The Cost of Money.

Rates are higher because the economy is strong, which can support further gains in equities. Higher rates hit hardest in the countries carrying the biggest deficits, including the US, which runs the largest in the group. What this means for each asset class.

I. THE STATE OF THE ECONOMY

II. WHY RATES STAY HIGHER

III. WHY EQUITIES CAN LIVE WITH IT

IV. THE COST, AND THE WAYS OUT

V. WHAT IT MEANS FOR MARKETS

Higher rates are the price of a strong economy. *The question is how much the economy can bear.*

The ten-year Treasury now yields 5.24%, the highest since 2007. The conventional reading is that this is a warning sign. We see it differently. **All of the rise since 2021 has come through the real yield, S&P 500 earnings are on track to grow 32% this year, and unemployment stands at 4.1%.** Rates are high because demand for capital is high.

What distinguishes this cycle is the number of large borrowers competing for capital at once. The federal government runs a deficit near 6% of GDP outside of a recession. The largest technology companies plan to spend more than $720 billion this year, much of it debt-financed, and war in the Gulf has pushed energy prices up 16%. **Treasury, corporate, and energy-driven demand are converging, which is why we expect rates to stay elevated.**

Market pricing has moved from one or two rate cuts at the start of the year to four more hikes now, but rate expectations have held up on earnings growth and AI-related investment. Further rate increases are likely, but we do not think the Fed will tighten as much as is priced in. Much of the current inflation stems from the war and the AI buildout, and core PCE stands at 3%. **Once the Fed stops tightening and inflation improves, long-end yields should fall, but likely by less than the market expects, given the demand for new debt.**

The debt is the constraint to watch, not the trigger. Higher rates are a sign of strength as long as growth and earnings keep pace with the cost of capital. Our view would change if growth slowed while inflation stayed high.

PART I

The state of the economy

Growth is beating forecasts and inflation is front-loaded by the war and the AI build-out.

Where things stand.

01 NOMINAL GDP GROWTH

5.4% *Q4 2025 on a year earlier*

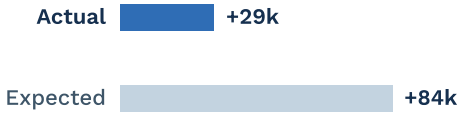
Growth is running above the ten-year yield



02 JOBS

+29k *payrolls added in September*

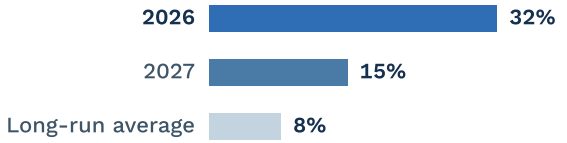
Roughly a third of what was expected



03 S&P 500 EARNINGS GROWTH

32% *consensus for 2026*

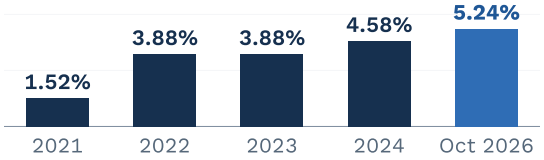
Four times the long-run average



04 TEN-YEAR TREASURY

5.24% *the most since 2007*

Up more than three points since 2021



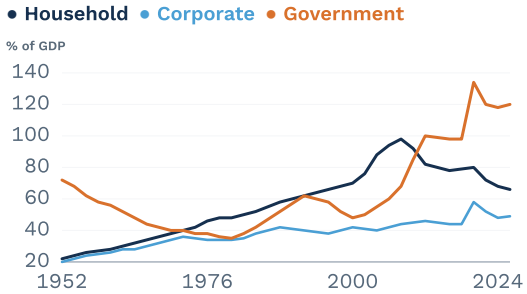
05 FED FUNDS RATE

3.75–4.00% *raised on 16 September*

40% chance of another rise by year-end



06 DEBT BURDEN HAS SHIFTED



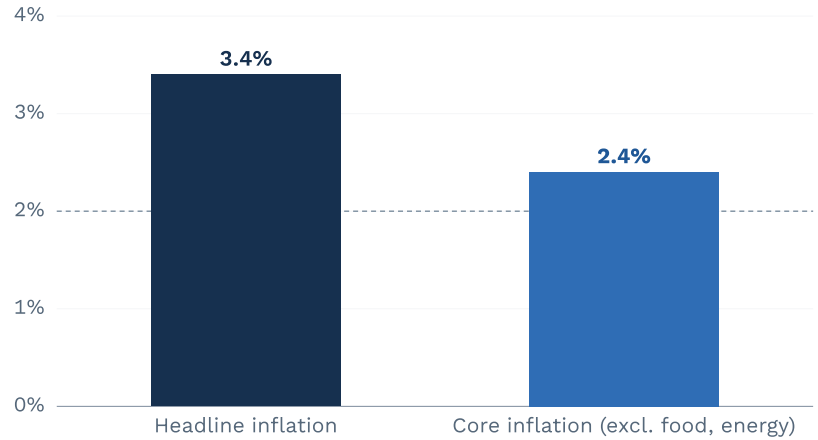
SOURCE *BEA via the Joint Economic Committee, Q4 2025, and BEA second estimate, Q2 2026 · BLS Employment Situation and CPI, September 2026 · FactSet Earnings Insight, September 2026 · US Treasury yields, 1 October 2026, and Federal Reserve H.15 year-end yields, 2021 to 2024 · Federal Reserve, 16 September · CME FedWatch, 1 October 2026 · CBO and Peterson Foundation · Haver Analytics and BofA US Equity & Quant Strategy, household, nonfinancial corporate and government debt as a share of GDP, 1952 to Q2 2026.*

We expect fewer rate hikes than the market is pricing in.

1 SHORT-TERM RATES

The market now prices **about three more 25bp rises by the end of 2027**, down sharply from expectations in October.

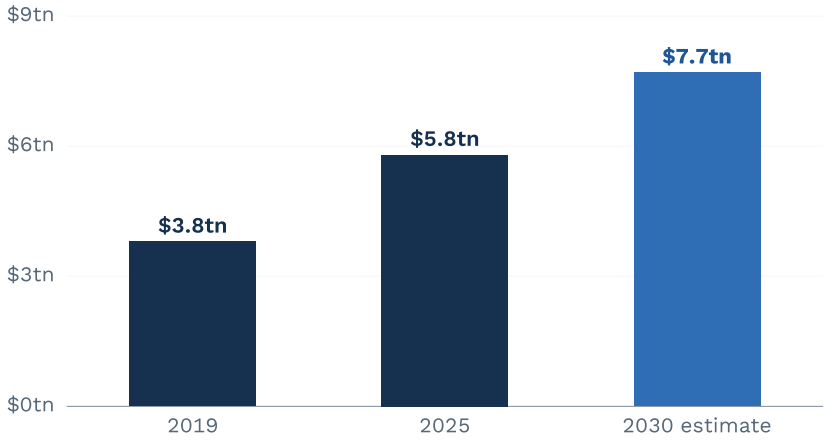
US inflation, August 2026 · % year on year · dashed: Fed target 2%



2 LONG-TERM RATES

Even with fewer increases, the US has to borrow far more. **Total borrowing needs roughly double by 2030.**

Net US borrowing needs, all borrowers · USD trillions



SOURCE *CME FedWatch and Fed funds futures, 1 October 2026 · BLS CPI, August 2026 · Federal Reserve · BlackRock Investment Institute, September 2026, net financing demand, read from the published chart. The view is Colter Lewis's. The 2030 figure is an estimate and may not come to pass.*

PART II

Why rates are structurally higher

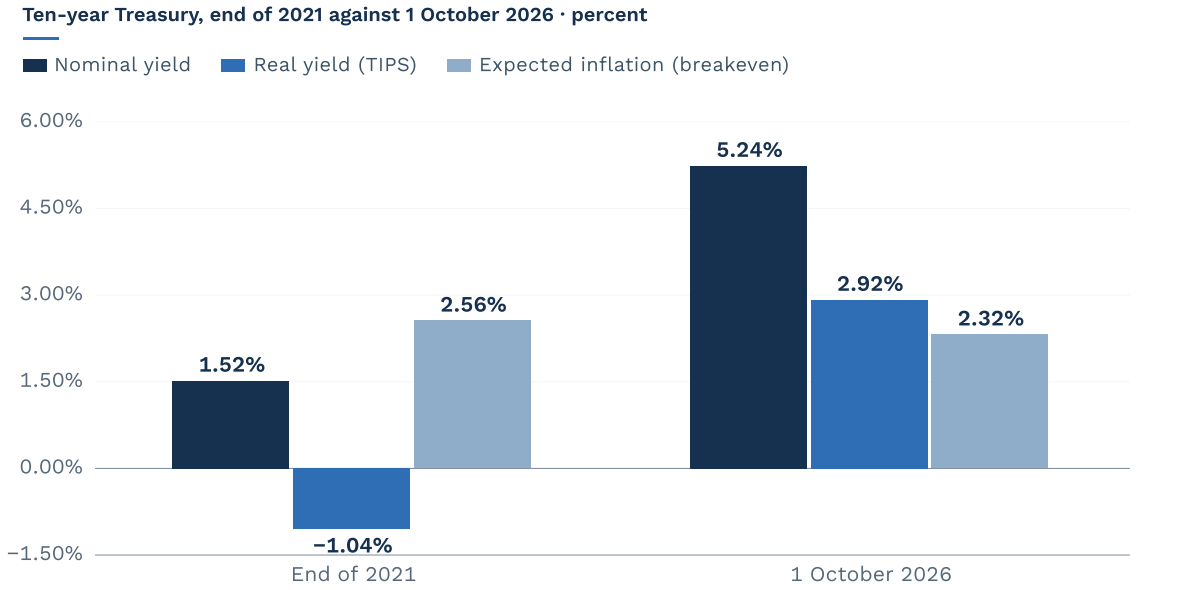
Real yields rose everywhere, the Fed stopped buying, and the Treasury, companies and foreign issuers are all competing for the same pool of savings.

