MEDALLION WEALTH MANAGEMENT

September 2026 Market Commentary

<u>The Ties That Bind</u>

Secretary of Treasury Scott Bessent speaks to the press outside the White House in Washington, Aug. 20. JIM WATSON/AGENCE FRANCE-PRESSE/GETTY IMAGES

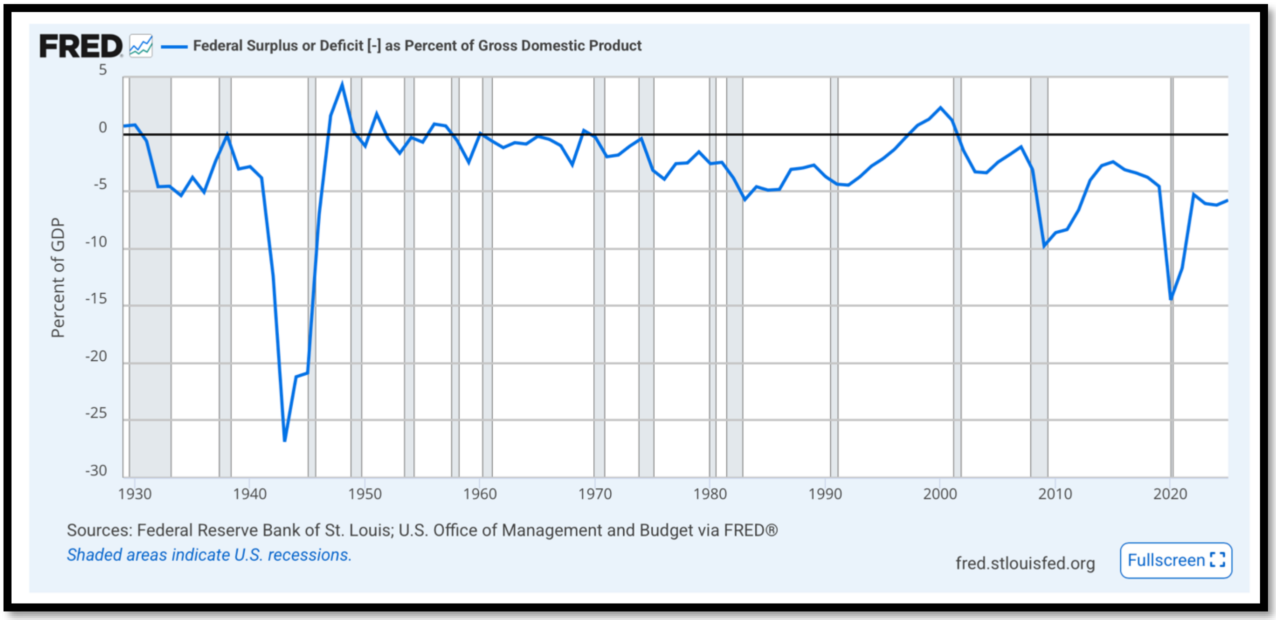
You're walkin' tough baby, but you're walkin' blind
To the ties that bind
The ties that bind
Now you can't break the ties that bind

By Bruce Springsteen
https://www.youtube.com/watch?v=CkL7_JVPxjo&list=RDCkL7_JVPxjo&start_radio=1

Who is the real Boss – Bruce Springsteen, Treasury Secretary Bessent, or the Bond Market? In my mind it's clearly the bond market (sorry Bruce). Every few years it seems like the Treasury Secretary and/or the Federal Reserve needs to go to war with the bond market, and the results of those battles are a temporary respite in higher rates, key word **temporary**.

