It's all ok...for now

Quarterly market letters are normally an exercise in listing the events of the prior three months, including the obligatory recitation of market returns and observations on earnings for the quarters ahead. A word or two on a handful of economic data points and a few lines on central bank policy complete the task. Since bear markets and recessions are exceedingly rare, the conclusions generally land on the positive. Markets are expected to go higher, supported by economies that continue to expand. Invariably, the focus is on the United States, as it remains the world's most dynamic market and economy.

Indeed, the data suggests the profits of U.S. companies will continue to rise in each of the next three years. Even adjusting for the enormous capital spending on artificial intelligence, the average stock is expected to see earnings rise as well. Aided by the vast sums being spent on AI infrastructure, the good times should roll along, with estimates of third-quarter GDP growth running above 5%.[1]

Remarkably, all of this unfolds against the backdrop of ruptures: regional conflicts, stubbornly high war-related inflation, fiscal profligacy, and nineteenth-century views on tariffs. As stocks push higher, investors appear unbothered by events. These ruptures are akin to flies at a summer picnic: annoying, not threatening. Perhaps investors have good reason to pay them little heed. Wars, hot and cold, have been a feature of life for more than 100 years. Conflict is constant, and fortune always finds a way of preventing the worst from happening. Companies adapt to protect and grow profits, and share prices dutifully follow. Human initiative being what it is, technological know-how continues to push the possibility frontier ever outward.

However, nothing in the realms of commerce, government policy, investing, or technological discovery is linear. Alliances and trading patterns of countries shift, government policy swings from help to hindrance, and technological breakthroughs are the product of enormous trial and error. Epochal shifts are important to spot because they determine how long investors might find themselves in the wilderness when events move off-piste.

Oh, no, Canada!

Of the shifts underway, I find two especially noteworthy. The first is the reordering of trading alliances brought on by tariff wars. Canada is important to follow because it is the United States' second-largest trading partner and views recent developments as a form of economic war. Tune in to Canadian Broadcasting Corporation ("CBC") television or radio for near-constant coverage of the trade war and Canada's place in the new world order. Its Prime Minister, Mark Carney, is focused on recasting the country's relationship with its trading partners to the east and west. Whether through new trade agreements with Asian countries for fossil fuels or associate membership in the European Union, the "Middle Powers" are attempting to turn from an American-led world order to a series of alliances built on shared values, trade, and defense. In matters of state, nothing moves swiftly, but the progression from

(cont'd.)

[1] Estimate from the Federal Reserve Bank of Atlanta GDPNow Forecast as of September 22, 2026, via Bloomberg.

Carney's "Middle Powers" speech at Davos in January to the suggested offer of associate EU membership unfolded with Silicon Valley-like speed.[2]

Investors took note: Canada's stock market has gained roughly 12% in local currency since the end of January (after Carney's speech).[3] A country rich in natural resources, ranging from oil and gas to fertilizers, Canada is an important trading partner to integral parts of the American economy. Decades of bilateral economic integration make a rupture with Canada especially difficult, with potentially long-lasting consequences. All eyes should be on events unfolding north of the border. The other Middle Powers are watching.

Rise ye Bond Vigilantes

Federal government debt hit $40 trillion during the quarter. With debt at 136.95% of GDP, the U.S. is in the same league as Italy, France, and Greece. The leader on this ignoble metric is Japan, which sports a 206% debt-to-GDP ratio.[4] Forecasts for U.S. government debt call for more of the same, with the debt building as yearly deficits march from $1.9 trillion this year to $3.1 trillion in 2036. Relative to GDP, the budget shortfalls grow from the current 5.8% to 6.7% in 10 years. Average deficits over the past 50 years were 3.8% of GDP.[5]

Deficits are funded by borrowing, and borrowing creates demand for money. Combining these enormous and growing deficits with an already mountainous debt pile results in high and ever-rising interest payments. Add to the government's requirements the insatiable need for capital to fund AI's build-out, and the result is a demand for money that drives its price higher, as we are witnessing with interest rates at generational highs.

This brings us to the second noteworthy shift, one that may be a natural feature of interest rates. Financial observer nonpareil James Grant has observed that interest rates move in long cycles, and that the record-low yield on the 10-year Treasury bond recorded in 2020 marked the end of the 39-year bull market in bonds that began in 1981. (See chart, next page.)

Examining 165 years of bond market data reveals the landscape of interest rates over multiple cycles. The longest bull market in bonds ran 39 years, as noted above; the shortest ran a mere 13 years, ending in 1943. Bear markets exhibit endurance as well, with the longest running 38 years. If we have entered a bond bear market, then the questions front and center are: for how long, and how bad?