All of the increase since 2021 is in the real yield, from negative 1% to positive 3%. *Expected inflation is lower.*

CHANGE IN THE REAL YIELD SINCE 2021

+3.96pp

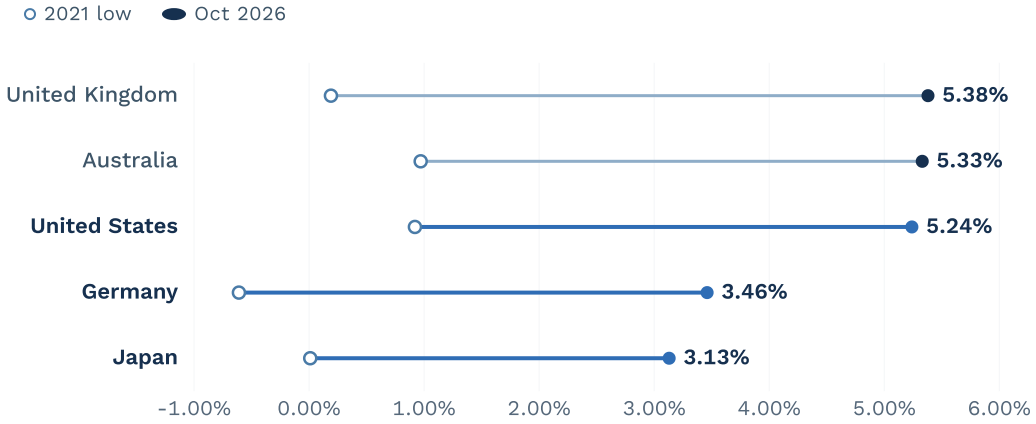
Ten-year nominal	1.52 → 5.24%
Ten-year real	−1.04 → 2.92%
Inflation expectation*	2.56 → 2.32%



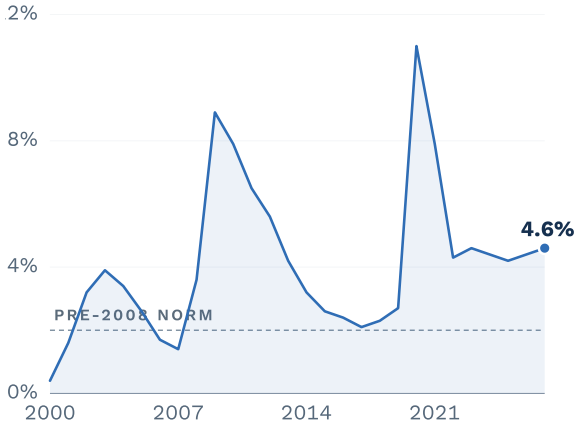
SOURCE *US Treasury constant-maturity nominal and TIPS yields, 31 December 2021 and 1 October 2026. *Measured by the TIPS breakeven rate. Breakeven is nominal less real, and is ours.*

Government bond yields have risen in every major economy *at the same time*.

Ten-year yield, 2021 low against the latest close



Aggregate deficit, eleven economies · % of GDP



−0.61 → 3.46%

Germany's ten-year, 2021 to October 2026, a rise of 4.07 points

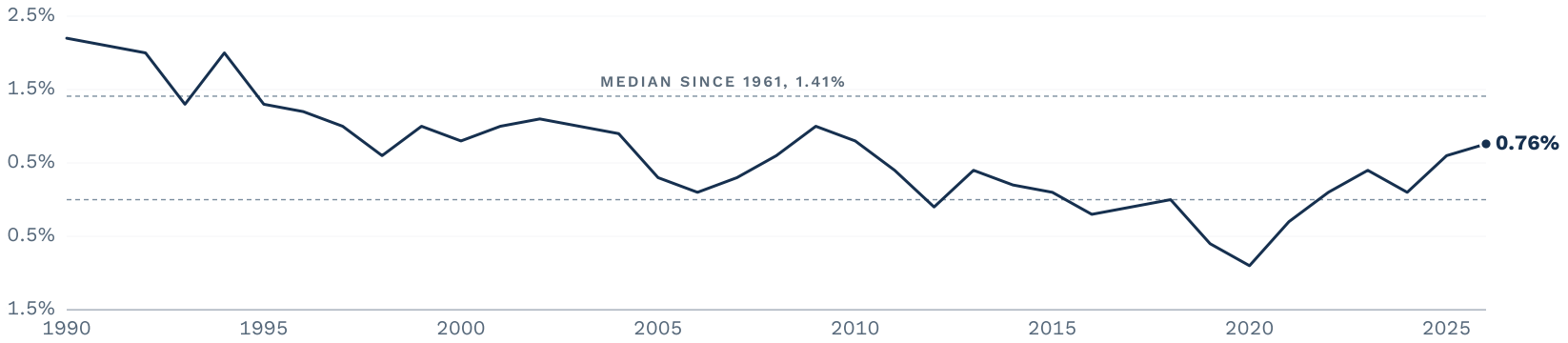
Every market at once

Diversifying across government bonds from different countries did almost nothing to protect a portfolio; short maturities and real assets did.

SOURCE *Benchmark ten-year yields at the 1 October 2026 close: US Treasury for the United States, Trading Economics for the other four · Bloomberg Markets Live, 17 August 2026, for the eleven-economy deficits, which we reconstruct. Italy is omitted for want of a verified September print.*

The term premium is back, but still *below its long-run median.*

Ten-year term premium, 1990 to 2026 · percent, annual



GAP TO THE LONG-RUN MEDIAN

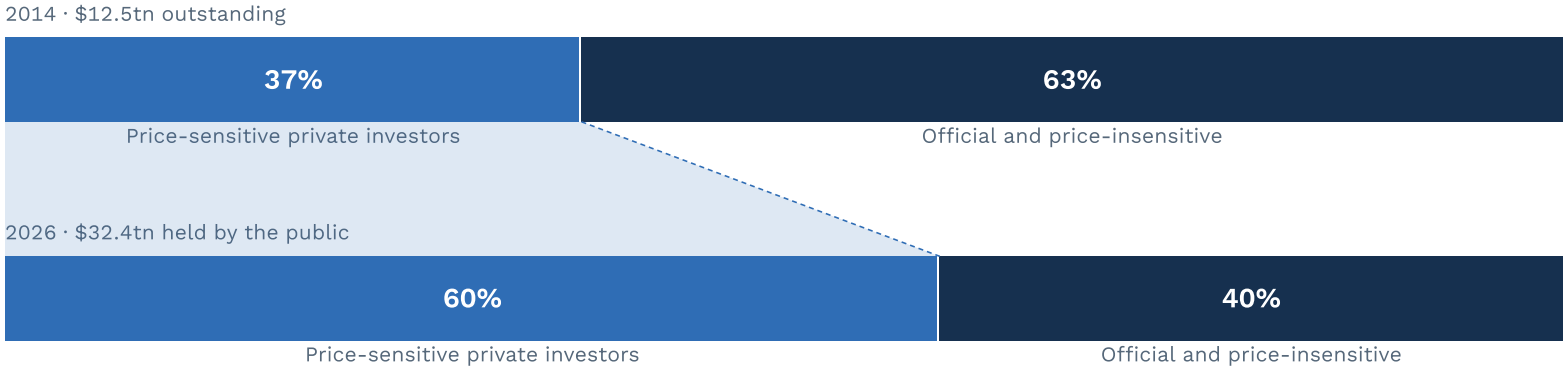
0.65pp

Rise since the Fed began cutting	+0.86pp
Ten-year if the premium returned to its median	~5.9%

SOURCE *BlackRock Investment Institute, from the New York Fed ACM model, September 2026, for 1990 to 2025 annual readings · Federal Reserve Bank of New York, Adrian-Crump-Moench term premium, via CEIC, monthly to August 2026 · Eco3min, 1961 to April 2026, for the median and percentile · New York Fed via MacroMicro for September 2024. The term premium is a model estimate, not a market price. The reversion figure is ours: today's ten-year plus the 0.65pp gap to the median.*

The investors replacing the Fed *are price-sensitive.*

Treasury securities outstanding, split by whether the holder responds to price · percent



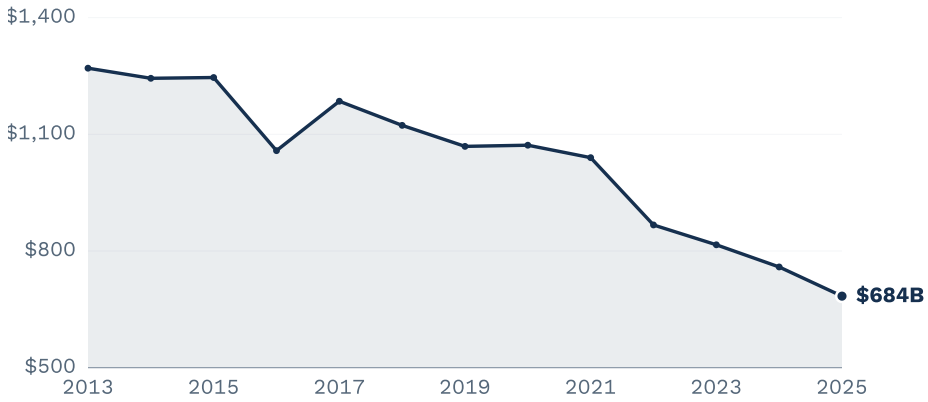
$2tn cash Treasuries held by hedge funds, end-2025, nearly three times five years earlier

