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# Quarterly Economic Update

June 10, 2026

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**MACROECONOMIC COMMENTARY**

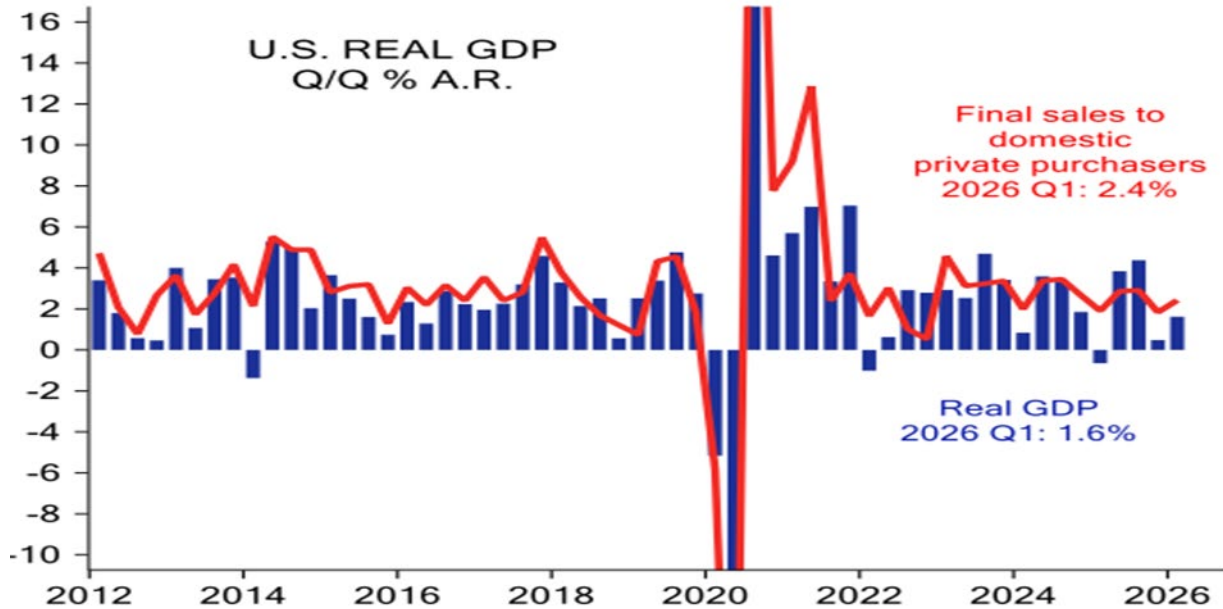
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# Economic Outlook

By Bobby Long

The U.S. economy expanded at a 1.6% annualized rate in the first quarter of 2026, according to the Bureau of Economic Analysis' second estimate of Gross Domestic Product (GDP). While this represented a meaningful slowdown from the economy's post-pandemic trend rate, it marked a modest acceleration from the weak 0.5% growth pace recorded in Q4 2025. Despite the relatively subdued headline growth figure, the composition of growth continues to reveal an economy supported disproportionately by business investment—particularly technology and AI-related capital expenditures—rather than by the consumer sector, which has historically driven U.S. expansions.

While headline GDP growth slowed to 1.6% in Q1, real final sales to private domestic purchasers—a cleaner measure of underlying private-sector demand that excludes inventories, trade, and government spending—rose closer to 2.4%, indicating firmer domestic demand than headline growth alone suggested. The chart below shows both real GDP and real final sales to private domestic purchasers.

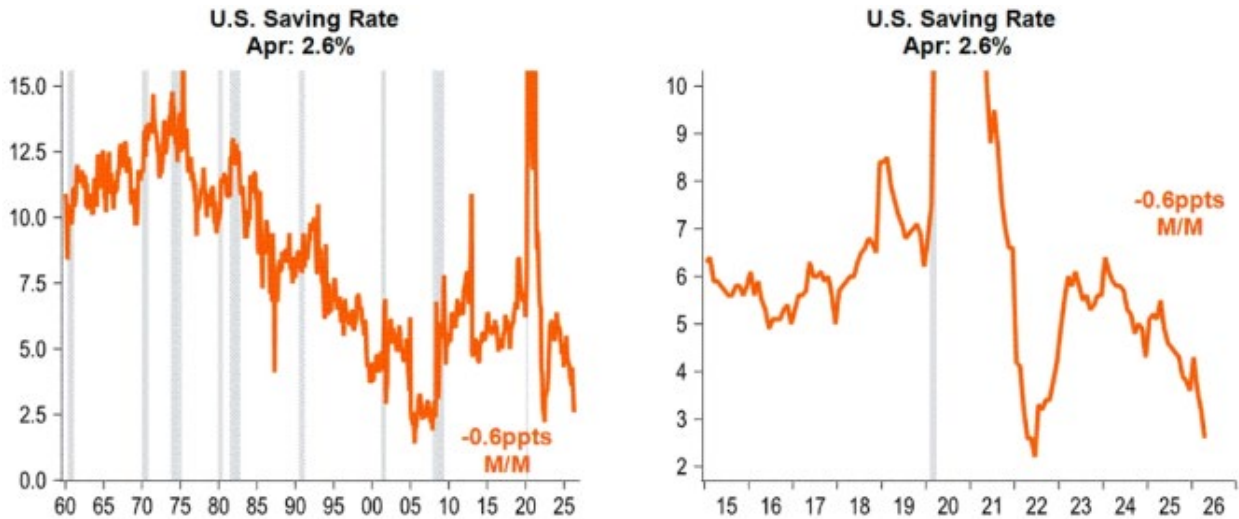


Source: Evercore ISI

Personal consumption expenditures (PCE), which account for roughly two-thirds of U.S. GDP, increased at only a 1.4% annualized pace in Q1. That represented a notable slowdown from stronger spending trends seen through much of 2025. Consumer spending has remained positive but has steadily lost momentum. There are pockets of strength, but not the broad-based spending across categories that is typically associated with a strong cyclical expansion. Households are becoming more selective and financially constrained by rising inflation, slower real income growth, lower savings rates, and higher borrowing costs. Rising gasoline prices have further added pressure over the past few months.

