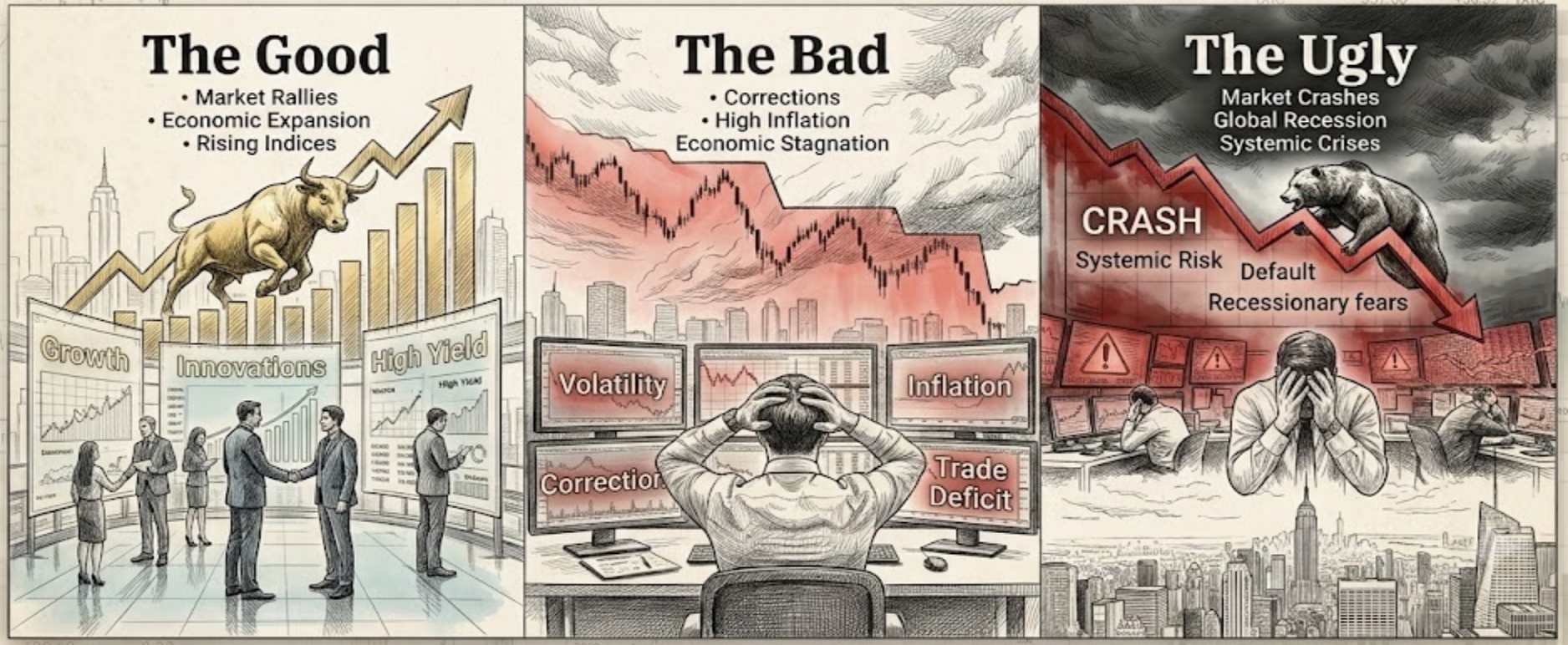
The Good, The Bad and The Ugly

Quick Takes on Markets and Economy



VOLUME IV

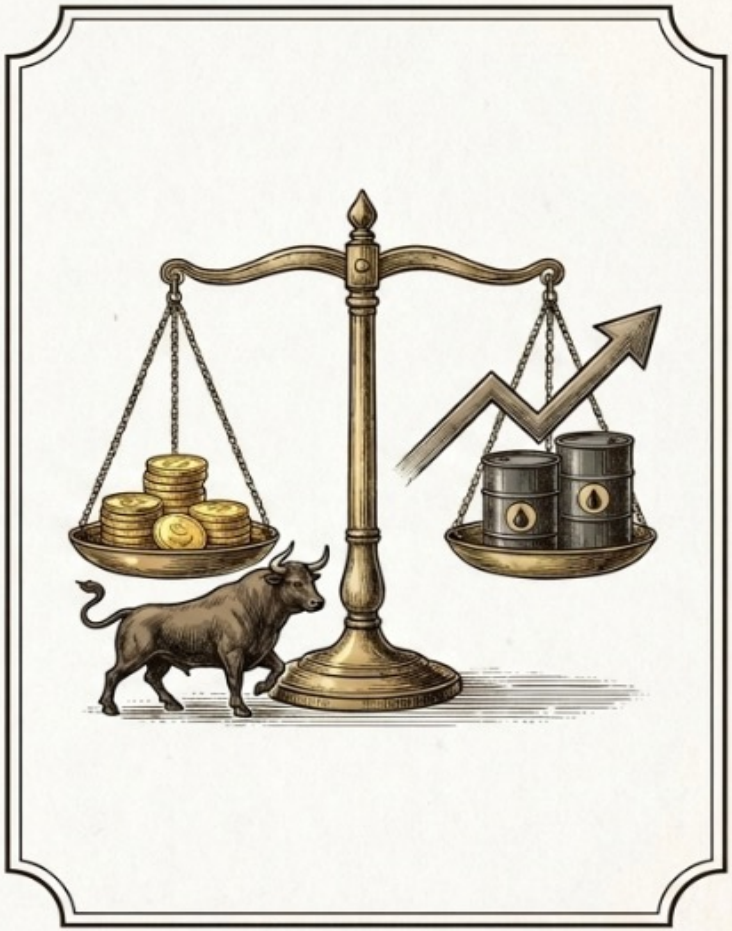
ISSUE 7

The Quarter at a Glance

The third quarter provided a wide range of returns for assets. Alternative investments and commodities dominated returns led by a 42% surge in Bitcoin (IBIT) and a 37% increase in oil (USO).

