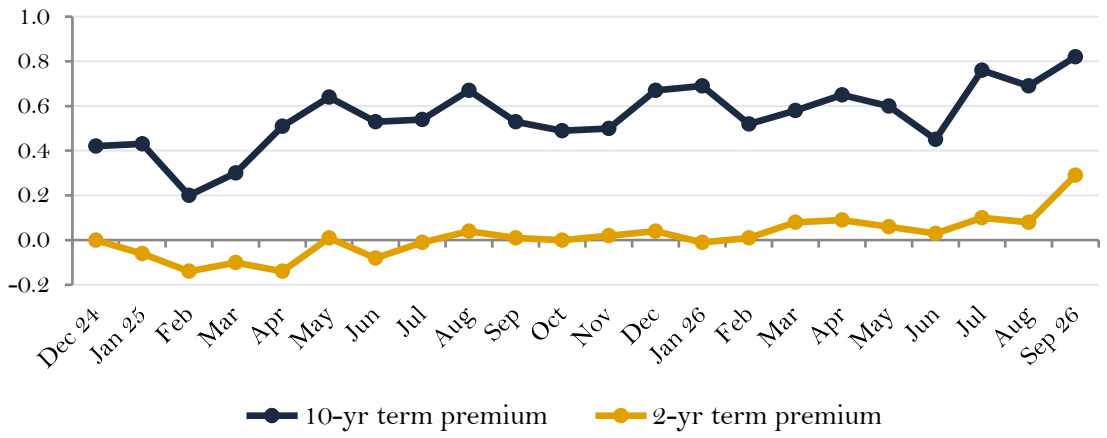
Sources: CME Group, FedWatch Tool (table as captured by the author, Oct 2, 2026; July 1 comparison); Oct 8 probabilities via Kaohoon International and Investing.com (secondary).

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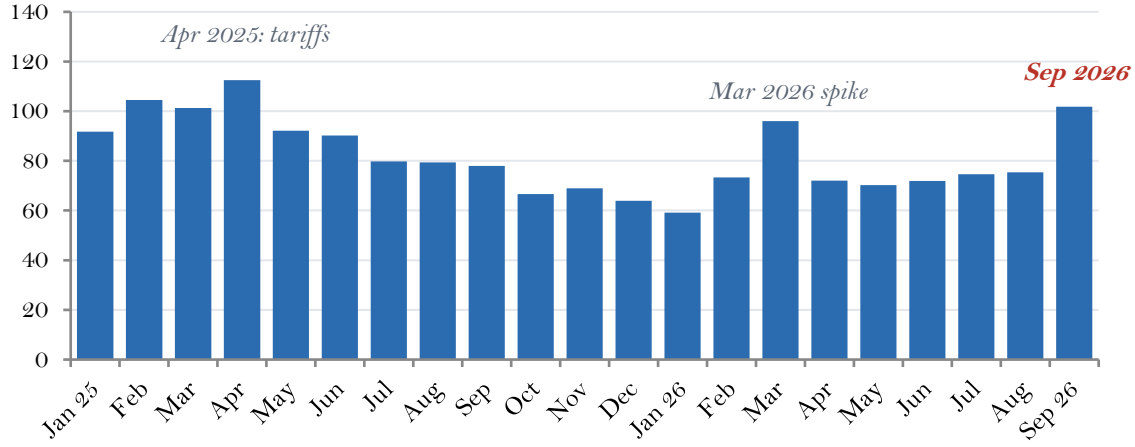
Term Premium at a 12-Year High: Investors Want Pay for Uncertainty

The extra yield for holding 10-year Treasuries broke out to a 12-year high, driving the latest leg of the selloff; every model points higher.

NY Fed ACM term premium estimates, month-end, %



MOVE index of Treasury option volatility, month-end (Sep: Sep 28)



By the numbers

0.82% — 10-yr term premium, NY Fed ACM model (Sep 30), a 12-year high

1.02% — 10-yr term premium, Fed Board Kim-Wright model (Sep 25)

+0.29% — 2-yr term premium, up from –0.14% in early 2025

101.8 — MOVE index (Sep 28), +35% in Sept; VIX ~16

Why it is rising: no single cause

Fiscal worries and rising supply, geopolitical risk, Fed opacity, stocks, and bonds falling together (so bonds hedge less), France and month-end selling. Aegon: "There's multiple ways to calculate it, but they're all going higher."

Sources: NY Fed ACM term premium (monthly, via eco3min.fr replication); Fed Board Kim-Wright (FRED THREEFYTP10); MOVE via convextrade.com and Benzinga; Bloomberg (Oct 9, 2026); full sources in the endnotes.

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Perspective: More Debt, Fewer Buyers, Higher Rates

Section 6: no single cause explains rising yields; underneath them all is governments spending beyond their means.

What the data says

- 10-year yields are up 0.6–1.3 points since December everywhere but China; the U.S. 10-year is ~5.3%.
- 10 of 19 Treasury auctions since July settled above the market's expected yield; buyers come, but at higher rates.
- Japan's savers are bringing money home; the IMF sees global public debt reaching 100% of GDP by 2029

Assessment

As fixed income managers consulted for this commentary agreed, no single factor explains it, and that is the point. Strong growth, AI-related corporate borrowing, inflation, and the war each add a little. Beneath them is a structural shift: governments everywhere borrow more just as the traditional marginal buyers, central banks, Japanese savers, pensions and reserve managers, step back. The root cause is fiscal: spending beyond means, and raising taxes on economies that are not growing enough. Productive, disciplined countries absorb higher rates; the rest are being repriced. France's "burn the bonds" debate is an early, if premature, sign of where that pressure leads.

What would change the view

- Deficits narrow and auctions clear at or below expected yields with strong foreign participation
- Central banks resume buying bonds: yields would fall, but as a sign of stress rather than health

The question

Why are long-term rates rising everywhere at once?

The view in one line

More debt, fewer buyers: the price of money is resetting.

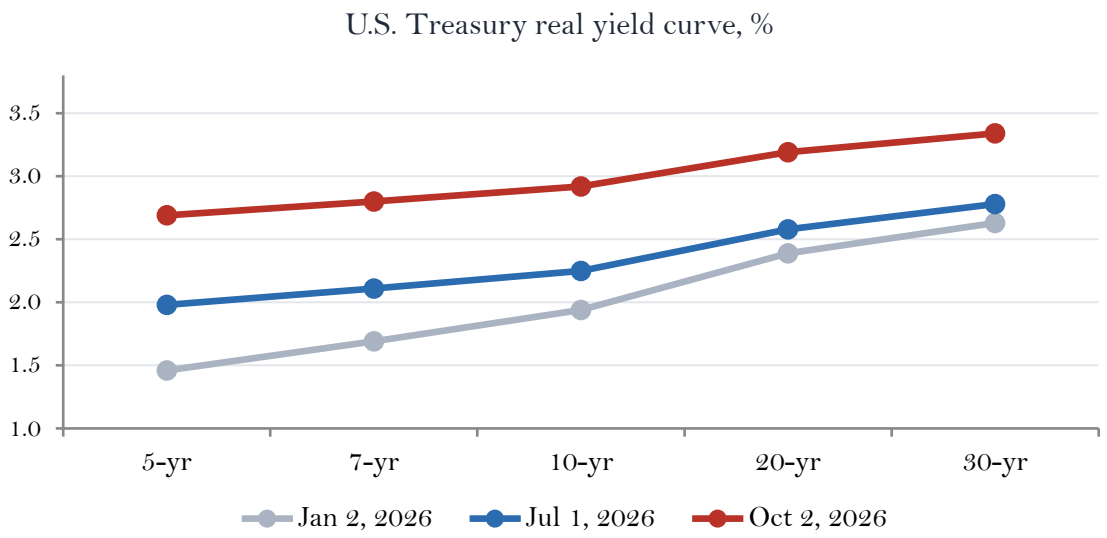
Where to look

p. 63 The usual suspects
p. 64 Beyond the suspects
p. 82 Auction results
p. 85 Burn the bonds?

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Why Rates Are Rising: Six Forces at Once

U.S. real (inflation-adjusted) Treasury yields are up about 0.7–1.2 points this year, and the move is global.



1 Japan

End of zero rates; capital heads home

2 Treasury activism

Response to Japan: FX intervention, buybacks

3 Persistent inflation

Central banks hiking worldwide

4 Fiscal debt

U.S., Europe, and global debt at records

5 AI borrowing

Corporate bonds compete with Treasuries

6 Hot U.S. economy

Strong growth lifts the real rate

The real-yield move

+0.98 — 10-yr real yield since Jan 2 (1.94% → 2.92%)

+0.67 — 10-yr real yield in Q3 alone

2.33% — 10-yr inflation breakeven (Oct 13): little changed

What it shows

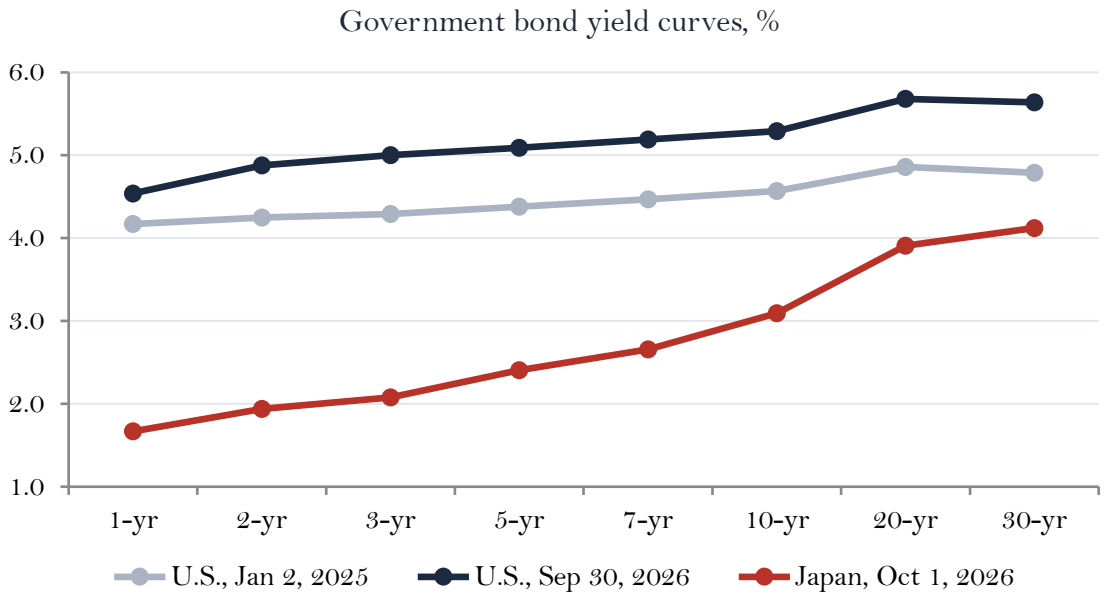
Investors are not demanding more inflation protection. They are demanding a higher real return to lend, which points to supply, demand, and policy forces, not inflation fear alone.

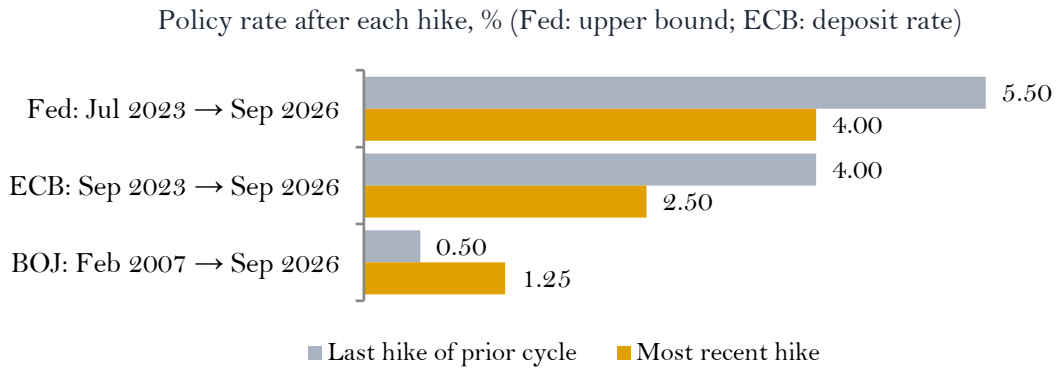
Sources: U.S. Treasury Daily Par Real Yield Curve Rates (Jan 2, Jul 1, Oct 2, 2026); FRED T10YIE 10-year breakeven inflation rate (Oct 2, 2026).

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Global Yield Curves Have Shifted Higher Since 2025

U.S. and Japanese government yield curves and the policy-rate hikes behind them





10-yr yields: then and now

	Jan 2025	Latest
U.S.	4.57%	5.29%
Japan	1.25%	3.09%
Euro area	3.09%	3.22%*
France	—	4.92%

**Euro-area figure is Jan 2026, the latest OECD monthly reading.*

2026 hikes

- Fed: Sep 16, to 3.75–4.00% (first since Jul 2023)
- ECB: Jun 11 to 2.25%, Sep 10 to 2.50% (first since 2023)
- BOJ: Sep 18, to 1.25%, a 31-year high

The U.S. curve has risen and steepened at the long end; Japan's long end now yields 3–4% after decades near zero.

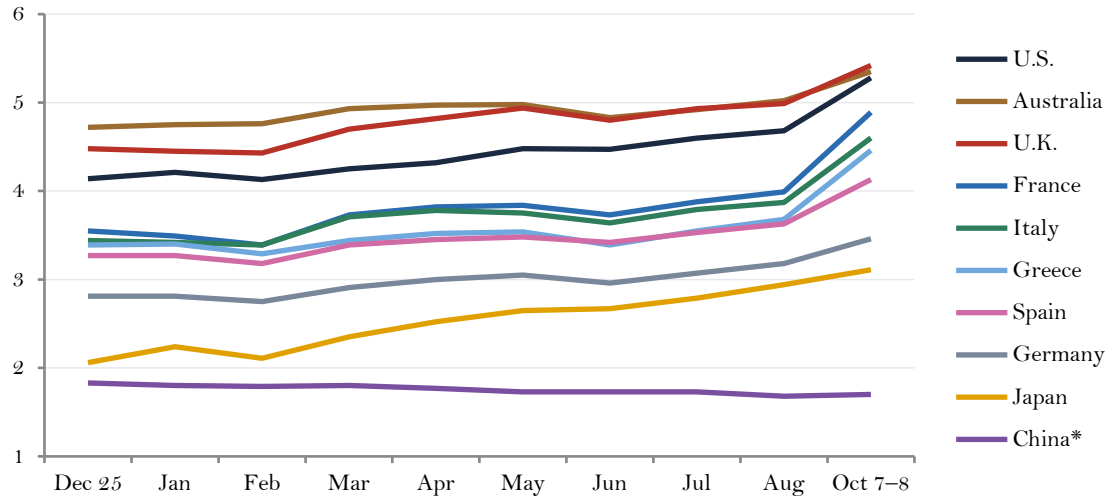
Sources: U.S. Treasury Daily Par Yield Curve (Jan 2, 2025; Sep 30, 2026); Japan Ministry of Finance JGB yields (Oct 1, 2026); full sources in the endnotes.

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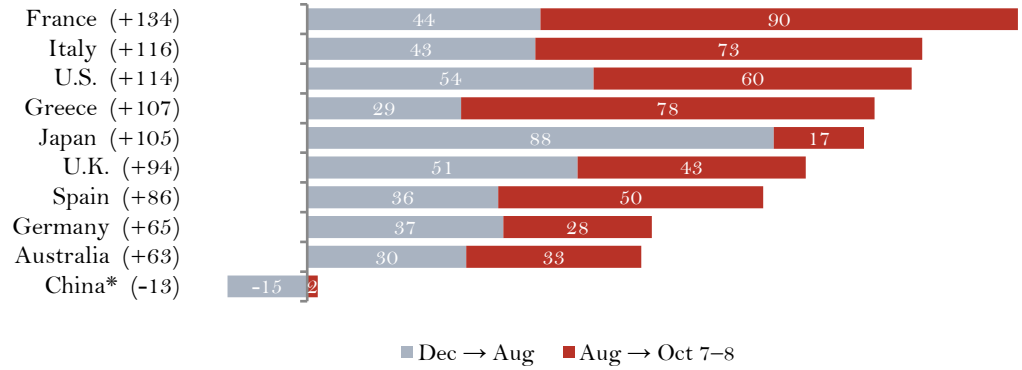
Bond Yields Jumped Worldwide in 2026, Accelerating Since August

All but China pay 0.6–1.3 points more to borrow for 10 years than in December; in the U.S. and Europe, half or more of the rise came since August.

10-year bond yields, % (monthly avg; last point = daily)



10-yr yield change since Dec 2025, bp (total in brackets)



By the numbers

+134bp — France since December, to its highest since 2002; spread over Germany ~1.4–1.5 pts

5.28% — U.S. 10-year (Oct 7), up 1.1 pts; Oct 7 auction highest since 2000

5.4–5.5% — U.K. 10-year, highest since 2007

3.11% — Japan 10-year (Oct 7), up 1.05 pts this year

Why it matters

This is a global repricing, not a U.S. story: borrowing costs rose together as inflation, deficits and war risk hit at once. China, with deflation, is the lone exception.

Sources: OECD 10-year yields via FRED (monthly avg, Dec 2025–Aug 2026); latest: U.S. Treasury, Japan MOF, Trading Economics (Oct 7–8); *China approximate; full sources in the endnotes.

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The Usual Suspects: Five Forces Most Cited for Higher Yields

Fixed income managers and economists agree no single factor explains the move; these five, plus country stories, carry most of it

1. Stronger growth

- U.S. Q3 GDPNow 3.6% after a 6.2% peak; unemployment 4.2%
- Real 10-yr Treasury yield up from 1.94% to 2.92% this year: strong growth raises the real rate

Details: p. 88

2. Corporate bonds crowd out

- U.S. investment-grade issuance ~$1.7tn through July, +27%; hyperscalers raised ~$132bn
- AI capex ~$725bn in 2026; the ECB also cites AI financing moving into bonds

Details: p. 87

3. Sovereign debt sustainability

- U.S. deficit $2.0tn in 11 months; interest now costs more than defense
- Global debt above $365tn (IIF); France's deficit 5.4%; Japan's record budget

Details: pp. 81–82

4. Persistent inflation

- U.S. CPI 3.7% (Sep); eurozone 3.8% (Sep); Australia 4.0% (Aug)
- Central banks hiking again; U.S. consumers expect 4.6% inflation next year

Details: p. 70

5. The Iran war and oil

- Brent averaged $114 in September vs $71 before the war; U.S. diesel +63%
- Tanker attacks and insurance costs keep energy, and inflation risk, high

Details: pp. 76–77, 101

Plus country stories

- France: budget, ratings and 2027 election; spread to Germany ~1.5 pts
- U.K.: new government and weak pension demand; Japan: Bank of Japan hikes and money going home

Details: pp. 64–68

Bottom line: these forces explain why yields are higher. The next page shows why the rise was so fast and so widespread.

Sources: Atlanta Fed GDPNow; BLS (unemployment, CPI); U.S. Treasury real yield curve (Jan 2 and Oct 2, 2026); SIFMA via 247wallst and company data (issuance); ValueAdd VC (capex); full sources in the endnotes.

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Beyond the Usual Suspects: Why Yields Rose Everywhere at Once

Growth, corporate borrowing, debt, inflation, and the Iran war explain much of it; six less-discussed forces made the move faster and broader.

1. Central banks hike together

- Fed (Sep 16), ECB (Jun, Sep), Bank of Japan (Jun, Sep), Australia (4 hikes), and Korea all raised rates.
- Fed's long-run rate projection moved up to ~3.2–3.25%: a higher "normal" rate lifts 10-year yields.

2. The biggest buyers step back

- ECB "not buying bonds anymore"; Bank of England says its bond sales add ~25bp to gilt yields; Bank of Japan tapering
- Reserve managers favor gold; China's Treasury holdings lowest since 2008

3. Pensions and insurers want less

- U.K. pensions: only 9% of new gilts are long-dated, yet long yields still rose
- Dutch pension shift: €550bn moved in Jan 2026, ~€1tn more in Jan 2027
- Japan's life insurers turned net sellers of super-long bonds

4. New sources of supply

- Germany: €180bn+ in 2026 and €838bn planned for 2027–30 (defense, infrastructure); EU joint borrowing €180bn
- Japan: record ¥122tn budget, tax cut, oil subsidies; U.S. deficit $2.0tn in 11 months

5. Politics and credit risk

- U.K.: new prime minister and chancellor (Jul 20), Budget Oct 28
- France: ECB backstop hard to use; Scope cut to A+; spread to Germany ~1.5 pts
- U.S.: pressure on Fed independence

6. Expectations and market mechanics

- U.S. 1-year inflation expectations 4.6% (from 4.0%); European gas ~€71/MWh
- Yields move together; oil–Treasury link tightest since 1990; leveraged funds sell into thin demand

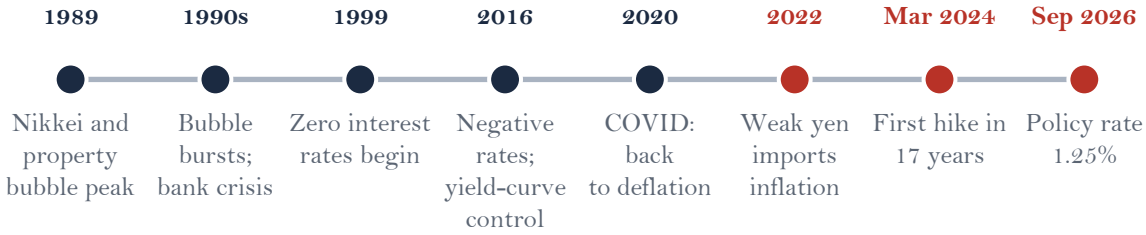
Common thread: buyers of long bonds are shrinking just as supply rises, so each shock moves yields further. The exception, China (~1.7%), still has deflation and domestic savers.

