



STRATEGY UPDATE • SEPTEMBER 2026

## The Treasury and the Fed pull apart

### KEY TAKEAWAYS

- We remain overweight equities into the November mid-terms, but we are now changing the composition of the risk rather than its amount: broadening US exposure toward equal weight, scaling up healthcare and consumer staples, and favouring uncorrelated strategies over additional beta.
- The long-dated Treasury yield has become the price on which everything else depends, the discount rate for AI equities, the financing cost of the capex cycle and the only fiscal disciplinarian Washington has left. We hold no long-dated G7 government bonds and keep fixed income at the short end, where today's yields absorb roughly three points of rate rise before income turns to loss.
- This is a tech-heavy, macro-light cycle. Employment and inflation data still matter, but the marginal driver of markets is whether AI infrastructure monetizes, and earnings, which keep beating, are themselves a consequence of that spending. We stay invested in the theme at market weight across its layers and balance it with sectors that move against it.
- We hold to "3% is the new 2%" on inflation, now reinforced on both sides of the Atlantic, and to gold as fiscal insurance rather than as a rate trade. The Fed can slow fiscal dominance; it cannot reverse a 6% deficit.
- Regionally we favor Japan, Italy and Spain and continue to underweight the European core. We will begin trimming emerging markets into strength toward year-end, for concentration reasons rather than momentum.

August was supposed to be the month nothing happens, and instead the two most powerful financial officials in Washington spent it pulling on opposite ends of the same rope. On the 17th the 30-year Treasury yield touched 5.33%, a 19-year high; the following day Treasury Secretary Bessent doubled the size of his long-end bond buybacks. The dollars involved were trivial, but the signal was not: the market had been shown where the Maginot line sits for long yields, and

gold, silver and the debasement trades rallied on the news. Ten days later Chair Warsh used his first Jackson Hole address to say the summer's better inflation prints "do not tell me that underlying trends have meaningfully improved," and the odds of a September hike went from a third to a coin flip in an afternoon. Equities were caught between the two and finished higher anyway. The S&P 500 peaked on the 13th, sold off into the 19th and recovered to close the month up 2.7%, carried by an earnings season that beat a record consensus bar and by Nvidia's guidance for 70% revenue growth, a figure its chief executive described as constrained only by how much the company can physically supply. Beneath the headline, dispersion was the story: Japan led the developed world, emerging markets followed, Spain and Italy beat the European aggregate, which barely moved, and gold rose almost 10% on the month. September has opened less serenely, with oil drifting higher as Hormuz traffic sits at two thirds of its pre-war level, a hotter inflation print, and a Russian finance minister appearing at the G20 in Asheville to the visible discomfort of his European counterparts.

#### RATES & FISCAL DOMINANCE

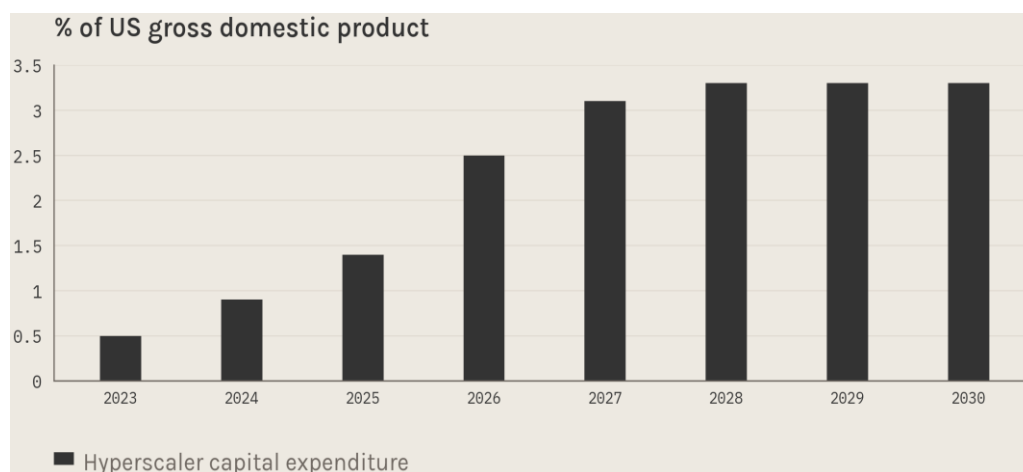
Stanley Druckenmiller, who once shorted sterling alongside a young Scott Bessent at Soros, wrote last month that **the long-term Treasury yield is the most important price in the world and the only fiscal disciplinarian the United States has left**, since neither party will run on entitlement reform. We think that is exactly right, and it is why the Bessent-Warsh contest matters more than any single rate decision. True federal interest expense including entitlements now runs above receipts and is growing at nearly twice their pace; hedge funds own more of the Treasury market than China, Japan and Saudi Arabia combined, which makes stable collateral a systemic necessity rather than a preference. **A well-intentioned Fed chair can slow fiscal dominance, but he cannot reverse a 6% deficit**, and the bond market knows it. Our fixed income positioning does not require us to guess who wins. **We hold no long-dated government paper across the G7, and we keep the allocation at the short end** for a reason that is now quantifiable: at current yields, short-dated investment grade paper can absorb a rise of roughly three percentage points over a year before the price loss exceeds the income earned. That is a margin of safety the long bond does not offer, where 85 basis points of extra carry buys seventeen years of duration and a 50 basis point move erases a decade of that premium in a fortnight. We are aware of the counterargument that a divided Congress could compress the political risk premium in long Treasuries, as it did after the 2018 mid-terms. But 2018 had a Fed turning dovish, a 30-year yield near 3% and a deficit half today's size, and the supply of bonds does not care who controls the House. The one thing that would change our view is **US real yields reaching 3%, the level that has historically cracked risk assets and at which long bonds finally become cheap at the same moment equities become vulnerable**. From around 2.25% today, we are not there.