The April 2026 Personal Income and Outlays report added to the emerging picture of a consumer sector that remains resilient on the surface but is increasingly strained beneath the headline data. Personal consumption expenditures (PCE) increased 0.5% month-over-month in April following a strong 1.0% gain in March. However, after adjusting for inflation, real consumer spending rose only 0.1%, indicating that much of the nominal spending increase reflected higher prices rather than stronger underlying demand.

Disposable income growth has lost momentum in recent months, and after adjusting for inflation, household purchasing power has weakened meaningfully. Real disposable income has declined for several consecutive months while the saving rate has fallen to 2.6%, suggesting consumers are increasingly relying on savings and wealth effects rather than income growth to sustain spending. This dynamic supports near-term consumption but raises questions about its durability later in the year. This has also occurred with the benefit of the One Big Beautiful Bill (OBBB) tax benefits, which have boosted consumers' discretionary cash flow this year. The charts below show how the savings rate has been declining sharply since the beginning of the year and how current levels are running below more recent and longer historical averages.



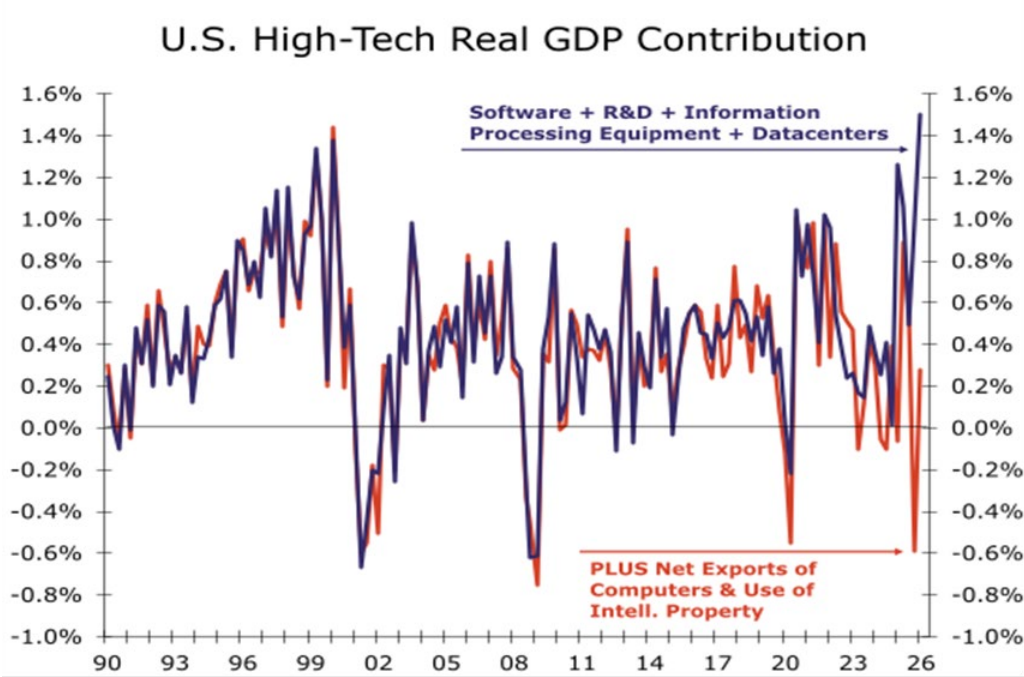
Source: Piper Sandler

Gross private domestic investment posted one of the largest positive contributions to Q1 GDP growth, increasing at an annualized 7.0% over the prior quarter. The strength was concentrated in nonresidential business investment—particularly equipment and intellectual property—while residential and structures investment remained weak.

Nonresidential fixed investment accelerated sharply, rising at an annualized 10.1% in Q1. This marked a significant improvement from the prior quarter and stood well above longer-run trend growth for business investment, which typically runs in the mid-single digits over a full cycle. The acceleration was driven by a 17.2% increase in equipment investment that was largely driven by information processing equipment related to AI infrastructure buildouts. Investment in intellectual property products increased 11.6%, with an acceleration in software and research and development spending. Nonresidential structures investment declined 5.4% in the quarter and has been persistently weak over