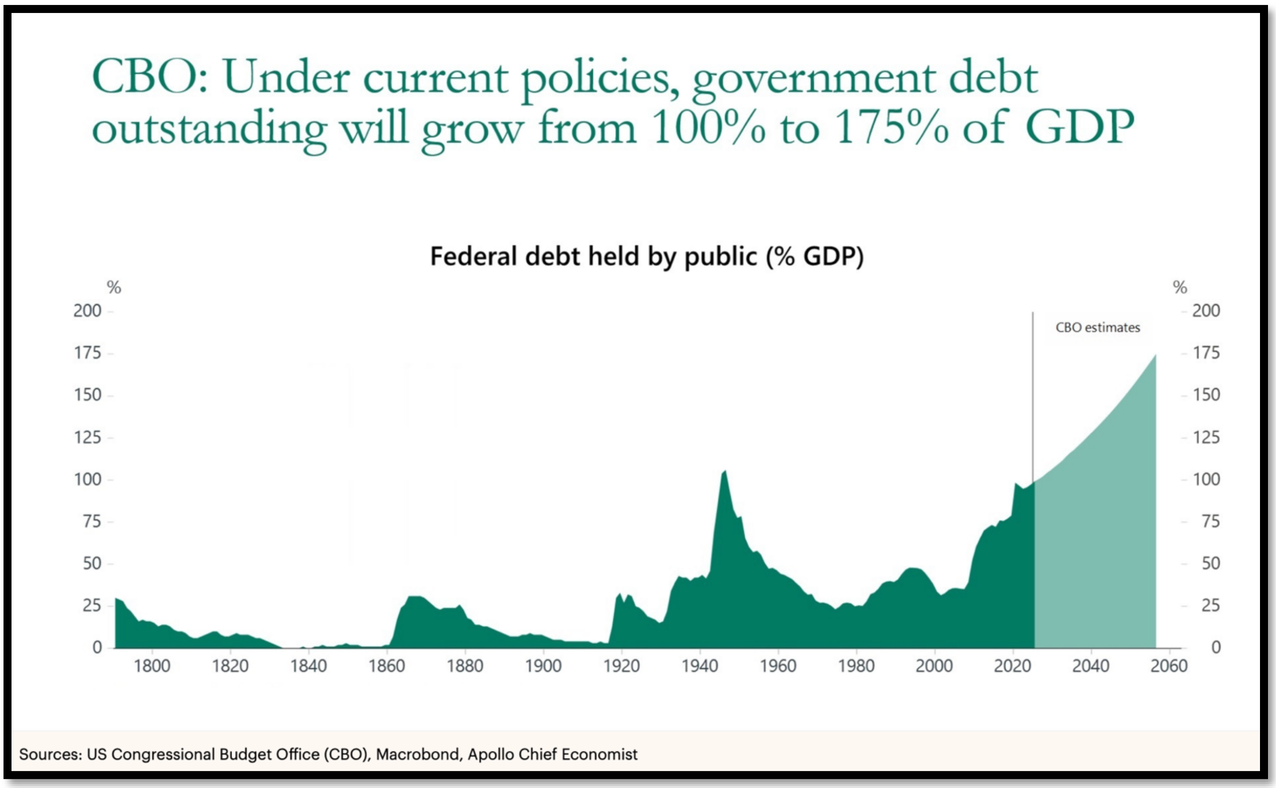
Bonds, and more importantly, interest rates, have been the most important variable in financial markets throughout history. What we are really talking about is the price of money. Many factors go into the level of interest rates: Inflation Expectations, Supply and Demand for Credit, Economic Growth, and Central Bank Policy are the most important. But for decades one of the biggest forces pushing rates higher has been the Government's unquenchable thirst for spending. The problem our politicians have (both parties) is that they are more than willing to spend more than they take in revenues (taxes).

The chart below shows our annual federal deficits or surpluses since 1930. The deficit was massive during WWII, pretty large during COVID, and usually larger during recessions, but rarely ever in a surplus.



The deficit in and of itself isn't bad, as long as the economy is growing faster than the level of spending. Unfortunately, this has not been the case, as the chart below shows that government spending as a percentage of GDP has been on a rather steady climb for decades.

The real problem arising from this perpetual cycle of deficit spending is the compounding nature of the debt. Every year the government is borrowing on top of the prior year's borrowing, they are even borrowing to pay the interest on the prior year's debt. **Federal debt now sits at about 123% of Gross Domestic Product!**