#### AI & CAPEX

The deeper shift, which we think investors have not fully absorbed, is that this is a tech-heavy, macro-light cycle. The era from the early 1980s to 2022 was a golden age for macro investors; reading the balance sheet recession correctly was the edge. Today employment and inflation data still matter, but they are no longer the marginal driver of asset prices. That role belongs to the **monetization of AI infrastructure**, and we would add that **earnings**, the other thing the market cares about, are themselves largely a consequence of that spending: one company's capex is another's revenue, which is why check writers and check receivers remain the most useful distinction we draw. The numbers have moved from large to strange. Cloud revenue backlogs at the hyperscalers exceed two trillion dollars, their capital expenditure is projected near 800 billion this year and 1.3 trillion next, and Nvidia's purchase commitments to its own suppliers more than doubled in a single quarter. The Jevons effect we described in August is now visible in the data, with the cost per token falling and total consumption rising faster still.

The risk in the system has migrated accordingly. Before 2008 it sat on overleveraged household balance sheets; today it sits on whether these assets generate cash. That raises a point we take seriously: **AI equities are long-duration assets**, valued on cash flows far in the future, and the hyperscalers increasingly depend on external financing. Their bond spreads have widened this year, well short of stress, but if rates rise further the damage arrives through two channels at once, the discount rate and the funding cost. The bond market, in other words, is the transmission mechanism for the entire equity thesis, which is one more reason the **long Treasury yield is the price to watch**. July's sharp correction in AI beneficiaries, we now know, was the forced liquidation of a leveraged hedge fund rather than a change in fundamentals, and the recovery since confirms the technical reading. **We stay invested across the layers of the theme, and we balance it deliberately with the sectors that move against it.**

AI remains primary market driver



Source: US Congressional Budget Office, Bloomberg, Julius Baer

#### PORTFOLIO POSITIONING

Which brings us to how we express caution in a market we still believe in. The answer is to change the composition of the risk, not its amount. Within US equities we are shifting weight from capitalization to equal weight: if the bull market is genuinely broadening, equal weight participates fully; if the concentrated top of the index corrects, we own less of it. We are taking **healthcare and consumer staples** from token positions to real ones. They are negatively correlated to the AI complex, they have been unloved for two years, and healthcare has historically been the standout sector under divided government, with prediction markets now putting close to nine in ten on a Democratic House and a Republican Senate. We continue to favor daily-liquidity **equity market neutral and macro strategies**, which raise portfolio resilience without lowering equity weight, and where clients hold **defined-outcome buffer structures** we are comfortable scaling them modestly into a period when index volatility historically rises. We also note that insurance is cheap while nobody wants it: index-level volatility sits near its low for the year while single-stock volatility is elevated, a market pricing dispersion rather than direction. The historical pattern into mid-terms is a flat market from August to Election Day, a median gain of 6% in the three months after and 13% over the following year, with divided government the better outcome for equities. We intend to be positioned for that, and we have written down in advance what would change our regime: hyperscaler credit spreads moving from widened to stressed, a break in earnings breadth that is fundamental rather than technical, and the 3% real yield above.

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REGIONS & HEDGES

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Regionally, the month reinforced our map. **Japan** led the developed world, and we retain conviction there: governance reform is intact, the Bank of Japan remains behind the curve, and a yen near 160 is the most undervalued major currency by a wide margin, with coordinated intervention having halted its slide but not reversed it. **Europe** rewarded differentiation more than direction once again. Spain and Italy outperformed a flat aggregate, and Eurozone inflation re-accelerated in July, raising the probability of another ECB hike this month, which is the European half of our "3% is the new 2%" thesis arriving on schedule. We remain underweight the core, where France carries the fiscal question and Germany the export one, and overweight the periphery through banks, utilities and the strategic autonomy capex cycle. **Emerging markets** require the most honesty. They outperformed again in August, and the reason we will begin trimming toward year-end is not momentum but concentration: three semiconductor stocks are still most of the index's gain, which makes the asset class a leveraged expression of the AI cycle rather than a diversifier. Reducing a position that keeps working is uncomfortable, and we would rather say so than pretend the rotation is costless.

**Gold** rose almost 10% in August and trades in the 4,300s, and the sequence tells you what it responds to: it surged on Bessent's buybacks, which the market read as the first step toward yield suppression, and gave back part of the gain on Warsh's hawkishness. That is the fiscal hedge behaving exactly as advertised, and it is why we own it as **insurance against deficit financing and monetary fragmentation rather than as an inflation or rate trade**. The statistic we would leave you with: the S&P 500 has returned 84% over five years in dollars and lost 27% measured in gold. On inflation persistence, our utilities position works as designed, contractual pass-through that compounds while the market argues about the next print.

Markets enter September a little over 1% below their highs, with volatility near its lows and the calendar about to get crowded: a Fed meeting where a hike is a coin flip, an election in nine weeks, a Middle East that has not been resolved, and a Treasury Secretary and a Fed chair who have not stopped pulling on the rope. **We are not reducing risk, because the earnings and the capex cycle do not yet justify it.** We are reshaping it, toward breadth, toward the sectors that move against the AI complex, toward strategies that do not depend on direction, and toward the short end of a bond market whose long end has become the world's most important price. That is how we intend to walk into the autumn: fully invested, and thinking already about the regime after this one.

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