32.5% held by foreign accounts, down from above 55% in 2008

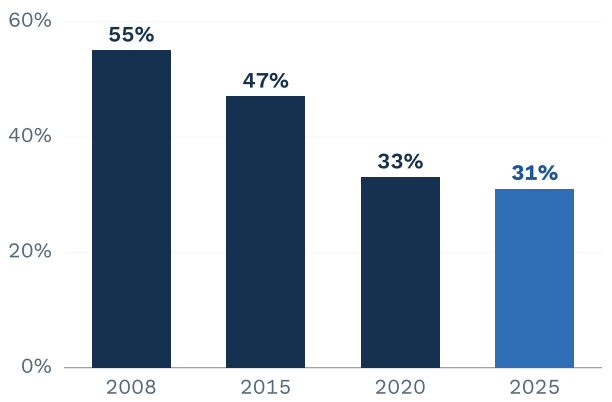
SOURCE *Schwab on Federal Reserve Z.1 accounts, March 2026 · Office of Financial Research, 19 August 2026 · Fed FEDS Notes, 15 October 2025. The residual is ours.*

Foreign central banks are cutting their Treasury holdings. *China now holds half what it did in 2013.*

China's holdings of US Treasuries, end of year · USD billions



Foreign share of publicly held US debt · %



CHINA'S HOLDINGS, 2013 TO 2025

−46%

SOURCE *US Treasury TIC, Major Foreign Holders of Treasury Securities, December figures 2013 to 2025, rounded · Congressional Research Service RS22331, 2026, for the foreign share (2008 is the peak, above 55%) · Federal Reserve FEDS Notes, October 2025, on Cayman holdings. Holdings are by country of custody. Earlier-year values are approximate.*

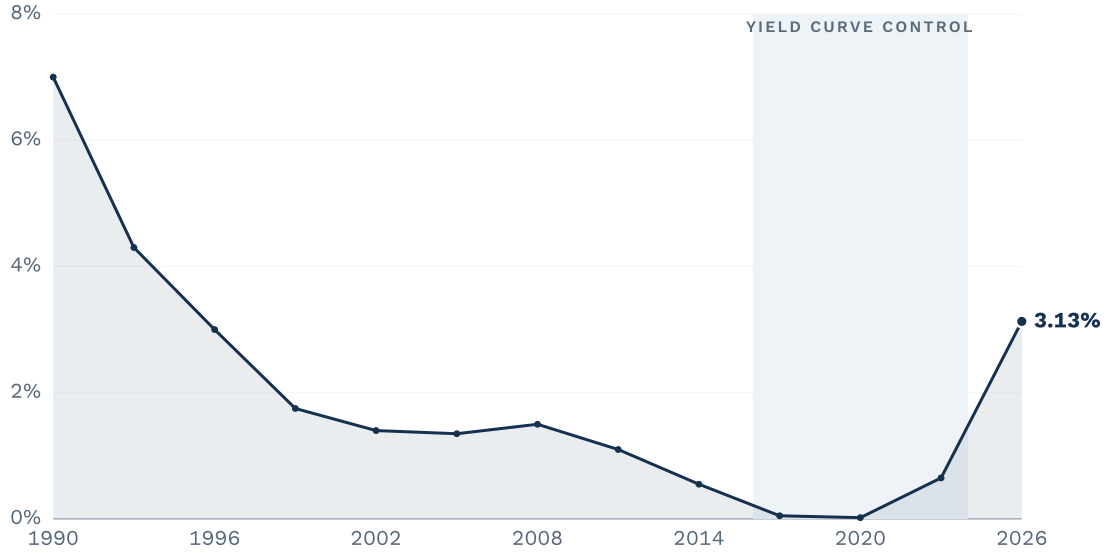
Japan ends thirty years of near-zero rates, and *Japanese savings are returning to Japan.*

US GOVERNMENT BONDS SOLD BY JAPANESE INVESTORS IN THE FIRST QUARTER OF 2026

$29.6B

JGB 10-year	3.13%
JGB 30-year	4.20%

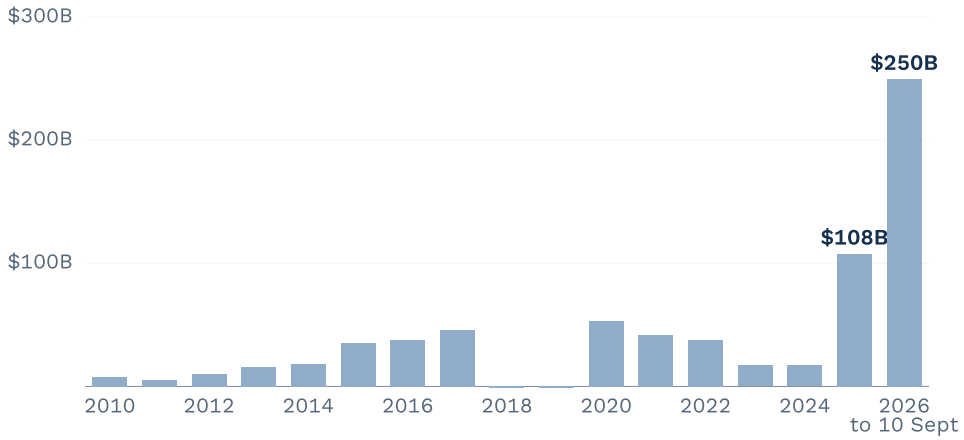
Japan ten-year government bond yield



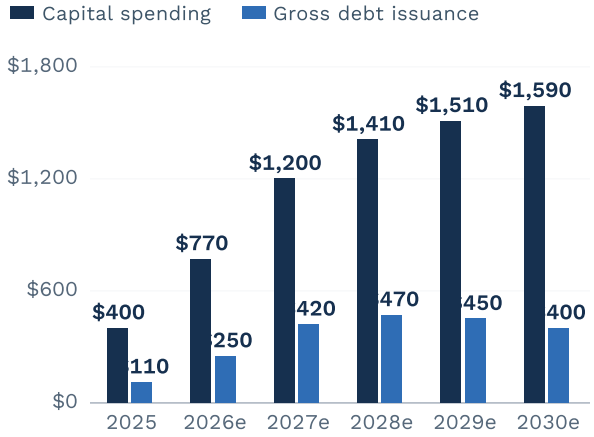
SOURCE *Trading Economics for the ten-year and thirty-year JGB at the 1 October 2026 close · Bank of Japan, policy decision of 18 September · Treasury international capital data, 17 August. Decade markers are indicative.*

Big Tech borrows heavily to build AI, *and the build-out runs to 2030.*

Investment-grade bonds sold by the five largest US tech companies · USD billions a year



AI capital spending against global gross debt issuance by 5 largest tech companies, 2025 to 2030 · USD billions



BONDS SOLD SO FAR IN 2026 AGAINST ALL OF 2025

2.3×

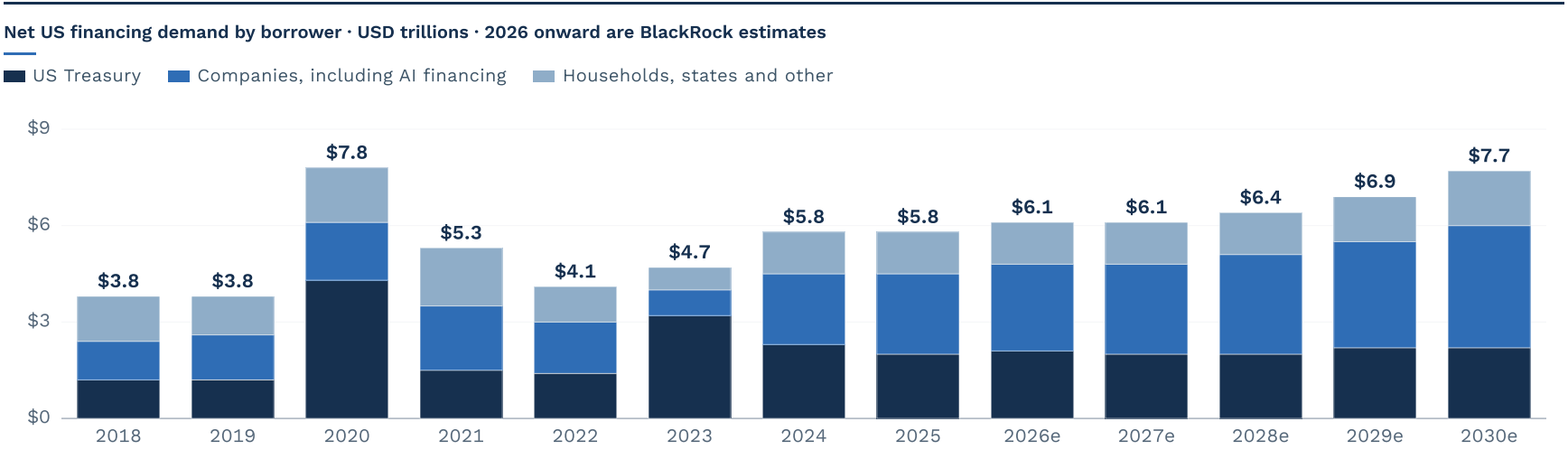
TECH COMPANY DEBT TO BE ISSUED, 2026 TO 2030 ESTIMATE