Sources: Fed (Sep 16 statement, SEP); ECB statement (Sep 10); Bank of Japan; RBA via CommBank; Bank of England QT decision (Sep 17) via The Edge; U.K. DMO remit 2026–27; full sources in the endnotes.

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1. Japan (Part 1): From Three Decades of Deflation to Rate Hikes

The world's longest zero-rate experiment is over, and Japan's savers no longer have to leave home to earn a return.



The lost decades

- The 1990–91 collapse of Japan's stock and property bubble left banks and households deleveraging for years; the Nikkei did not regain its 1989 peak until 2024.
- Prices fell or barely rose for most of 25 years, so the Bank of Japan held rates at or below zero from 1999 and bought bonds on a vast scale.

COVID, then imported inflation

- COVID pushed Japan back toward deflation in 2020–21; then a weak yen and the global energy shock raised import costs for a country that buys most of its fuel and much of its food abroad.
- Core inflation stayed at or above the 2% target from 2022 into 2025, and wages began to follow.

The Bank of Japan normalizes

- March 2024: the BOJ ended negative rates and yield-curve control, its first hike in 17 years.
- Sept 18, 2026: raised to 1.25%, the highest in 31 years; the BOJ expects inflation "clearly above 2%" from late fiscal 2026 on oil, AI-chip costs, and the weak yen.
- August headline CPI was 1.9%, held down by energy subsidies; producer prices are at 3-year highs.

Japan by the numbers

1.25% — BOJ policy rate, Sept 18, 2026 (was −0.1% until Mar 2024)

3.06% — 10-yr JGB yield, Sept 24: a 30-year high

4.18% — 30-yr JGB yield (Sept 2), a record for the maturity

Why it matters

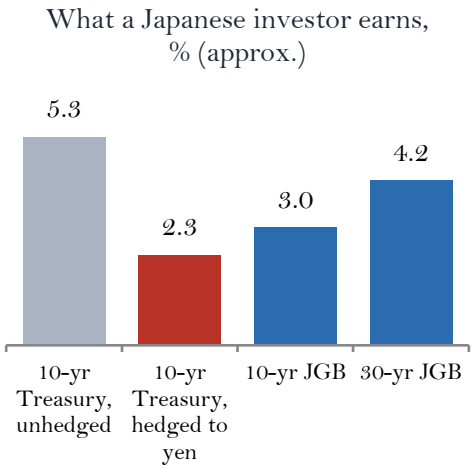
For 25 years, Japan exported its savings because they earned nothing at home. With JGBs paying 3–4%, that flow is reversing, and the world's cheapest money is getting more expensive.

Sources: Bank of Japan statement (Sept 18, 2026); CNBC (Sept 18 & 24, 2026); Wolf Street (Sept 2, 2026); Investing.com Japan CPI (Sept 2026); full sources in the endnotes.

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1. Japan (Part 2): A Marginal Buyer of Treasuries Is Going Home

Japan is the largest foreign holder of U.S. Treasuries; its savers can now earn more at home, without currency risk.



Who holds the Treasuries

- $1.104 trillion in July, the largest foreign holder (UK $998bn is next)
- Ministry of Finance FX reserves (not the BOJ), life insurers, pension funds such as GPIF, and banks
- Holdings fell $12.8bn in July to the lowest since Jan 2025.

Why the money is coming home

- Hedging dollars back to yen costs roughly the U.S.–Japan short-rate gap, about 3 points, which turns a ~5.3% Treasury into ~2.3% in yen, below a 3% JGB.
- Life insurers shifted back into JGBs from mid-2025; March 2026 saw record inflows to JGB funds.

How it feeds into the dollar and U.S. rates

- A weak yen (164 per dollar in late July) forces Tokyo to sell dollar reserves to defend it, which can mean selling Treasuries; one reason the U.S. joined the July 31 intervention.
- Every dollar Japan stops buying must come from price-sensitive buyers who demand higher yields, just as U.S. deficits grow.

The repatriation risk

$1.10tn	Japan's Treasury holdings (July)
~3 pts	Approx. cost to hedge dollars into yen
200%+	Japan government debt to GDP

Why it matters

Japan is one of several marginal buyers, with the UK and U.S. domestic investors, amid a slow global shift away from Treasuries. (China's holdings are the lowest since 2008.) As Japan fades, the U.S. must pay more to attract price-sensitive buyers.

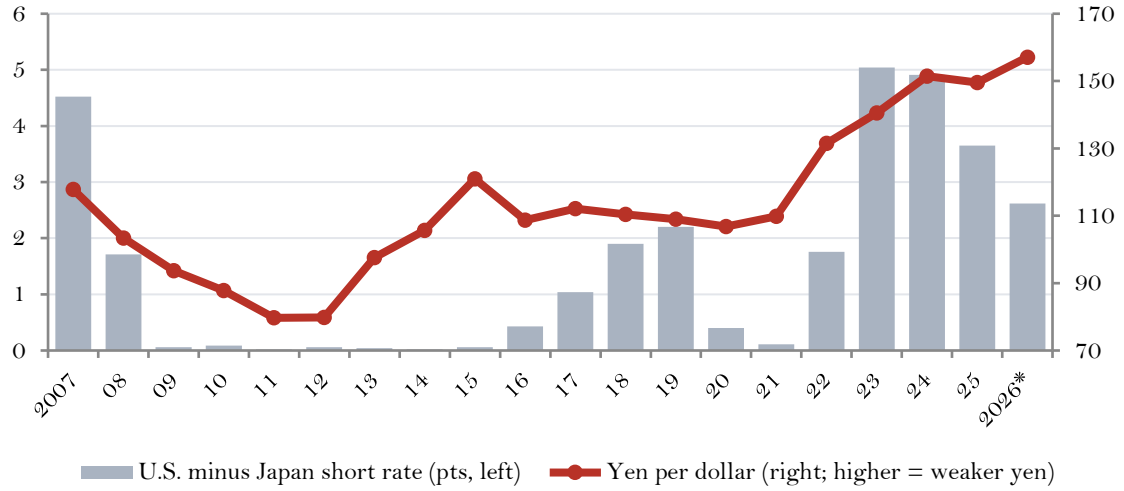
Sources: U.S. Treasury TIC (July 2026); Fortune (May 17, 2026); BlueBay. Hedged yield = Treasury yield minus U.S.–Japan short-rate gap (an estimate); full sources in the endnotes.

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The Yen: Why It Swings and What Drives It Now

For most of the past 15 years, the yen has tracked the gap between U.S. and Japanese interest rates; in 2026, it has stayed weak even as that gap narrowed.

Yen per dollar vs. U.S.–Japan short-rate gap, annual average



Strong-yen periods

- 2011–12: ~¥80. U.S. rates near zero erased the carry; the yen acted as a safe haven after 2008.
- Aug 2024: ¥162 → ¥142 in three weeks as a BOJ hike forced carry trades to unwind

Weak-yen periods

- 2013–15: Abenomics QE pushed the yen from ~¥80 to ~¥120
- 2022–24: the Fed hiked to 5.5% while Japan stayed negative; the gap hit ~5 pts and the yen fell past ¥150
- 2026: ~¥164 in July, weakest since 1986, despite BOJ hikes

The rule: a wider U.S.–Japan rate gap weakens the yen; a narrower one, or a shock, strengthens it, often violently.

Why the yen is weak in 2026

- Japan's real rate is still negative: 1.25% policy rate vs ~1.9% inflation
- U.S. yields rose too: the 10-yr pays ~5.3% vs ~3.1% for a JGB
- Oil near $100 raises Japan's import bill and sends yen abroad
- Debt above 200% of GDP limits how far the BOJ can hike

The dollar side

Strong U.S. growth and high real yields support the dollar, but Treasury joined Japan's July 31 intervention to "correct the substantial undervaluation of the yen."

What would turn it: more BOJ hikes, a Fed pause, cheaper oil, or a risk-off shock.

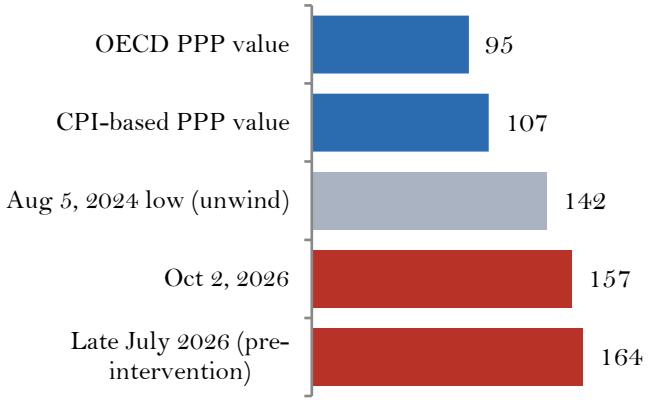
Sources: Fed G.5A (yen per dollar), fed funds and OECD Japan call rate via FRED, annual avg 2007–2025. *2026 = latest: ¥157.1 (Oct 2); gap = Fed target midpoint 3.875% minus BOJ 1.25%; full sources in the endnotes.

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1. Japan (Part 3): The Yen, the Carry Trade and U.S. Rates

The yen is historically cheap, the carry trade is shrinking but not over, and an unwind would hit stocks first and U.S. bonds in two directions.

Yen per dollar: fair value vs. market



How carry trades work

- Borrow yen near zero, buy higher-yielding dollar assets: Treasuries, credit, U.S. tech stocks
- The Fed–BOJ gap that pays for it has roughly halved, from ~5.3 pts in 2024 to ~2.6 pts
- Still profitable, so the trade is shrinking, not over

What an unwind does

- Yen: borrowers buy yen to repay loans, causing sharp snap-back rallies; in Aug 2024, the yen jumped from ~162 to ~142 per dollar in about three weeks
- Stocks: forced selling hits risk assets first; on Aug 5, 2024, the Nikkei fell 12.4%, the VIX hit 65 intraday and the S&P 500 fell 3%
- U.S. bonds, two directions: a panic briefly pushes yields down as investors flee to Treasuries; the slower structural shift, Japanese money going home, pushes the term premium up

Why the yen is still weak despite hikes: Japan's 1.25% policy rate is still below inflation, U.S. real yields near 2.9% pay far more, and Japan's 200%+ debt and import bill weigh on the currency.

Valuation by the numbers

157.1	Yen per dollar, Oct 2; near 164 in late July, the weakest since 1986
62	Yen real effective rate (2020 = 100), July: near 60-year lows
~40%	How far the yen trades below OECD PPP (¥95)
~2.6 pts	Fed–BOJ policy gap, down from ~5.3 in 2024

Why it matters for U.S. rates

A cheap yen can rebound violently. Each BOJ hike narrows the carry and makes Japanese money likelier to come home, removing a buyer of Treasuries just as supply rises.

Sources: TradingKey (USD/JPY, Oct 2, 2026); BIS real narrow effective exchange rate via FRED (RNJPBIS, July 2026); OECD PPP (~¥95, cited by Richard Katz, Feb 2025); full sources in the endnotes.

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2. Treasury Activism: "I Am the House"

Japan is the cause; Washington's response, managing the market through FX intervention, buybacks and debt mix, adds its own risk premium.

> *"It's my dream. I have asymmetric information. Like I am the house now. So when we intervene with the Japanese yen I have pretty good insight into what the Bank of Japan's going to do … but you can bet against me if you want."*
> **Treasury Secretary Scott Bessent, SMU conversation**

How it connects to driver 1 (Japan)

- To defend a collapsing yen, Tokyo must sell dollars, mostly its $1.1tn of Treasuries, the largest foreign holding.
- That selling would push Treasury yields up and U.S. mortgages and corporate and federal borrowing costs with them; the July 31 yen support partly protected the Treasury market.

What Treasury is doing

- FX intervention with Japan; buybacks doubled to $4bn+ per operation in 10–30 year bonds
- More bills (~16% to ~22% of debt); cash-account draw floated

Why it lifts long rates rather than lowering them

- Discretionary policy widens the range of outcomes, raising the term premium; an issuer claiming an information edge gives lenders reason to demand more.
- Buybacks (~$128bn a year) are small vs ~$2tn of supply; the 30-year rose 5.25% → 5.49% after Sept 9.

By the numbers

164→155 Yen per dollar, before and after July 31

$4bn+ Size of each long-end buyback since Sept 9

16→22% Bills as share of debt since 2023

House or borrower?

In currency markets, coordinating with Japan, Treasury can act like the house. In the bond market, it is the borrower: it needs about $2 trillion a year from the same investors and must return to the table every week. Of the six drivers, this is the smallest: it amplifies the others.

Sources: Bessent (SMU conversation) via "The Long End Is Repricing" draft; U.S. Treasury buyback release (Aug 19, 2026); NISA; Fortune (Aug 20, 2026); full sources in the endnotes.

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3. Persistent Inflation: Central Banks Are Hiking Again

Inflation has run above target for more than five years in the U.S., and an energy shock is keeping it there worldwide.

United States

- September CPI 3.7% y/y; PCE 3.4%, core PCE 3.0% (Aug), the Fed's preferred gauge
- Energy up 20.4% y/y and gasoline 34.2% (Sep CPI), with crude near $100
- The Fed hiked to 3.75–4.00% on Sept 16, its first increase since July 2023; Warsh: inflation "too high and has been for too long"

Abroad

- Eurozone inflation reached 3.8% in September, a three-year high; the ECB has hiked twice this year.
- The BOJ raised rates to 1.25%, a 31-year high, and expects inflation clearly above 2%.

The nuance for bonds

- The market's 10-year inflation breakeven is 2.33% (Oct 13), little changed all year, so bond investors are not pricing runaway inflation.
- Inflation pushes yields up mainly through central-bank tightening and higher real rates.
- Households disagree: Michigan 1-year expectations 4.6%, 5–10 year 3.4%

Bottom line: While inflation stays above target, central banks tighten together, keeping a floor under yields.

By the numbers

3.7%	U.S. CPI, y/y (Sep)
3.8%	Eurozone inflation (Sept)
14 of 33	Major central banks that have hiked since Q2 (IMF)

Why it matters

Sticky inflation keeps central banks tightening at the same time, which lifts short rates and the whole curve. If household expectations spread into market pricing, long yields would rise further.

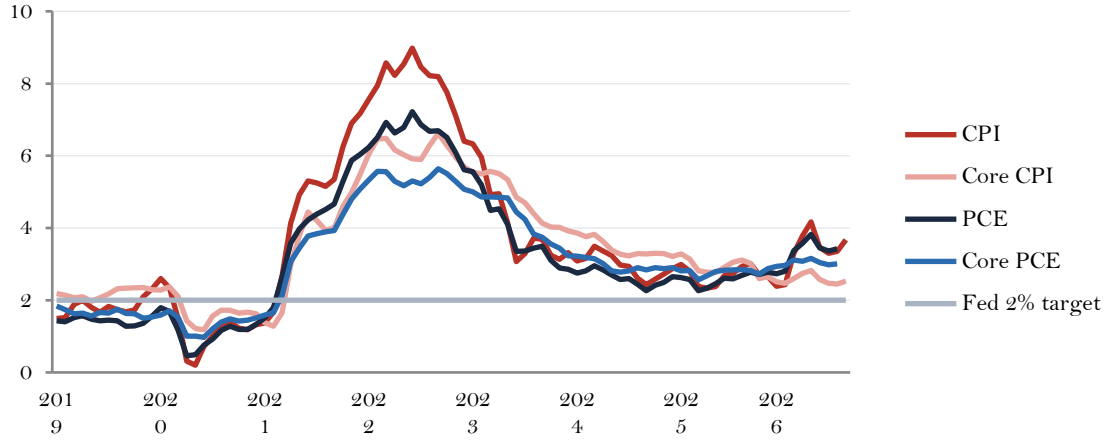
Sources: BLS CPI (Sep 2026) and BEA PCE (Aug 2026); IMF GFSR (Oct 13, 2026); FOMC (Sept 16, 2026); Euronews (Oct 2, 2026); Bank of Japan (Sept 18, 2026); FRED T10YIE; full sources in the endnotes.

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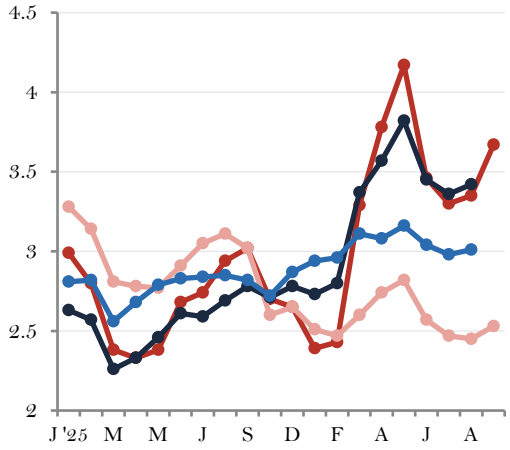
3. Inflation in Detail: Oil Drives Headline; Core Sticky, Firming

CPI and PCE, headline and core, % change from a year earlier: the war pushed headline inflation up this spring; core has stayed near 2.5–3%

Year-over-year inflation, Jan 2019 – Sep 2026 (PCE to Aug), %



Since January 2025, %



Latest	Year/ year	3-mo ann.	2026 peak	2022 peak
CPI (Sep)	**3.7%**	4.4%	4.2% (May)	9.0%
Core CPI (Sep)	**2.6%**	3.3%	2.8% (May)	6.6%
PCE (Aug)	**3.4%**	1.0%	3.8% (May)	7.2%
Core PCE (Aug)	**3.0%**	2.1%	3.2% (May)	5.6%

3-mo ann. = Jul–Sep (CPI) or Jun–Aug (PCE) at an annual rate. CPI y/y is BLS not seasonally adjusted. Oct 2025 CPI not collected (shutdown), interpolated. September PCE is due Oct 29.

By the numbers

3.7% — CPI inflation, Sep 2026, up from 3.4% in Aug and 2.4% in Jan

3.0% — Core PCE (Aug), the Fed's preferred gauge; above 2% for 5½ years

3.3% — Core CPI over the past three months, annualized, up from ~2%

+0.6 — Core PCE minus core CPI, pts; usually the gap runs the other way

Perspective

The war drove the spring spike, and gasoline lifted headline again in September. Core is sticky near 3% and accelerating to about 3.3% over three months; on-again, off-again Iran peace talks keep oil and inflation volatile.

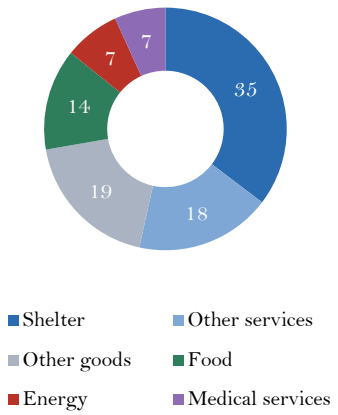
Sources: BLS CPI (CPIAUCSL, CPILFESL; Sep 2026 release, Oct 14) and BEA PCE price indexes (PCEPI, PCEPILFE, through Aug 2026), via FRED.

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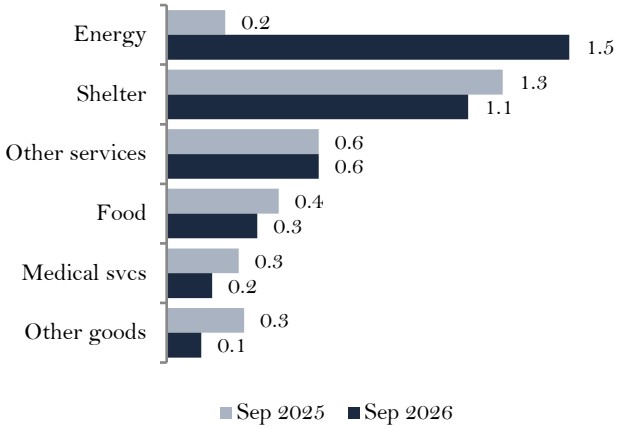
3. Inside CPI: Energy Added Everything; the Rest Cooled

Weights and contributions of the CPI-U components, September 2026 vs a year earlier: energy turned from minor to the largest driver, while shelter, goods, food, and medical care eased.