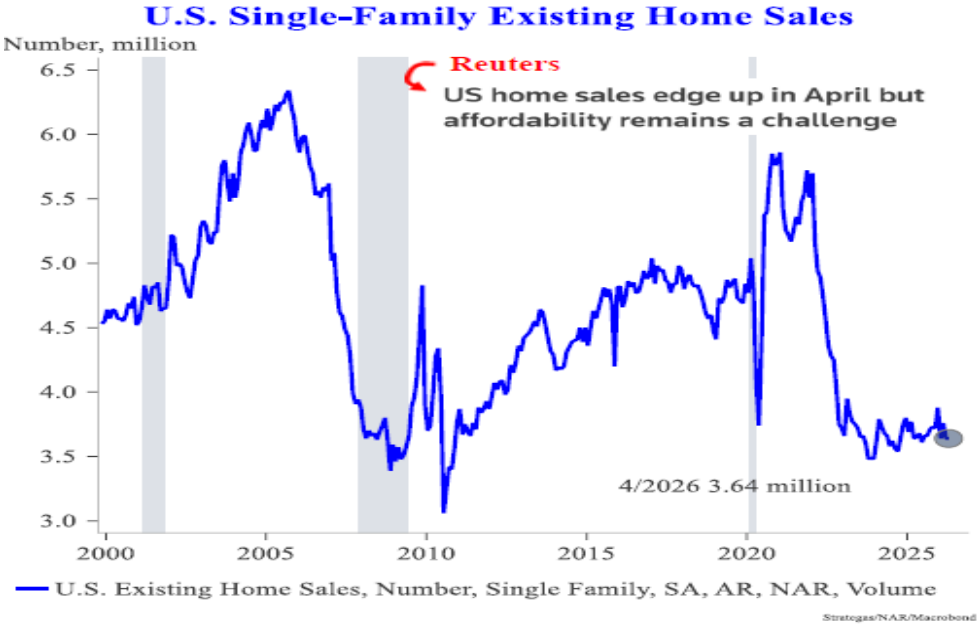
the past couple of years. While datacenter and AI-related manufacturing projects continue to attract capital, broader commercial construction remains constrained by elevated financing costs and softer real-estate demand. Reshoring, industrial policy, and defense spending are also supportive, but this is not offsetting the sluggishness in traditional manufacturing, office, retail, and other commercial structures. As a result, the current capex cycle is being driven more by equipment and technology investment than by a traditional economy-wide construction boom.

The impact that AI-related capital investment is having on the current economic cycle is especially important as consumer spending and labor markets show signs of moderating strength. The chart below aggregates the contribution this spending is having towards GDP growth and shows that it contributed 1.5% to the first quarter's growth. This is the largest single-quarter contribution of tech-related spending on record that exceeds the tech boom of the late 1990s. While this is notable and helps quantify these massive spending levels, in the current economic cycle, this accounts for nearly all of Q1's 1.6% growth. If you back this capex out, it means economic growth would be close to stall speed without the investment. The chart also highlights that much of this investment has been directed towards imported tech equipment, which diminishes the impact the investment is having on broader domestic activity. This suggests that the current investment cycle may not be as supportive as previous cycles.



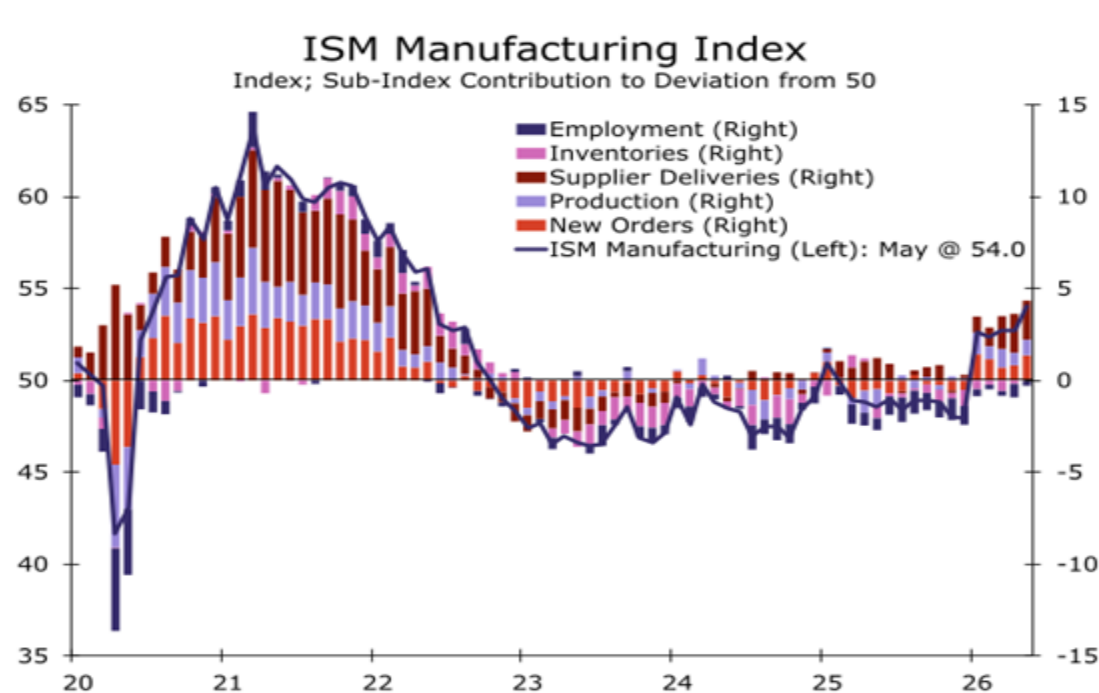
Source: U.S. Department of Commerce and Wells Fargo Economics

Residential fixed investment remains a clear weak spot and declined 6.2% in Q1, marking another quarter of contraction and extending a prolonged period of housing-sector weakness. Single-family construction activity has been impacted by affordability issues. Housing remains undersupplied versus demand, but elevated mortgage rates and high home prices have depressed activity, as new-home inventories face slower absorption by the market. Existing home sales also remain weak and continue to weigh on broader housing-related spending. The chart below shows that existing home sales are not deteriorating from recent trends but have stabilized at a lower historical level and are not showing any meaningful improvement.