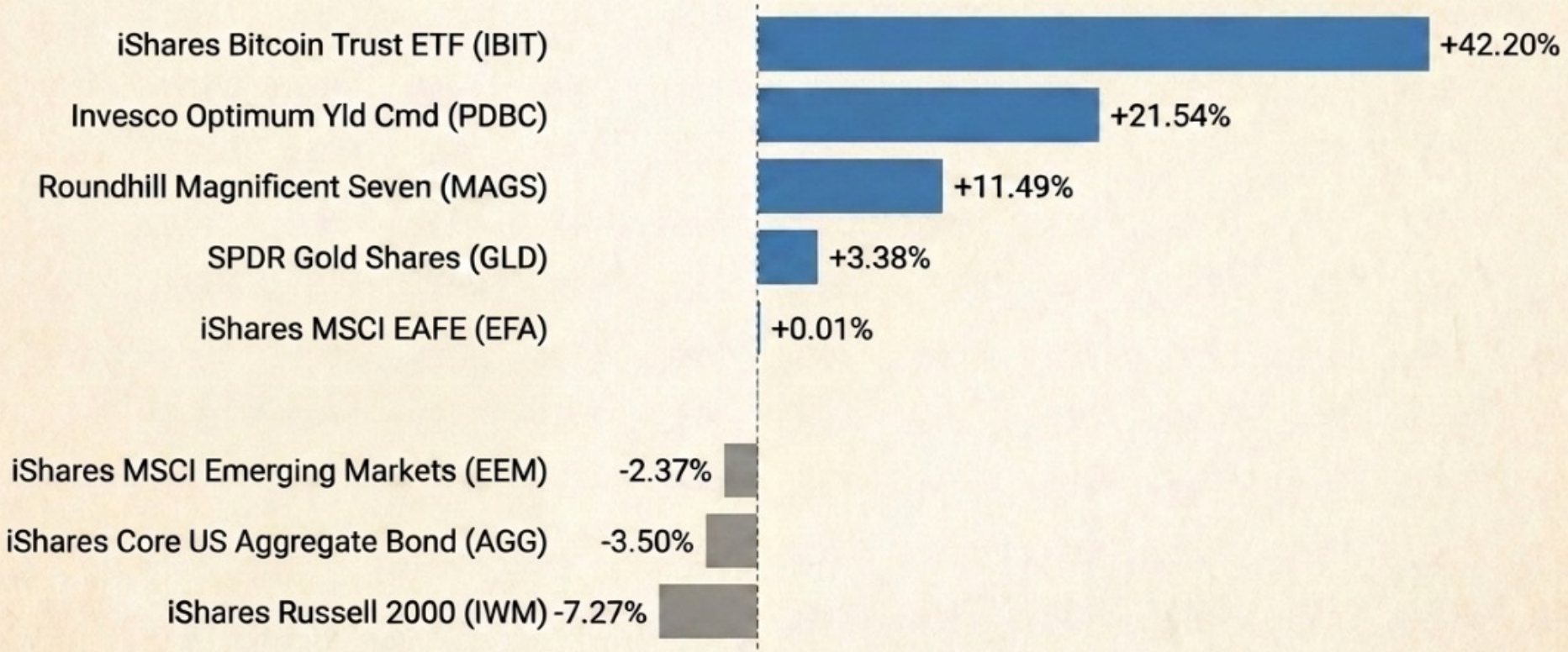
The minor gain of the S&P 500 index masked significant turbulence underneath the headline number. Energy and specialized technology performed really well while interest-rate sensitive sectors – specifically housing and utilities – declined sharply, impacted by rising interest rates.

Fixed income had one of its most challenging quarter in a long-time, negatively impacted by the sharp increase in the U.S. 10-year yield from 4.46% to 5.30%.



Source: YCharts

Divergence at the Macro Level



Source: YCharts

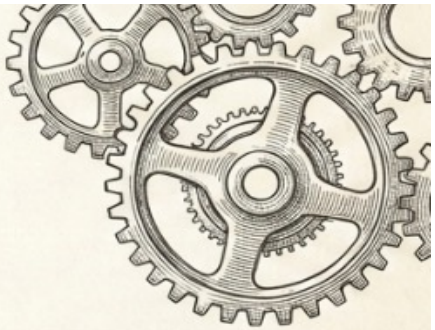
The Market is Not the Index



> "Investors monitoring only the S&P 500 witnessed a quiet quarter. Investors looking beneath the surface witnessed a profound asset rotation."