Basket weights, %



Contribution to year-over-year CPI inflation, pts



Component	Weight	Y/Y Sep 2025	Y/Y Sep 2026	Contribution	Change
Energy	7.4	2.9%	**20.4%**	**1.51**	+1.30
Shelter	35.3	3.6%	**3.2%**	**1.13**	−0.13
Other services	18.1	3.1%	**3.1%**	**0.57**	0.00
Food	13.5	3.1%	**2.5%**	**0.34**	−0.08
Medical services	6.8	3.9%	**2.5%**	**0.17**	−0.09
Other goods (core)	18.8	1.5%	**0.7%**	**0.13**	−0.16
All items	100	3.0%	**3.7%**	**~3.9***	+0.7

*Contribution = weight × annual change (pts). *Components sum to ~3.9 vs 3.7 reported, because weights shift with prices. Other services derived from services less energy. Year-earlier changes seasonally adjusted. Gasoline +34%; used cars −1.5%.*

By the numbers

1.5 pts — Energy's contribution to 3.7% CPI, vs ~0.2 a year ago

+0.7 — Rise in headline inflation; energy alone added +1.3

1.1 pts — Shelter, still the largest steady piece, cooling to 3.2%

0.7% — Core goods inflation over 12 months, despite tariffs

Perspective

Remove energy and 12-month inflation is still easing across most of the basket, so today's inflation is largely supply-driven. But September's monthly firming in core goods and shelter is the early warning to watch.

Sources: BLS CPI release, Table 1 (Sep 2026, Oct 14; weights Aug 2026); year-earlier changes from FRED CPI series, SA.

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3. CPI Month by Month: Energy Swung Wildly, Core Stayed Steady

Monthly % change by category, seasonally adjusted, March–September 2026, and the 12 months to September

Category	Mar	Apr	May	Jun	Jul	Aug	Sep	12 mo
All items	**0.9**	**0.6**	**0.5**	**-0.4**	**0.1**	**0.4**	**0.6**	**3.7**
Food	**0.0**	**0.5**	**0.2**	**0.2**	**0.1**	**0.1**	**0.0**	**2.5**
Food at home	-0.2	0.7	0.1	0.2	-0.1	0.0	-0.1	**1.8**
Food away from home	0.2	0.2	0.3	0.2	0.3	0.3	0.2	**3.5**
Energy	**10.9**	**3.8**	**3.9**	**-5.7**	**-1.5**	**2.1**	**5.2**	**20.4**
Gasoline	**21.2**	**5.4**	**7.0**	**-9.7**	**-2.9**	**3.9**	**9.1**	**34.2**
Fuel oil	**30.7**	**5.8**	**3.8**	**-9.2**	**-1.7**	**10.1**	**15.3**	**74.2**
Electricity	0.8	**2.1**	0.6	**-1.0**	0.1	-0.2	0.2	**4.4**
Utility (piped) gas	-0.9	-0.1	-0.5	0.5	0.7	**-1.1**	-0.3	**5.0**
Core (ex food & energy)	**0.2**	**0.4**	**0.2**	**0.0**	**0.2**	**0.3**	**0.3**	**2.6**
Core goods	0.1	0.0	-0.1	-0.1	0.2	0.1	0.3	**0.7**
New vehicles	0.1	-0.2	-0.3	0.0	0.1	0.3	0.2	**0.6**
Used cars and trucks	-0.4	0.0	0.1	-0.2	0.4	0.4	0.7	**-1.5**
Apparel	**1.0**	0.6	0.3	-0.6	0.1	0.0	0.3	**3.4**
Medical care goods	**-1.0**	-0.4	-0.7	-0.2	-0.6	-0.2	-0.7	**-3.3**
Core services	0.2	0.5	0.3	0.0	0.2	0.3	0.4	**3.1**
Shelter	0.3	0.6	0.3	0.1	0.1	0.3	0.4	**3.2**
Transportation services	0.6	0.3	-0.6	-0.3	0.3	0.5	0.6	**2.7**
Medical care services	0.0	0.0	0.5	-0.1	0.6	-0.2	0.3	**2.5**

Red = rise of 1% or more in a month; blue = fall of 1% or more. War began Feb 28: gasoline +21% in March, −10% in June, +9% in September.

Takeaway: energy drove the swings in headline CPI (+0.6% in September, gasoline +9.1%); core held at 0.3%, but core goods and shelter firmed.

By the numbers

+0.6% — All-items CPI in September; 3.7% over 12 months

+9.1% — Gasoline in September: over half the monthly rise

0.3% — Core CPI in September, as in August (2.6% y/y)

+0.4% — Shelter in September, up from 0.3%

Perspective

Inflation is still riding on energy, but September shows early leakage: core goods, used cars, airfares, and shelter all firmed. Not yet a spiral; the risk is that energy and pipeline costs keep seeping into core.

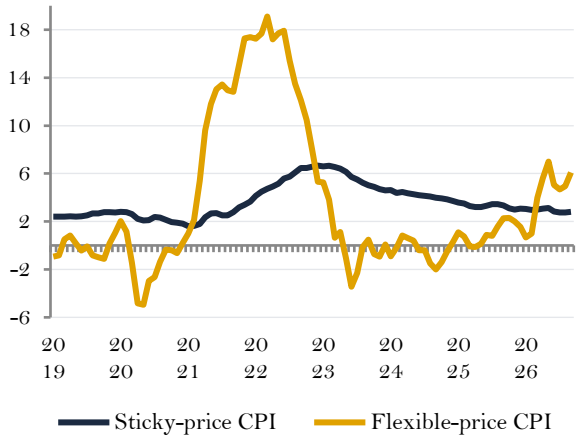
Source: BLS, CPI news release Table A (Sep 2026, released Oct 14, 2026), seasonally adjusted monthly changes; 12-month change not seasonally adjusted. Table compiled by Philip Chao.

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3. Underlying Inflation: Sticky Prices Edge Up as Flexible Prices Jump

Prices that change slowly carry the inflation people expect. September saw them firm while flexible prices jumped again; trimmed-mean PCE (Aug) is 2.2%.

Atlanta Fed sticky and flexible CPI, 12-month %



PCE, ann. %	1m	6m	12m	12m
	Aug	Aug	**Aug**	May
Headline	3.8	3.6	**3.4**	3.8
Core	3.0	2.7	**3.0**	3.2
Trimmed mean	1.9	2.3	**2.2**	2.4

Dallas Fed trimmed mean drops the most extreme price moves each month to show the trend.

How to read it

- Sticky prices (rent, insurance, medical care) change rarely, so they reflect expected future inflation; 2.8% in September, below 3.3% a year ago but rising at a 3.4% annualized pace in the month.
- Flexible prices (gasoline, food, airfares) react to shocks; they jumped from about 1% to 7% in May, eased to ~5%, and rose to 6.1% in September as gasoline surged.
- Trimmed-mean PCE (2.2%, Aug) and core sticky CPI (2.8%, Sep) put the underlying trend near 2–3%, but the slow-moving core is now firming.
- The risk: if flexible-price inflation persists, it can seep into sticky prices and expectations, as in 2021–22.

By the numbers

2.8% Sticky-price CPI, Sep (2.7% in Aug); 3.4% annualized in Sep

6.1% Flexible-price CPI, Sep (4.9% in Aug); 7.0% peak in May

2.2% Trimmed-mean PCE, 12 months to Aug

1.9% Trimmed-mean PCE in August, annualized

Perspective

The underlying trend is still calmer than the headline, but September is the first sign the slow-moving core is turning up. If it continues, inflation becomes more entrenched.

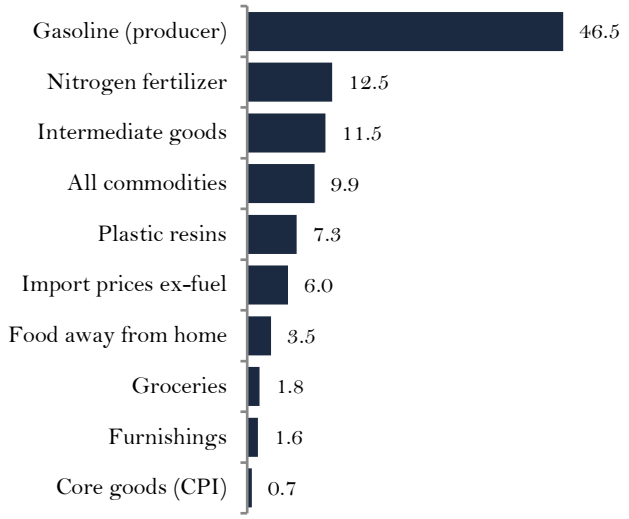
Sources: Federal Reserve Bank of Atlanta, Sticky-Price CPI (Sep 2026, Oct 14; history via FRED); Federal Reserve Bank of Dallas, Trimmed Mean PCE (Aug 2026).

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3. From Oil to Shelf: Costs Are Rising Upstream, Not Yet at the Store

Producer costs are up sharply since the war began, but consumer goods prices have barely moved; businesses are absorbing the difference, for now.

Price change vs a year earlier, latest month, %
(upstream at top, consumer at bottom)



PPI (Aug) for the top five; import prices (Sep, released Oct 16, 2026, ex-tariffs) and CPI (Sep) below. Farm crops (PPI): −2.4%.

Why shelves lag

- Weak demand: 70% of households plan to cut back, so retailers fear losing sales.
- Lags: costs take 6–18 months to pass through contracts and inventories.
- Tariff-era stockpiles still being sold at old costs.
- Offsets: used cars −1.5% (Sep), cheaper electronics
- But pressure is building: ISM input prices near 78; about a third of small firms report raising prices (NFIB).

Farmers squeezed first

- Fertilizer and diesel up sharply; farm crop prices down 2.4%
- Crops are a small share of grocery prices; packaging, transport, and labor matter more.
- Bigger effect likely on the 2027 harvest

Tariffs: real, but in margins

- Import prices +6.0% ex-fuel before tariffs (Sep), the most since 2022: suppliers are raising prices.
- Exemptions, deals, and stockpiling delayed the effect.
- The cost sits in business margins, not yet with consumers.

By the numbers

+11.5% Intermediate goods prices, what factories buy

+0.7% Core goods prices consumers pay

+12.5% Nitrogen fertilizer, after +22% a year earlier

−2.4% Farm crop prices: farmers absorb the squeeze

Perspective

This is pressure in the pipeline, not yet at the store. If demand holds or margins run out, goods inflation could rise in 2027 even if oil eases: sticky, supply-driven inflation.

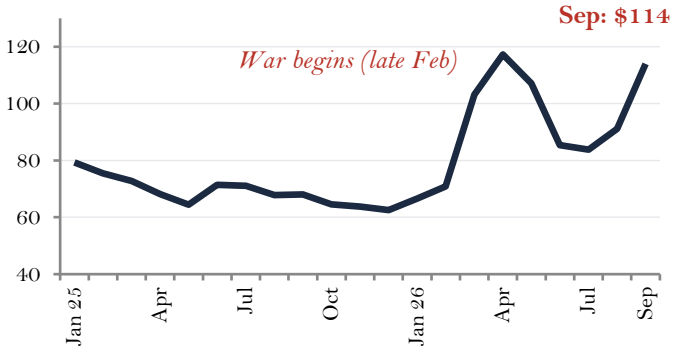
Sources: BLS producer, consumer and import price indexes via FRED (PPI Aug; CPI Sep; import prices Sep, released Oct 16, 2026; series in the endnotes); ISM (Sep); NFIB (Aug); full sources in the endnotes.

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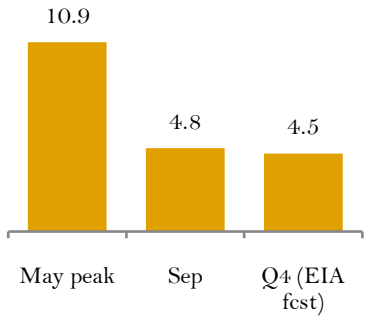
3a. Oil: Supply Is Returning, but Prices Are Stuck Above $100

Gulf output is coming back, yet Brent averaged $114 in September, 61% above its pre-war level; the oil shock keeps inflation above target.

Brent crude, monthly average, $/barrel



Middle East output shut in, mb/d



Why prices stay high	Evidence
Attacks raise costs	At least 9 tanker attacks Oct 1–7; ship transits ~90% below normal; insurance 7.5–12.5% of ship value (~$4–6/bbl) plus Iran's ~$2m toll*
Escalation risk	Saudi bypass pipeline hit Sep 10–11 (restarted at low rates Sep 22); Houthis threaten Red Sea shipping; more U.S. forces head to the Gulf.
Empty tanks	Global stocks fell 507 million barrels from February to August (IEA).
Fuel shortage	Gulf diesel exports ~25% of pre-war; Russian product exports near a halt; U.S. diesel up 94%
Inflation hedge	Investors buy oil as protection while bond yields and inflation rise.

By the numbers

$131 — Brent's September peak (Sep 15), after the pipeline attack; 2026 high $138 (Apr 8)

1.9 mb/d — Global stock draw in Q3 (EIA)

~1 day — World oil use covered by the G7's 100m-barrel release

$105 — EIA Brent forecast for Q4; $84 in 2027

What it means for rates

Oil keeps headline inflation high, so central banks keep hiking and real yields rise. The 10-yr inflation breakeven is still 2.33%: bond investors see the shock as temporary. If $100 oil lasts into 2027, that view is at risk.

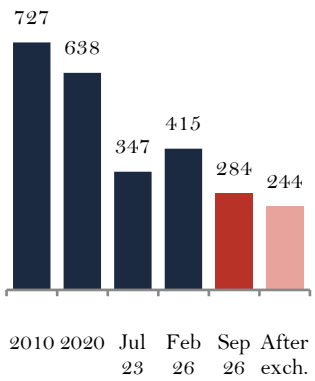
Sources: EIA via FRED and EIA STEO (Oct 2026); IEA Oil Market Report (Sep 11); UKMTO via CBS; Kpler; Breakwave; Euronews; *per-barrel cost is an estimate; full sources in the endnotes.

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3b. Emergency Oil Stocks: Enough for Now, Thin for a Second Shock

Governments have released a record 325 million barrels; about 1.5 billion remain, roughly two weeks of world oil use.

U.S. Strategic Petroleum Reserve, million barrels



Million barrels	Pre-war	Released	Latest	Days of use
IEA members (all)	1,800	~325	**~1,475e**	~14
U.S. SPR	415	~132	**284**	~3
Japan	470	~120e	**~350e**	~3
Korea (government)	100	22	**~78**	<1
China onshore (est.)	~1,250e	drawn	**1,230**	~12

e = estimate. Days = barrels ÷ ~102 mb/d world use (EIA 2026). Japan holds ~190 days of its own use.

Reading the drain

- Enough for today's gap: world stocks fell 2.8 mb/d from February to August, what is left could cover that pace for more than a year.
- Not enough to replace Hormuz: pre-war flows were ~20 mb/d; the remaining stocks would last about two weeks if the strait closed again.
- The U.S. SPR is 40% full, the lowest since 1983; U.S. releases are loans that must be repaid with extra barrels, adding to demand later.
- China drew stocks in May, June, and August; imports are rising again (7.8 mb/d in Sept, Kpler), so restocking adds to demand.

By the numbers

426m — Barrels pledged in the IEA's record March release

325m — Delivered by Oct 3; 75m still to come

100m — G7 release of crude and diesel over 4 months (Oct 2), partly the same barrels

40m — New U.S. SPR exchange, delivered Nov–Dec

Why prices stay high anyway

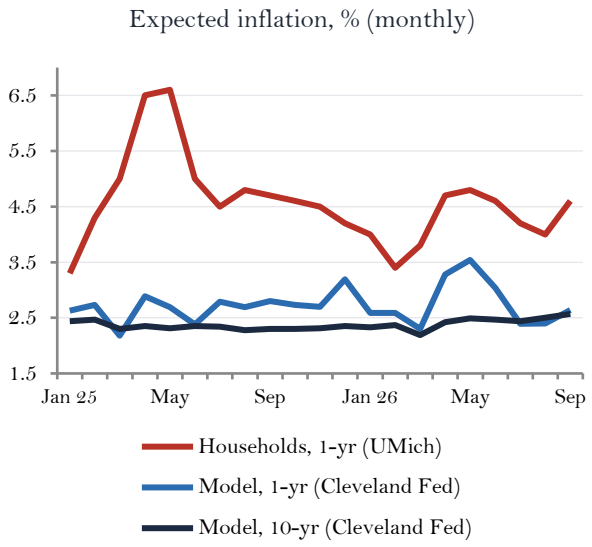
Reserves fill a gap; they cannot insure against a new one. Markets price the risk that the war reignites with the U.S. reserve a third smaller than in February.

Sources: EIA Weekly Petroleum Status Report (SPR, Feb 13 & Sep 25, 2026); DOE (Sep 29); IEA; Euronews (Oct 3); AP; METI; KNOC; Kpler; full sources in the endnotes.

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3. Inflation Expectations Jumped After the War; Markets Stay Calm

Households now expect 3.9–4.7% inflation over the next year; businesses and bond markets still expect about 2.3–2.6%.



Gauge, %	Now	Pre-war	Term
UMich	**4.6**	3.4	1y
UMich	**3.4**	3.3	5–10y
NY Fed	**3.9**	~3.0	1y
NY Fed	**3.3**	~3.0	3y
Atlanta BIE	**2.4**	~1.9	1y
Cleveland Fed	**2.57**	2.37	10y
Breakeven	**2.33**	2.32	10y

Latest: Sep 2026 (UMich Oct prelim 4.7%); breakeven Oct 13. Pre-war = Feb 2026; NY and Atlanta Fed values approx.

What it means

- Households react to gasoline and grocery prices: 1-year expectations jumped after Feb 28 and stay near the 2025 tariff highs.
- Longer-run household expectations (3.3–3.4%) have edged up, the part the Fed watches most closely.
- Businesses and bond markets still expect about 2.3–2.6%: they see a temporary energy shock, not a new inflation regime.
- The gap is the risk: if households keep expecting 4%+, they may demand higher wages and buy ahead, turning expectations into inflation.

By the numbers

4.6% Households' 1-yr expectation (UMich, Sep), from 3.4% in Feb

3.9% NY Fed consumers' 1-yr, highest since 2023

2.33% 10-yr market inflation breakeven, little changed

2.4% Businesses' expected unit-cost growth (Atlanta Fed)

Perspective

Households have jumped; markets have not. The Fed's hikes are aimed at that gap. If longer-run expectations keep rising, the Fed would have to hike more, even into a slowdown.

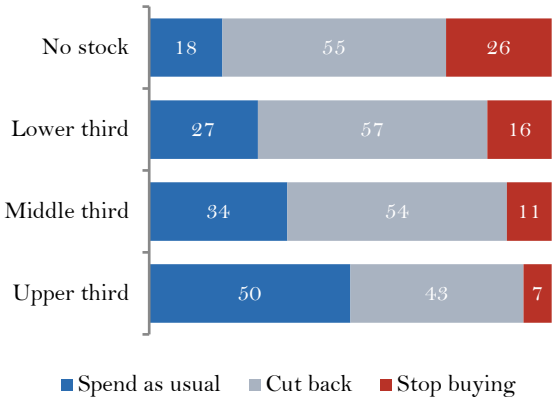
Sources: University of Michigan (Sep 2026 final; Oct prelim); FRBNY Survey of Consumer Expectations (Oct 7, 2026); Atlanta Fed BIE (Sep 23, 2026); full sources in the endnotes.

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3c. Inflation Psychology: Consumers Expect Prices to Keep Rising

University of Michigan (Oct 9): the war reversed the improvement in inflation expectations; most households plan to cut back, the bottom of the K most of all.

Response to big price increases, by stock holdings, %



Expectations, by spending plan

Plan	Share	1-yr	5–10 yr	Jobs worse
Spend as usual	**31%**	3.2%	2.9%	43%
Cut back	**54%**	4.7%	3.5%	64%
Stop buying	**16%**	5.3%	4.7%	71%

Median expected inflation; "jobs worse" = share expecting unemployment to rise. Sentiment: 78.6, 42.5, 27.5. The "stop buying" group holds stagflationary views.

What the survey shows

- Gas drove it: about $2.93 a gallon before the war, above $4.50 in May, and near $4.50 again in September; gas mentions replaced tariff mentions.
- Expectations stay elevated: the 2026 improvement reversed after Feb 28, and most consumers expect gas prices to keep rising.
- Only 31% will spend as usual on items with big price increases; 70% will cut back or stop: food, durables, cars, dining out, and travel.
- Advance buying ("buy before prices rise") has ticked up to 2022–23 levels; historically, it preceded inflation surges by about two years.
- Debt aversion matches 2022 and 1981: 14% think it is OK to buy on credit, 24% to use savings.

By the numbers

70% Plan to cut back or stop buying items with big price increases

50% vs 18% Spend as usual: top third of stockholders vs non-owners

4.7% Long-run inflation expected by the "stop buying" group

$4.50 Gas near its May peak again in September (AAA)

Perspective

Inflation psychology is not yet 1970s-like, but it is primed. The top of the K keeps spending; the bottom cuts back. That split keeps headline spending up while the base weakens.

Source: University of Michigan, Surveys of Consumers, "Gasoline Prices and Expected Consumer Spending" (J. Hsu, Oct 9, 2026), 3,492 interviews Jun 23–Sep 21, 2026; AAA via UMich.