Government spending increased 4.4% in Q1, providing a meaningful but somewhat temporary boost to Q1 GDP following an unusually large federal drag in late 2025 associated with shutdown-related disruptions. While the rebound in public spending supported headline growth, much of the improvement reflected normalization rather than a new fiscal impulse.

The Institute of Supply Management’s Manufacturing PMI index rose to 54.0% in May, up from 52.7% in April and marked the fifth consecutive month of expansion. This aligns with the S&P Manufacturing PMI index and a composite of regional Fed surveys that are in expansion territory. Together, these paint a picture of broad improvement across manufacturing industries. The ISM survey highlighted that 89% of industries reported growth. All ISM headline components increased or held flat in the most recent report. New orders were up sharply.



*Source: Institute for Supply Management and Wells Fargo Economics*

While ISM improvement is positive, respondents are increasingly expressing concern about higher raw material costs and supply disruptions due to the Middle East conflict. S&P specifically noted that growth in output and sales was in part driven by stockpiling to mitigate price rises and supply delays. Manufacturing activity is clearly improving; however, some strength may be attributed to clients building up stocks in the face of inflationary pressures and supply chain disruptions that come at the expense of future activity.

Labor market conditions remain broadly stable but noticeably cooler than the pace that characterized the post-pandemic expansion. The latest payroll and ADP reports both point to moderate job gains. The most recent Bureau of Labor Statistics (BLS) establishment survey showed that nonfarm payrolls rose by 115,000 in April, following a gain of 185,000 in March and a decline of 156,000 in February. The decline in February was largely attributed to temporary conditions related to winter storms and healthcare strikes, which have been confirmed by reversals in the following months. The April nonfarm payrolls report showed a concentration of job gains in health care, transportation and warehousing, and retail trade. Job declines were reported in information, financial services, and government employment, which have been experiencing losses for several months now.

ADP reported a 122,000 increase in private-sector employment in May, following a gain of 105,000 in April, 61,000 in March, and 66,000 in February. The ADP report showed a similar pattern with private hiring concentrated in education and health services and trade/transportation/utilities sectors. Other industries, with the exception of information technology, also added jobs for the month.

The consistency between the two reports strengthens the signal that hiring remains positive, but not broad-based. Recent job gains are modest relative to longer-run expansionary periods. A monthly payroll gain near 100,000 is still consistent with a growing economy, particularly given slower labor-force growth, but it is well below the stronger pace seen during the immediate post-pandemic recovery and below the type of broad-based hiring momentum typically associated with an accelerating economy. The three-month average has been distorted by the February decline and March rebound, but the underlying message is that payroll growth has shifted from robust to moderate. This does not yet point to recessionary labor conditions, but it does indicate less cushion against future shocks.

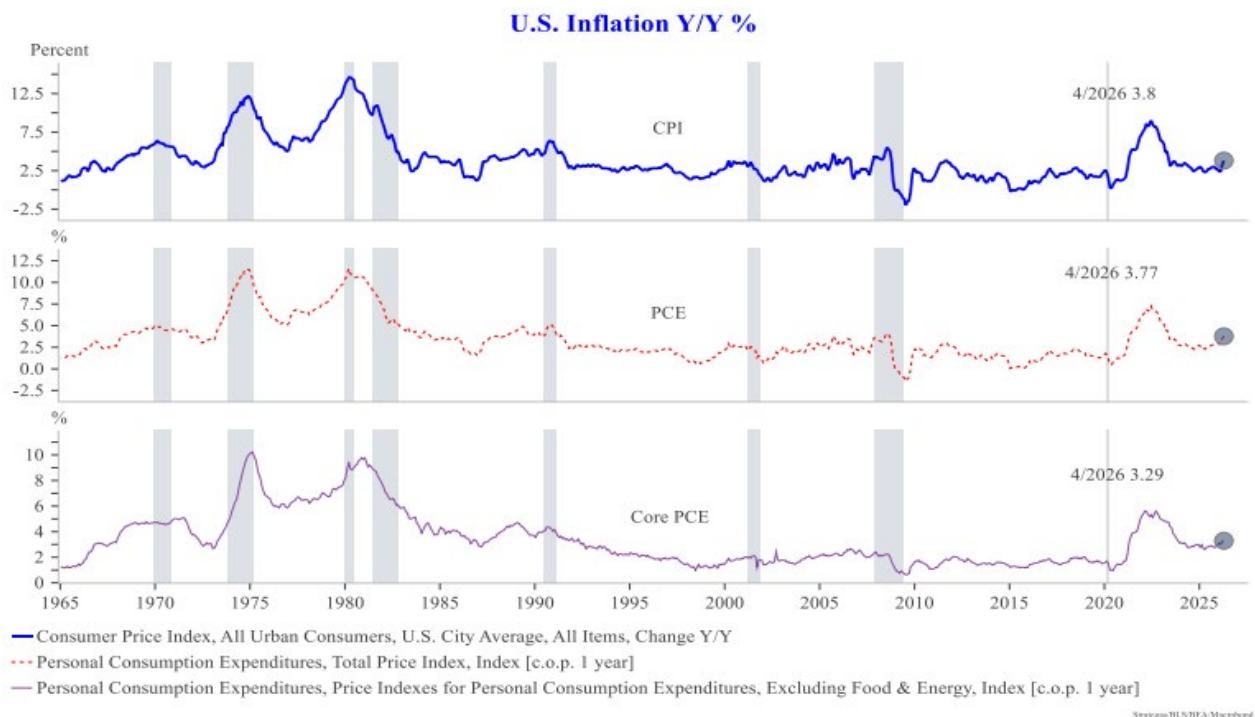
The unemployment rate remains low but has drifted above the tightest levels of the prior cycle. The unemployment rate was unchanged at 4.3% in April, with 7.4 million people unemployed. Labor force participation was little changed at 61.8%, and the employment-population ratio stood at 59.1%. Long-term unemployment was essentially unchanged at 1.8 million, representing roughly one-quarter of all unemployed workers, while the number of people working part-time for economic reasons increased to 4.9 million. These details suggest that while headline unemployment remains contained, some measures of labor-market slack have become less favorable.