Source: YCharts

Most S&P 500 Sectors Experienced a Down Quarter



Energy (XLE) +16.50%	Health Care (XLV) +6.55%	Communication Services (XLC) +3.91%
Technology (XLK) +2.86%	Financials (XLF) -0.04%	Consumer Staples (XLP) -2.33%
Materials (XLB) -3.75%	Real Estate (XLRE) -6.31%	Consumer Discretionary (XLY) -6.99%
Industrials (XLI) -9.61%	Utilities (XLU) -12.37%	

Source: YCharts

The Cloud & Cyber Rebound



SKYY (Cloud Computing)

+21.87%

IGV (Tech-Software Sector)

+17.53%

CIBR (Nasdaq Cybersecurity)

+14.74%

Source: YCharts

The Domestic Consumer & Infrastructure Headwinds

ITB (US Home Construction)

-16.01%

JETS (US Global Jets)

-15.05%

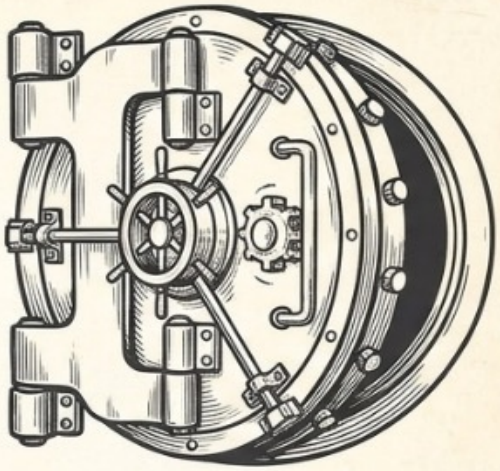
KRE (Regional Banking)

-6.70%



Source: YCharts

The Duration Squeeze in Fixed Income



Short-End:
1-3 Year Treasury
(SHY) -0.22%

Core Squeeze:
Core US Aggregate
(AGG) -3.50%

Mid-Curve:
7-10 Year Treasury
(IEF) -4.58%

Corporate Drag:
Inv Grade Corporate
(LQD) -5.18%

Long-End Pain:
20+ Year Treasury (TLT)
-8.95%

Source: YCharts

Broad international benchmarks were mostly flat to down during the quarter.



Developed Markets (EFA)

+0.01%



All Country ex-US (ACWX)

-0.64%



Emerging Markets (EEM)

-2.37%

Source: YCharts

Quarterly summary

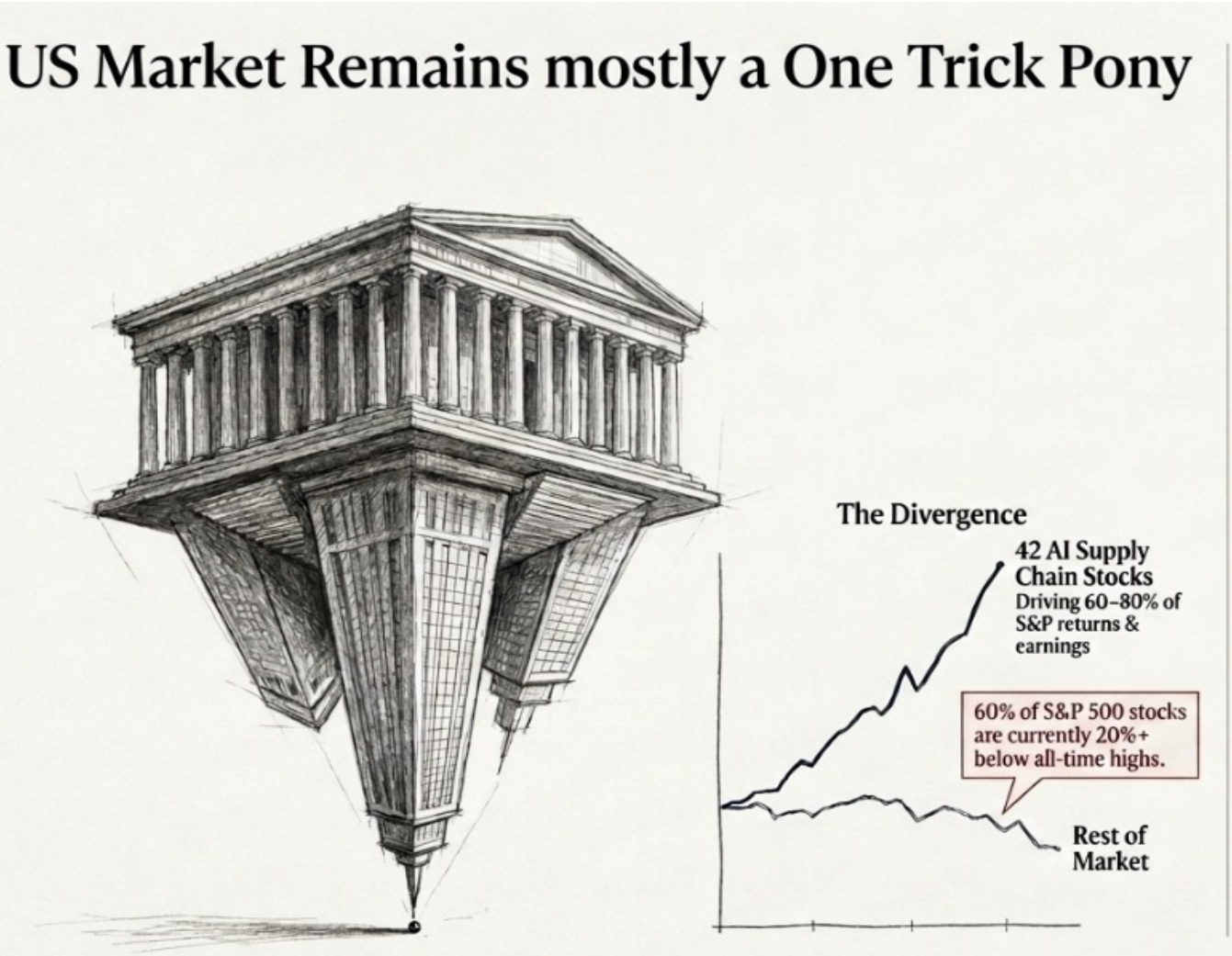
1. Commodities Eclipsed Equities: The most aggressive capital flows chased energy and hard assets, leaving broad equities nearly flat.