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3d. The Stagflation Risk: Higher Prices, Slower Real Gains

Stagflation is not expected in 2026 or early 2027; the risk is a slowdown if inflation stays above trend or rates keep climbing.

Signal	Latest	Flashing?	What it means
Inflation vs target	PCE 3.4%, core 3.0% (Aug)	**Yes**	*Five-plus years above 2%*
Price pressure ahead	ISM prices 77.9 / 74.0; oil >$100	**Yes**	*Costs still feeding through*
Expectations	UMich: elevated since Feb	**Yes**	*Risk of self-fulfilling inflation*
Real incomes	Flat; real hourly pay −0.3%	**Yes**	*Spending relies on savings*
Hiring	51k jobs a month in Q3	**Partly**	*Low hire, low fire*
Growth	Q3 GDPNow 3.6%	**No**	*AI investment carries growth*
Unemployment	4.2%; Sahm rule 0.00	**No**	*No recession signal yet*

Assessment: a slowdown, not stagflation, is the nearer risk.

- Not in 2026, likely not in the first quarter or two of 2027: AI investment and top-of-the-K spending keep growth solid, though the lower K already feels prices outrunning pay.
- The economy slows if inflation stays above trend or long rates keep spiking from here; that slowdown, not stagflation, is the nearer risk.
- Today's inflation is mainly supply-driven (energy, war, tariffs). Hiking another 25–100bp will not fix it; only a much larger hike that engineers a recession would, which is not expected under this administration.

By the numbers

4 of 7 — Stagflation signals flashing; growth and jobs still hold

3.4% — Fed's 2026 core PCE projection (headline 3.7%), vs 2% target

−0.3% — Real average hourly earnings, year over year

16% — Consumers with stagflationary expectations (UMich)

What would change the view

Stagflation becomes a 2027 risk if growth slips below ~1.5% with core inflation above ~3%: an AI capex pause, a second oil shock, or both. Bonds and stocks would then likely fall together, as in 2022.

Sources: BEA (Aug PCE); Fed SEP (Sep 16); ISM (Sep); BLS; Atlanta Fed GDPNow (Oct 8); FRED (SAHMREALTIME); UMich (Oct 9).

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4. Fiscal Debt: Investors Are Questioning the Math

Record government borrowing in the U.S., Europe, and Japan means more bonds to absorb and more compensation demanded.

United States

- Gross federal debt passed $40.1 trillion in September, up $2.67 trillion in a year.
- FY2026 deficit about $1.8 trillion through August, net interest $1.02 trillion, up 9%, on track for 3.2% of GDP.
- The Supreme Court tariff ruling removed revenue; CRFB estimates about $2.4 trillion more debt by 2036 once refunds are paid.

Europe and Japan

- France: debt 119% of GDP, 10-year yield 4.92% (a 24-year high), €340bn to borrow next year, elections in spring
- UK 30-year gilt yields topped 6%, the highest since 1998; Japan's debt exceeds 200% of GDP.

The global picture

- Global debt passed $365 trillion in the first half of 2026, up about $10 trillion (IIF).
- Governments everywhere are borrowing at once, so they compete for the same savings.

Bottom line: Debt is no longer a slow-burning issue; it is being priced into long-bond yields now, here and abroad.

By the numbers

$40.1tn	U.S. gross federal debt
$1.02tn	U.S. net interest, FY26 through Aug
$365tn	Global debt, a record (IIF)

Why it matters

Higher yields raise interest costs, which widen deficits and require more issuance. That loop is why investors demand a higher term premium on long bonds everywhere.

Sources: Joint Economic Committee debt update; Peter G. Peterson Foundation; CBO; CRFB (via "The Long End Is Repricing" draft); Euronews (Oct 2, 2026); full sources in the endnotes.

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4a. Fiscal Debt in Practice: Buyers Take Supply Only at Higher Yields

10 of 19 auctions settled above the market's expected yield, with the largest misses in mid-to-late September; most misses were under 1bp.

2026	Term	Expected	Settled	Diff, bp
Jul 7	3-yr	4.185	4.179	−0.6
Jul 8	10-yr	4.586	4.580	−0.6
Jul 9	30-yr	5.061	5.058	−0.3
Jul 22	20-yr	5.158	5.163	+0.5
Jul 27	5-yr	4.399	4.408	+0.9
Jul 28	7-yr	4.471	4.473	+0.2
Aug 11	3-yr	4.296	4.291	−0.5
Aug 12	10-yr	4.682	4.683	+0.1
Aug 13	30-yr	5.212	5.216	+0.4
Aug 19	20-yr	5.199	5.204	+0.5
Aug 26	5-yr	4.391	4.393	+0.2
Aug 27	7-yr	4.512	4.512	0.0
Sep 8	3-yr	n/a	4.474	n/a
Sep 9	10-yr	4.849*	4.834	−1.5
Sep 10	30-yr	5.335	5.308	−2.7
Sep 15	20-yr	5.400	5.420	+2.0
Sep 23	5-yr	5.002	5.033	+3.1
Sep 24	7-yr	5.078	5.085	+0.7
Oct 6	3-yr	4.934	4.932	−0.2
Oct 7	10-yr	5.317	5.300	−1.7

Reading the results

- Settled above expected: 5-yr 3 of 3, 20-yr 3 of 3, 7-yr 2 of 3; but 10-yr only 1 of 4, 30-yr 1 of 3, 3-yr 0 of 3
- The two biggest misses came late: 20-yr +2.0bp (Sep 15) and 5-yr +3.1bp (Sep 23); since then, the 3- and 10-yr sold below expectations.
- Settled yields are up 0.6–0.75 pt at 3–10 years since July (10-yr: 4.580% to 5.300%).

*Yields in %. Expected = when-issued yield just before bidding; Settled = auction high yield; Diff = settled minus expected (red = higher, weaker demand). *Implied from reported 1.5bp stop-through. Excludes Oct 8 30-yr reopening.*

By the numbers

10 of 19 — 2026 auctions since July that settled above the expected yield; average miss near zero

+3.1bp — 5-year, Sep 23: the weakest sale of the period

52.5% — Foreign-type (indirect) share at the Sep 15 20-year, lowest on record

5.30% — 10-year auction yield Oct 7, highest since Nov 2000

What it shows

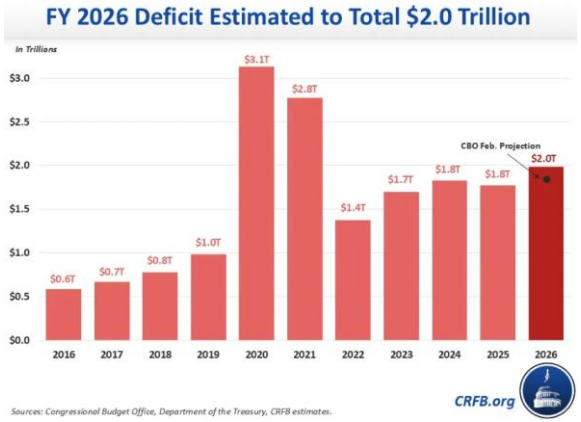
Buyers show up, but only at higher yields. The 5-, 7- and 20-year sales cleared above expectations as foreign demand slipped; the 10- and 30-year drew strong bids once yields jumped.

Sources: U.S. Treasury Fiscal Data auctions (Jul 7–Oct 7, 2026); when-issued yields: Newsquawk, InvestingLive, ZeroHedge, Wolf Street; full sources in the endnotes.

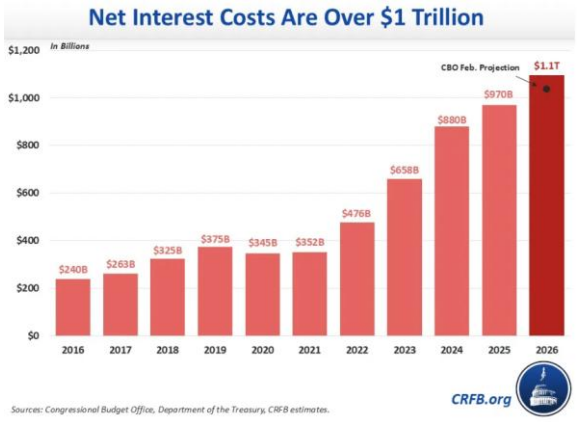
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4b. FY2026: A $2 Trillion Deficit, and Interest Now Tops Defense

The fiscal year ended Sept 30 with a deficit of 6.2% of GDP; interest costs reached a record 3.4% of GDP, the second-largest line in the budget.



CRFB: FY2026 deficit totaled $2.0 trillion



CRFB: net interest costs over $1 trillion

FY2026 (CRFB estimate)	$ trillions	% of GDP	vs FY2025
Deficit	2.0	6.2%	+$210bn
Spending	7.4	22.9%	+$370bn
Revenue	5.4	16.7%	+$160bn
Net interest	**1.1**	**3.4% (record)**	+$125bn
Debt held by the public	32.3	100%	

By the numbers

$2.0tn — FY2026 deficit (CBO: +$218bn vs FY2025)

$1.1tn — Net interest, more than defense or Medicare

100% — Debt held by the public, % of GDP

$135bn — Deficit above CBO's February projection

Why it matters

The deficit widened in a strong economy, and interest is now the fastest-growing major cost. More borrowing at higher rates is the fiscal loop behind higher long-term yields (pp. 81–82).

Sources: CRFB, "U.S. Ran a $2 Trillion Deficit Last Year, We Estimate" (Oct 1, 2026; charts reproduced from CRFB as captured by the author); CBO, Monthly Budget Review (Oct 8, 2026).

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October 15, 2026

4c. How the National Debt Reaches Households and Businesses

The Conference Board models five fiscal paths and translates them into costs for students, home buyers, retirees, and small businesses.

Conference Board, Aug 2026	Value
Total public debt outstanding (July 2026)	$39.7 trillion
Debt per American	~$116,000
Debt by 2036: good / baseline / higher-deficit scenario	126% / 154% / 180% of GDP
Social Security retirement trust fund insolvent	2032
Small-business loan payments if the U.S. defaults for one week (2029)	+6.1% (~$20,000)
Student loan costs under the same default	+2.8% (~$2,900)
Mortgage costs for a family buying in 2036	+4.4% (~$45,000)

The report's recommendations

- A bipartisan fiscal commission to move debt toward a sustainable path and address trust fund solvency
- A Social Security package: benefit adjustments, new revenue, protection for vulnerable retirees
- Modernize Medicare and federal health programs; reform the congressional budget process

By the numbers

$39.7tn Total public debt (July 2026)

154% Debt/GDP in 2036, baseline

2032 Social Security trust fund depletion

4 groups Students, home buyers, retirees, small firms

Why it matters

"The national debt is not just a number on the government's balance sheet" (David K. Young, CED). Higher debt means higher borrowing costs for families, not just the Treasury.

Sources: Conference Board / CED, "How the National Debt Affects All Generations of Americans" (Aug 18, 2026). Total debt includes intragovernmental holdings (public: ~$32.3tn, CRFB).

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4d. Burn the Bonds? When Debt Outgrows the Economy

A French front-runner's pitch to set debt on fire is a symptom: most big economies borrow beyond their means or grow too slowly to outrun their debt.

BURN THE BONDS?

> ***"All we have to do is take the 18% held by the Bank of France and chuck it in the fire."***
>
> *— Jean-Luc Mélenchon, France Unbowed leader and 2027 presidential front-runner, on the campaign trail (Aug 2026)*

2026 (% GDP)	Gross debt	Primary balance	Net interest	Real growth	Main pressure
U.S.	125.8	**−3.7**	3.8	2.3	*Spending: big primary deficit*
Japan	204.4	**−1.7**	0.3	0.7	*Huge stock as rates rise*
China	106.9	**−7.0**	1.1	4.4	*Deficits; debt +16 pts since 2024*
France	118.4	**−2.7**	2.2	0.9	*Deficit plus slow growth*
U.K.	103.6	**−1.2**	2.7	0.8	*Interest bill, slow growth*
Italy	138.4	**+0.8**	3.6	0.5	*Surplus, but too little growth*
Germany	64.6	**−2.8**	0.9	0.8	*Low debt; defense deficits*
Switzerland	38.5	**+0.3**	−0.1	1.3	*Disciplined: debt falling*

IMF projections for 2026 (April 2026). Primary balance = budget before interest; net interest = overall minus primary balance.

Can you just burn them? The reality check

- Target: ~€600bn, the 18% of French debt held by the Bank of France; EU treaties bar central banks from financing governments
- Blanchard: net effect ~zero; the state saves interest but loses the central-bank profits it receives, while investor trust takes the hit

By the numbers

100% Global public debt/GDP by 2029, a year sooner than the IMF expected

3.8% U.S. net interest, % of GDP in 2026 (calculated from IMF)

+0.8% Italy's primary surplus, yet debt 138% with 0.5% growth

38% Swiss debt/GDP and falling: discipline plus steady growth

Why it matters

Overspending and weak growth create the vulnerability; higher rates expose it. Productive, disciplined countries absorb high rates. The rest choose among austerity, inflation, or, in Mélenchon's version, default by another name.

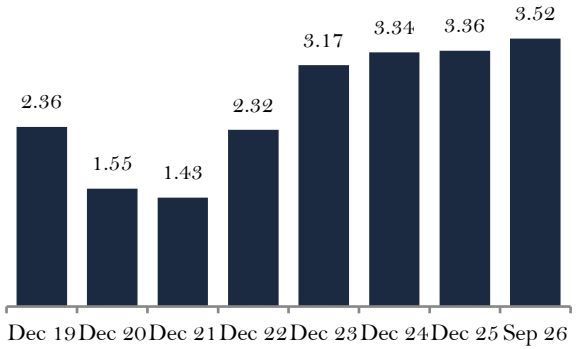
Sources: IMF WEO and Fiscal Monitor data (April 2026 vintage; October update released Oct 13); Reuters (Aug 26, 2026); Euronews (Aug 27, 2026); full sources in the endnotes.

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4e. The Refinancing Wall: Cheap Debt Rolls Into Expensive Debt

Debt issued near zero in 2020–21 is being replaced at 3.5–5%; a bill-heavy strategy meets a hiking Fed, and taxpayers absorb the difference.

Average interest rate on marketable Treasury debt, %



By type, Sep 30, 2026	Avg. rate
Bills (reprice fast)	3.87%
Notes	3.38%
Bonds	3.47%
TIPS	1.15%
Total marketable	3.52%

Bills now carry the highest rate; each Fed hike reaches the interest bill within weeks.

Bills meet a hiking Fed

- Treasury has leaned on bills (~16% to ~22% of debt) to avoid locking in 5%+ long rates.
- But bills reprice every few weeks, so every Fed hike flows straight into the deficit.
- Roughly a third of marketable debt matures within a year: rates turn into cost quickly.
- Options: more bills, new buyers (stablecoins, bank rule changes), pressure on the Fed to slow hikes or buy bills

Buybacks, Fed losses: who pays?

- Old 2% bonds trade below par: Treasury may pay ~$60 to retire $100 of face value.
- Headline debt falls, but the $60 is borrowed at ~5%: $3 a year of interest replaces $2. No free lunch.
- The Fed pays ~4% on reserves but earns less on its 2020–21 bonds; it has stopped sending profits to Treasury ($234bn owed to itself).
- Either way, taxpayers pay through larger deficits.

By the numbers

3.52% Average rate on marketable debt, up from 1.43% in Dec 2021

~⅓ Marketable debt maturing within 12 months

$1.1tn Net interest, FY2026: 3.4% of GDP, more than defense

$234bn Fed losses carried as a deferred asset (Oct 7)

Watch: fiscal dominance

If the Fed is pressed to ease for the budget's sake, the signs are a rising term premium, a weaker dollar, higher inflation expectations, and stronger demand for gold.

Sources: U.S. Treasury FiscalData, Average Interest Rates on Treasury Securities (through Sep 30, 2026); CRFB (Oct 1, 2026); Federal Reserve H.4.1 via FRED (RESPPLLOPNWW, Oct 7, 2026); full sources in the endnotes.

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5. AI Borrowing: Corporate Bonds Compete With Treasuries for Savings

Hyperscalers are issuing record investment-grade debt to fund the AI build-out, "crowding out" in reverse.

Record corporate issuance

- Investment-grade issuance about $1.7 trillion through July, 27% ahead of last year, on track to top $2 trillion for the first time
- The five largest hyperscalers raised about $132bn year to date, vs $93bn in all of 2025; seven of nine $20bn+ deals were hyperscaler-linked, including a 100-year bond
- The four largest plan about $725bn of 2026 capex, up 77%

How it lifts Treasury yields

- Much of the paper is long-dated, competing directly for the investors who buy 20- and 30-year Treasuries.
- Credit spreads stayed tight despite the supply, so investors are choosing corporate over government duration, and Treasuries must yield more to clear.

The Fed agrees

- Warsh cited "competition for capital" from hyperscalers as a leading reason long yields rose.

Bottom line: The AI boom is a rates story as well as an equity story: the capex that lifts stocks also lifts yields.

By the numbers

$1.7tn	IG issuance through July, +27%
$132bn	Top-5 hyperscaler bonds, 2026 YTD
~$725bn	2026 capex, top 4 hyperscalers

Why it matters

These borrowers are nearly indifferent to the rate they pay, given the returns they expect from AI. That makes them an inelastic competitor for the same pool of savings the Treasury needs.

Sources: Fortune ("reverse crowding out"), Vanguard, Sage Advisory (via "The Long End Is Repricing" draft); ValueAdd VC capex compilation (2026); FOMC press conference (Sept 16, 2026).

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6. A Hot U.S. Economy: Strong Growth Raises the Real Rate

Spending, investment, and employment are strong enough that the Fed does not see policy as restrictive.

Growth is running hot

- Atlanta Fed GDPNow: Q3 at 3.6% (Oct 8), down from a 6.2% peak in August; Q2 was revised up to 2.2% and Q1 to 2.5%
- August consumer spending rose 0.6% after inflation, led by goods; business investment in AI equipment is surging.

The job market is at full employment

- Unemployment 4.2% in September; layoffs at a 1.0% rate, down from 1.2% a year ago
- Warsh: "I would be hard pressed to describe broad financial conditions as restrictive"

Why strength means higher real yields

- Faster growth and AI-driven productivity raise the "neutral" interest rate, the rate that neither stimulates nor slows the economy.
- Warsh named "economic strength" as the first reason long yields rose.
- This is the benign driver, but it is uneven: strength is concentrated in the upper half of the K-shaped economy.

Bottom line: This is the one driver that fades on its own if growth cools, the most likely path to lower yields.

By the numbers

3.6%	Q3 GDPNow estimate (Oct 8)
+0.6%	Real consumer spending, Aug
2.92%	10-yr real yield (Oct 2)

Why it matters

A strong economy lets the Fed keep tightening without fear of recession, and it raises the return investors expect from lending. Both keep real yields high.

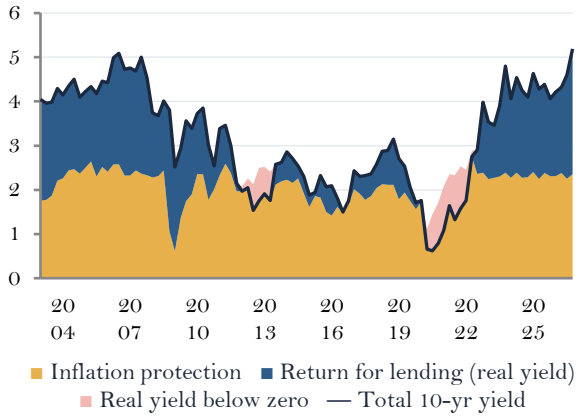
Sources: Atlanta Fed GDPNow (Oct 8, 2026); BEA GDP and Personal Income (Sept 30); BLS JOLTS (Aug 2026); FOMC (Sept 16); Treasury real yields (Oct 2); full sources in the endnotes.

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Real Yields: Why the Inflation-Adjusted Rate Matters Most

The real yield is the true cost of money; when it rises fast, history shows growth slows and the most leveraged borrowers break first.

10-yr Treasury yield and its two parts, %



What it is
10-yr yield = inflation protection (2.3%) + return for lending, the real yield (2.9%) ≈ 5.2%

Who gains
Savers, cash, lenders, the dollar

Who pays
Borrowers, governments, growth stocks, real estate, gold, emerging markets

Why it hurts
Raises every investment hurdle, lowers asset values, strains those who borrowed cheap

Episode	Real-yield move	What followed
1979–82	Real rates above 5% (Volcker)	Back-to-back recessions; Latin American debt crisis
1994	10-yr +2.7 pts, inflation flat	Orange County bankruptcy; Mexican peso crisis
1999–2000	TIPS near 4% in a tech boom	Dot-com bust and the 2001 recession
2013	−0.7% to +0.7% in 5 months	"Taper tantrum": emerging-market sell-off, mortgage rates jump
2018	0.5% to 1.1%	S&P 500 fell ~20% in Q4; the Fed paused, then cut
2022–23	−1.0% to +2.4%	Stocks and bonds fell together; UK gilt crisis; bank failures (Mar 2023)

By the numbers

2.9% — 10-yr real yield (Oct 2026), highest since 2008

~1.0% — Average, 2003–2019

+1.0 pt — Rise since February 2026

2.3% — 10-yr inflation breakeven, little changed

Perspective
Rising real yields are a tax on borrowers and on distant future cash flows. Fast rises rarely end quietly; something leveraged usually breaks. When the real rate exceeds real growth (~2%), debt grows faster than the economy.