Initial and continuing unemployment claims reinforce the view that layoffs remain limited, but hiring has become less dynamic. Initial claims have hovered steadily in a tight, historically low range, confirming that widespread corporate firing has not materialized despite some headline announcements. Initial claims rose to 215,000 for the week ended May 23, while the four-week moving average increased to 209,000. Continuing claims rose to 1.786 million for the week but have trended lower over the past six months. The claims data are therefore consistent with a labor market that is cooling through slower hiring rather than rising job losses.



Inflation has reaccelerated in recent months, interrupting the more benign disinflation trend that appeared to be developing earlier in the year. The most recent data show inflation running meaningfully above the Federal Reserve’s 2% objective across the major price measures. In April, headline PCE inflation rose 0.4% month over month and 3.8% year over year, up from 3.5% in March and roughly 2.9% in January and February. Core PCE, the Fed’s preferred underlying inflation gauge, increased 0.2% in April and 3.3% year over year, compared with 3.2% in March, 3.0% in February, and 3.1% in January.

The CPI data tell a similar story. Headline CPI rose 0.6% in April, after a much larger 0.9% increase in March, bringing the year-over-year rate to 3.8%, up from 3.3% in March. Core CPI rose 0.4% in April, after increasing 0.2% in each of the prior two months, and was up 2.8% year over year, compared with 2.6% in March. The details of the CPI report suggest a mix of renewed goods and energy pressure layered on top of still-sticky services inflation. Energy prices were the most visible driver: gasoline rose 5.4% in April and was up 28.4% from a year earlier, while the broader energy index was up 17.9% year over year. Food inflation also firmed, led by a 0.7% monthly increase in food at home, including gains in beef, fruits and vegetables, dairy, and nonalcoholic beverages. Within core inflation, shelter remains a key source of persistence, with both rent and owners’ equivalent rent up 0.5% in April. Airline fares, household furnishings, personal care, apparel, and education also increased, while new vehicles, communication, and medical care were partial offsets.

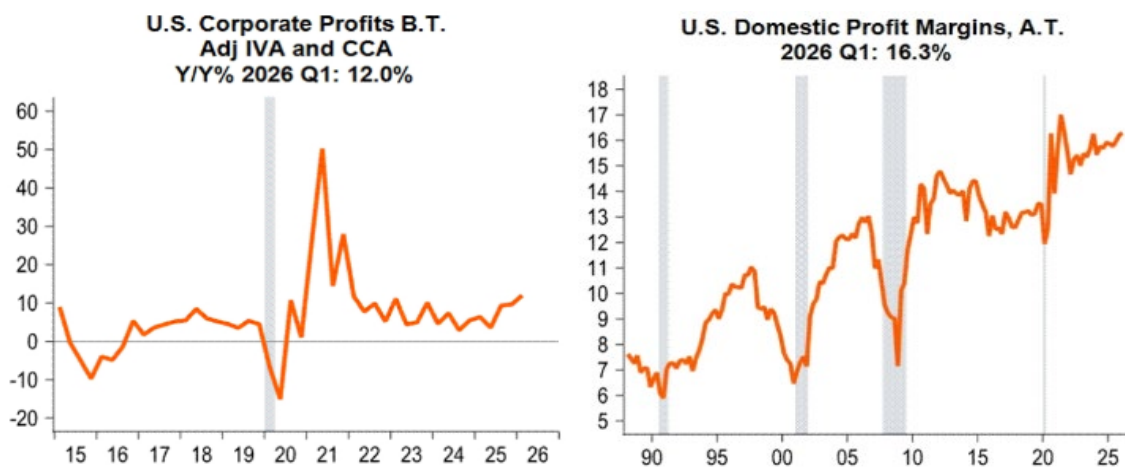


Producer prices point to a more concerning upstream inflation picture. The PPI for final demand rose 1.4% in April, following gains of 0.7% in March and 0.6% in February. That was the largest monthly increase since March 2022, and final-demand PPI was up 6.0% year over year, the largest 12-month increase since December 2022. The breadth of the

increase is notable: final-demand goods rose 2.0%, while services rose 1.2% and accounted for nearly 60% of the monthly increase. Core PPI excluding food, energy, and trade services rose 0.6% in April and 4.4% year over year, suggesting that upstream price pressure is not solely an energy story. The PPI components indicate meaningful pipeline pressure that could feed into consumer prices if sustained. These increases matter because higher input, transportation, and distribution costs can pressure business margins or eventually be passed through to end consumers.

Overall, inflation is no longer simply a lagging shelter issue or a narrow services problem. Energy, food, transportation, trade margins, and several core service categories are all contributing to renewed price pressure. The most immediate threat is that higher energy and producer costs pass through into consumer prices while shelter and service inflation remain sticky. That would keep real wage gains under pressure, limit household purchasing power, compress business margins, and reduce the Federal Reserve’s ability to ease policy in response to slower growth. In that sense, inflation remains one of the central risks to the durability of the current expansion—not because prices are rising at 2021–2022 rates, but because the recent trend has moved in the wrong direction and is broad enough to complicate both household behavior and policy choices.