2. The Tech Niche Resiliency: While broader markets stalled, highly specific technology industries (Cloud, Cyber) experienced strong returns.

3. The Defensive Penalty: Traditional rate-sensitive sanctuaries (Treasuries, Utilities, Real Estate) suffered the quarter's sharpest punishments.

4. The Global Fracture: Flat to slightly down broad indices masked volatile double digit moves in countries like Poland, Grek, Colombia and Singapore.

Source: YCharts



With the S&P 500 index near its all-time high, everything appears healthy in the economy and the broader stock market. However, the market continues to rely heavily on a small group of 42 AI companies for its performance. (Sidebar: These companies account for an astonishing 49% of the index total weight, meaning the remaining 458 stocks collectively account for just over half.)

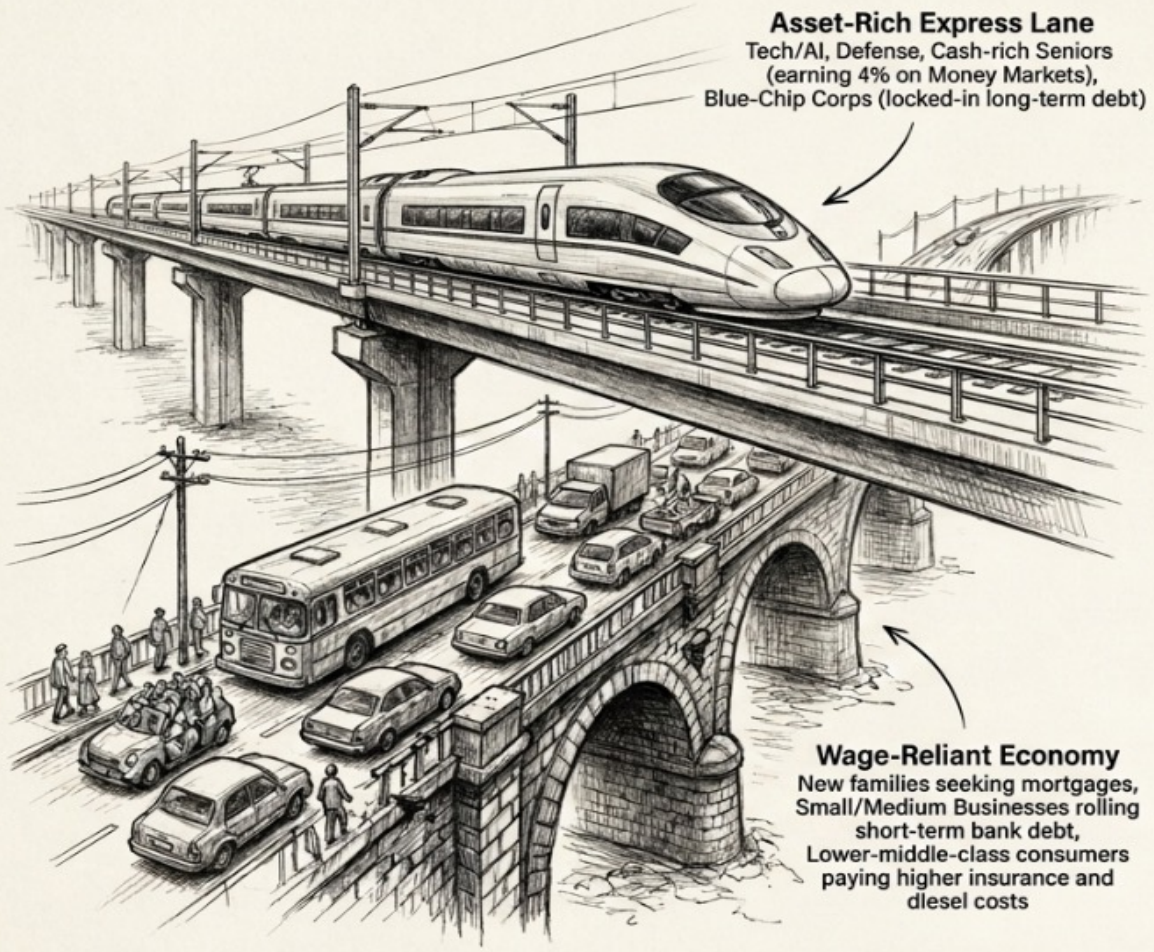
Since January 2024, these 42 AI-related companies have been responsible for approximately 60–80% of the S&P 500's growth in market value, profits, and investment spending. This makes the market look healthier than it really is.

Yes, many companies are benefiting from the AI boom by selling the equipment and technology needed to build AI systems. However, many others are seeing little to no profit growth.

While the overall S&P 500 index is near record highs, around 60% of its stocks are at least 20% below their own peak prices. In other words, 60% of stocks are in a bear market.

The primary risk to the market and the economy has not changed over the past three months: both remain too dependent on AI. If it fails to deliver the expected productivity gains or companies reduce their capital spending on AI infrastructure, the S&P 500 will likely decline sharply, and the economy could slip into a recession.

Source: Eye On The Market October 8th, 2026



The Two-Speed Economy

Today's economy presents an apparent contradiction: stock prices sit near record highs, while consumer confidence sits near record lows. This gap is not an accident—it is the direct result of an economy moving at two completely different speeds.

When interest rates rise in a heavily indebted economy, the pain is not shared equally. For those who already hold significant wealth or capital, high interest rates can act as a financial boost. Retirees with large cash balances earn higher risk-free income from money market accounts and CDs. Major corporations with deep cash reserves and low, fixed-rate debt may see their profits rise. Meanwhile, industries supported by massive government spending—such as defense, healthcare, and big tech—continue to boom.