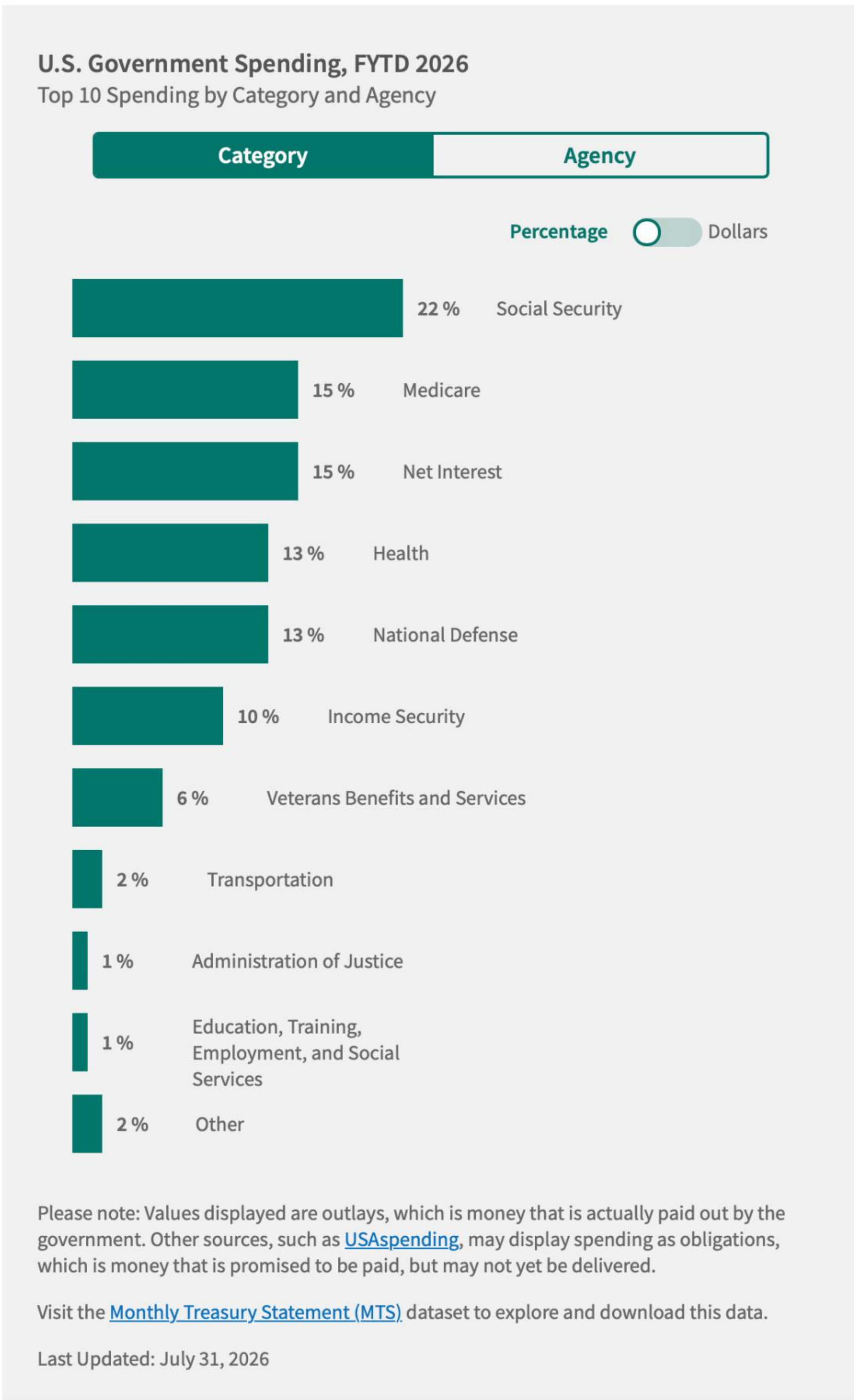


As anyone who spends more than they take in will tell you, paying interest on the interest on your debt is brutal. It's like paying the minimum on your credit cards or student loans and realizing that you owe more than you actually borrowed.