~$2.0tn

SOURCE *BlackRock Investment Institute, with Dealogic data, September 2026, for bonds sold, all currencies, by Alphabet, Amazon, Meta, Microsoft and Oracle; 2026 is year to date through 10 September · Goldman Sachs Global Investment Research, as of 15 September 2026, for capital spending and debt issuance, which excludes data-center financings issued through special purpose vehicles. Values are read from published charts and rounded, and are approximate. The 2.3× is ours. Estimates may not come to pass.*

Every borrower in the economy *wants more money at the same time.*

Net US financing demand by borrower · USD trillions · 2026 onward are BlackRock estimates



2× financing demand, 2019 to 2030: $3.8tn to $7.7tn

~half of 2030 demand from companies, against a third in 2019

~$2tn a year needed by the Treasury, 2026 to 2030

SOURCE *BlackRock Investment Institute, with US Congressional Budget Office, Federal Reserve and EIA data, September 2026. Company borrowing groups nonfinancial corporate debt, noncorporate business debt, private bonds and syndicated and private loans; net equity retirement is left out. Values are read from the published chart and rounded; they are approximate. Forward-looking estimates may not come to pass.*

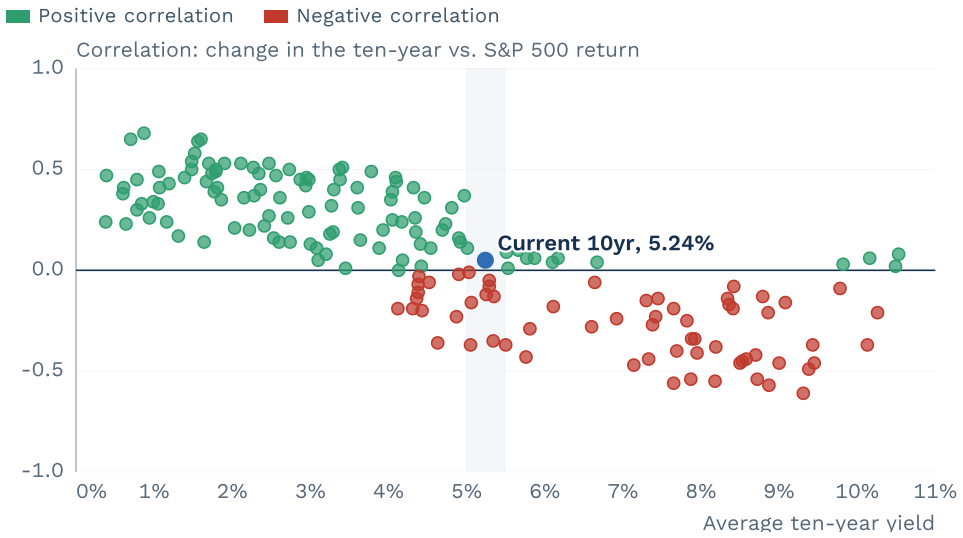
PART III

Why equities can live with it

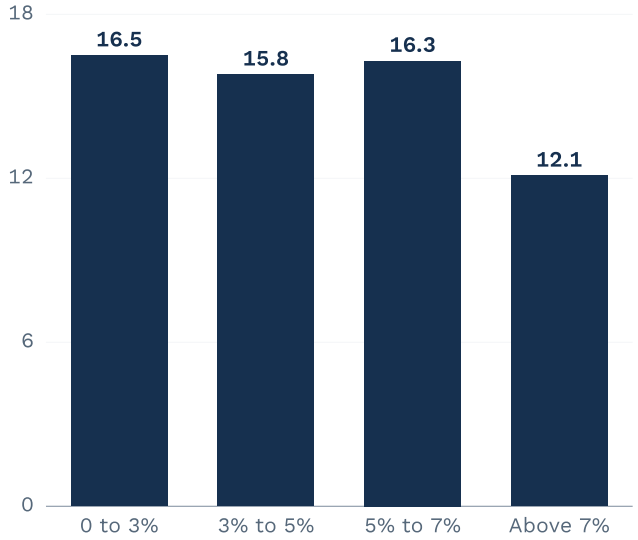
Earnings growth has carried stocks, and valuations have already adjusted.

Below about 5%, rising yields have usually helped stocks. *Above 6%, returns have been negatively correlated with higher rates.*

Each dot is one calendar quarter since 1962, by its average ten-year yield and its correlation with the S&P 500 that quarter



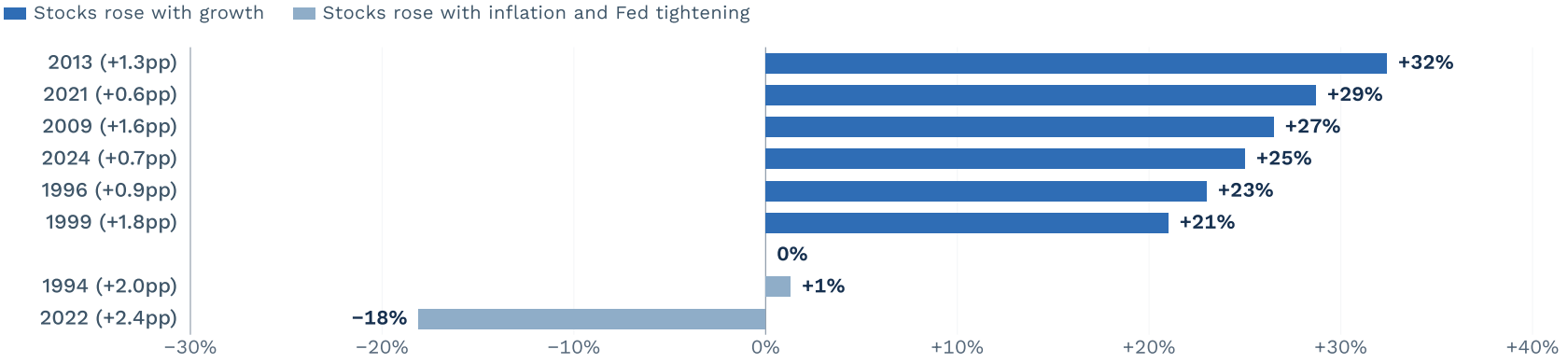
Median monthly S&P 500 forward P/E by ten-year yield, 1986 to August 2026



SOURCE *Bloomberg and BofA US Equity & Quant Strategy, correlation between daily changes in the ten-year yield and the S&P 500, by calendar quarter, 2Q 1962 to 2Q 2026, and median monthly S&P 500 forward P/E by ten-year yield bucket, 1986 to 31 August 2026, via FactSet. Scatter recreated from the published chart; individual quarter placements are illustrative, not sourced data points. The correlation flip above 6% and the P/E-by-bucket figures are BofA's reported values.*

When growth pushed yields up, *stocks did well*. When inflation did, stocks did not.

S&P 500 total return in the year · change in the ten-year yield in brackets



+26% average return across the six growth-led years, against −8% in the two inflation-led years

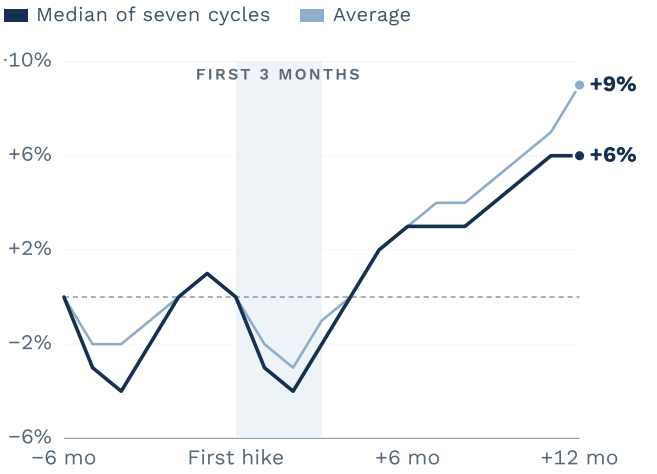
19.2× today's starting S&P 500 earnings multiple, against 21.5× when 2022 began

Both, this year 2026 has features of both groups, but the valuation has already fallen and earnings are rising, not falling

SOURCE *S&P Dow Jones Indices calendar-year total returns · Federal Reserve H.15 year-end ten-year yields. The years shown are every calendar year since 1990 in which the ten-year yield rose at least 0.5 points. The grouping is Colter Lewis's. Past performance is not indicative of future results.*

Stocks usually dip after the first rate increase, then recover.
Industrials has led most often, with utilities as good as tech or energy.

S&P 500 return around the first hike · %



2 of 7 cycles were up three months after the first hike. A year on, the median gain is about 6%.