Corporate profits remain a meaningful source of support for the U.S. expansion. Relative to history, profits and profit margins remain unusually strong. Profits increased 12% in the first quarter over the prior year. After tax profit margins increased to 16.3%. This has been supported by lower labor costs and net interest expense. With input costs rising, margins are likely to face pressure, but OBBA capex depreciation, deregulation, and lower tariffs can be supportive.



Source: Piper Sandler

Strong internal cash flow gives firms more capacity to fund capital expenditures without relying as heavily on external financing, which is especially valuable while borrowing costs remain high. For labor markets, strong profits can help delay broad-based layoffs by giving firms more room to absorb slower demand, higher wages, or input-cost volatility. At the same time, elevated margins do not automatically translate into faster hiring. Companies may prioritize automation, technology investment, buybacks, dividends, or productivity improvements over headcount expansion. If profit growth begins to materially

slow, firms could shift more aggressively from hiring restraint to cost-cutting, which would likely translate to weaker capex and increasing layoffs.

Economic conditions reflect an economy experiencing a mid-cycle slowdown, yet still in the midst of an expansionary cycle that could continue over the next several quarters. Conditions appear resilient enough to weather the shock from the Middle East conflict, which is creating supply chain disruptions and pushing energy and commodity prices higher, although this risk increases the longer these disruptions persist.

We are undergoing a unique and relatively narrow investment cycle, driven by exceptionally strong capex spending and funded largely through the cash flows of a small group of well-capitalized companies. Funding markets have also remained open in support of this investment. The current AI-related investment cycle is having a meaningful effect on economic activity, with datacenter construction accelerating and providing continued support for near-term growth. However, significant equipment shortages and bottlenecks across the high-tech supply chain pose risks to the cycle, potentially adding to cost pressures and constraining the pace of investment and development.

It should also be recognized that this investment cycle is unlikely to compound indefinitely. As a result, it is increasingly important to see current investment translate into measurable productivity gains across economic sectors to support longer-term growth.

Consumer spending remains resilient, supported by strong financial markets and elevated asset prices. However, spending growth is decelerating, and real disposable income is declining for much of the population, making the consumer less likely to serve as a meaningful source of incremental growth in the current environment. Greater confidence in the expansion will require broader capex and job growth across economic sectors, along with further easing in inflationary pressures.

History suggests that investment-led expansions are typically less durable unless accompanied by stronger consumer fundamentals and broader participation across housing and physical construction. It also suggests that recessions are less common when profits are growing.

Job creation has slowed as firms scale back expansion plans and become more selective in hiring, while job destruction remains relatively limited outside of a handful of industries undergoing structural adjustment. Reduced hiring rates and slower job turnover indicate that labor market rebalancing is occurring primarily through softer labor demand rather than large-scale workforce reductions. Overall, current “low-hire, low-fire” labor conditions suggest an employment backdrop that remains sufficiently stable to support continued expansion.

Taken together, the economy appears to be slowing but not contracting, with continued expansion dependent on sustained investment, broader labor and capex participation, and easing inflationary pressures.

# RSA PORTFOLIO STRATEGY

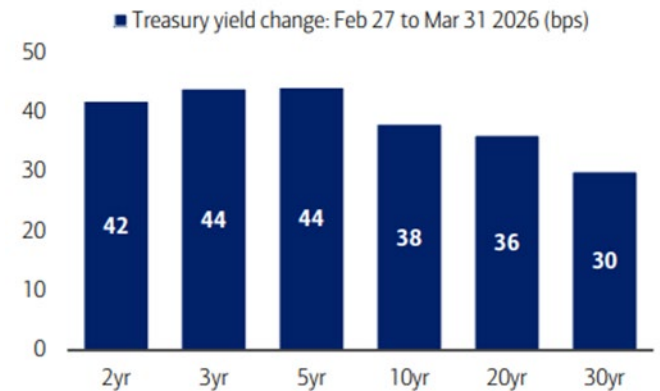
## Fixed Income Strategy

By Lance Lachney

At the time of our last economic update, financial markets anticipated the Federal Open Market Committee (FOMC) would remain on hold until summer, eventually delivering interest rate cuts in July and October, leaving the federal funds rate hovering slightly above the 3.00% range by year-end. Despite a few obstacles, Kevin Warsh was expected to be appointed as Fed Chairman, leading a new regime of lower rates, less regulation, and a smaller balance sheet. Often, things do not come to fruition as originally planned. The United States, in accordance with Israel, conducted airstrikes on strategic targets within Iran, eliminating the Ayatollah and other senior officials in the process. The immediate response by the regime was to launch missile attacks on energy infrastructure in the region and effectively close the Strait of Hormuz, leading to supply disruptions within the commodity complex. The global landscape had been significantly altered.