Sources: FRED (DFII10, 10-yr TIPS, monthly average; DGS10, T10YIE), U.S. Treasury; historical episodes from Federal Reserve and FRED data; full sources in the endnotes.

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Perspective: Stocks Are Priced for Perfection

Section 7: when safe bonds pay more than stocks earn, investors are paying up for growth that must arrive.

What the data says

- The S&P 500's earnings yield is below the 10-year Treasury yield: stocks no longer out-earn the safe rate.
- Fifty years of evidence: rising rates have preceded market peaks; a 10-year near ~5.5% has compressed valuations.
- Analysts expect S&P profits up 25–32% in 2026; breadth is the weakest on record since 2000.

Assessment

When a risk-free Treasury yields more than the market's earnings yield, investors are paying for future growth, AI growth in particular. History says rising rates rarely stop a market at once, but they shrink the margin for disappointment. Today's market needs everything to go right: strong AI earnings, stable rates, and continued foreign buying. A decline needs only one of them to break. That asymmetry, not a forecast of timing, is the concern.

What would change the view

- Earnings growth broadens beyond AI leaders and market breadth improves.
- The 10-year yield retreats meaningfully, restoring the stock market's earnings advantage.

The question

Can stocks keep rising when bonds pay this much?

The view in one line

Only if earnings keep delivering

Where to look

p. 93 Rates and peaks
p. 94 Stocks vs. safe rate
p. 96 What could tip it

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Q3 Scorecard: Large Growth and Energy Led; Small Caps Fell

A narrow quarter: large growth stocks, tech, energy, and health care rose, while small and mid caps, industrials, utilities, and consumer stocks fell.

U.S. style box: Q3 2026 total return

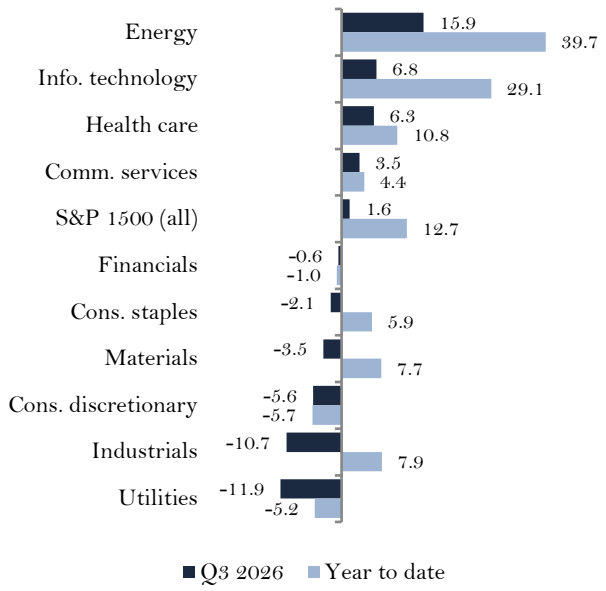
	Value	Blend	Growth
Large	+0.90%	+2.30%	+3.44%
Mid	−1.98%	−3.00%	−5.84%
Small	−4.91%	−7.23%	−9.39%

U.S. style box: trailing 1 year to Sep 30

	Value	Blend	Growth
Large	+12.49%	+15.74%	+18.42%
Mid	+16.89%	+12.02%	−2.73%
Small	+20.77%	+16.20%	+12.05%

Large = S&P 500 indexes; Mid = Russell Midcap; Small = Russell 2000 (value, blend, growth).

S&P 1500 sectors, total return %



Key indexes, total return %

Index	Q3	YTD	3-yr*
S&P 500	2.30	12.75	22.89
Nasdaq 100	0.58	21.01	28.31
Dow Jones	−2.45	6.80	16.39
Russell Mid	−3.00	11.84	17.20
Russell 2000	−7.23	13.71	17.72

**Annualized. Dow is net return. Real estate is not in the feed.*

Small caps led the S&P 500 through June, then gave up 7% in Q3.

By the numbers

+3.4% Large growth (S&P 500 Growth) in Q3, the best style box

−9.4% Small growth (Russell 2000 Growth) in Q3, the worst

+15.9% Energy in Q3, best S&P 1500 sector (+39.7% YTD)

−11.9% Utilities in Q3; industrials −10.7%

Perspective

Q3 was carried by two themes: AI (tech) and the war (energy). Over twelve months, value still led among mid and small caps. A market leaning on a few themes is a delicate equilibrium; breadth is worth watching.

Source: Morningstar Direct (09-30-2026); index total returns in USD (S&P, Russell, Nasdaq, Dow Jones). Past performance is no guarantee of future results.

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Q3 Scorecard: Bonds Fell, the 60/40 Stalled, Korea Soared

Bonds lost money as yields rose, so a balanced 60/40 portfolio was flat in Q3; markets tied to the AI supply chain led the world this year.

Bond indexes, total return %

Bloomberg index	Q3	YTD	3-yr*
U.S. Aggregate	−3.51	−2.91	4.06
U.S. corp. IG + HY	−3.59	−2.59	5.47
Municipal	−6.35	−4.18	2.89
High-yield corp.	−1.82	0.10	8.03
Global ex-U.S. (hdg)	−1.79	−0.24	4.28
EM local currency	2.26	2.11	7.60
EM hard currency	−3.49	−1.91	8.09

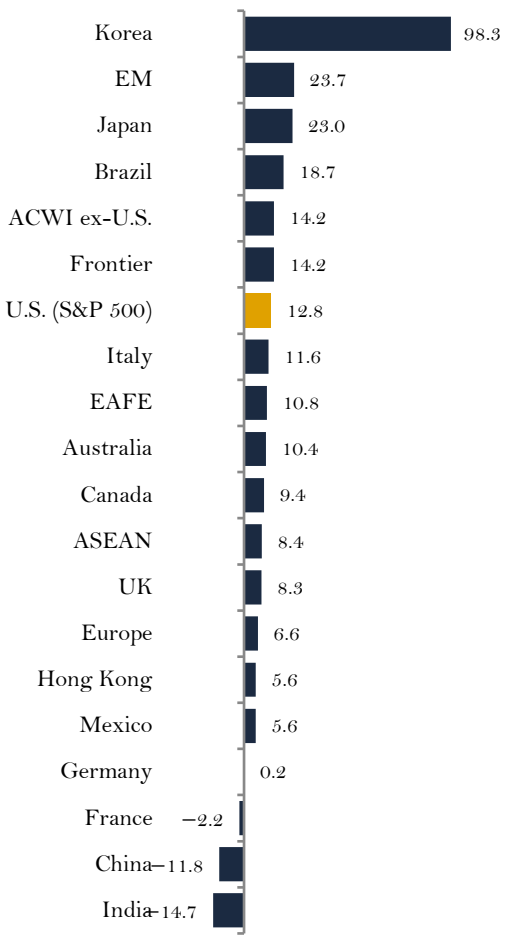
Balanced portfolios, total return %

Portfolio	Q3	YTD	3-yr*
U.S. 60/40	−0.02	6.48	15.36
International 60/40	−0.21	8.42	14.16
Memo: MSCI ACWI	1.17	13.30	21.78

*U.S. = S&P 500 / U.S. Agg; international = MSCI ACWI ex-U.S. / Bloomberg Global Agg ex-U.S. (hedged). *Annualized.*

Q3: stocks +2.3%, bonds −3.5%. No cushion.

MSCI markets, 2026 YTD %, USD



Korea fell 9.4% in Q3. Taiwan is not in the feed.

By the numbers

−3.5% U.S. bonds (Bloomberg Agg) in Q3, as yields rose

−0.02% U.S. 60/40 in Q3; +6.5% this year

+98% Korea this year (MSCI, USD), despite −9.4% in Q3

−14.7% India this year; China −11.8%

Why it matters

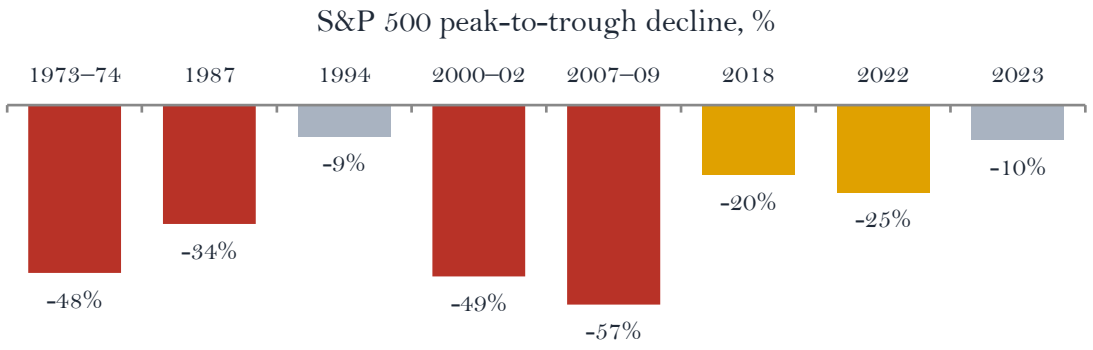
Bonds fell as stocks rose only slightly, so the classic 60/40 cushion failed again (see Diversification Under Strain). Korea, home to the AI memory-chip makers, nearly doubled: the world is wired into the same AI trade.

Source: Morningstar Direct (09-30-2026); Bloomberg and MSCI (gross) total returns in USD; 60/40 portfolios as in the feed. Past performance is no guarantee.

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Rising Rates and Market Peaks: 50 Years of Evidence

Rising yields rarely end a bull market right away, but most major bear markets of the last 50 years came after a sustained rise in rates.



Episode	10-yr yield	Fed funds	S&P	What else broke
1973–74	6.5% → 8.0%	5.9% → 12.9%	**–48%**	Oil embargo, inflation
1987	7.1% → 9.5%	6.4% → 7.3%	**–34%**	Stocks yielded less than bonds
1994	5.3% → 8.0%	3.1% → 5.9%	**–9%**	Strong earnings; no bear market
2000–02	4.6% → 6.7%	4.8% → 6.5%	**–49%**	Tech valuations, capex bust
2007–09	4.7% → 5.1%	1.0% → 5.2%	**–57%**	Housing and credit; lagged
2018	2.6% → 3.1%	1.3% → 2.4%	**–20%**	Fed hikes plus balance-sheet runoff
2022	1.5% → 4.0%	0.1% → 4.1%	**–25%**	Inflation shock
2023	3.5% → 4.8%	4.6% → 5.3%	**–10%**	10-yr touched 5%; saved by AI earnings
2026 YTD	**4.5% → 5.3%**	**3.6% → 3.9%**	**+13%**	**?**

Yields and fed funds are monthly averages for the start and peak month of each episode; 2026 row is June–Sept, fed funds after the Sept 16 hike.

The pattern

Rates work with a lag
Stocks usually keep rising for one to two years after yields and the Fed starts moving up.

The break comes at the crossover
1987 and 2000 peaked when bonds yielded as much as or more than stocks earned.

Earnings are the defense
In 1994 and 2004–06, strong profit growth absorbed higher rates without a crash.

A second shock does the damage
Oil in 1973, a capex bust in 2000, credit in 2008, inflation in 2022

Sources: S&P 500 peak-to-trough declines: Yardeni Research bull/bear market tables (1994: S&P index history); 10-year Treasury: multpl.com (Fed H.15 data); effective fed funds: FRED.

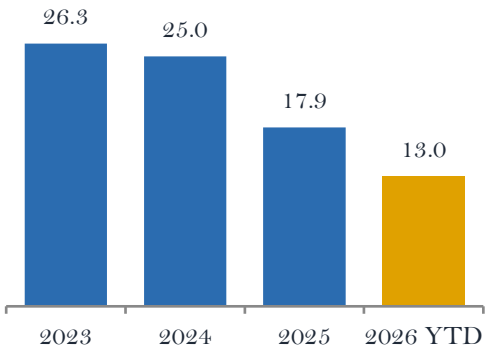
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Today: Stocks No Longer Out-Earn the Safe Rate

The S&P 500's forward earnings yield (5.2%) is now below the 10-year Treasury yield (5.29%): no premium for equity risk.

5.29%	10-yr Treasury yield (Treasury, Sep 30)
5.2%	S&P forward earnings yield (1 ÷ 19.2 P/E)
–0.1 pts	Equity risk premium: now slightly negative
+32%/+15%	Expected S&P earnings growth, 2026 / 2027

S&P 500 total return, %



Illustrative S&P move if investors demand a risk premium of:

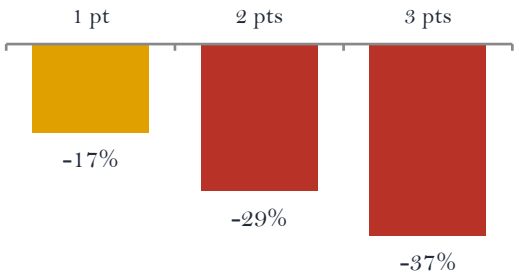


Illustration: P/E = 1 ÷ (10-yr yield + risk premium), earnings held constant.

How to read the right chart

Holding earnings and the 10-year yield where they are, a 1-point risk premium would require a P/E of 15.9x instead of 19.2x. Earnings growth is the offset: the expected 15% rise in 2027 profits would roughly cover a 1-point premium. That is why earnings delivery, not the P/E, is the key risk.

Where this can break

What keeps the bull alive

- AI earnings arrive as forecast (+32% this year)
- Valuation is not extreme: 19.2x vs a 10-yr average of 19.0x
- Yields ease if oil falls or the Fed stops

What ends it

- 10-year keeps climbing toward 5.5%+ while earnings estimates stall
- AI returns disappoint; circular deals among AI firms unwind
- A second shock: oil, a failed auction, or credit stress

Watch

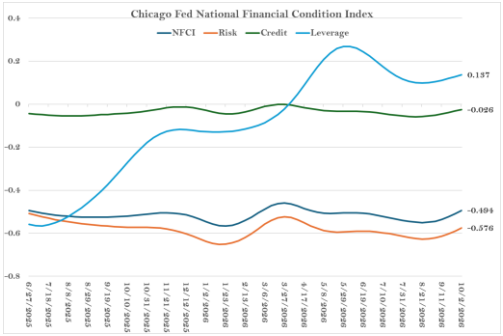
- Forward EPS revisions (direction, not level)
- 10-yr real yield, 2.92% (Treasury, Oct 2)
- Next FOMC hike and Nov 4 refunding

Sources: FactSet Earnings Insight (Sept 25, 2026) for forward P/E and EPS growth; U.S. Treasury par yield curve (Sept 30, 2026); S&P 500 total returns via Slickcharts (through Sept 29).

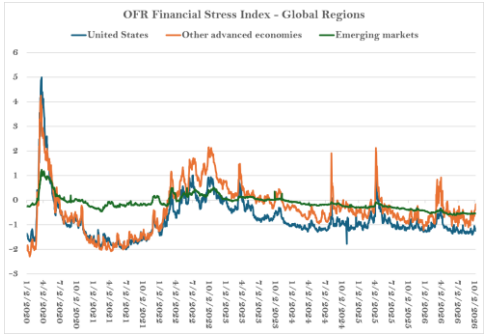
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Financial Conditions: Loose at the Top, Tightening Underneath

Official gauges, built mostly from prices in large markets, still read loose; for small firms, households, and the typical stock, conditions are tightening fast.



Chicago Fed NFCI and subindexes, to Oct 2



OFR stress index by region, to Oct 2026

Measure	Latest	Reads as
Chicago Fed NFCI	−0.49 (week to Oct 2; 0 = average)	**Loose (big markets)**
St. Louis Fed stress index	−0.47 (Oct 2)	**Low stress**
Typical stock	48.9% above 200-day avg; mid −6.8%, small −7.5% since Aug 13	**Tightening**
Small-business loan rate	8.2% (Sep), up 0.7 pt in a month	**Tightening**
30-yr mortgage	7.40% (Oct 8)	**Tight**
Credit cards and autos	Cards ~21%, standards tighter; auto loan demand weaker	**Tightening**

Why the headline gauges miss it

- They weight prices in large, liquid markets: they show what the biggest borrowers pay, not whether a small firm can refinance or a family can afford a car loan.
- Stress gauges stay low until they jump: 2020, 2022, March 2023, and April 2025 each rose within weeks.

By the numbers

−0.49 Chicago Fed NFCI: loose at the top (0 = average)

8.2% Small-business short-term loan rate, Sep (NFIB), +0.7 pt in a month

48.9% S&P 500 stocks above their 200-day average

7.40% 30-year mortgage rate, Oct 8

Perspective

Conditions are loose for companies that fund in bond and stock markets, led by AI, and tightening fast for households, small firms, and the typical stock. The economy looks steadier on average than it is underneath. Not a forecast.

Sources: Chicago Fed NFCI and FRED STLFSI4 (Oct 2, 2026); OFR FSI; NFIB SBET (Sep 2026, Oct 13); Fed SLOOS (Jul 2026); Freddie Mac; S&P index data; charts by Philip Chao.

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Resilience vs. Repricing: What Could Tip the Market

Stocks sit near records on narrow leadership and record foreign buying, about 0.2 pt below the yield level where valuations historically compress.

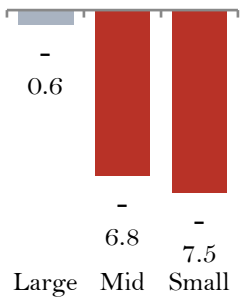
~20%
Foreign-owned U.S. stocks (Fed Z.1, Q2 2026); ~29% with direct stakes

$426bn
Foreign net purchases of U.S. equities and funds, Q2 2026 (record)

48.9%
S&P 500 stocks above their 200-day average (Sep 25)

5.29%
10-yr Treasury vs ~5.5% compression level

S&P 500 / 400 / 600 since the Aug 13 record, %



Factor	Where it stands	Signal
10-yr yield	5.29% vs ~5.5% compression level	● Close
Earnings	+25–32% in 2026, +14–15% in 2027	● Holding
Breadth	Weakest at a record since 2000	● Weak
Growth / jobs	Q3 GDPNow 3.6%; jobs narrow, revised down	● Mixed
Foreign flows	Record buying; reverses if dollar falls	● Supportive
Yen carry	Unwind would hit stocks first	● Watch

Why foreign ownership matters

- Foreign buyers have been a key support for U.S. stocks, and much of it is not hedged against the dollar.
- If the dollar weakens (a yen rebound, money going home), foreigners lose twice, turning a correction into selling.
- The same forces pushing Treasury yields up are a risk to foreign demand for U.S. stocks.

Three tipping signals

1. **10-yr above 5.5%, sustained**
   Valuations and financing costs reprice together
2. **Earnings estimates turn down**
   Removes the only cushion against higher yields
3. **Layoffs rise from 1.0%**
   Weak growth plus high yields is the dangerous mix

Status: none has triggered yet. Two of three would mark the shift from resilience to repricing.

Sources: Federal Reserve Financial Accounts, Z.1 via FRED (foreign ownership ~20%, ~29% with direct investment, Q2 2026); full sources in the endnotes.

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Perspective: A Managed War Is a Persistent Supply Shock

Section 8: the Iran conflict is being managed, not resolved, and that keeps energy costly and inflation sticky.

What the data says

- Brent averaged $114 in September vs $71 before the war; tanker attacks and insurance costs keep moving oil expensive.
- Emergency oil stocks cover only about two weeks of world use, leaving little room for a second shock.
- Only 34% approve of the war, and 52% expect it to last another year; midterms are Nov 3

Assessment

The conflict is being managed, not resolved. Oil is flowing again, but attacks on tankers, higher insurance, and rerouting keep the cost of moving energy high. And reserves covering about two weeks of world use leave little cushion. Low and falling public support raises the political cost of escalation before the midterms but also rewards ambiguity over resolution. For the economy, the war acts as a persistent supply shock: it keeps inflation higher, the Fed tighter and yields up, at home and abroad.

What would change the view

- A verified end to tanker attacks and secure passage through Hormuz, with Brent sustained well below $100
- The warning sign: renewed escalation or another closure of the Strait

The question

How much can the war and global shocks disrupt the economy?

The view in one line

A managed conflict is a persistent supply shock.