Three months after the first hike · S&P 500 return, and each sector against it

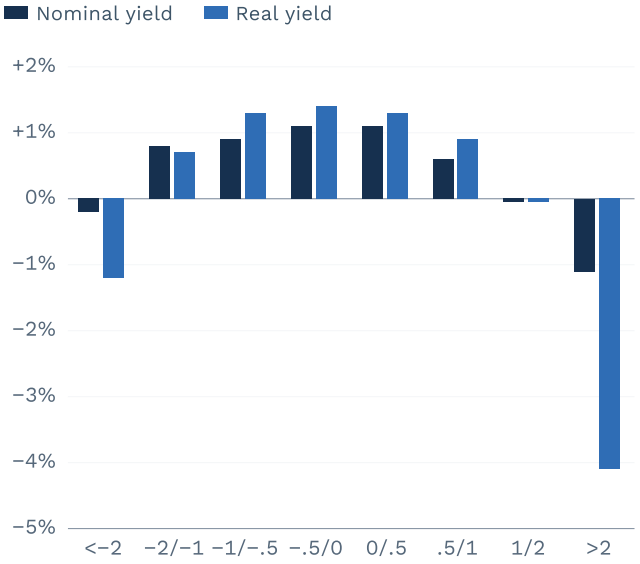
	1988	1994	1997	1999	2004	2015	2022	Median	Beat index
S&P 500 return	+7%	−3%	+13%	−6%	−2%	−2%	−16%	−2%	29%
SECTOR RETURN ABOVE OR BELOW THE INDEX · PERCENTAGE POINTS									
Energy	−5	−1	−6	+5	+13	+4	+25	+4	57%
Info tech	+8	+4	+11	+12	−8	0	−3	+4	57%
Materials	+6	−2	−6	−2	+5	+3	+5	+3	57%
Industrials	0	−2	+2	+1	+2	+3	+1	+1	71%
Utilities	−1	−5	−11	+1	+9	+15	+8	+1	57%
Financials	+5	+3	0	−9	+2	−8	−3	0	43%
Comm services	0	+2	−5	0	+3	+3	−4	0	43%
Staples	−5	+1	−1	−4	−3	+6	+8	−1	43%
Discretionary	+2	−1	−4	−5	+1	−1	−9	−1	29%
Health care	−6	+1	+4	−3	−4	−5	+5	−3	43%

10+ | 5 to 9 | 1 to 4 | 0 | −1 to −4 | −5 to −9 | −10 or worse

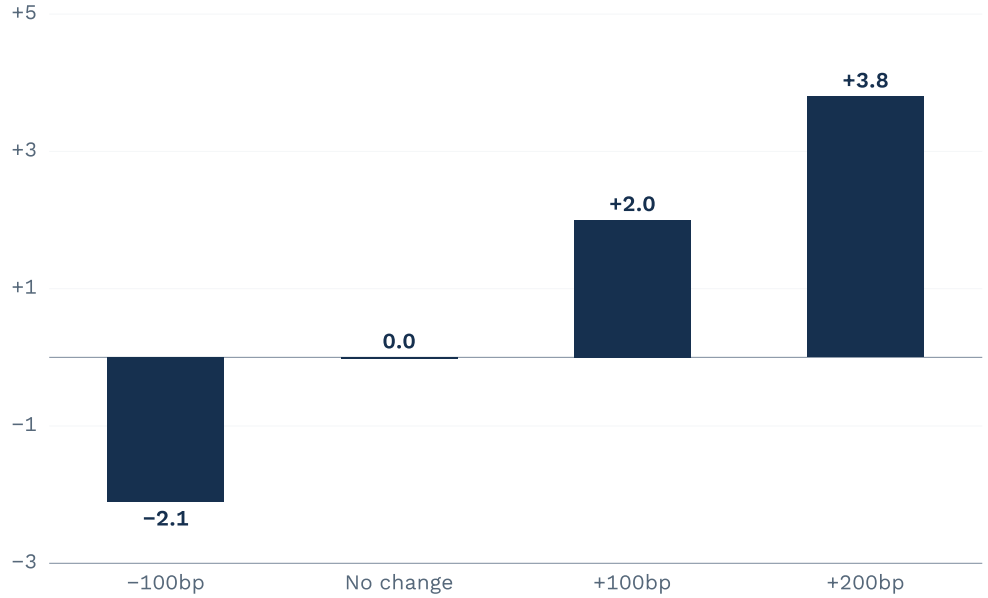
SOURCE *Goldman Sachs Global Investment Research. First hikes in 1988, 1994, 1997, 1999, 2004, 2015 and 2022. Sector figures are excess returns against the S&P 500 in the three months after the first hike; "Beat index" is the share of the seven cycles with a positive excess return. Line values are read from the published chart and rounded. Historical patterns, shown for context; not a sector recommendation. Past performance is not indicative of future results.*

Equities can absorb higher yields as long as growth stays solid.

Average monthly S&P 500 return by size of the one-month yield move · z-score against the past three years · left: yields falling fast, right: yields rising fast



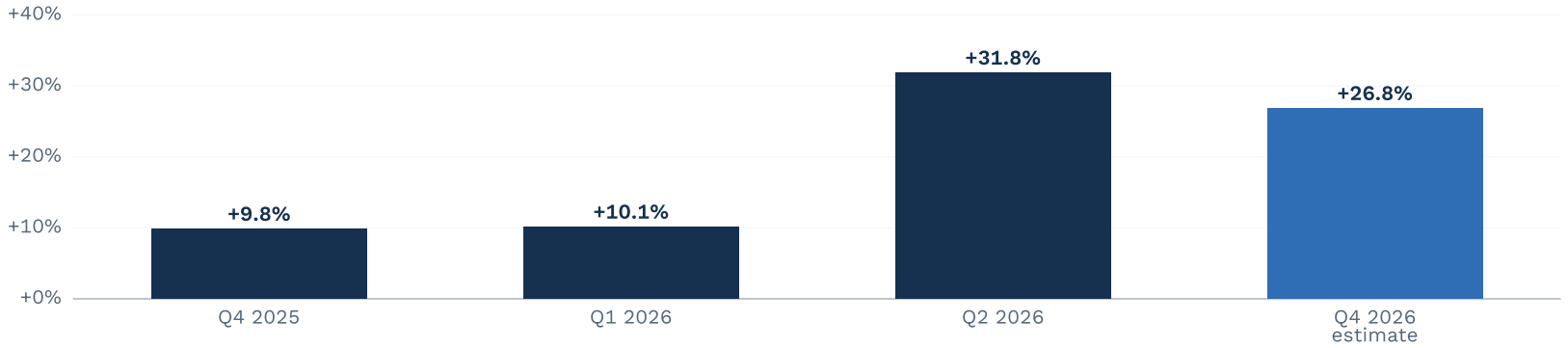
Extra long-term growth needed to hold valuations, by change in the ten-year · pp



SOURCE *Goldman Sachs Global Investment Research. The z-score is the one-month change in the yield against its past three years. Values are read from the published chart and rounded; they are approximate. The watch signal is Colter Lewis's. Past performance is not indicative of future results.*

This is a broad earnings boom, *not only the seven largest companies.*

Earnings growth for the other 493 S&P 500 companies · percent, year on year



EARNINGS GROWTH FOR THE OTHER 493, Q2 2026

+31.8%

Magnificent 7, Q2 2026	+118.5%
Q4 2026 estimate	26.8 vs 23.2%
Top contributors to Q2 growth	Micron, Chevron

SOURCE *FactSet, blended growth rates for the other 493 companies: Q4 2025 (27 February 2026), Q1 2026 (20 April), Q2 2026 and the Q4 2026 estimate (August 2026).*

PART IV

The cost, and the ways out

Each point on federal debt costs $401 billion a year. Faster growth and new buyers help.

There are five ways a government gets out of a debt this size. *Two are under way, and neither was announced.*

1

Grow out of it

Needs real growth of about 3.4% a year for a decade. CBO puts potential growth at 2.1% a year through 2030, below what is needed even though current quarters are running hotter.

HOPED FOR

2

Cut the deficit

Needs a swing of about 5% of GDP. The 2025 tax act added $3 to $5 trillion instead.

NOT CHOSEN

3

Default

Would destroy the market the debt is funded in. Not a realistic option for the US.

RULED OUT

4

Surprise inflation

Worked in 2021 to 2023. With a third of the debt repricing each year, it works less well now.

PARTLY USED

5

Hold rates below inflation

Real policy rate just 0.2%, bank rules eased to hold more Treasuries, long-end buybacks.

UNDER WAY

SOURCE *Carmen Reinhart and Kenneth Rogoff, IMF Working Paper 13/266, Box 1, on the five elements of debt reduction · Congressional Budget Office, The Budget and Economic Outlook: 2026 to 2036, for potential real GDP growth of 2.1% a year, 2026 to 2030 · Committee for a Responsible Federal Budget on the ten-year cost of the July 2025 act · Federal Reserve final rule on the leverage ratio, effective 1 April 2026. Potential growth is trend capacity, not a single quarter's print; actual growth has run above and below it (see page 17). The real policy rate is the 3.875% target midpoint less July PCE inflation of 3.7%. The 3.4% growth requirement and the verdicts are Colter Lewis's.*

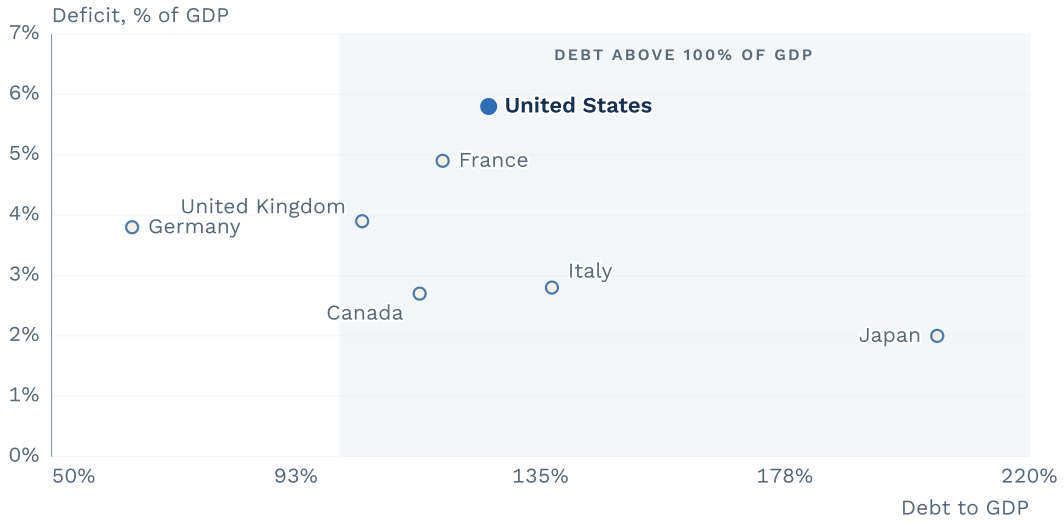
Six of the G7 owe more than a year's output. *The US runs the largest deficit of them.*

