

DIVIDENDCAFE | PODCAST TRANSCRIPTION

FRIDAY – OCTOBER 9, 2026

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Hello and welcome to the Friday edition of Dividend Cafe. I'm your host, David Bahnsen. I'm very, very happy to be with you. I am very happy to say that a wide array of meetings this week here in the city are behind me. It has been a whirlwind, a roller coaster, a whole lot of clichés and analogies. And I am moments away from a rather lengthy recap, a meeting with the other senior members of our investment committee. We're gonna kind of bounce things off each other. I'm gonna save all that discussion for you for next week. The Friday Dividend Cafe next week is gonna be devoted to just a play-by-play of a lot of the meetings and takeaways we've had with some really significant portfolio managers here in the city, and the takeaways we have had from this week and how it's gonna be applied in our own client portfolios and what our basic thinking is as we come upon the last quarter of this year and begin to think about next year. So I'll save all that for next week. Today, I wanna talk about bond yields, and I think you wanna hear about bond yields.

And you could say, "Well, he's being sarcastic as he's doing one of those really funny jokes he does about how certain boring things are really exciting, but they're not really exciting." But there is a sense in which I presume people who listen to and watch and read The Dividend Cafe are investors, and there are no investors that are not highly levered, no pun intended, to the story of interest rates right now. And by interest rates, I am not primarily referring to the interest rates that we talk about most, which are the ones that the Fed will control, the short-term rates. And we think about the policy lever of the federal funds rate and how it plays out into short-term borrowing costs that are very relevant for floating-rate borrowers, very relevant to certain levels of auto loans, sometimes mortgages, credit cards, real economy stuff. But then what has happened in the long end of the yield curve, the 10-year maturities, the 30-year maturities, that are a little bit less of a Fed conversation, or some may say, and more of a macroeconomic discussion, and certainly one that has had a big impact in markets in the last month or so.

And so I wanna get into this, what we're looking at with longer-term yields. I'll focus more on the 10-year than the 30-year, but the story has been pronounced in both. It's just that the 10-year is, by leaps and bounds, more widely held and therefore relevant in financial markets as a barometer of price of money. And so we're gonna get into that and then really try to spend the bulk of our time, after I'm done with the wonky economic stuff, just getting down to what it means to investors, and I'll leave you with some takeaways there.

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Okay, so first and foremost, let me just say that I did get very tempted to change the subject to Dividend Cafe this week around the story Thursday about OpenAI's big, big, big decrease in expected revenue quarter over quarter. And I don't mean decrease from what the revenue was before, but rather decrease in revenue relative to what had been expected to be. And there's a link in Dividend Cafe about the story, and I'm gonna address it more on Monday because I do think that there are some tangential elements that are interesting. So in the Monday Dividend Cafe, I'll cover that. But right now, let's get on with the story at hand.

So first and foremost, let's talk about debt. I do not believe any person who has ever followed me or read me or paid any attention to what I have to say, and I'm referring to all seven of you, could possibly accuse me of being dovish about U.S. national debt. It is the issue of my lifetime in terms of macroeconomics. Everything I believe about what has been in the last twenty-five-plus years that I've been professionally managing money and will be going forward is rooted to the underlying story of a significant expansion of U.S. national debt. So when I say what I'm about to say, it is not me being dovish on the U.S. debt story. It is me being mathematical and logical. That people believe that the 10-year borrowing cost to the U.S. federal government three months ago was 4.5%, and now it is 5.25% because, oh my goodness, we're borrowing more. The deficit may come in about \$2 trillion. The national debt is now \$40 trillion. The national public debt is now \$33 trillion. And that that is the reason for 75 basis points of higher borrowing cost in the last three months, I don't believe stands up to scrutiny.

I want to point out that the price of money and the relative amount of debt inside a total economy, a debt-to-GDP metric, is not merely the amount when you're talking about how interest rates, how it's gonna play down to interest rates. It's not merely the public debt, but the public and private debt combined. And that when you look as a percentage of GDP at the public and private debt 20 years ago to now, it is identical. And I wanna put a chart up on the screen courtesy of Jim Bianco, who is just a fantastic analyst, economist, and someone I admire a great deal. That essentially you're looking at a 370% combination. Now the difference, of course, is the composition. The amount of private debt to GDP has come down, and come down substantially, and the amount of public debt to GDP as a percentage, again, public debt as a percentage of GDP, has gone up. But in total, it represents 370%.