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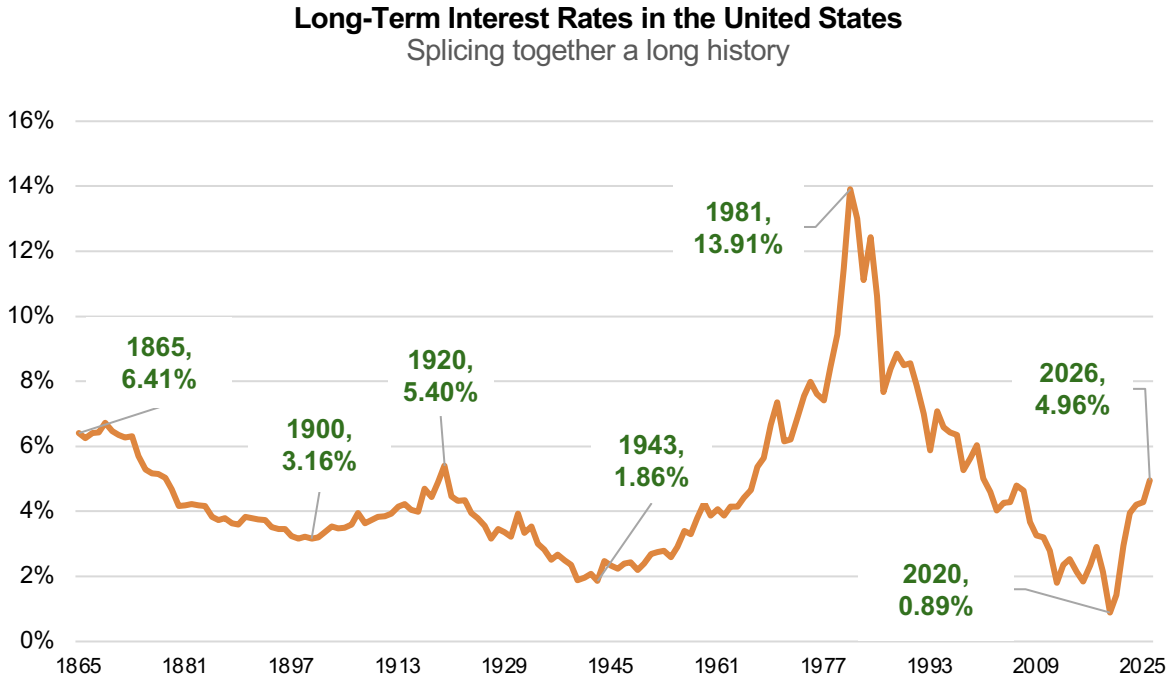
[2] The notion of Middle Powers was advanced by Giovanni Botero in the 1500s, who described them as countries that participate in a multinational order through diplomacy and contribute to a stable world order but are not the leading military or economic powers. Prime Minister Carney's speech at the World Economic Forum asserted that the Middle Powers throughout Europe and Asia need to work together to create a counterweight to the American turn away from its historic role in the post-WWII system.

[3] Canadian market represented by the S&P/TSX Composite Index. In USD terms, 7%. Both returns include income.

[4] Debt-to-GDP statistic from World Bank Group and Eurostat via Bloomberg.

[5] Congressional Budget Office, The Budget and Economic Outlook: 2026 to 2036. Published February 2026.

U.S. INTEREST RATES MOVE IN LONG CYCLES



Source: American RR Bonds from 1865-1918 from NBER Macrohistory Database via FRED; 1919-1943 Yield on LT U.S. Government Bonds NBER Macrohistory Database via FRED value determined in December every year; 1944-1967 LT Government Bonds via NBER Macrohistory Database via FRED; 1967-2025 Long-Term Government Bonds 10-year average annual via FRED. 2026 Generic 10-year yield on September 21, 2026 via Bloomberg. Data acquisition and aggregation via Claude. Brooklands Partners, LLC.

Historical experience suggests years, if not decades. This bear market is in year six and counting. How severe the bear market can get is impossible to estimate; however, if the relationship between interest rates and inflation serves as a guide, there is more "price adjustment" ahead. Calculating the real yield on the 10-year Treasury using a version of the Federal Reserve's preferred measure of inflation, the Personal Consumption Expenditures ("PCE") price index, reveals an average real yield of 2.42% over roughly 64 years. The average using the Consumer Price Index ("CPI") is 1.95%.[6] Current readings of real 10-year yields stand at approximately 1.04% using PCE and 1.05% using CPI, suggesting that, if inflation remains at current levels, yields should trend higher, catalyzing further price declines in fixed income.

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[6] The 10-year real yield is calculated by subtracting the year-over-year change in either the PCE or CPI from the yield on the 10-year Treasury.

It can get interesting from here...

Since interest rates are a fundamental factor in the price of nearly everything, rising interest rates influence asset prices. This is already evident in the housing market, where high mortgage rates have suppressed purchases. Bond investors are swimming in a sea of red this year, as every sector of the Bloomberg US Aggregate Bond Index is down except for the 1–3-year segment of the yield curve.[7] Intensifying attention on rising interest rates in September sent nine of the 11 market sectors of the S&P 500 Index lower.[8] According to Bloomberg reporting, market ructions in the closing days of the quarter caused the postponement of several initial public offerings as issuers waited for more accommodating markets.

The S&P 500 Index has been treading water since early August. With interest rates trending higher, it becomes especially important for earnings season to deliver if the market is to hold the year's gains and finish strongly. From our perch, a bull market in bond yields and a bear market in bond prices are firmly in place, which will keep interest rates higher for longer and put pressure on highly levered private and public companies to navigate the end of easy money. This is all a break from the multi-generational arc of interest rates to which investors and consumers have become accustomed.

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[7] Returns from Bloomberg through September 29, 2026.

[8] Bloomberg.