US GOVERNMENT DEBT, 2026 TO 2031

126% → 142%

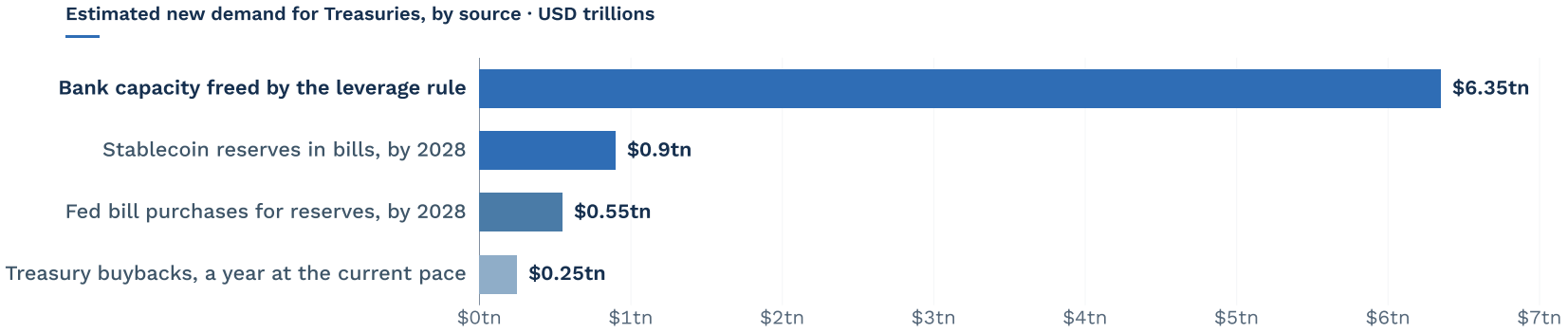
US total public debt	$40.3tn
Held by the public	$32.4tn
Net interest, annual rate	$1.1tn

Gross government debt against the annual deficit, IMF 2026 projections



SOURCE *IMF World Economic Outlook and Fiscal Monitor, April 2026, general government gross debt and overall balance, 2026 projections; Japan on the IMF's revised consolidated basis · US Treasury Debt to the Penny, 22 September 2026 · Peterson Foundation, September 2026.*

New buyers are being created: *banks, stablecoins, the Fed and the Treasury itself.*



POTENTIAL NEW DEMAND, ALL FOUR SOURCES

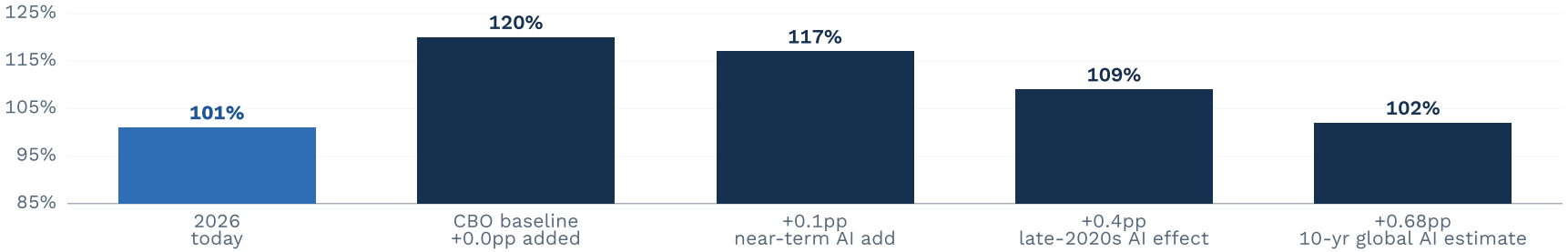
~$8tn

Bank capacity, range of estimates	$5.5–7.2tn
Stablecoins in circulation	~$270B
Buybacks, July to September	$63B

SOURCE *Goldman Sachs Global Investment Research (Richard Ramsden), June 2025, estimating the eSLR recalibration could unlock $5.5 to $7.2 trillion of bank balance-sheet capacity, via Lance Roberts, Could Changes to the SLR End the Bond Bear? · Federal Reserve, FDIC and OCC final rule on the enhanced supplementary leverage ratio, effective 1 April 2026 · Standard Chartered, February 2026, for $0.8 to $1.0 trillion of stablecoin bill demand and $0.5 to $0.6 trillion of Fed reserve management purchases by 2028 · Brookings, August 2026, for stablecoins in circulation · US Treasury refunding statement, 5 August 2026, for buybacks. The buyback pace annualizes one quarter, midpoints are used where sources give ranges, and the total is ours. Balance-sheet capacity is not committed buying and may not all be used.*

Productivity is the one lever that eases the debt without a policy fight. *Small, sustained gains compound.*

Federal debt held by the public in 2036, by productivity growth added to CBO's baseline · % of GDP



−$317B cumulative deficit reduction per 0.1pp of extra productivity, 2027 to 2036, CBO's rule of thumb

1.7% → 1.9% Goldman's forecast for economy-wide productivity growth, near term against the early 2030s, as AI adoption spreads

+0.1pp AI productivity already inside CBO's baseline growth forecast

SOURCE *CBO, The Budget and Economic Outlook: 2026 to 2036, February 2026, for the debt baseline and the $317B rule of thumb per 0.1pp of productivity, 2027 to 2036 · Goldman Sachs Research, What Is the US Economy's Potential Growth Rate?, October 2025, for productivity forecasts of 1.7% through 2029 and 1.9% in the early 2030s, and a 0.68pp per year AI productivity boost estimate over ten years from Goldman's global AI research. The four debt bars beyond the baseline apply the CBO rule of thumb to each productivity scenario and are Colter Lewis's calculation; they are illustrative, not a CBO or Goldman projection of the debt ratio.*

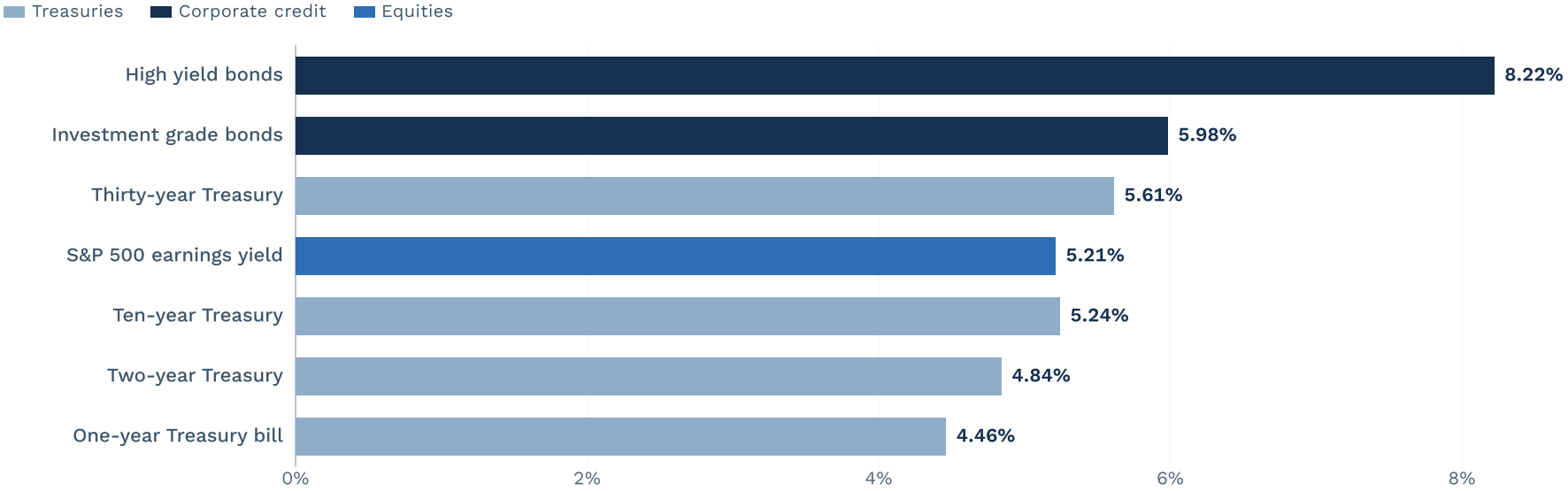
PART V

What it means for markets

What each asset yields or has returned, and how it would fare in each scenario.

Short Treasuries pay almost as much as corporate bonds, *with far less risk*.