Conversely, everyday consumers and smaller firms face the opposite reality. Small businesses that rely on short-term loans may see their profits wiped out by high borrowing costs. Young families are locked out of homeownership by high prices and mortgage rates of around 7%. At the same time, middle-class households are squeezed by relentless price increases for essentials like food, energy, and insurance, forcing them to work far more hours just to maintain the lifestyle they had three years ago.

The Fed's interest rate hikes have not slowed the economy evenly. Instead, they have rewarded those with assets and cash while forcing non-asset owners and small businesses into their own private recessions.

Source: David Lin Podcast with Lyn Alden 10/5/26



The Two-Speed Economy

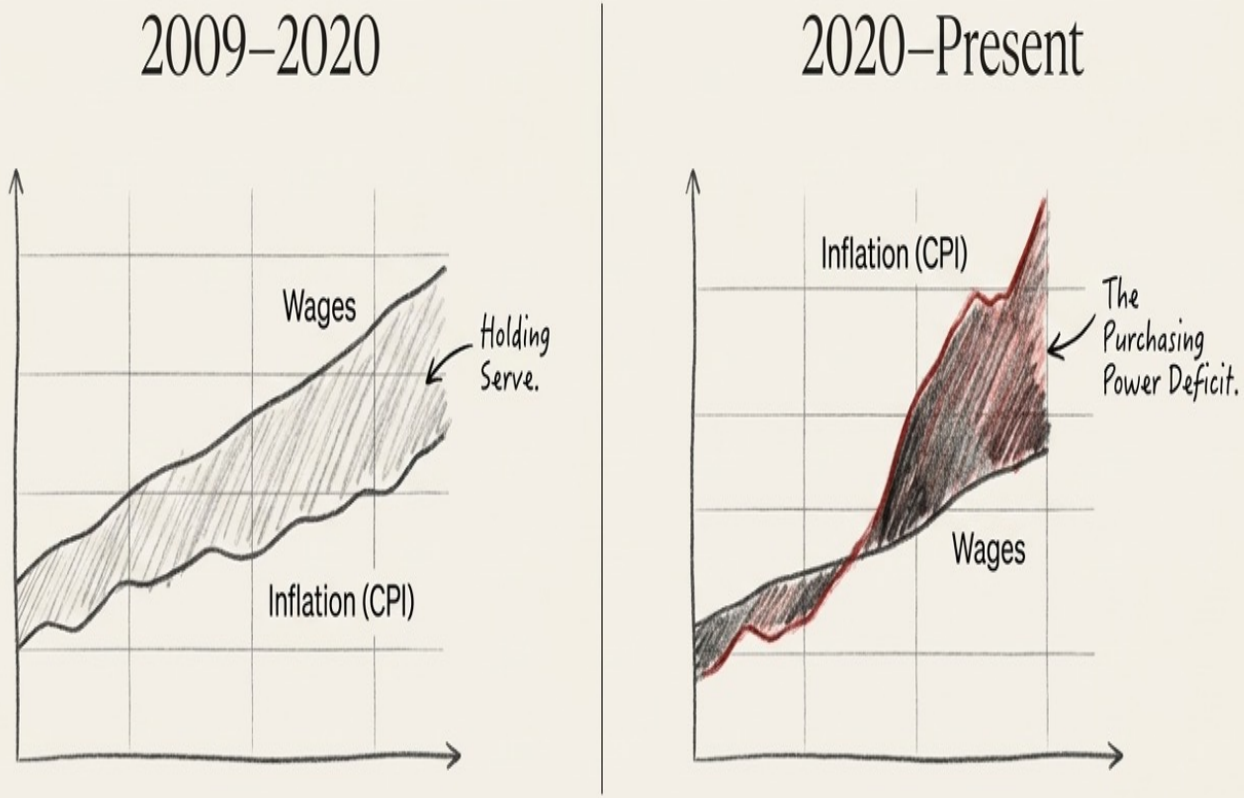
We are in a fiscal-dominance environment, where central bank interest rate policies no longer work the way they used to. Normally, raising interest rates slows the entire economy by making loans and credit more expensive. Yet, despite rapid and steep rate hikes over the past few years, overall U.S. economic activity has remained surprisingly resilient.

While capital investment in AI is a major source of economic growth in the U.S., consumer spending remains the largest component of the economy. Today, the bottom 30% of households account for less than 15% of total consumer spending. These families rely on debt and are hit hardest by rising credit card balances and high mortgage rates. The wealthiest 20% drive the vast majority of consumer spending. For the most part, their spending is determined not by their paychecks, but by their overall portfolio wealth.

Ironically, higher interest rates have actually benefited the top tier. As noted earlier, by raising interest rates, the Federal Reserve has provided wealthy investors with a higher, relatively risk-free stream of income by boosting returns on cash and money market funds. Combined with strong stock market returns, the wealthiest households have more assets than ever, keeping national spending high despite tighter monetary policy.

The economy now resembles a top-heavy hourglass. Until higher interest rates erode the investment wealth of the richest households, rate hikes will simply widen the divide between the winners and losers.

Source: Forward Guidance Podcast 10/2/26



Post-COVID: Cumulative CPI is up 31%. Cumulative Wages are up 26%.