I'll put up a second chart here that lays it out even more, where you see the kinda orange or yellow line dropping as much as it has. That's deleveraging as a percentage of total economic output in the private sector. And then the blue line is just how they replaced it with government stepping into that balance sheet and leveraging themselves up. In neither chart am I looking at anything I consider good, because I would, all things considered, prefer a higher private debt than public debt if, to the extent that I assume that some of that private debt is money-good, productive, being put into something that gets a multiplier on it, that private borrowings are used to go do something good in the economy. That's not always the case, and

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when private debt goes up because of consumption and other things that do not have a return on invested capital, on borrowed capital, that could be very problematic for an overlevered economy. But almost all public debt is like that, and that's what we are now seeing.

But to the extent that even with this spike in interest rates that we've seen lately, a higher-rate regime, the interest cost to GDP is well below historical averages. And so I simply do not believe that the news, which by the way, whether you're talking about governmental borrowings that are new in this year, the amount owed on the company credit card, total governmental debt, there's nothing about it that is remotely new in the last 90 days. No surprise. No new announcement. Nothing that the left didn't know, that the right didn't know, that CBO didn't know, that Goldman Sachs didn't know, that you didn't know, that I didn't know. Nothing new. And the idea that that has potentially pushed up bond yields just strikes me as fanciful. Now, I don't like there being less productive debt in the total debt structure, in the total national debt picture of the United States. I don't like crowding out of the private sector. But that is a very different story than saying this is explanatory to higher cost of borrowing.

Now let's talk about inflation. And first of all, we have to parse out the difference between inflation and inflation expectations. They're not the same. They're certainly similar, and I would argue that inflation expectations are certainly informed by present levels or recent levels of inflation. But inflation expectations matter to long-term expectations in the bond market. And when you look at the current level of price moves, that invites us coming back to our old word "transitory." And you go, "Well, transitory proved to be such a joke, and it was so misused and kind of turned into a caricature, a pun almost," in 2022 when Chairman Powell famously said it. But here's what I want to point out. Just because a word was used wrongly in the past does not mean that it is never true.

Like, there are certainly things that everybody would agree a price going up can be, and often is, transitory. Now, when we look at Strait of Hormuz issues, we could debate about whether or not the Hormuz will be reopened and refinery spreads will come down and shipping costs will come down, and there will be some sort of improvement in oil prices in three days, three weeks, or three years. But that does represent an element in which the very market itself we're citing, when we cite \$90 WTI crude, we are looking at a 30-day contract for that commodity price, and the same exact WTI crude pricing mechanism when you go out 90 and 180 and 270 and 365 days is itself assuming that the current levels are transitory, that there is what we call backwardation, whereby future contracts for oil are being sold at lower prices. And again, I can't get into the geopolitical expectation of how it may get better. But my point being that there is certainly an element in which that need not be entrenched, even as everybody, I think, would agree geopolitically, the impact of Strait of Hormuz closing has gone on longer than expected.

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But let's look at the other element that I think is a big contributor to higher prices in 2025 and 2026. That's tariffs. The New York Fed released a wonderful report this week where you got to really unpack a lot of that data. I put a link to it in dividendcafe.com, demonstrating that tariffs have added 2.9% on tariff-price goods from their implementation through the measurement window earlier this year. And in fact, it is probably much worse than that to the extent that there had been deflationary elements. You were going into price decreases also across a lot of goods, and therefore, the impact is even more than that 2.9 delta. But again, I am critical of tariff policy for their distortions, for the cronyism, for the way they put downward pressure on production, the way that they hurt American importers, including manufacturers that are themselves importing unfinished goods.

I have all sorts of things I could say about it, but even a critic like me recognizes that if you tariff something and it goes from 100 to 110, and the same tariff is there the next year and it's still 110, you had a 10% price move one year and you had a 0% the next year. It's not defense of the tariffs, and it does reflect an embedded cost structure increase. But it's a supply shock issue, not something—again, I won't use transitory, we don't want to—but it's not something that becomes embedded on a year-over-year basis, which is what bond yields have to measure. But we don't have to speculate on this, my friends. The bond market has a mechanism for transmitting the information to us about what inflation expectations are going forward.

TIPS spreads. And I'm gonna put another chart up right now. TIPS spreads are higher over the last 90 days. The 10-year breakeven rates that give you the implied expectation for inflation over 10 years have gone up by 12 basis points, 0.12%, but the 10-year in that same 90-day period is up 75 basis points. I'm sorry. The inflation theory doesn't cut it. So what does explain the situation when you factor in that, at most, the debt concerns and inflation concerns are supplementary over this period of time? The problem is that the right explanation is just too complex for sound bites, for easy explanation, and that is the incredible supply-demand reality around AI debt issuance that you are looking at this year.