Where to look

p. 98 OECD view
p. 101 The war at eight months
p. 77 Emergency oil stocks
p. 102 Public opinion

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Global Risks & Challenges: The OECD View

OECD Interim Economic Outlook (September 2026) — risks to the baseline projections

Key downside risks

Middle East conflict & energy supply

- Prolonged Hormuz or Bab al-Mandeb disruption could lift prices and cause shortages
- Thin buffers: low European gas, oil and diesel stocks
- Faster China import recovery could lift prices further

El Niño & food inflation

- NOAA: 95% odds of a very strong El Niño, Oct–Dec 2026
- Drought in Australia, India and SE Asia; food prices up for as long as 2 years
- Gulf fertiliser disruption adds pressure on food costs

Rising long-term sovereign yields

- Drivers: fiscal worries, heavy AI bond issuance, tighter policy
- Raises borrowing costs across the economy
- Could trigger equity repricing, especially of AI earnings

AI: a two-sided risk

- Returns may disappoint or be delayed by power and chip bottlenecks
- Leverage and complex financing could amplify a sentiment shift
- Earnings must accelerate fast to meet expectations

Upside risks

Conflict resolution: Credible deal; Hormuz fully reopened
Business resilience: Firms keep adapting supply chains
Structural tailwinds: EVs, energy efficiency, AI productivity

Downside scenario

Illustrative OECD NiGEM simulation: impact in 2027 vs. baseline

−0.7pp	+1.1pp	~+1pp
Global GDP growth	Global inflation	Policy rates (most economies)

Shock assumptions (2027)

- Oil +24%, gas +31% vs. baseline (prices held until Q4 2027)
- Energy rationing: efficiency −1½% in most-exposed economies, −¾% elsewhere
- Food prices +10% (El Niño + fertiliser)
- Equities −15%; risk premia +35bp; term premium +25bp

Upside: oil & gas prices −10%

+0.1pp Growth 2027 −0.3pp Inflation 2027

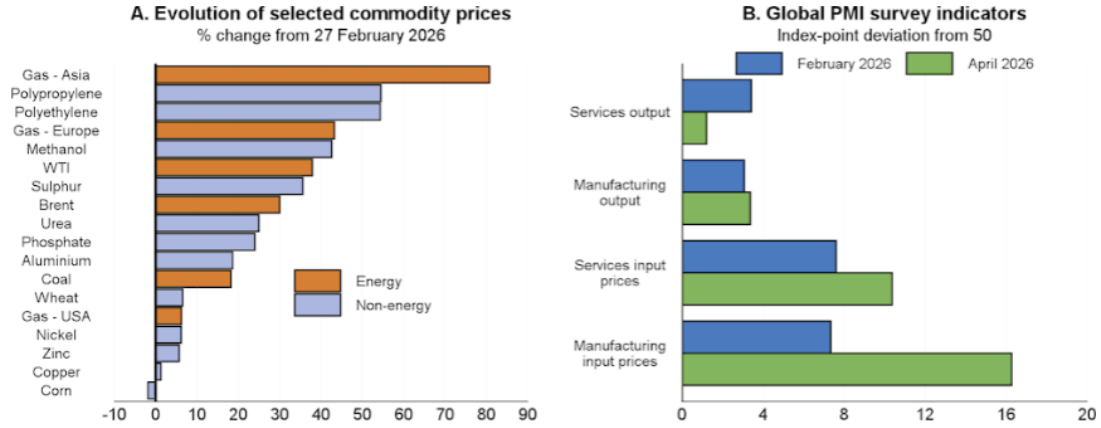
From Q4 2026. Also likely: lower policy rates, better market sentiment

Source: OECD Interim Economic Outlook, September 2026, "Risks and challenges." pp = percentage points; bp = basis points.

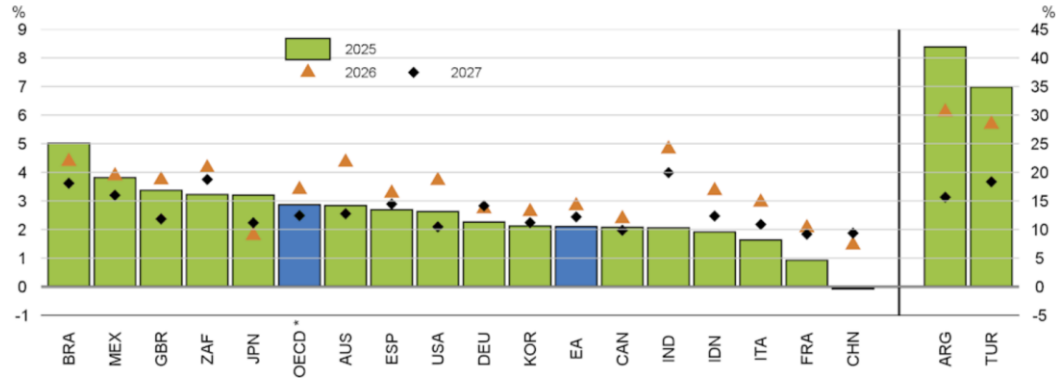
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OECD: The Energy Shock Is Feeding Through to Prices

OECD Economic Outlook, June 2026 (data through late May): energy and input costs jumped after the war began, and inflation was projected to rise this year.



Energy prices weigh on activity. A: commodity prices, % change Feb 27–May 27, 2026. B: global purchasing managers' indexes, points above 50, Feb vs Apr 2026.



Headline inflation, %: 2025 (bars) and 2026–27 projections. U.S. = PCE; OECD = median.

June projections; the September 2026 interim outlook (previous page) updated them.

By the numbers

+80% — About: Asian gas prices, Feb 27 to May 27; Brent about +30%

16 — About: manufacturing input-price PMI above 50 in April (about 7 in Feb)

3.8% — About: June projection for U.S. PCE inflation in 2026 (2.6% in 2025)

3.5% — About: OECD median inflation projected for 2026 (2.9% in 2025)

Why it matters

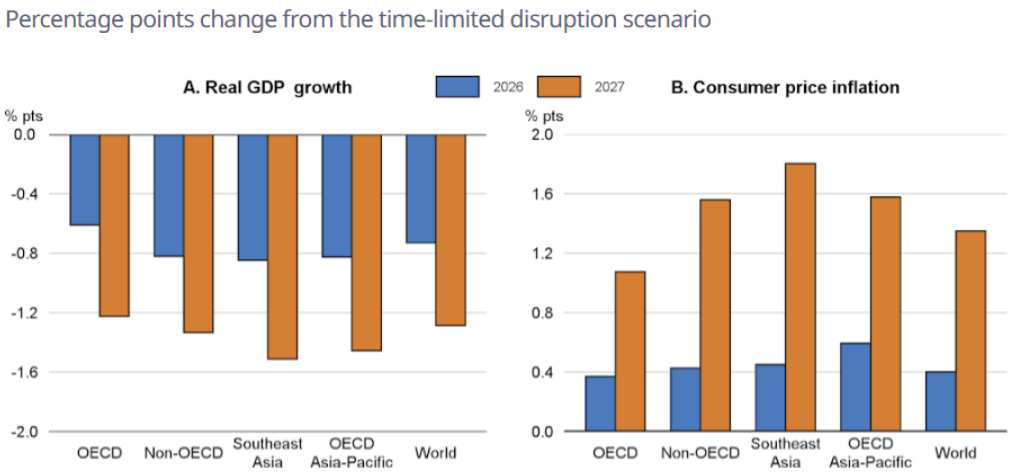
Input costs rose fastest while services output slowed: the mix that squeezes margins and real incomes and the stagflation risk for the lower K. Readings are approximate, from OECD charts.

Source: OECD Economic Outlook No. 119 (June 2026); LSEG; S&P Global; OECD calculations. Data through May 27, 2026. Panel values are approximate, read from the charts.

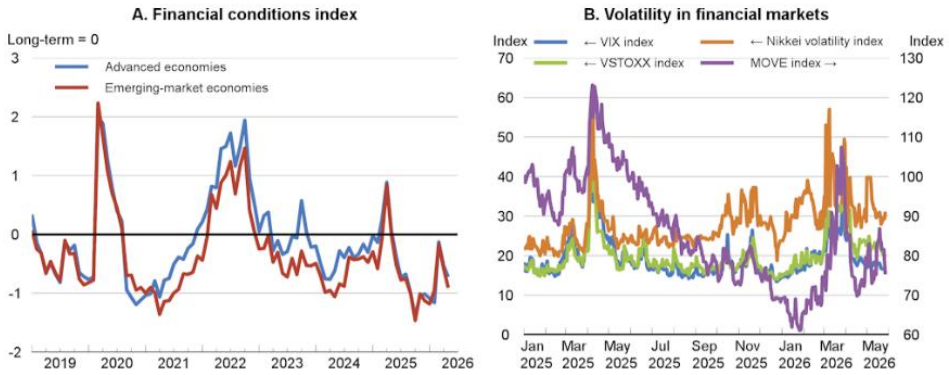
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OECD: A Long Disruption Would Cut Growth, Lift Inflation

OECD Economic Outlook, June 2026: if energy supply stayed disrupted into 2027, growth would slow further and inflation would rise; markets were already volatile.



Prolonged vs time-limited disruption, pp: A real GDP growth, B consumer inflation.



A: financial conditions (higher = tighter), to Apr 2026. B: volatility, to May 27, 2026.

June scenario; the September interim scenario (previous page) differs: a smaller hit.

By the numbers

−1.3pp	About: world GDP growth in 2027, prolonged vs time-limited case
+1.4pp	About: world consumer inflation in 2027, same comparison
+50%	Oil, gas and fertilizer prices vs the time-limited case, 2026Q3–2027Q3
−0.7pp	September interim downside: global GDP in 2027 (+1.1pp inflation)

Why it matters

Southeast Asia and OECD Asia-Pacific would be hit hardest: the energy-importing AI supply chain. By Q3, U.S. stress gauges had calmed again (see Financial Conditions).

Source: OECD Economic Outlook No. 119 (June 2026); NiGEM; FRED; LSEG; data to May 27, 2026. Values read from charts; September figures: OECD Interim Outlook.

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The Iran War at Eight Months: Oil Flows Back, the Risk Stays

Gulf exports are near pre-war levels by rerouting around Hormuz, but tanker attacks, a U.S. blockade, and stalled talks keep fuel prices high.

$6.20
Diesel, $/gal (Oct 5), +63% since Feb 23

$4.35
Gasoline, $/gal (Oct 5), +48% since Feb 23

$114
Brent, Sept average, vs $71 in February

~$38bn
U.S. defense cost to Aug 1 (CBO)

The conflict

- U.S.–Israel campaign began Feb 28; the Islamabad MOU (Jun 17) lapsed without a deal when its 60-day window closed Aug 17
- U.S. blockade of Iranian ports since Jul 15; "Operation Economic Outcast" sanctions (Aug 24); talks at an impasse
- President Trump (Oct 8): no U.S. strikes before the Nov 3 midterms, and the blockade stays

Energy flows

- Gulf exports (ex-Iran) back to ~16.5 mb/d in Sept, the pre-war pace, but ~40% now bypass Hormuz vs 17% before (Kpler)
- Output shut in fell from 10.9 mb/d (May) to 4.8 mb/d (Sept) (EIA); Saudi East-West bypass pipeline hit Sep 10–11, restarted Sep 22 at low rates

New since late September

- At least 9 tanker attacks Oct 1–7 (UKMTO); a second U.S. carrier group and 2,000+ Marines heading to the Gulf
- G7 release of up to 100m barrels (Oct 2); new 40m-barrel U.S. reserve exchange (Sep 29)

What to watch

- Nov 3 midterms: the next policy turning point; no U.S. strikes promised before then
- Hormuz: whether ships keep using Iran's permit lane or the U.S.-backed route; attacks and insurance costs
- Saudi bypass pipeline: full repair expected to take 6–8 weeks
- Winter fuel: heating oil averaged $6.04/gal (Oct 5), with diesel stocks tight

Why it matters

Supply has adapted, but at a higher cost and with less margin for error. Any new escalation would hit a market with thinner reserves, pushing up inflation and yields.

Sources: EIA weekly retail diesel, gasoline and heating oil prices (Feb 23 and Oct 5, 2026) and Short-Term Energy Outlook (Oct 2026); FRED/EIA Brent; full sources in the endnotes.

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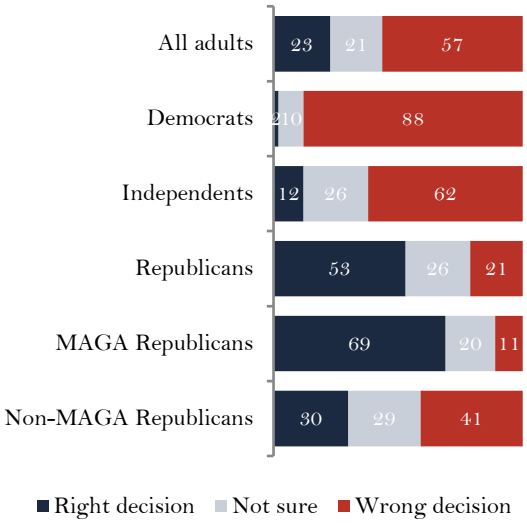
Iran War Opinion: The Least Popular U.S. Military Action in Decades

Gallup: 34% approval, lower than Libya, Iraq, or Haiti at a similar stage; YouGov: 57% call the decision to go to war wrong.

Gallup	Initial	Follow-up	Change
Iran, 2026	n/a	**34%**	—
Libya, 2011	47%	39%	−8
Iraq, 2003	76%	60%	−16
Haiti, 1994	54%	36%	−18

% approving U.S. military action; Iran measured after 93 days (June 1–15). By party: Republicans 79%, independents 26%, Democrats 8%.

Going to war with Iran was the…
(YouGov, Sep 18–21), %



What the polls say

- Approval started low and has stayed low: only 34% approved after three months, the weakest in Gallup's comparison.
- Republican support is eroding: 53% say it was the right decision, down from 68% in April.
- 61% want a deal to end the war as soon as possible (70% in April).

By the numbers

34% Approve of U.S. military action (Gallup, June)

57% Say going to war was the wrong decision (Sept)

53% Of Republicans say right decision, from 68% in April

61% Want a deal to end the war quickly

Why it matters

Low and falling support raises the political cost of escalation before the Nov 3 midterms, one reason markets see a "managed" conflict rather than a decisive one.

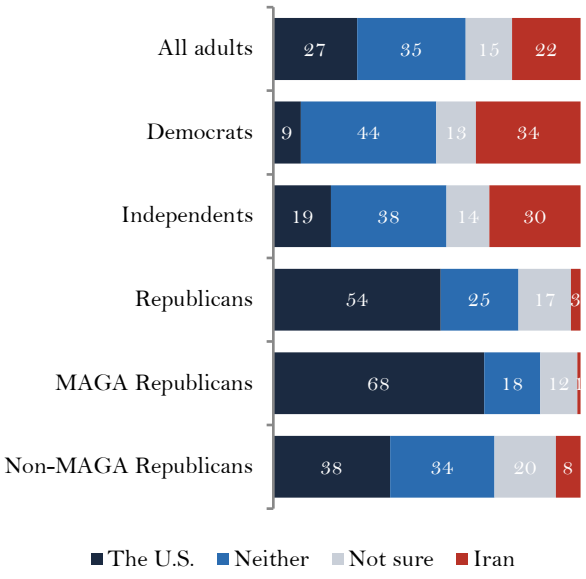
Sources: Gallup, "Approval of Iran War in Historical Context" (June 19, 2026; n=1,001, ±4 pts); The Economist/YouGov poll, Sept 18–21, 2026.

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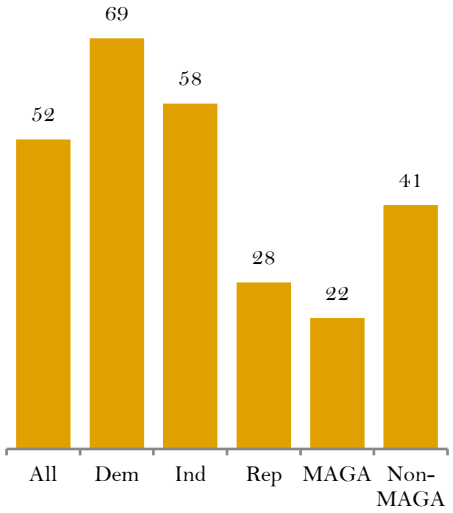
Who Is Winning the Iran War? A Divided Country Expects a Long One

Only 27% say the U.S. is winning; 52% now expect the war to last at least another year, up from 32% in March.

Who is winning? (YouGov, Aug 14–17), %



Expect war to last at least another year (Sep 18–21), %



What stands out

- More Americans say "neither side" (35%) than say the U.S. is winning (27%); 22% say Iran.
- Expectations of a long war keep rising: 32% (March), 46% (July), 50% (August), 52% (September).
- Partisan split is stark: 68% of MAGA Republicans say the U.S. is winning vs 9% of Democrats.

By the numbers

27% Say the U.S. is winning (Aug)

35% Say neither side is winning

52% Expect another year or more (Sept)

32% Expected a year or more in March

Why it matters

A long-war expectation matches what energy markets price: a risk premium in oil and higher inflation expectations that last beyond a ceasefire headline.

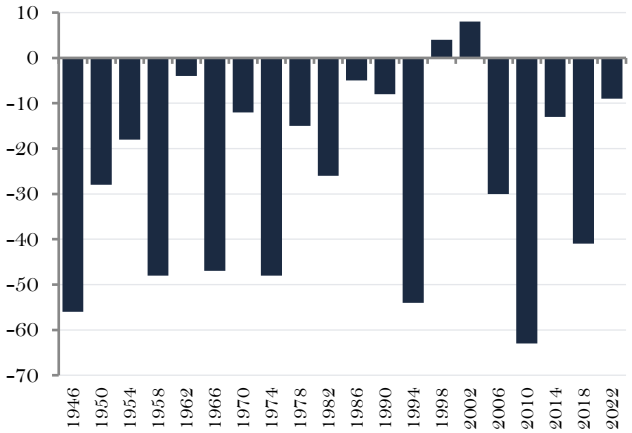
Sources: The Economist/YouGov polls, Aug 14–17, 2026 (who is winning) and Sept 18–21, 2026 (expected duration; trend from earlier Economist/YouGov polls).

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The Midterms: History and Polls Point to a Divided Government

Forecasters favor Democrats to win the House and lean toward them in the Senate, well short of 60 votes; history says the president's party usually loses ground.

House seats gained or lost by the president's party at midterms



Gains only in 1998 and 2002. Average 1946–2022: −26 House seats, −3.5 Senate seats.

Forecast (Oct 8–10)	House	Senate
Decision Desk HQ	D 76%	D 56%
Silver Bulletin	D 93%	D 75%
Expected seats (Silver)	D ~239	D ~52

Control scenario (DDHQ)	Odds
Democrats win both	54%
Split: D House, R Senate	22%
Republicans keep both	22%

Assessment: what a divided government would likely mean

- Legislation slows: no party near 60 Senate votes and a presidential veto mean major new laws are unlikely either way.
- Policy shifts to the executive branch: tariffs, regulation, and emergency powers become the main tools, so policy can change faster and with less warning.
- More friction: funding deadlines, shutdown risk, and congressional oversight add noise; policy uncertainty, already elevated, may stay high.
- Markets have usually looked through it: the S&P 500 averaged 12.4% in the 12 months after midterms (1900–2025); returns under divided and one-party government were not significantly different.

By the numbers

18 of 20 Midterms since 1946 in which the president's party lost House seats

−35 Average House loss when the president's approval was below 50%

Nov 3 Election day; new Congress sworn in January 2027

<60 Senate votes either party is likely to hold

Perspective

Forecasts and history point the same way: a likely shift in the House and a closer Senate. Expect less legislation and more executive action. The economic effect runs mostly through policy uncertainty, not a change in direction.

Sources: UC Santa Barbara American Presidency Project (seat changes, Gallup approval); Decision Desk HQ (Oct 10, 2026); Silver Bulletin via Newsweek (Oct 8–9); U.S. Bank (Sep 28, 2026); full sources in the endnotes.

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Perspective: One Bet, One World, Thin Diversification

Section 9: the U.S. market has become the world's market; the gains are shared and so would be the losses.

What the data says

- Foreigners hold $22 trillion of U.S. stocks, about a fifth of the market, and $9.2 trillion of Treasuries.
- $14.7 trillion of dollar debt is owed outside the U.S.; Asia's exports and Europe's chip-tool makers ride U.S. AI spending.
- Global private capital is financing U.S. data centers; in past U.S.-led crashes, markets abroad fell as much or more.

Assessment

No. The U.S. financial market has become the world's market. Foreign savers own a fifth of U.S. stocks. The dollar funds trade and debt worldwide. Asia's export boom and Europe's chip-tool makers depend on U.S. AI spending, and global private capital is financing American data centers. This co-dependence has amplified the gains across stocks, bonds, and public and private markets, and it would amplify losses. When the U.S. falls, the world falls with it; geographic diversification offers less protection than investors assume.

What would change the view

- Growth and earnings abroad driven by domestic demand rather than U.S. AI, with falling correlations
- Foreign investors diversify away from U.S. assets gradually rather than all at once

The question

If the U.S. stumbles, can the world escape?

The view in one line

No: diversification is thinner than it looks.

Where to look

p. 109 Stocks
p. 110 Bonds and the dollar
p. 112 AI supply chain
p. 114 Contagion history

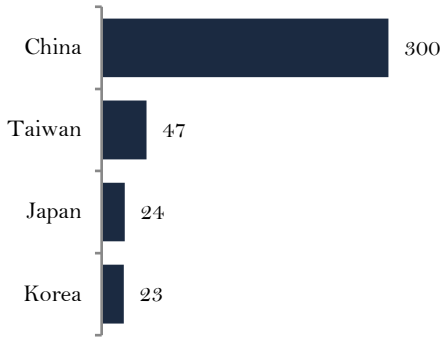
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Savings Glut 2.0: Global Imbalances Return, This Time Pushing Yields Up

Asia's surplus savings again flow to the U.S. but into stocks and corporate bonds rather than Treasuries, so yields are rising rather than falling.