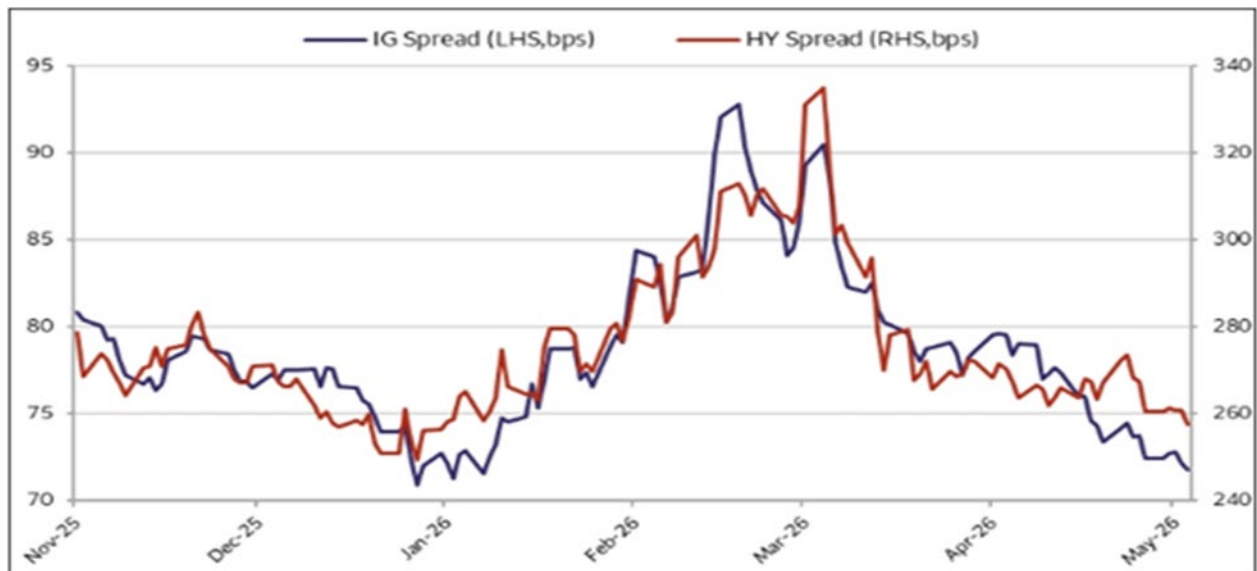
The month of March proved to be painful for relatively all asset classes. Global equity and bond markets declined as crude prices soared and rate volatility ensued. A dramatic shift in policy expectations followed in developed markets as potential inflation worries and fiscal concerns took hold. The Bank of England, the European Central Bank, and the Federal Reserve all witnessed their year-end rate assumptions repriced by 100bps, 75bps, and 50bps, respectively. Treasury yields moved 30-45bps higher, led by the front-end as the curve bear flattened during the month. Investment-grade and high-yield spreads widened to intramonth peaks of 94bps and 346bps, respectively, before pulling back towards the end of the month, as a slowdown in supply and dealer inventory levels helped, from a technical perspective. IG corporate bonds fell approximately 2.00%, while high-yield debt fared a little better due to its lower duration profile. Policymakers held rates steady at the March FOMC meeting but revised their yearly inflation projections higher, considering the developing uncertainty in the Middle East.

**Exhibit 4: Treasury yield curve bear flattened in March**  
2yr Treasury yield was up 42bps, 30yr Treasury yield – up 30bps.

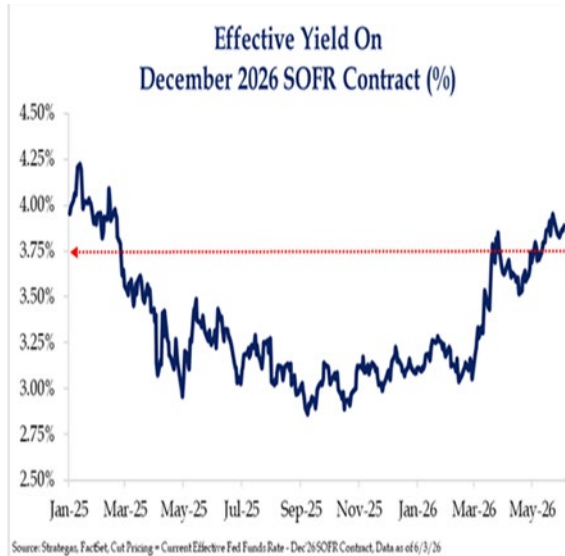


Source: Bloomberg

BofA GLOBAL RESEARCH



Risk-on sentiment filtered through financial assets in April due to the resilience of the domestic economy and the de-escalation of the war despite the oscillating moves in energy prices. An agreed-to ceasefire early in the month led to an abrupt drop in oil prices, only to be reversed a short time later after the US authorized a naval blockade. In turn, treasury yields declined during the first part of the month and then reversed course in the latter half, leaving them marginally higher by month-end. March payroll data shattered expectations, driven by growth in education and health services. The unemployment rate dropped to 4.3%; however, hours worked and wages came in below expectations. Retail sales came in stronger than expected despite the surge in gasoline prices. Investment-grade spreads tightened approximately 10bps as overall corporate yields remained attractive around 5.15%. High-yield debt provided a healthy total return of 1.70%, while lower CCC-rated securities registered returns closer to 3.00%. This should come as no surprise, given that the S&P 500 reached all-time highs with double-digit returns in the month of April. At the FOMC meeting near the end of the month, Chairman Powell announced his intention to stay on “for a period of time” as a Fed Governor and “keep a low profile,” despite the Department of Justice dropping its probe regarding building cost overruns. There were three dissenting votes due to the continuation of an easing bias, indicating inflation as the near-term concern for policymakers.