Inflation Remains Elevated

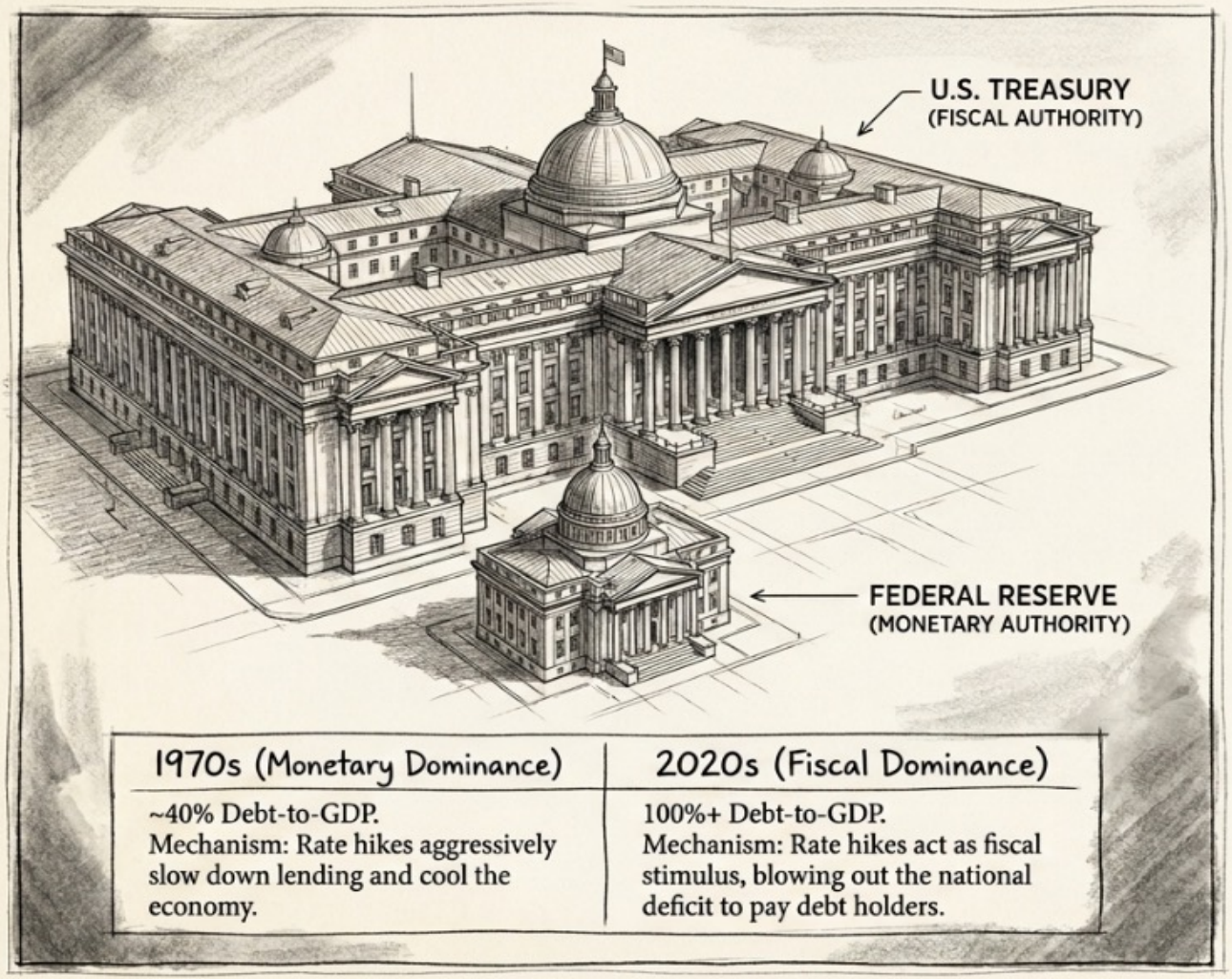
Wealth inequality is not new—the gap between the rich and the rest of the population has existed for decades. What makes today feel like an unprecedented crisis is how rapidly and severely everyday purchasing power has eroded.

For the bottom 50% of the population—people who live paycheck to paycheck, rent their homes, and own few or no investments—the only way to keep up with rising costs is to earn higher wages.

From 2009 to 2020, regular workers managed to hold their ground. Over that decade, wage growth outpaced inflation. When people went shopping, their paychecks covered the same essentials and occasionally a little more. They were not getting wealthy, but they were not falling behind either.

Since the end of the COVID, this dynamic has reversed. The Consumer Price Index (CPI) has been above the Fed's 2% inflation target for 66 consecutive months. On a cumulative basis, CPI is up 31%, while wages are up just 26%. This purchasing power deficit poses a significant challenge to the long-term stability of the economy.