And I wanna be clear about what I'm not saying in a moment. But what I am saying at a high-grade debt level, highly creditworthy issuers, in some cases names that have a higher credit rating than the United States government, but all names that are basically considered very, very, very top of the pecking order of credit quality and no concern about credit risk, your Amazons, Microsofts, Googles, et cetera. \$200 billion of new debt in 2026, hundreds of billions more anticipated. And we throw those numbers out there in a cavalier manner. It's a big deal. And I think it's a big deal in terms of supply and demand, which is, I think you know, a pretty basic element in economics, okay?

And so a junk bond, let's say a B-minus-rated bond that comes out, that's not competing with a Treasury. That's not pushing—it can impact spreads, but it doesn't impact the reference rate,

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the base rate, the risk-free rate, the core rate of borrowing that is isolated to what an investor can get for time measured in Treasuries. So essentially what you have is a whole lot of new supply that's come in, and the demand level is such that, first of all, people have to sell Treasuries to buy some of this. There's a lot of supply that then needs to see spreads go higher to get the supply satisfied, to get investors to buy it relative to the total opportunity set. Equal level of demand, or even if it's a slightly growing level of demand for that paper, it is disproportionate to the increase in supply. So you get downward pressure on prices as you get higher levels of yields to bring the supply and demand into equilibrium.

You add into this that many investors, hedge funds, have now increased their exposure to rates, to duration risk, so they have to hedge some of that. So you end up with a lot of short positioning in the Treasury curve, along with this other supply-demand component. There is a chart. I'll put it up on the screen right now real quick, but you're not gonna be able to see a lot of it. I want you to go to dividendcafe.com and look at it if you're interested in the nitty-gritty. But the way in which the transmission mechanism of this matters to bond yields came across just a wonderful chart that in a granular way lays it out.

At the end of the day, without me trying to oversimplify the case, I'm not just talking about Microsoft and big, huge brand-name hyperscalers issuing more debt. Very creditworthy borrowers issuing a ton of debt, but then there's a ton of new debt issued by other utility companies, data center companies, other developers, the sort of AI-adjacent story, right? And across power, infrastructure, real estate, there's this debt-fueled compute story with a huge issuance of supply, and at the same time, it's led to an increase in yields, and that's with \$200 billion and markets anticipating more of this.

All right? So at the end of the day, is this positive or negative? Well, you could look at it and go, it reflects a productivity boom. It reflects demand for real capital. Higher yields are just a market mechanism for allocating savings into this investment. I think that's a perfectly fair theory, but it still has the byproduct of higher yields. You could also say that it represents a borrowing binge that crowds out other elements of public financing needs, which is why muni yields have gone up so much, or potentially other even private sector needs that are outside of the AI story. Look, all I can tell you is that it's clear it's had the impact of crowding out things in other parts of borrowing and financial markets.

Whether or not the former case that it ends up just proving to be a productivity boom is TBD. But I don't think that most investors care why bond yields go up or down and impact their portfolio. I think that they care that they do. And what I want to say is that the 75 basis points of expansion in the 10-year could very well hold for longer. I do not believe it holds longer because of the debt or inflation theory of the case. And ultimately, what you're seeing is a flattening yield curve. Both the short end and long end have come up. There's not a lot of delta

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between the short end and long end. And at some point, when the short end comes down, I think the term premium will drop a bit, and then obviously the reference rate drops too.

Now, I don't need to make a rate prediction here. There's a bond vigilantism implied in the present rate action that believes that the Fed is either gonna make a policy mistake, in which case you would end up with an inverted yield curve and a correction that would really damage many of the things currently benefiting. Or you basically end up being surprised by the Fed. And I think Chairman Warsh is one who is, shall we say, willing to do what bond markets didn't want him to do, and I think is gonna prove to be willing to do what bond markets don't expect him to do. Because ultimately, I think he looks to financial markets, and I think financial markets are essentially going to show the policy error in the short end coming too much.

Now, to the extent anyone disagrees with me on what is causing the current situation around debt and inflation, then they have to disagree with my conclusion too, because that would mean that Chairman Warsh believes it's his job to try to chasten Congress with debt, the debt concern, or that in a supply shock inflation, that he can bring that down with monetary policy. And I can't speak to what he believes. But I will say that all financial market activity seems to have gone on the side of the boat of believing that they will continue to hold a short end in the high threes, low fours, that I believe will prove not to be true. This doesn't mean they won't hike once more this year. But do I think that you're gonna end up seeing that short end held up and then a term premium to the long end held up for the foreseeable future? I do not.