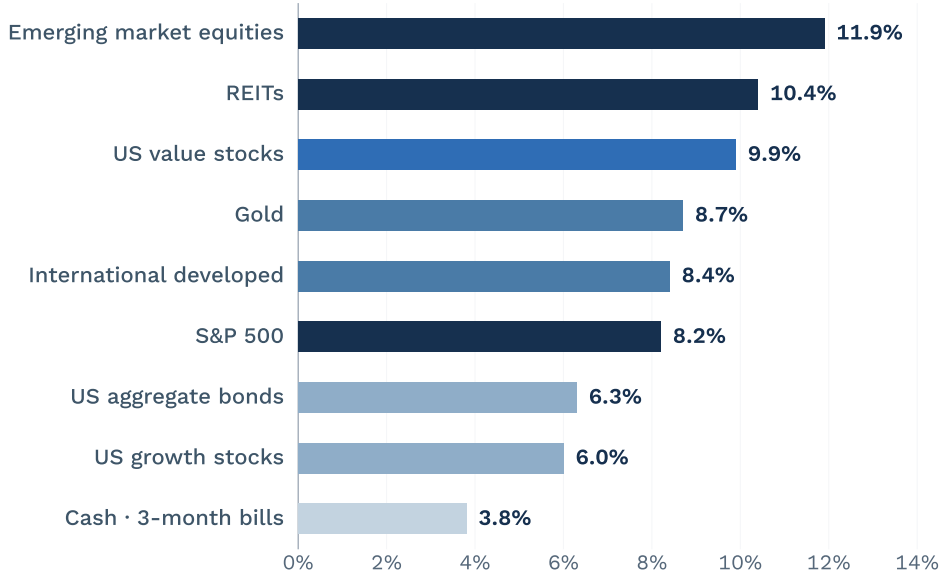
Yield to an investor today · percent



SOURCE *US Treasury, 1 October 2026, one-year bill at 1 October · ICE BofA US Corporate and High Yield indices via StreetStats and FRED, 1 October, yields and option-adjusted spreads · FactSet for the earnings yield. Twenty-year spread averages are approximate, from the same ICE BofA series.*

The last time money had this price, *different assets led.*

Annualized total return in USD · 1997 to 2007



TEN-YEAR REAL YIELD · 1997 TO 2007 AVERAGE

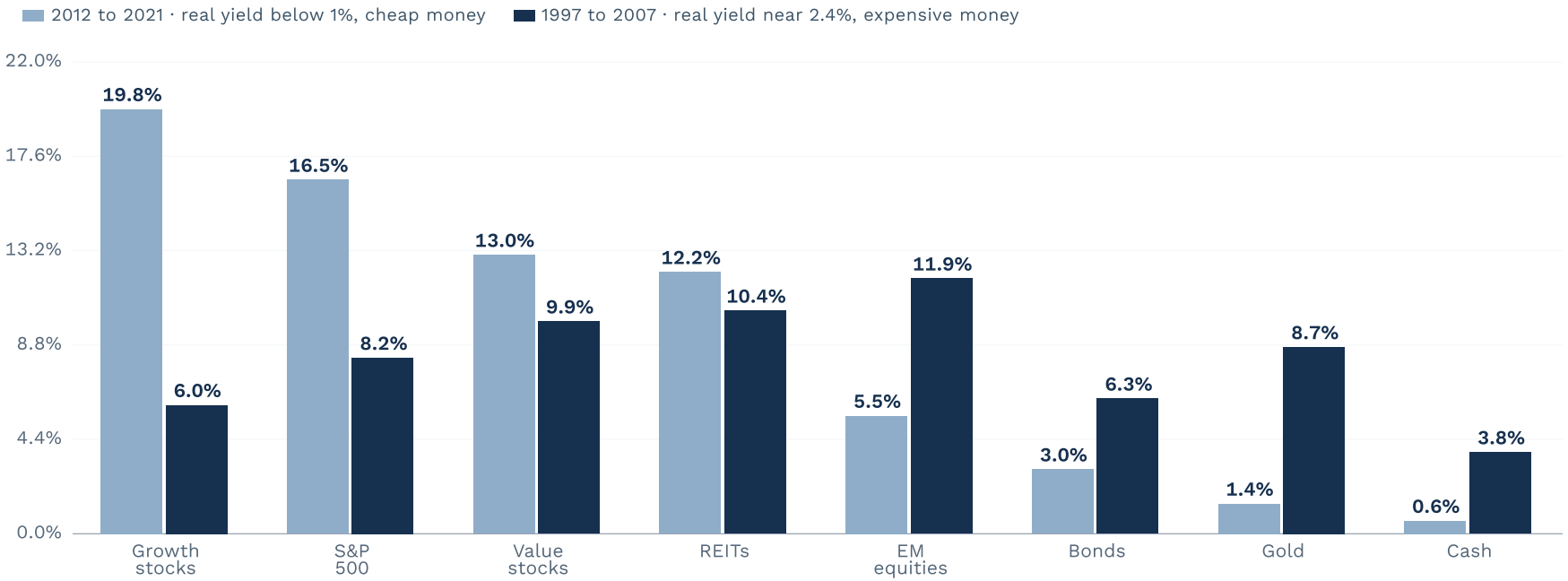
2.4%

Value over growth	+3.9pp
S&P 500 drawdown inside the window	−49%
Cash · real return per year	+1.4%

SOURCE *Colter Lewis calculations from the FTSE NAREIT All Equity, MSCI EM, MSCI EAFE, S&P 500, Russell 1000 Value and Growth, Bloomberg US Aggregate, LBMA gold and three-month Treasury bill series, total return in USD, rounded · Federal Reserve H.15 and FRED ten-year TIPS constant maturity (2.4% average over the window). Past performance is not indicative of future results.*

Cheap money and costly money reward *different portfolios*.

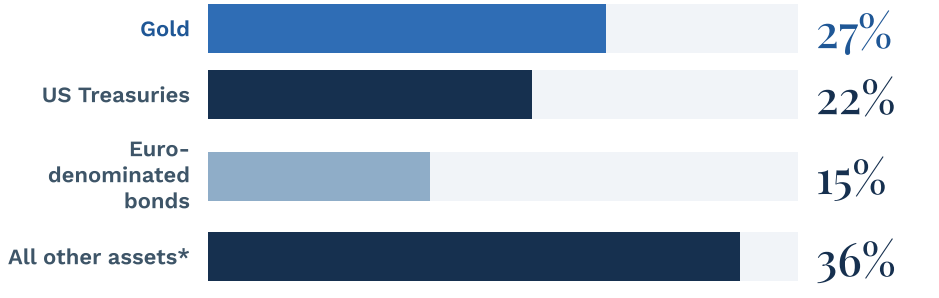
Annualized total return in USD, by era



SOURCE *Colter Lewis calculations from the same index series as the preceding page, 2012 to 2021 against 1997 to 2007, rounded · Invesco, December 2025 (value the best performing US factor of 2025; banks and basic resources the leading global sectors) · State Street Global Advisors, June 2026 (first-quarter 2026 leadership in value, cyclicals and small capitalization, with a second-quarter rotation). Past performance is not indicative of future results.*

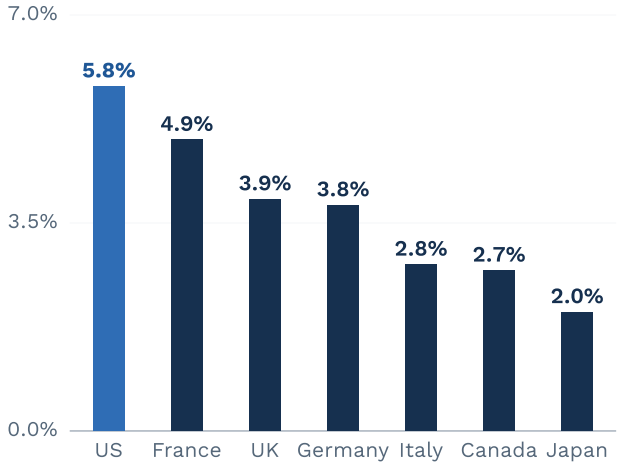
Every G7 government runs a deficit, *and central banks now hold more gold than Treasuries.*

What all central banks hold: share of official reserves at market value, end of 2025



FIRST TIME GOLD HAS LED AS THE SINGLE LARGEST RESERVE ASSET SINCE 1996. *NON-TREASURY DOLLAR ASSETS PLUS THE YEN, STERLING, YUAN AND SMALLER RESERVE CURRENCIES, COMBINED.

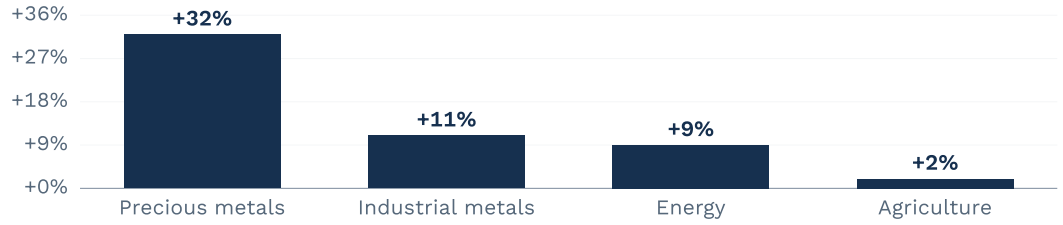
G7 government deficits, 2026 · % of GDP



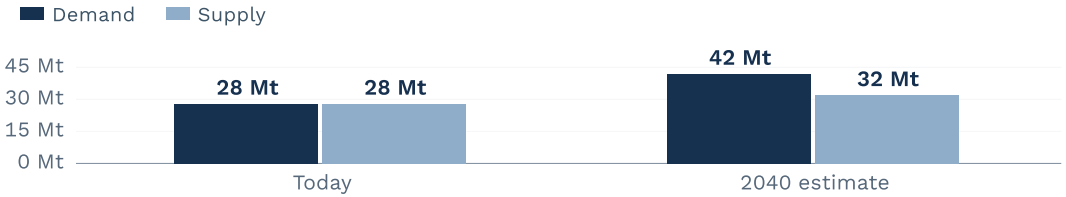
SOURCE *European Central Bank, The International Role of the Euro, June 2026, reserve shares at market value, end-2025, the first time gold has exceeded Treasuries since 1996 · IMF Fiscal Monitor, April 2026, for G7 deficits · World Gold Council, Central Bank Gold Reserves Survey 2026 and Gold Demand Trends, on PBoC purchases · Trading Economics for the price · US Treasury refunding statement, 5 August 2026, for buybacks (see page 27) · Bloomberg reporting, September 2026, on Bank of Japan intervention and US Treasury support for euro-side operations. A Federal Reserve note of 3 September 2026 finds the crossover mainly reflects the rise in the gold price, and that by June 2026, after gold's fall, foreign official Treasury holdings were again larger in dollar terms.*