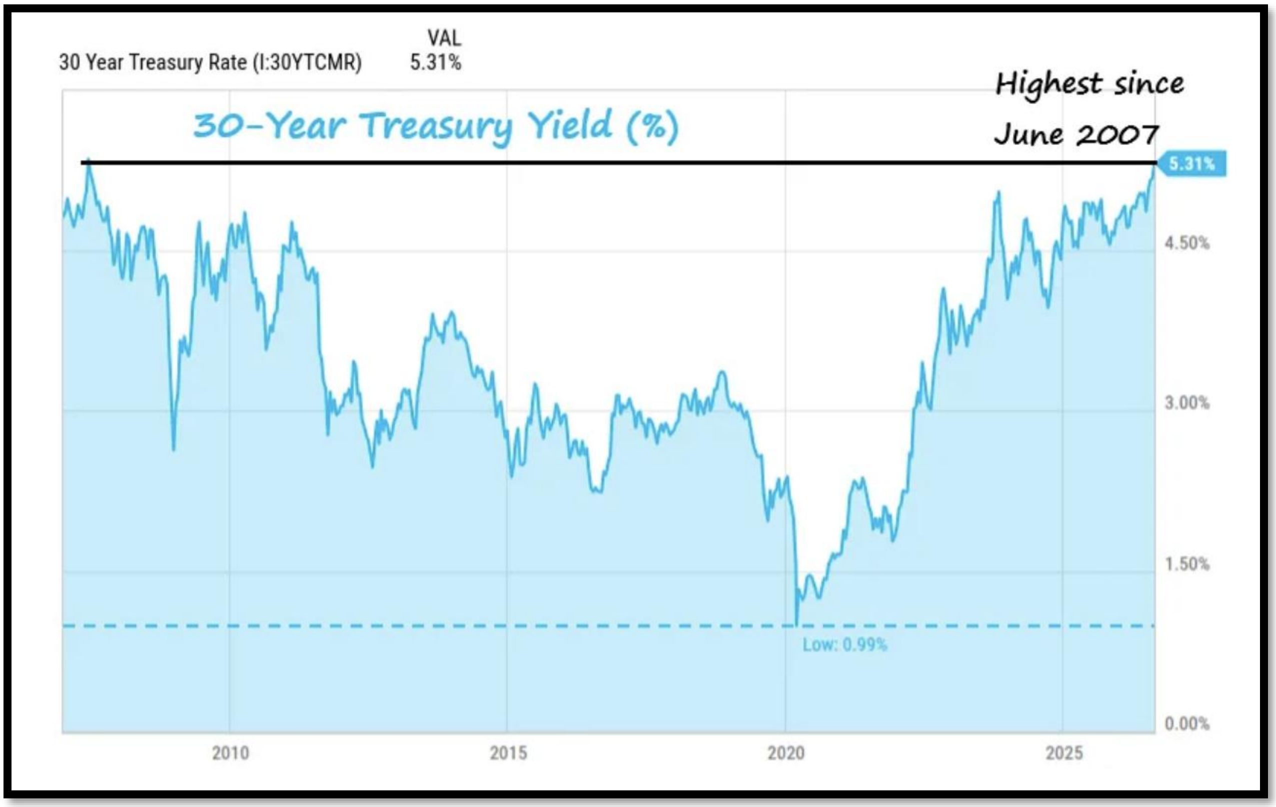
When you look at everything that our government spends money on, just paying the interest on the debt (not the principal) is now the second largest government expenditure, tied with Medicare and rapidly climbing towards Social Security. This means that the price the government pays to borrow becomes one of the most important variables in Washington. Fortunately, the government doesn't have absolute power over what it pays to borrow, Mr. Bond Market (or more precisely "Bond Vigilantes") also have some say.

That power has a name and a history. In 1983, economist Ed Yardeni coined the term "Bond Vigilante" to describe the power that bond investors have to force yields higher by refusing to buy bonds at what they consider low interest rates compared to inflation. When the Bond Vigilantes felt that government spending was getting out of control and causing inflation to rise, they could force rates higher which would force the government to reconsider their spending habits.

This market-based discipline worked pretty well until 2008 when the Great Financial Recession caused the Fed to implement a Zero Interest Rate Policy (ZIRP). It didn't matter if the bond vigilantes stopped buying bonds, the Fed bought everything forcing rates to zero. Unfortunately, they left rates at zero far longer than necessary, causing inflation to surge and politicians to spend like drunken sailors.



Fast forward to today. As our national debt soars over $40 trillion, interest rates have risen to 19-year highs. The bond vigilantes are stirring.