	Before 2008	Now
Excess savings, 3-yr rise	~$1.5tn (2005–08)	**~$1.95tn (2023–26)**
Main holders	Foreign central banks	**Private funds, pensions, hedge funds**
Where it went	Treasuries, mortgage bonds	**U.S. stocks and corporate bonds, much of it AI**
Effect on U.S. yields	Held them down	**Pushing them up**
Central banks' share of Treasuries	41% (Jun 2008)	**12% (Jun 2026)**

Rise in current account surplus, 2025, $bn (IMF)



U.S. deficit ~0.9% of world GDP; China surplus ~0.6%, its largest widening since at least 2000 (IMF).

Where the savings go: the AI loop

- Foreigners bought a net ~$1.5tn of U.S. stocks from Jan 2024 to Jul 2026; about 20% of their U.S. stock holdings sit in AI-related sectors, up from ~10% in 2019.
- Korean investors' net buying of U.S. stocks rose from $17bn in 2023 to $69bn in the 12 months to July 2026.
- "Tech dollars are the new petrodollars"; chip surpluses in Taiwan and Korea are recycled into U.S. assets, as Gulf oil money was in the 1970s.
- Two views: funding a tech revolution with global savings is efficient but "not a blank check"; with government debt far higher than in the 1990s, higher rates bite harder.

By the numbers

$1.95tn Rise in global excess savings, 2023–26, vs $1.5tn before 2008

~20% Share of foreign-held U.S. stocks in AI sectors (~10% in 2019)

$69bn Korean net buying of U.S. stocks, 12 months to Jul 2026

12% Foreign central banks' share of Treasuries, from 41% in 2008

Perspective

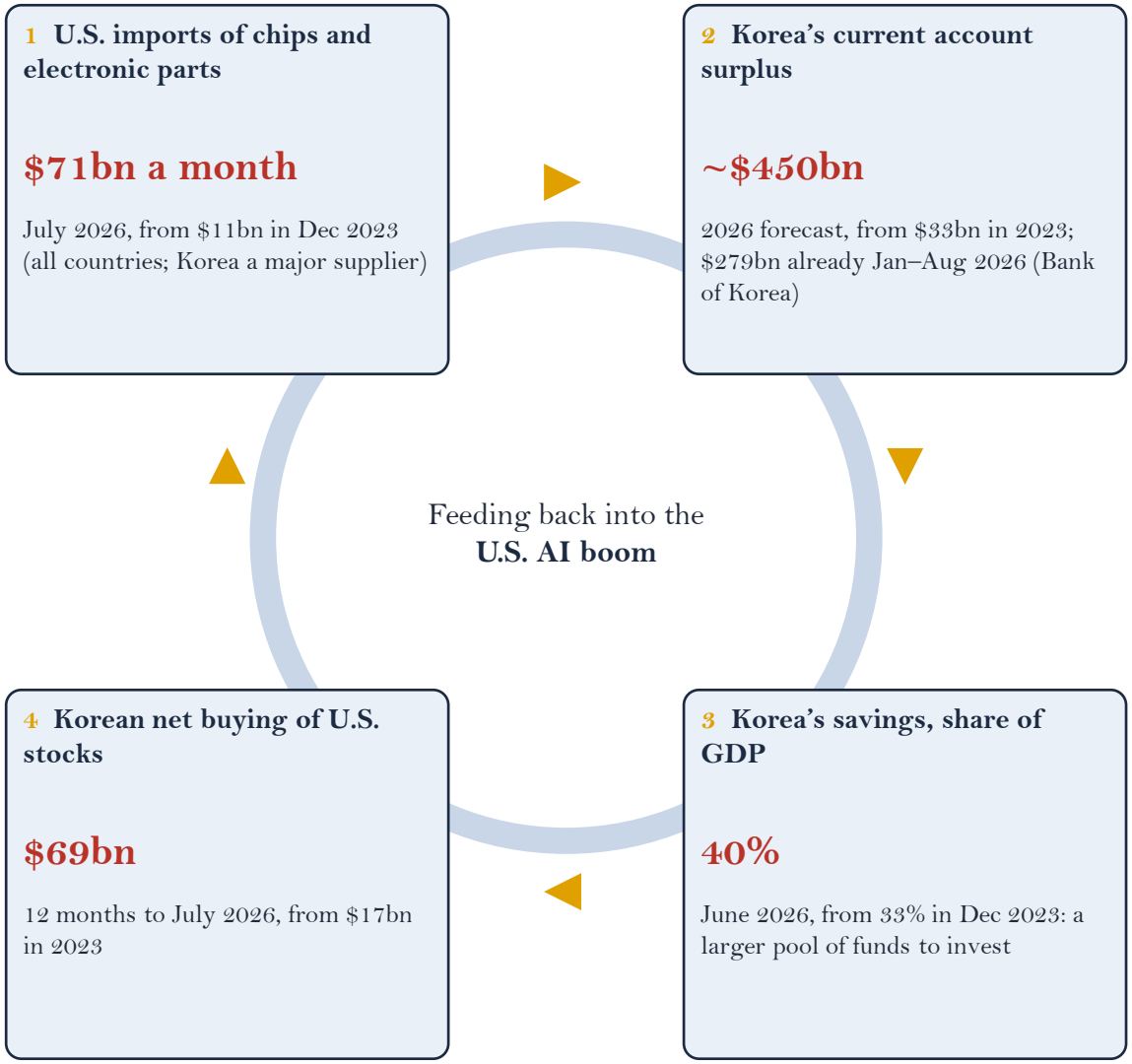
The savings that once held U.S. yields down now chase AI returns. That spreads the risk of an AI stumble to savers in Asia and beyond and leaves Treasuries with buyers who sell faster in a shock.

Sources: IMF External Sector Report 2026 (Jul 30); Bloomberg (Oct 12, 2026), incl. Bloomberg Economics and IMF-based estimates; U.S. Treasury via Axios (Aug 20, 2026).

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The Korea Loop: AI Trade and Capital Run in a Circle

One example of the AI savings loop: chips sold to the U.S. become Korean savings, and part of those savings return to buy U.S. stocks.



By the numbers

~6x	Rise in U.S. monthly chip and component imports since Dec 2023
13x	Korea's current account surplus, 2026 forecast vs 2023
4x	Korean net buying of U.S. stocks vs 2023
$46bn	Korea's August surplus, second-largest on record

Perspective

The loop works while AI demand grows. In a downturn it runs in reverse at once: fewer chip sales, smaller surpluses and less buying of U.S. assets.

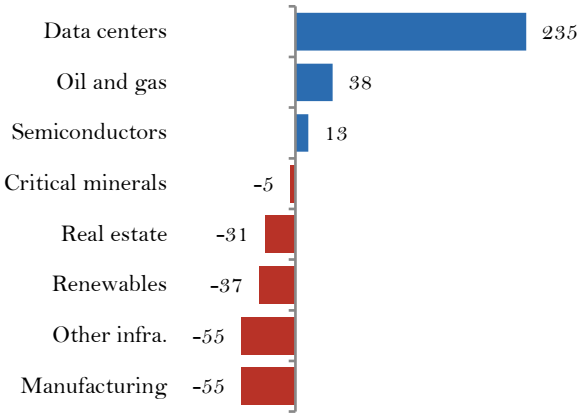
Sources: U.S. Census Bureau; Bank of Korea (Balance of Payments, Aug 2026); IMF; Bloomberg Economics (2026 forecast); U.S. Treasury TIC; as compiled by Bloomberg (Oct 12, 2026).

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Global Investment Follows AI: Data Centers Lead, Other Sectors Shrink

UN data show cross-border investment rose in 2025 mainly on AI megaprojects, while renewables, other infrastructure, and manufacturing declined.

Change in announced project value, 2024 to 2025, $bn



Greenfield plus project finance. Other infra. excludes renewables and data centers.

Foreign direct investment, 2025

Measure	2025
Global FDI	$1.6tn, +6%
Developed economies	+11%
Developing economies	+2%
U.S. inflows (largest)	$277bn
U.S. greenfield value	+30%
Megaprojects' share	44% (22% in 2017)
Largest project	TSMC, $100bn in U.S.

What it means

- AI is pulling global capital toward a few places and sectors: UNCTAD warns data centers may be crowding out other infrastructure.
- Investment now follows industrial policy: semiconductors, AI, clean energy and critical minerals are almost half of announced greenfield projects, and new investment policy measures hit a record.
- U.S. companies are keeping more at home: the foreign share of top U.S. multinationals' assets fell from 43% (2017–19) to 39% (2022–24).
- The Iran war is a new drag: UNCTAD expects it to depress FDI in 2026 as costs rise, uncertainty grows, and Gulf investors turn cautious.

By the numbers

$1.6tn Global FDI in 2025, up 6% after two years of decline

$235bn Rise in announced data-center project value in 2025

44% Megaprojects' share of greenfield value, double 2017

$277bn FDI into the U.S., the largest host economy

Perspective

Global investment is concentrating in the same AI theme that dominates markets. That deepens the co-dependence: if AI spending slows, the world's investment pipeline slows with it.

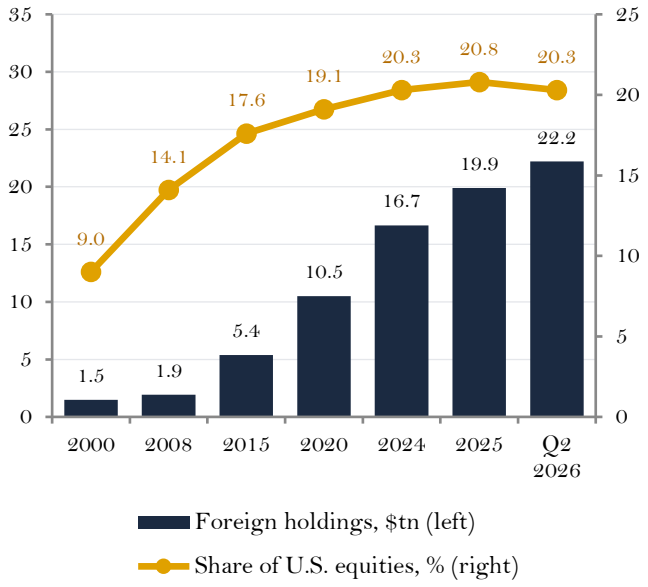
Source: UNCTAD, World Investment Report 2026: International Investment in a Turbulent Era (2026), based on fDi Markets, The Financial Times and LSEG data.

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Stocks: The World Owns the U.S. Market

Foreign investors hold $22tn of U.S. stocks, about one-fifth of the market and more than double their share in 2000.

Rest-of-world holdings of U.S. corporate equities



Largest holders of U.S. stocks, Jun 2025

Country	$tn
Cayman Islands*	2.16
Canada	2.06
United Kingdom	2.06
Ireland*	1.47
Luxembourg*	1.36
Japan	1.17
Switzerland	0.94
Norway	0.83

**Fund and custody centers: the owners live elsewhere. Total foreign holdings: $19.8tn.*

By the numbers

64.2% U.S. weight in the MSCI All Country World Index (Sep 30, 2026)

25.4% Weight of just 10 stocks in that world index, led by NVIDIA, Apple, Microsoft

$453bn Net foreign buying of U.S. stocks, Jan–Jul 2026 (all of 2025: $742bn)

~20% Foreign share of U.S. stocks, Q2 2026 (~9% at end-2000; ~29% with direct stakes)

Why it matters

A "global" stock portfolio is now about two-thirds U.S., and a quarter of it sits in ten mostly AI-linked companies. When U.S. megacaps fall, investors everywhere fall with them.

The other side of the trade: savers abroad are heavily in U.S. stocks

- Norway's $2tn+ oil fund: the U.S. is 52.9% of its stocks, about 38% of the whole fund (Jun 2026).
- Japan: the two most popular NISA retail funds (All-Country and S&P 500) took ¥4.4tn of 2025 inflows; both are mostly U.S.
- Euro area: holdings of U.S. stocks quadrupled from 2015 to 2025, twice as fast as all equity holdings (ECB).

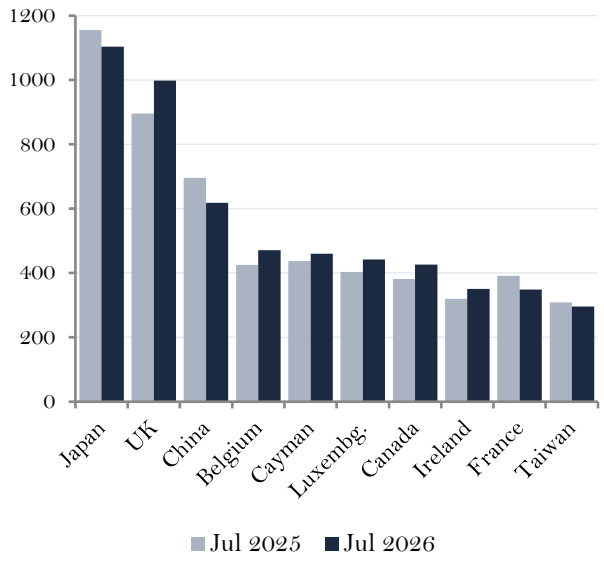
Sources: Federal Reserve Financial Accounts (Z.1, Sep 11, 2026), rest-of-world holdings of corporate equities; share = foreign holdings ÷ U.S.-issued equities (full sources in the endnotes.)

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Bonds and the Dollar: The World's Collateral

Foreigners hold $9.2tn of Treasuries and owe $14.7tn in dollars; central banks are trimming while private buyers fill the gap.

Largest foreign holders of U.S. Treasuries, $bn



The dollar's reach

Dollar share of…	%
Global FX trades (2025)	89%
Foreign-currency bonds	~60%
Cross-border loans	~55%
Central bank reserves	56.7%
…vs. around 2000	~71%

Reserves: IMF, Q2 2026. Bonds and loans: 2024.

$14.7tn of dollar debt owed by borrowers outside the U.S., about 30% of it by emerging economies (BIS, Mar 2026)

By the numbers

$9.25tn Foreign holdings of Treasuries, Jul 2026

31% Foreign share of Treasury debt held by the public, down from 56.5% in 2008

$4.9tn Foreign holdings of U.S. corporate bonds (Q1 2026), plus $1.5tn of agency debt

$450bn+ Peak Fed dollar swap lines to foreign central banks in 2020 (~$580bn in 2008)

Why it matters

The world runs on dollars. When U.S. markets crack, foreigners scramble for dollars, the dollar spikes, and the Fed has had to lend to other central banks. A U.S. shock becomes a global funding shock.

Slow diversification: the marginal foreign buyer is changing

- Over the past year, foreign central banks cut Treasuries by $113bn (China –$78bn) while private holders added more; total foreign holdings still rose $139bn.
- Central banks now hold more gold (27% of reserves) than Treasuries (22%) at end-2025, mostly because gold prices soared.
- Foreign central banks' share of Treasuries is 12%, from 41% in 2008; Fed staff find the market more price-sensitive as hedge funds and other private buyers replace them, so supply and shocks move yields more.

Sources: U.S. Treasury TIC, Major Foreign Holders of Treasury Securities (Jul 2026 vs Jul 2025); IMF COFER (Sep 30, 2026); full sources in the endnotes.

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Private Markets: Global Money, U.S. Assets, Hidden Leverage

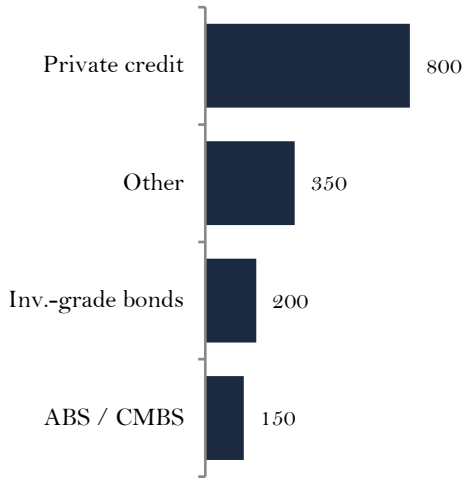
Foreign governments and funds are pledging trillions to U.S. AI and power; much of the build-out is financed off public markets.

Foreign money committed to U.S. AI and power

Source	Amount	Focus
Japan	$550bn	~$332bn energy and nuclear; AI infrastructure
Korea	$350bn	$200bn strategic (max $20bn/yr); $150bn ships
Saudi Arabia	~$1tn	Pledge, raised Nov 2025
Abu Dhabi (MGX) with BlackRock	$40bn	Bought Aligned Data Centers, Jul 2026

Pledges are multi-year and may not be fully delivered. Meta's $27bn Hyperion campus was financed by a private bond (Blue Owl, PIMCO).

Who funds the $1.5tn data-center gap (to 2028), $bn



The leverage links: where a fall would surface

- Banks: $2.6tn of credit lines to nonbank lenders; private credit, PE and BDCs are ~25% and growing 17% a year (Fed)
- Insurers: Bermuda reinsurers hold $1.5tn, over 80% of it from U.S. policies, often managed by private-credit firms.
- Early cracks: Tricolor and First Brands failed in 2025; in Q1 2026 investors asked to pull 10–40% from several private-credit funds that allow 5% a quarter.

By the numbers

~$2tn Global private credit; the U.S. is about two-thirds

57% North America's share of global private capital (PE, credit, real assets)

$800bn Private credit's expected share of data-center financing to 2028

$121bn Hyperscaler bond issuance in 2025, ~4x the 5-yr average

Why it matters

Private assets are not priced daily, so losses show up late and all at once. Foreign pledges, private credit, and insurers are now tied to the same AI and power projects.

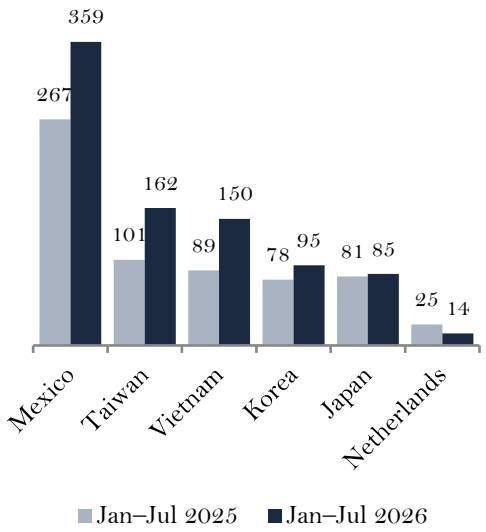
Sources: IMF GFSR briefing (Apr 2026); FSB (May 2026); Federal Reserve FEDS Note (May 2025) and Financial Stability Report (May 2026); Preqin via Crowdfund Insider (secondary); full sources in the endnotes.

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The World Is Wired Into the U.S. AI Build-Out

U.S. imports from the AI hardware supply chain have surged in 2026; Taiwan has overtaken China as a source of U.S. imports.

U.S. goods imports by country, Jan–Jul, $bn



Country	Change	Role in the AI chain
Mexico	+34%	Server assembly; ~35% of U.S. server imports
Taiwan	+60%	Chips & AI servers (TSMC, Foxconn)
Vietnam	+69%	Electronics assembly (not all AI)
Korea	+22%	Memory chips; Sept chip exports +263%
Japan	+4%	Chip materials & tools (indirect)
Netherlands	–44%	ASML tools ship to Asia, not the U.S.

How the chain works

Netherlands ASML lithography tools → **Taiwan & Korea** Chips and memory → **Taiwan, Mexico, Vietnam** Server assembly → **United States** Data centers

Value is added in Asia: over 95% of the inputs in Mexican-assembled servers are imported.

By the numbers

$187bn — U.S. imports from Taiwan, Jan–Aug, now above China ($183.5bn)

+137% — Korea's exports to the U.S. in September

€43–45bn — ASML 2026 sales forecast, raised twice on AI demand

$56bn — TSMC 2026 capital budget (up to)

Why it matters

Asia's export boom and Europe's chip-tool makers depend on U.S. AI spending. If that spending slows, the shock travels the whole chain, so global markets offer less diversification than they appear to.

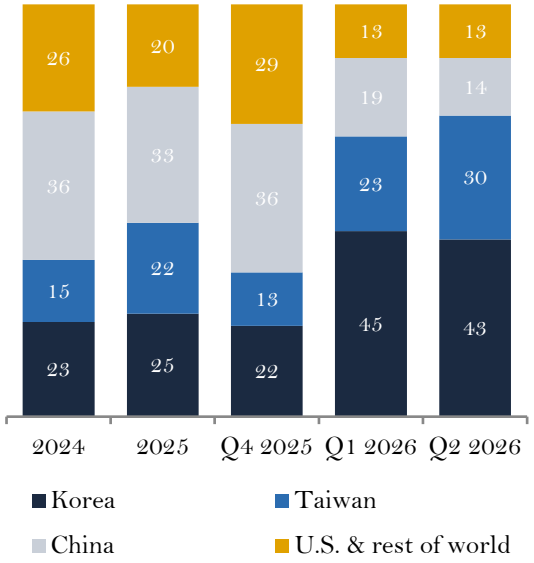
Sources: U.S. Census Bureau country trade data (Jan–Jul 2025 vs 2026, not seasonally adjusted) and year-to-date top trading partners (Jan–Aug 2026); Xinhua (Korea Sept exports); full sources in the endnotes.