Source: Rational Dissent Podcast Episode 12th



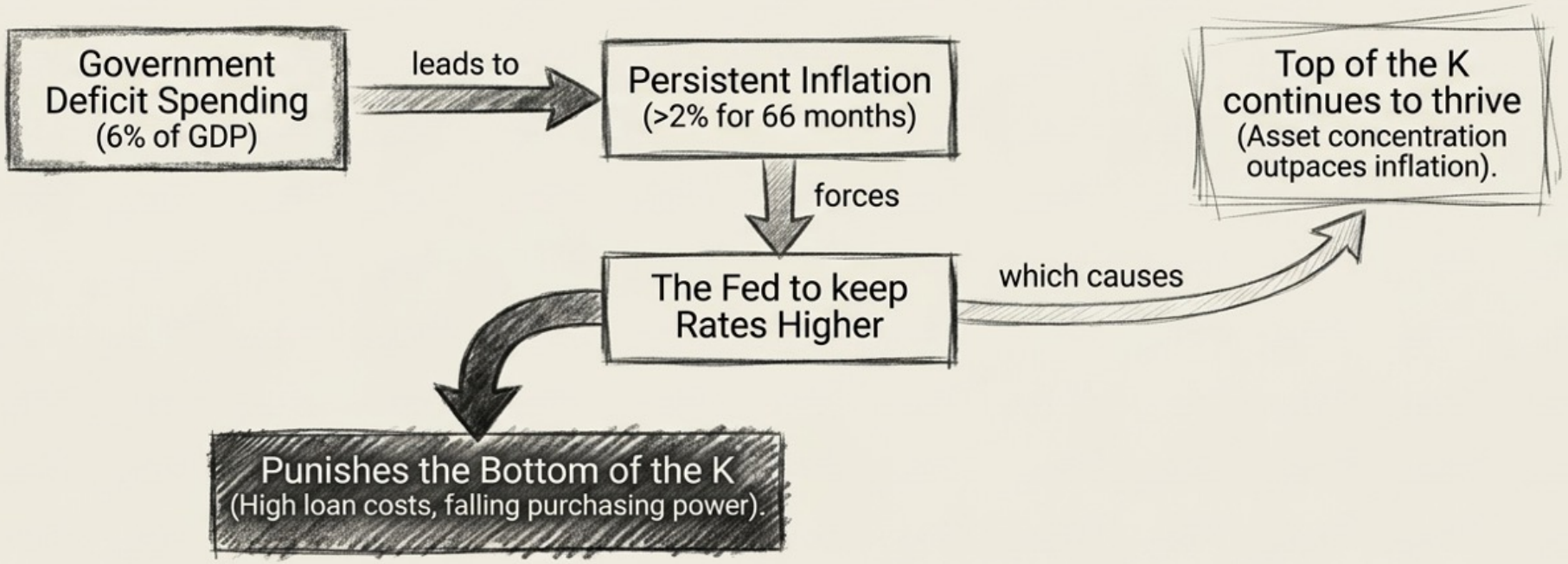
Fiscal Dominance

Our economic regime has changed. We have shifted from monetary dominance to fiscal dominance. In a monetary-dominance regime, the primary drivers of inflation are the Federal Reserve's monetary policy, including its control over the money supply and interest rates. In that environment, the Fed operates independently and uses interest rates primarily to achieve price stability and manage the economic cycle. The mechanism was simple: when inflation accelerated, the Fed hiked interest rates, raising borrowing costs across the economy and softening demand for goods and services. Inflation would eventually fall back to the Fed's target. All of this was possible because the debt-to-GDP ratio was manageable.

Today, we find ourselves in a fiscal-dominance regime, where government deficits, enormous debt loads, and substantial Treasury issuance play a major role in driving inflation. This is reflected in our current debt-to-GDP ratio of over 100% and our annual fiscal deficit of 6.6% of GDP, even in a strong economic environment. (Imagine what this deficit would look like in a recession.) In this type of environment, a rate hike no longer acts as a straightforward economic brake. Instead, it increases the government's interest bill, potentially forcing more borrowing and crowding out private-sector activity. The Fed's monetary authority becomes less influential relative to sovereign debt dynamics. In other words, the Fed is trapped.

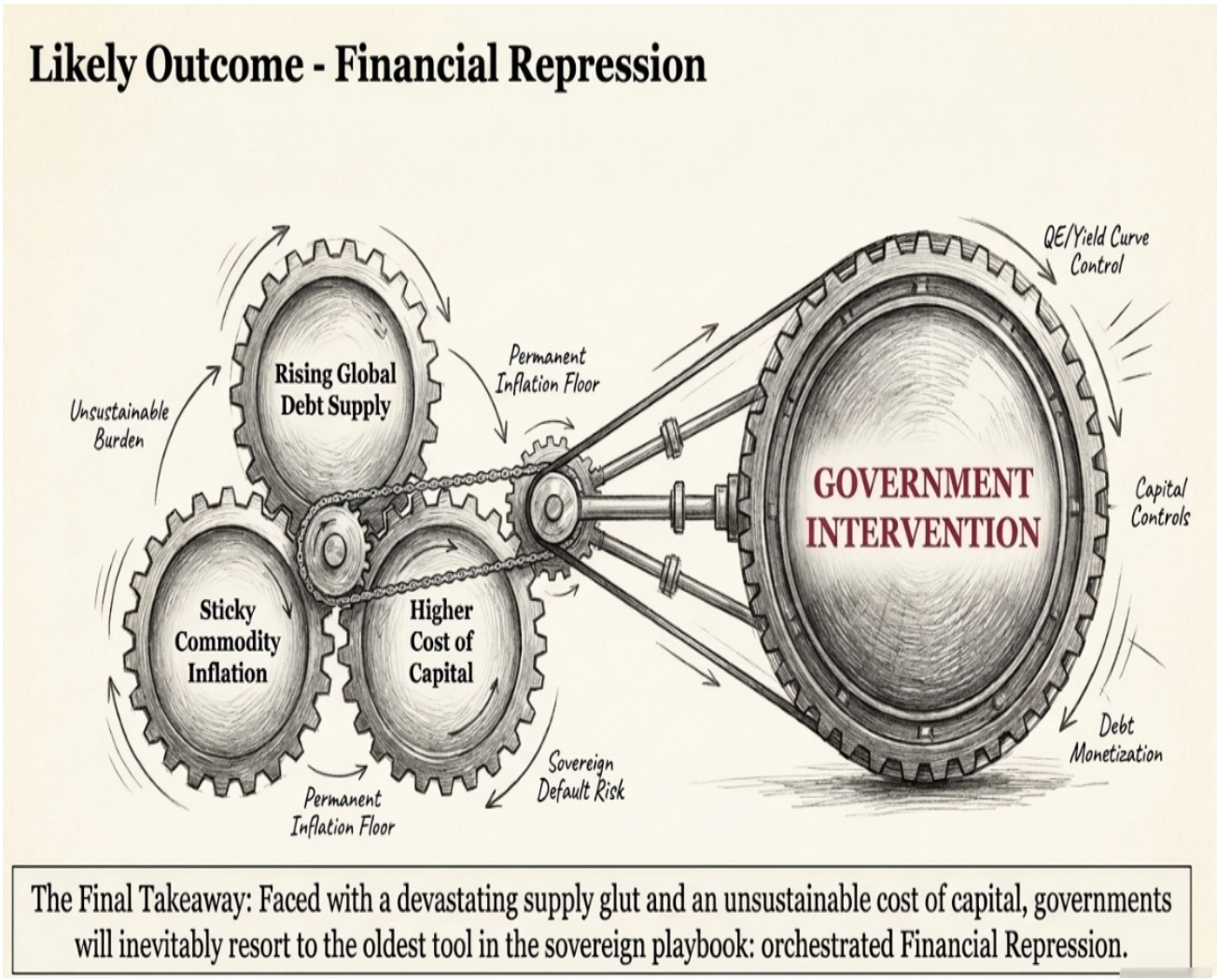
Source: David Lin Podcast with Lyn Alden 10/5/26