Demand for metals and energy is rising faster than supply. *That is the case for commodities.*

Commodity sector returns, 2026 year to date · total return, percent



Global copper demand against supply · million tonnes a year



BLOOMBERG COMMODITY INDEX, TOTAL RETURN

~14%

1
AI DATA CENTERS

27 t

of copper per megawatt

2
ELECTRIC VEHICLES

3×

the copper of a petrol car

3
SOLAR PANELS

~17%

of global silver demand, up from 5% a decade ago

4
COPPER SHORTFALL BY 2040

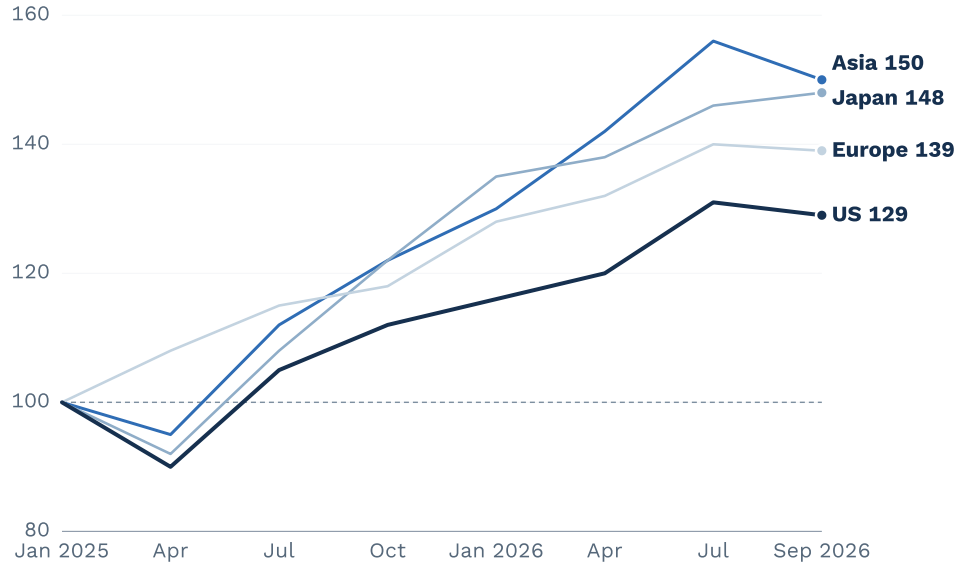
10 Mt

a quarter of copper demand

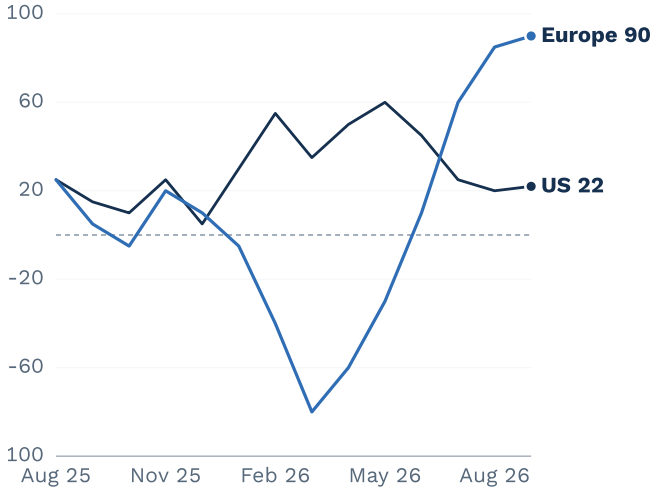
SOURCE *Bloomberg Commodity Index and sub-indices, total return, year to date through 1 October 2026 · S&P Global, Copper in the Age of AI, January 2026 (demand of 42 Mt by 2040, a 50% rise; supply deficit of 10 Mt; 83 kg per EV) · Macquarie and IEA estimates of data-center copper demand by 2030 · Microsoft Chicago data center, about 27 tonnes per MW · IEA, Electricity Grids and Secure Energy Transitions, for the copper intensity of renewable generation · Silver Institute, World Silver Survey 2025, for solar's share of silver demand · S&P Dow Jones Indices and Bloomberg US Aggregate for 2022. "Today" copper demand is derived from the 50% increase; 2040 supply is demand less the deficit. Sector return figures are read from the published chart and rounded; they are approximate. Past performance is not indicative of future results.*

Market leadership has rotated. *Every major region has outpaced the US since 2025.*

Equity index, price in local currency · January 2025 = 100



EUROPE'S DATA HAS BEEN BEATING EXPECTATIONS

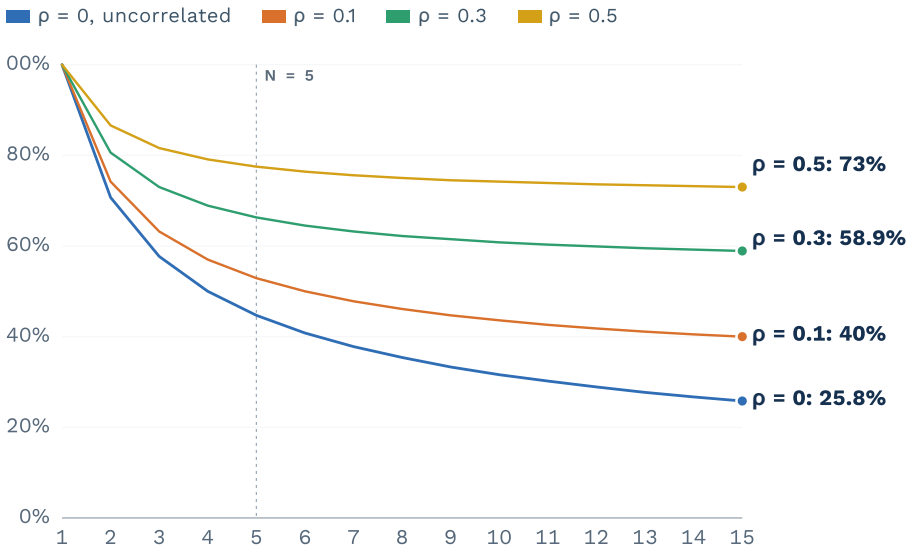


Positive means data is beating forecasts. **Europe swung from the worst surprises on the page to the best in under a year, while the US has cooled.**

SOURCE *Datastream, STOXX and Goldman Sachs Global Investment Research, to September 2026, for the regional price indices · Citi Economic Surprise Index via Bloomberg, data through late August 2026. Values are read from published charts and rounded; they are approximate. Past performance is not indicative of future results.*

Diversification only works if the pieces aren't correlated.
Uncorrelated bets compound; correlated ones barely help.

Portfolio risk vs. a single holding, first 15 positions · percent



RISK CUT BY JUST 5 UNCORRELATED POSITIONS

55%

Uncorrelated, ρ = 0	−55%
Low correlation, ρ = 0.1	−47%
Moderate correlation, ρ = 0.3	−34%
High correlation, ρ = 0.5	−23%

SOURCE *Colter Lewis calculation. Portfolio risk shown as a share of a single position's risk, for N equally weighted, equally risky positions with pairwise correlation ρ: risk = sqrt(ρ + (1−ρ)/N) × 100%. Illustrative math, not a forecast of any specific portfolio's risk.*

55% BASE CASE

Growth holds

US large-cap equities	▲ Positive
US small-cap equities	▲ Positive
Foreign equities	▲ Positive
Short Treasuries	▲ Positive
Long Treasuries	– Neutral
Investment grade credit	– Neutral
High yield credit	– Neutral
Gold	▲ Positive
Commodities	▲ Positive
Diversifiers	▲ Positive

25%

Rates overshoot

US large-cap equities	▼ Negative
US small-cap equities	▼ Negative
Foreign equities	▼ Negative
Short Treasuries	▲ Positive
Long Treasuries	▼ Negative
Investment grade credit	▼ Negative
High yield credit	▼ Negative
Gold	– Neutral
Commodities	▲ Positive
Diversifiers	▲ Positive

20%

Growth weakens

US large-cap equities	▼ Negative
US small-cap equities	▼ Negative
Foreign equities	▼ Negative
Short Treasuries	▲ Positive
Long Treasuries	▲ Positive
Investment grade credit	– Neutral
High yield credit	▼ Negative
Gold	▲ Positive
Commodities	▼ Negative
Diversifiers	▲ Positive

SOURCE *Colter Lewis scenarios and probabilities. Each rating is the expected direction of return after inflation over twelve months. Diversifiers refers to uncorrelated strategies such as market-neutral and macro. These are judgments, not forecasts of specific returns, and not recommendations.*

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As of 1 October 2026

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