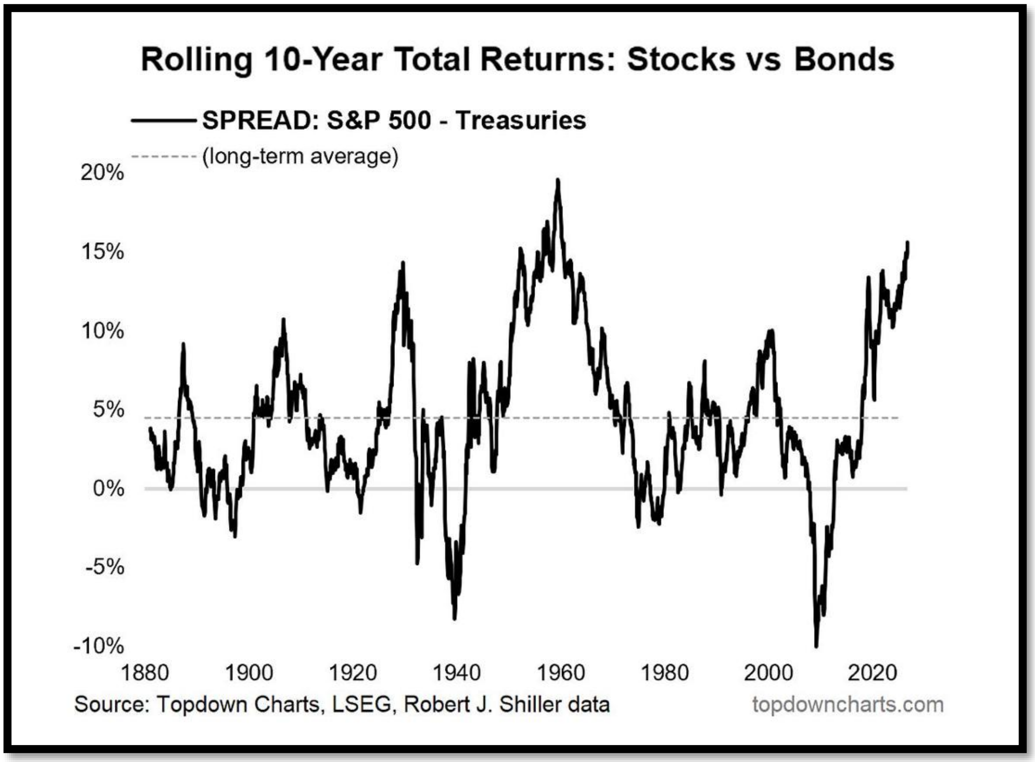


This rapid rise in yields has caught the attention of our Treasury Secretary Bessent, who has announced that if the bond vigilantes won't buy his debt, then the Treasury will buy it themselves. Again, attempting to stifle the free-market pricing mechanism for the cost of money.

It's fascinating that both Treasury Secretary Bessent and Fed Chair Warsh worked for one of the most notorious bond vigilantes of all time, billionaire hedge fund manager Stanley Druckenmiller. And Mr. Druckenmiller is none too pleased with his protégé Bessent. In a very popular WSJ op-ed on August 24, 2026, Druckenmiller wrote, ***"Let the bond market speak. The long-term Treasury yield is the most important price in the world [and] the only fiscal disciplinarian the U.S. has left. Governments defending prices against fundamentals always lose. The only variable is how much they spend before conceding."***

<u>What does this mean for us humble investors?</u>

Not surprisingly, as interest rates moved from zero to their new 19-year high, bonds have been a lousy investment (rising rates = falling prices). And because money was artificially cheap, stocks have done extremely well. As the chart below shows, stocks have outperformed bonds on a 10-year annualized basis by 15%, the highest level since 1960.



This is all well and good, but this is history - where do we go from here. I am not an economist, but an investor. The difference between me and an economist is that my pontification doesn't end on a blackboard but rests in real-life decisions. Yes, stocks have had a generational rally versus bonds, will they continue this outperformance or will the tide turn towards bonds?

First, let's look at the math. Stocks have outperformed bonds by about 15% per year for the last decade. With high quality bonds yielding over 5% today, stocks would have to continue appreciating by 20% a year just to match the outperformance they've recently achieved. It's possible, but not likely.

Generally speaking, stocks do well when earnings go up, and earnings go up during economic expansions, and down during recessions. Meanwhile bonds do well when inflation is falling and central banks are cutting rates, and do poorly when inflation and interest rates are rising. (aka "It's the economy, stupid").

Right now, the macro environment is still leaning in favor of stocks. The economy is doing well, corporate earnings are great, and unemployment is low, here's what could change that.

- **Inflation Risk**: continues to lean higher. Commodity prices continue to move higher on both demand growth and tight capacity.
- **Political Risk**: Consumer sentiment is at lows usually seen in the depths of a recession, mostly caused by the fall in real (inflation adjusted) wages. This is leading to a marked uptrend in anti-capitalism.

So where does this leave me? I want to be optimistic. I want to believe that our politicians will get our fiscal house in order. I want to believe that the Treasury and Fed won't manipulate interest rates too much. I want to believe that AI will mostly be used for the good of mankind. I want to believe that college football will get its act together. I want to believe.

Unfortunately, I'm also a realist, and being a realist makes me hesitant to be too bullish here. After the shellacking that bonds have taken over the last decade, 6% yields on decent-quality bonds look pretty appetizing, all things considered. A balanced portfolio makes sense; the 60/40 portfolio is not dead. Remember that bonds are the ties that bind it all together.

We're runnin' now but darlin' we will stand in time
To face the ties that bind
The ties that bind

As always, be careful out there.

Chris Wiles, CFA

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