The Inescapable Economic Trap: A Systemic Feedback Loop



The architecture of the trap. Deficits fuel the inflation that forces the Fed's hand, creating a high-rate environment that exclusively punishes the wage-reliant class while asset-holders insulate themselves.

Source: Rational Dissent Podcast Episode 12th



Financial Repression

The Fed faces an increasingly difficult balancing act as the U.S. national debt and the cost of servicing it continue to grow. The government faces a set of challenging choices.

The first option is to do nothing, effectively kicking the can down the road while allowing the debt burden and interest costs to grow. The second is to reduce the federal deficit through spending cuts, higher tax revenues, or a combination of both. DOGE represented an attempt to reduce government spending, although meaningful, sustained deficit reduction requires broader fiscal changes, which few politicians seem willing to take on.

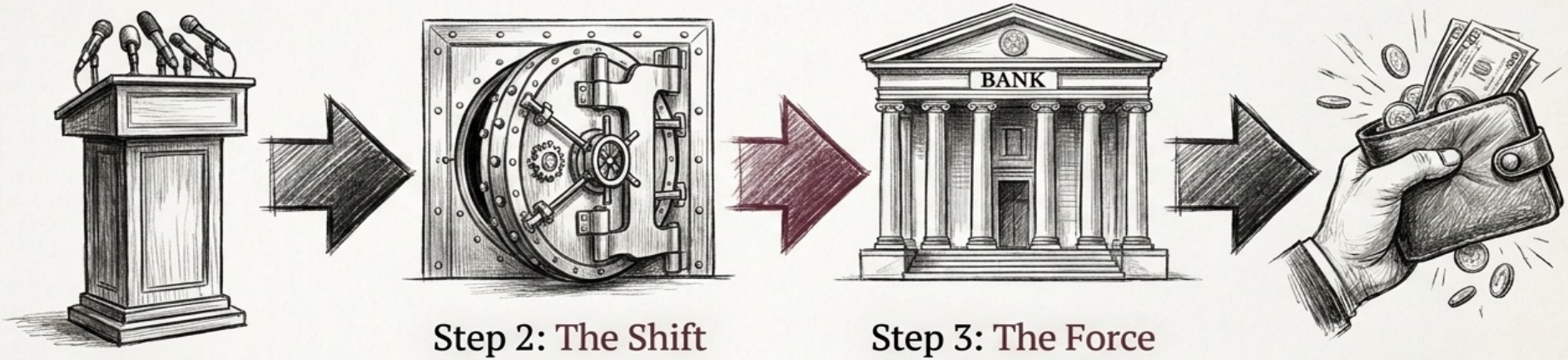
The third option, which describes the environment we are currently in, is to grow the economy faster than the cost of servicing the debt. By generating nominal GDP growth that exceeds the average interest rate on government debt, the U.S. could stabilize or gradually reduce its debt burden relative to the size of the economy. However, pursuing stronger nominal growth through persistently loose policies risks reigniting inflation and triggering bond market volatility, which is precisely what occurred this past quarter.

The fourth possibility is financial repression—government policies that keep borrowing costs artificially low relative to inflation. One potential tool is yield curve control, in which the Federal Reserve buys government bonds as necessary to maintain targeted yields. Another possible outcome is dollar debasement, in which inflation gradually erodes the dollar's purchasing power.

Under this last scenario, if interest rates on government debt remain below inflation, the government benefits because the real value of its debt declines over time. Savers and bondholders, however, lose purchasing power when their returns fail to keep pace with inflation. In this environment, investors will want to own more real assets than bonds.

Source: Jurien Timmer Weekly Asset Allocation 9/15/26

The Mechanism of Financial Repression



Step 1: The Illusion

The Fed holds rates or raises slightly, creating the public **illusion** of fighting inflation to pacify bondholders.

Step 2: The Shift

Behind the scenes, the Treasury moves debt issuance from long-term bonds (where the market sets the rate) to **short-term bills** (where the Fed controls the rate).

Step 3: The Force

Implement regulatory **changes** (like the Clarity Act) to legally **force domestic** banks, pension funds, and stablecoins to buy this short-term debt, replacing the fleeing foreign capital.

Step 4: The Consequence

The bill is paid by **savers**. Anyone holding dollars or bonds earns a yield **lower** than the true rate of inflation.

Gemini Notebook

Source: YCharts

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