In the meantime, what does this do for investors? Well, let's be clear. It's done a lot of damage here when people say, "Ah, it hasn't been that bad, a lot of this tech stuff, semiconductor stuff, AI." Investors are treating Mag Seven-type names, and in this case only three or four of them, as a safety trade. And I'm sorry, that's one of the craziest things I've ever said. It's one of the craziest things I've ever seen. But I'm not wrong that that's what they're doing. Now, I am wrong if I were to offer a projection as to when that will be undone.

What I can tell you is that 89% of stocks in the Russell 3000, that's a very broad index covering an awful lot of the market, 89% are down 10% or more since the summer. Okay, 54% are down 20% or more. So that's broader than just the S&P 500. Those numbers are not as pronounced in the S&P. But I mean, 29% of names, 1,000 out of 3,000 Russell 3000 companies, are down 30% or more. This lack of market breadth story is real. This is not a data misnomer. It's not a misunderstanding. Earnings expectations from three or four companies are very, very high, and I gotta tell you that that embeds a certain vulnerability that lacks a timing mechanism, but let's just say creates a high bar.

Okay? And in the meantime, when someone says, "What should investors be thinking about given this rate situation?" Given my belief in contrarianism and my belief in being early, not

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late, I would suggest that on the AI side, this hyperscalers-can-do-no-wrong narrative is connected to bond yields, even if markets don't yet reflect it. And number two, when valuations become very high and need to become higher to maintain expected returns, a higher risk-free rate, a higher cost of capital poses a much, much higher risk. But again, even if markets right now do not reflect that. And I think that in the last month, when you've seen REITs or financials, industrials, consumer staples, that those things become places to go because of a higher cost of capital, and then people say, "I wanna go hide in the safety of AI," I think you've lost the plot to some degree.

Look, let's stay off the AI story for a second and just look at where there is opportunity. First of all, on a relative basis, there's no question that a higher boring bond fixed-income allocation right now is more attractive than it's been in most of the periods of time I've been managing money professionally. I could go back and look pre-crisis at some of those given moments. But right now, anyone who believes rates are gonna go meaningfully higher from here would disagree. But I can say that there is a carry, that there are people saying such ridiculously dumb things like, "Look how bad the return has been the last three and five years in boring bonds. Why would anyone wanna go there?" But of course, that is based on a mathematical equation that by definition can't happen again. And what I mean by can't happen is a 10-year can't go from 1% to 5%. Now, if you say it's going from 5% to 10%, that's fine, but it's not going from 1% to 5%. It's already done it.

So either rates stay the same and you're getting a five carry, which is really good, or rates drop and you're getting the carry you locked in addition to price appreciation. I'm not gonna do rate speculation. But from a risk-reward standpoint, it's just abundantly clear that it's more attractive than it has been. That's a mathematical statement. But it doesn't solve what I really care about for the majority of our clients, which is growth of income and growth of principal. And to me, what you have to look to there is the elements that have capacity for profit growth. And what has been kinda hit in this period of time of higher yields, the benefits either from yields staying where they are or even dropping.

I think that the REITs, the industrials, the financials, you look at the banks, that really traditionally would go higher with better net interest margin. I think that there's been a big misunderstanding in some of these sectors that create dislocation. I do not think this is getting corrected, fixed, and repriced in 15 days. But in 15 months, do I think that some of these things will be reflective of a very different story than they are now? I do. What people have to do is avoid the biggest fallacy in all of investing, which is that what just got done going up is the thing most likely to go up next. But there's an inverse to that too, which is that, "Oh, what just went down is the thing I most want to avoid." Both are equally fallacious.

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And I would suggest that when one becomes comfortable with not picking up a top or a bottom, but on a value basis and a disciplined basis, looking into the future, it is an opportunity in front of you now because the bond yield story has changed valuation and a lot of forward expectation, expected rates of return. And that is a very good thing for some asset classes, and I think will prove to be not good for others. So therein lies the rub: comfort level around the uncertainty of timing with the fundamentals underneath. That's our case around the long yield, the long bond yields, and what it has meant for investors in recent months.

I'm gonna leave it there. Thank you, as always, for listening, watching, and reading The Dividend Cafe. Look forward to being with you Monday for our normal Monday Dividend Cafe. And then again next Friday, where I'll be recapping all of these meetings and managers and giving quite a few takeaways as to what has taken place this week and what our point of view is going forward. Thanks again. Have a wonderful weekend.