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Upstream: Dutch Chip Tools Flow to Korea and Taiwan

ASML's sales have swung from China to the AI memory and logic makers in Korea and Taiwan.

ASML sales by customer location, % share



Volume vs. value

Period	Systems sold	EUV	Net sales
2024	418	44	**€28.3bn**
2025	327	48	**€32.7bn**
H1 2026	170	n/a	**€18.1bn**
2026 guide	—	~65*	**€43–45bn**

Fewer machines, more money: units fell 22% in 2025 while sales rose 16%. EUV tools averaged about €240m each in 2025, so the mix shift to AI-grade tools drives value, not volume.

By the numbers

73% — Korea + Taiwan share of ASML sales in Q2 2026, up from 47% in 2025

14% — China's share in Q2 2026, down from 36% in Q4 2025

€43–45bn — 2026 sales guidance, raised twice this year (from €34–39bn in January)

+30% — Planned EUV and DUV capacity increase in each of the next two years

Why it matters

Europe's largest chip-tool maker now earns most of its sales from tools for AI chips. Its outlook depends on U.S. hyperscalers continuing to spend.

Why direct U.S. imports from the Netherlands fell

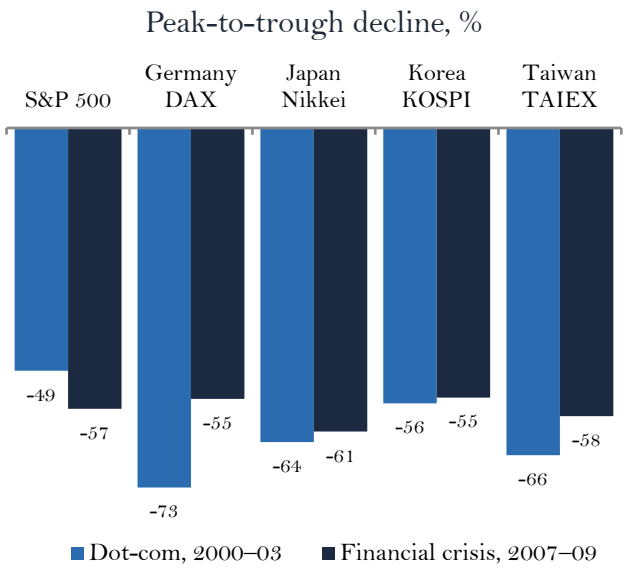
- ASML ships its machines to the chip plants, and the plants are mostly in Korea and Taiwan (SK Hynix, Samsung, TSMC).
- Those plants turn the tools into memory and AI chips, which reach the U.S. as Korean, Taiwanese and Mexican imports.
- So the Dutch link to U.S. AI demand is one step removed: it shows up in ASML's order book, not in U.S. customs data.

Sources: ASML quarterly and annual results (Q4 2025, Q1 2026, Q2 2026 press releases and 2025 Annual Report); regional shares as reported in ASML investor presentations via TrendForce; full sources in the endnotes.

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When the U.S. Falls, the World Falls With It

In past U.S.-led crashes, markets abroad fell as much or more; diversification failed exactly when it was needed.



Why the links are tighter now

- U.S. and foreign stocks moved together with a correlation of 0.49 in 1970–89 and 0.87 in 2000–22.
- One global factor drives ~60% of asset prices in the U.S., Europe, and Japan, and it weakens after U.S. rate hikes.
- 2022: S&P 500 –25%, Korea –35%, Taiwan –32%, and global bonds fell too, their worst drawdown since 1990.

How a U.S. fall would travel

U.S. AI stocks and long bonds fall →

- **Wealth:** $22tn foreign-held U.S. stocks
- **Dollar funding:** $14.7tn of dollar debt abroad
- **Trade:** Taiwan, Korea, Mexico, ASML orders
- **Private credit:** Banks, insurers, pension funds

By the numbers

~20% Foreign-owned U.S. stocks (Fed Z.1, Q2 2026) vs ~8% in 2000; ~29% with direct stakes

64% U.S. share of the world stock index

–63% MSCI EAFE (developed markets ex-U.S.) in 2007–09, worse than the S&P 500's –57%

0.87 Correlation of U.S. and foreign stocks since 2000

Assessment

The world is more tied to U.S. markets than in 2000 or 2008. A U.S. fall would hit foreign wealth, dollar funding, Asian exports, and private credit at the same time. The links work both ways, and that is the risk.

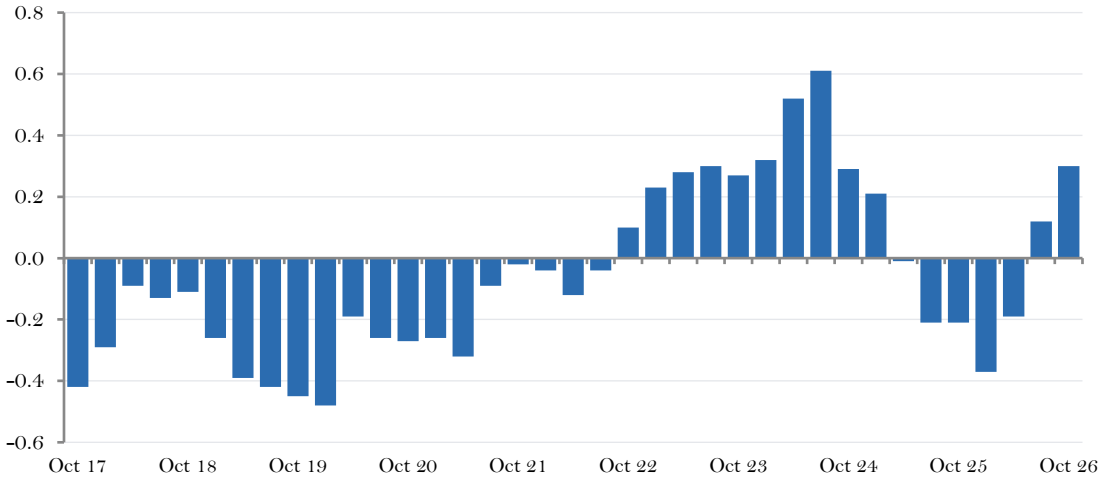
Sources: index closing levels (S&P Dow Jones, Deutsche Börse, Nikkei, Korea Exchange, TWSE), calculations in local currency; peaks and troughs vary by market (e.g; full sources in the endnotes.)

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Diversification Under Strain: Stocks and Bonds Now Move Together

When inflation and policy drive both markets, bonds stop cushioning stocks, and a traditional stock-bond mix diversifies less than it used to.

S&P 500 vs 10-yr Treasury: rolling 52-week correlation of weekly returns (above 0 = moving together)



Positive in 2022–24 (inflation shock), negative in 2025, positive again in 2026 (+0.34 year to date).

What it means

- From 2000 to 2021, bonds usually rose when stocks fell, because falling growth brought lower inflation and lower rates.
- When inflation is the main risk, rising rates hurt both at once: 2022 and again in 2026, when the S&P 500 returned 12.8% through September while U.S. bonds lost 2.9%.
- A portfolio split between stocks and bonds is less diversified than its labels suggest when both respond to the same forces.
- The Bank of England warns an AI growth miss could hurt government bonds too, since budgets count on AI productivity: one shock where bonds may not cushion stocks.

By the numbers

+0.30 Stock-bond correlation, past 52 weeks

+12.8% S&P 500 total return, 2026 to Sep 30

−2.9% U.S. bonds (Bloomberg Agg), 2026 to Sep 30; −3.5% in Q3

−0.48 Correlation in January 2020, when bonds still cushioned stocks

Perspective

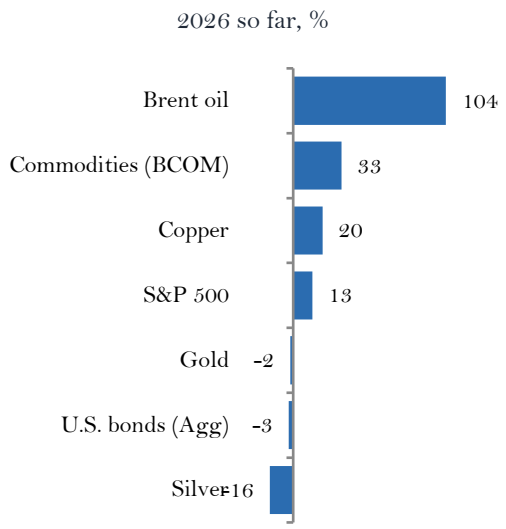
Stocks, bonds, and private and public markets are tied by the same economic, financial, and industry forces. In this regime, diversifying across asset labels may protect less than it appears.

Sources: FRED (SP500, DGS10); Morningstar Direct (Sep 30, 2026); Bank of England FPC Record (Sep 30, 2026); full sources in the endnotes.

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Commodities and Metals: Inflation Hedge Now, Diversifier When AI Wanes?

Commodities hedged 2026's inflation, driven by war and AI demand; whether they diversify an AI bust depends on which kind of shock it is.



Brent Dec 31–Oct 6; BCOM, S&P 500 and Agg total return through Sep 30; copper at its Sept 22 record; gold and silver to Oct 9.

Asset	Correlation with S&P 500	If the AI effect wanes
Copper	+0.40 (2016–26); +0.58 in 2026	*Likely falls with AI demand*
Oil	−0.52 in 2026 (war shock)	*Hedges supply shocks, not a slump*
Gold	Turns negative in sell-offs (World Gold Council)	*Most likely to hold up*
Silver	Half industrial; −50% from peak	*Volatile hybrid*

How to read correlation: +1 = moves with stocks; 0 = no link; −1 = moves opposite. FRED (weekly oil, monthly copper).

Assessment: two kinds of shock

- Supply shock (war, weather): commodities rise as stocks and bonds fall, which is 2026 so far. This is when commodities diversify.
- Demand shock (an AI bust): copper and energy fall with stocks. In months the S&P 500 fell over 3% (2016–26), copper fell 2.6% and broad commodities 2.3% on average.
- Gold failed this year as real yields and the dollar rose, but it has historically held up when stocks sold off.

By the numbers

+33% Commodities (BCOM) through Q3; best since 2000

$5,405 Gold record (Jan 29); now ~$4,214

−50% Silver from its January peak of $121.62

$14,875 Copper record per tonne (LME, Sep 10)

Perspective

Commodities hedged inflation this year, but part of the gain is the AI trade itself. If AI demand fades, industrial metals likely fall with stocks; gold has historically been more likely to hold up.

Sources: Bloomberg (Oct 8, 2026); FRED (DCOILBRENTEU, PCOPPUSDM, PALLFNFINDEXM, SP500, DGS10); BullionVault; World Gold Council; others in the endnotes.

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The AI Story: One Bet, Built on Borrowed Money, Shared by the World

Connecting the pages: how the AI build-out grew from a technology theme into a dependency for growth, markets, interest rates, and countries.

1. **The spending** Big-tech capex of ~$800bn in 2026 now exceeds operating cash flow; the U.S. build-out could reach ~$9tn by 2032, larger than the railroad boom — *p. 15, 18*
2. **The borrowing** ~$2.4tn of commitments, mostly off balance sheet; ~$450bn of AI debt this year, double 2025; hyperscalers went from <1% to 10% of investment-grade issuance (IMF) — *p. 15*
3. **The world's savings** Asian surpluses flow into U.S. AI stocks and bonds rather than Treasuries; ~20% of foreign-held U.S. stocks are AI-related — *p. 106–108*
4. **The ripple** AI supplied over half of U.S. growth in Q1, 47% of world trade growth and most new global investment, while other investment shrinks — *p. 12, 108*
5. **The cost** The build-out bids up chips, power, labor and savings, helping keep inflation and real yields high (~2.9%) for every other borrower — *p. 17, 89*
6. **The cracks** AI credit spreads widen while other credit stays calm; Meta and xAI rent spare capacity to a few investor-funded AI labs; the Bank of England warns a miss would hit government bonds too — *p. 15, 115*

The conclusion: AI has become the world's largest shared bet. The technology is real, but the financing, the concentration, and the global dependence mean a stumble would not stay in Silicon Valley; it would travel through credit, trade, savings, and government bond markets at once.

The view in one line

The technology will likely endure; the risk lies in how it is financed and how many now depend on it.

Why it matters

Few portfolios or countries sit outside this bet. The IMF warns a severe correction could cascade through the leveraged, circular AI ecosystem and spread worldwide.

What would change the view

Better: AI revenue outgrowing capex; productivity gains showing up (IMF: up to ~0.5 pt a year of global growth)
Worse: capex guidance cuts; AI credit spreads widening further; trouble at leveraged cloud providers

Sources: as cited on the pages referenced (filings, NBER, IMF incl. Georgieva blog Oct 15, 2026, UNCTAD, WTO, Bank of England, FRED, BEA, Bloomberg).

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An Opinion: Five Uncertainties, One Compounding System

These are not five separate risks; they are connected.

War drives inflation; inflation constrains the Fed. A constrained Fed raises the rate at which a third of the debt reprices every year. The compounding interest bill crowds out the private economy, and a debt-burdened, higher-rate world is the one environment the AI trade is not priced for and is cumulatively costly for a high-debt nation.

War and oil: a managed conflict, not a peace process

The Islamabad MOU has not held. Strikes continue, waivers have been revoked, and the Strait at times partially reopens: a conflict being managed rather than resolved. The ambiguity is deliberate, and the incentive to preserve the appearance of diplomacy likely holds only through the November midterms. The consequence for the economy is the disruption: energy supply stays impaired, and each escalation is another supply shock.

Inflation: moving away from target, not toward it

Inflation is sticky, and September showed some acceleration: CPI rose to 3.7% and core's three-month pace to about 3.3%. The energy shock compounds tariffs and sticky services, and on-again, off-again Iran peace talks keep oil supply and prices volatile, adding to inflation uncertainty. The risk is a longer, higher plateau than official baselines assume; slowing growth with rising prices is the classic stagflationary setup.

The Fed: hawkish rhetoric meeting fiscal arithmetic

Chair Warsh has made price stability the centerpiece: a September hike, guidance retired, no dot submitted, and another hike expected by year end. Whether conviction or signaling, that stance plus September's acceleration makes another hike at the October 28 meeting likely. Tightening into a ~$40T debt load and ~$2T deficit raises the government's own interest bill; whether rhetoric stays policy is the central question.

Deficit: the refinancing wall converts rates into cost

Roughly a third of marketable debt matures within twelve months, so debt issued near zero in 2020–21 reprices at ~4%+ today. The average rate on the debt has climbed from about 1.4% in 2021 to 3.52% in September 2026, and net interest has passed $1 trillion, larger than defense. Every year the Treasury must roll a growing maturity pile and fund a ~$2T deficit at rates set by a market absorbing record global sovereign supply.

AI: the economy's engine and its single point of failure

AI capex and earnings now carry the market and a meaningful share of GDP growth. Capex now exceeds cash flow, much of it financed off balance sheet, and circular deals make demand look more organic than it may be. AI is also a cause of higher rates, not only exposed to them: it bids for global savings and adds to cost pressure. A reversal would travel the same channels; the Bank of England warns it could hit government bonds as well as AI stocks.

The common thread: each uncertainty feeds the next. A shock in any one of them travels through the others, which is why the equilibrium on the next page is delicate.

Sources: figures as cited in this commentary (BEA, Fed SEP, CRFB/CBO, U.S. Treasury). Average interest rate and maturity share: U.S. Treasury.

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Putting It Together: A Delicate Equilibrium

The supports are real but narrow, and the pressures are now global; it would take only one of them to tip the balance.



SUPPORTS

AI earnings
S&P profits expected +25–32% in 2026 and +14–15% in 2027

AI-driven trade
WTO: world goods trade +3.9% in 2026; AI goods 47% of growth

Foreign capital
~20% of U.S. stocks owned by foreign investors (Fed Z.1, Q2 2026); ~29% including direct-investment stakes

Strong growth, full employment
GDPNow 3.6% (Oct 8); unemployment 4.2% on a shrinking workforce; few layoffs

Wealth effect
Household net worth $195.9tn; the top 10% keep spending

The asymmetry

Upside needs everything to go right. Downside needs one thing to break.

PRESSURES

Global rates
U.S. 10-yr ~5.3%, near the ~5.5% where valuations compress; yields up 0.6–1.3 pts worldwide

Fewer bond buyers
Central banks, pensions and reserve managers step back; auctions clear only at higher yields

The Fed
Hiked to 3.75–4.00%; most officials expect another hike; term premium 0.82%

Oil and the Iran war
Brent above $100; tanker attacks; emergency stocks ~2 weeks of world use

Narrow foundations
Weakest breadth at a record since 2000; jobs from three sectors; housing out of reach

The common thread: the world is making one bet on U.S. AI and the power to run it, funded by savings that once held yields down, as the pool of buyers for long-term debt shrinks. That bet supports earnings, trade and foreign inflows today, and it also drives record borrowing and higher yields everywhere.

Sources: as cited on the preceding slides (FactSet, UBS, WTO, Federal Reserve, Treasury, BLS, BEA, EIA, OECD and others).

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What to Watch: Eleven Signposts for the Fourth Quarter

Where each pressure stands today and the level that would signal the delicate equilibrium is tipping

Signpost	Where it is now	Warning level	Why it matters
10-year Treasury	~5.3%	**Sustained above ~5.5%**	*Where stock valuations have compressed in the past*
Treasury auctions	10 of 19 settled above expected	**Repeated large tails; weak foreign demand**	*Buyers demanding ever-higher yields to absorb supply*
The Fed	3.75–4.00%; Oct 28 hike now likely after Sep CPI	**Hikes into a slowdown, or pressure to accommodate Treasury**	*Policy error, or erosion of Fed independence*
Inflation	CPI 3.7% (Sep); core PCE 3.0% (Aug)	**Core PCE above ~3.5%**	*Keeps the Fed hiking and yields rising*
Jobs	Layoffs 1.0%; unemployment 4.2%	**Layoffs above ~1.3%; Sahm rule off zero**	*With little hiring, job losses would compound fast*
Consumer	Saving rate 4.1%	**Delinquencies spreading to cards and autos**	*Spending on savings cannot last indefinitely*
Oil and the war	Brent $114 (Sept avg)	**Renewed escalation; Hormuz closure**	*A second supply shock with thin reserves*
AI earnings and capex	Profits +25–32% expected; AI credit already wider	**Capex cuts or a pause; AI credit spreads widening; GPU rental prices falling**	*AI carries earnings, trade and growth*
Japan and the yen	¥157 per dollar; BOJ 1.25%	**Sharp yen rally or BOJ surprise**	*A carry-trade unwind hits stocks, then bonds*
France and Europe	10-yr ~4.9%; ~1.4–1.5 pts over Germany	**Spread above ~2 pts; debt-cancellation politics**	*Sovereign stress spreading across Europe*
Midterm elections	Nov 3; forecasters favor Democrats for the House	**Divided government; more policy by executive action**	*Tariff, spending and regulatory paths stay unclear until the result*

How to use this list: these are markers, not forecasts. One signpost crossing its line is a warning; several crossing together is what would tip the balance described on the previous page.

Thresholds are judgment calls; current readings as cited on the pages referenced. Midterm odds: Decision Desk HQ and Silver Bulletin (see the midterm page).

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Appendix: Data Notes and Items to Verify

Where figures are estimated, come from secondary sources, or have not been independently confirmed

Estimates

- Hedged Treasury yield (~2.3%): Treasury yield minus the U.S.–Japan short-rate gap
- ~5.3% nominal 10-yr on Oct 2: real 2.92% + 2.36% inflation breakeven
- Equity risk premium and implied S&P moves: P/E = 1 ÷ (yield + premium), earnings held constant
- MOVE index August 2026 (~75): backed out from a reported +35% September move
- Saving rate "~5.3% in February": read from BEA chart
- Sector detail in the jobs slide compares July and September levels (two months)

Secondary or unverified sources

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- Hyperscaler capex (~$725bn): company guidance compiled by ValueAdd VC
- ACM term premium: eco3min.fr replication of the NY Fed workbook
- MOVE index monthly closes: convextrade.com (ICE index is proprietary)
- Yen CPI-based PPP (~¥107): independent analysis of BIS/BOJ data
- BOJ 2007 hike, Japan history timeline and "real yields highest since 2007" not independently re-checked
- Breadth from Backtest; UBS and Societe Generale views as reported. Co-dependence section: MSCI EAFE drawdown, correlations, pledges, Bermuda and redemption data are secondary

Data conventions

- U.S. Treasury yields: Treasury Daily Par Yield Curve and Par Real Yield Curve (latest Sept 30 / Oct 2, 2026)
- Payroll figures: latest BLS estimates; August and September remain preliminary, and the annual benchmark revision arrives in early 2027
- Wealth groups (Fed DFA) are ranked by wealth, not income; consumer-credit shares are Q1 2026, the latest available
- 2024–2025 quarterly GDP figures predate BEA's Sept 30 annual update and may be revised

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