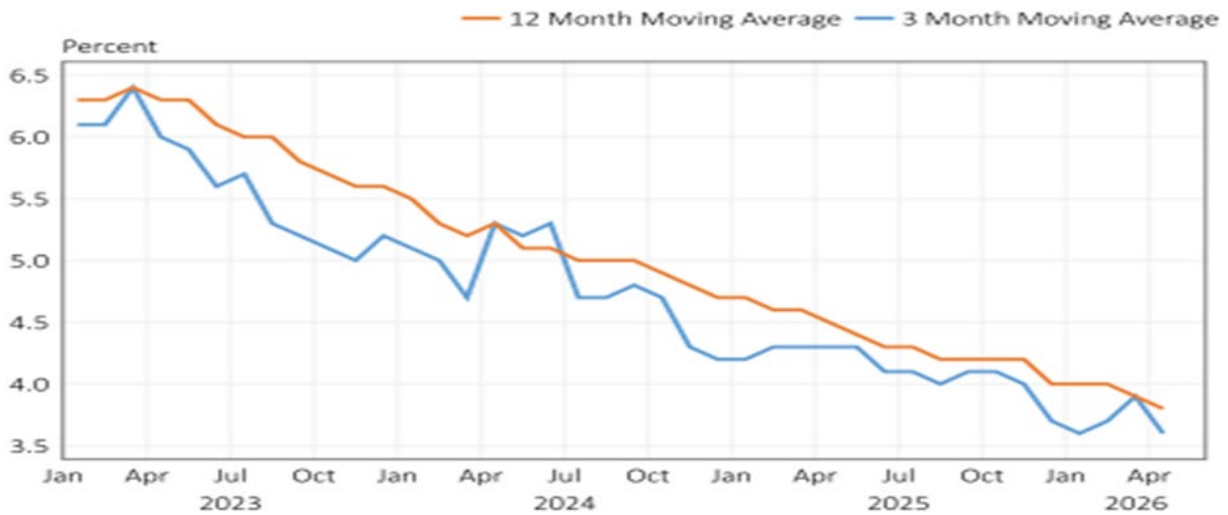
While the stalemate in the Strait continued in May, energy prices remained high, igniting prolonged inflation fears, and pushing global yields to decade highs. Coupled with political strife, UK borrowing costs soared as 10yr gilts eclipsed 5.00%, up 70bps since the war began. The Reserve Bank of Australia raised rates at its third consecutive meeting. Domestically, April CPI data came in hotter than expected, with upward movement in core services inflation. Headline prices at the production level jumped 1.4% in April and 6.0% yoy. Benchmark 10yr and 30yr treasury yields hit 4.67% and 5.18% respectively, pushing the long bond to its highest level since 2007. Corporate credit spreads have

remained unfazed by the ongoing conflict and rising government yields, falling back to levels last witnessed in the late 90s. There was a relief rally in the long end of global yield curves towards the end of the month as reports of a deal were moving in the right direction.

Trading within the fixed income portfolio has been mostly reinvestment-induced from maturing debt. The fund has replaced two treasury maturities, taking advantage of the increase in treasury yields during this period. In the corporate sector, the RSA purchased a short block of Ford paper at an attractive spread level to replace a maturing note in the same name. The fund also initiated 5yr and 7yr positions in Honeywell Aerospace to help shore up our underweight positioning in the sector. Other purchases included a 4nc3 bank note issued by Morgan Stanley and Aflac's new 10yr security. In the agency sector, one that has been largely ignored, the RSA purchased a sizable 3yr callable note that trades at a 30bp discount to its bullet counterpart. Within the mortgage sector, the objective has been to reduce interest rate risk by purchasing 15yr securities and swapping lower coupon notes into higher coupon alternatives.



## Atlanta Fed Wage Growth Tracker



Source: Evercore ISI, Federal Reserve Bank of Atlanta

The current interest rate environment appears poised to drift higher with a flattening bias in the near term. The labor market can be described as relatively stable while core inflation remains elevated on a 3-month, 6-month, and year-over-year basis. The economic windfall afforded by the acceleration of technological innovation should keep yields somewhat elevated. Investment-grade corporate issuance has surpassed \$1 trillion so far in 2026, a 20%+ increase from the previous year, in large part due to the amount of capital being deployed at the largest tech companies. Corporate spreads look to be fully valued from a historical perspective; however, earnings continue to rise, recession fears have abated, and a looming default cycle ahead seems far-fetched. Other central banks are likely to raise short-term interest rates over the next couple of weeks. Despite the shift towards rate hiking expectations, the fund believes the bar for the Fed to make a similar move remains high, absent an uptick in wages due to labor market tightness. So, at this time, the consensus is that policymakers will remain on hold through the end of the year. Real consumer spending has started to wobble as wage growth is struggling to keep up with rising consumer prices. Absent second-round effects, we believe raising rates in response to a supply-side driven move in inflation might prove to be a mistake down the road.

# Domestic Equity Strategy

*By Kevin Gamble*

“May you live in interesting times” is an English expression claimed to be a translation of a traditional Chinese curse. Well, we are certainly living in interesting times! Just to start, we have a U.S. stock market as measured by the S&P 500 hitting all-time nominal highs at the very same time U.S. consumer sentiment is recording the lowest readings in 75 years of data from the University of Michigan. For some reason, we are back to expanding the Federal Reserve’s balance sheet (QE since early December) despite recording 62 consecutive months of inflation readings above the stated 2% target. In addition to QE from the Fed, the Federal government continues to run an extremely large budget deficit (6%+ of GDP), which is an inflationary policy on the margin. On top of this, we have a war in the Middle East with the closure of the Strait of Hormuz straining many commodity markets that flow through the strait, not the least of which is 20% of the world’s daily oil supply (20 million barrels a day).

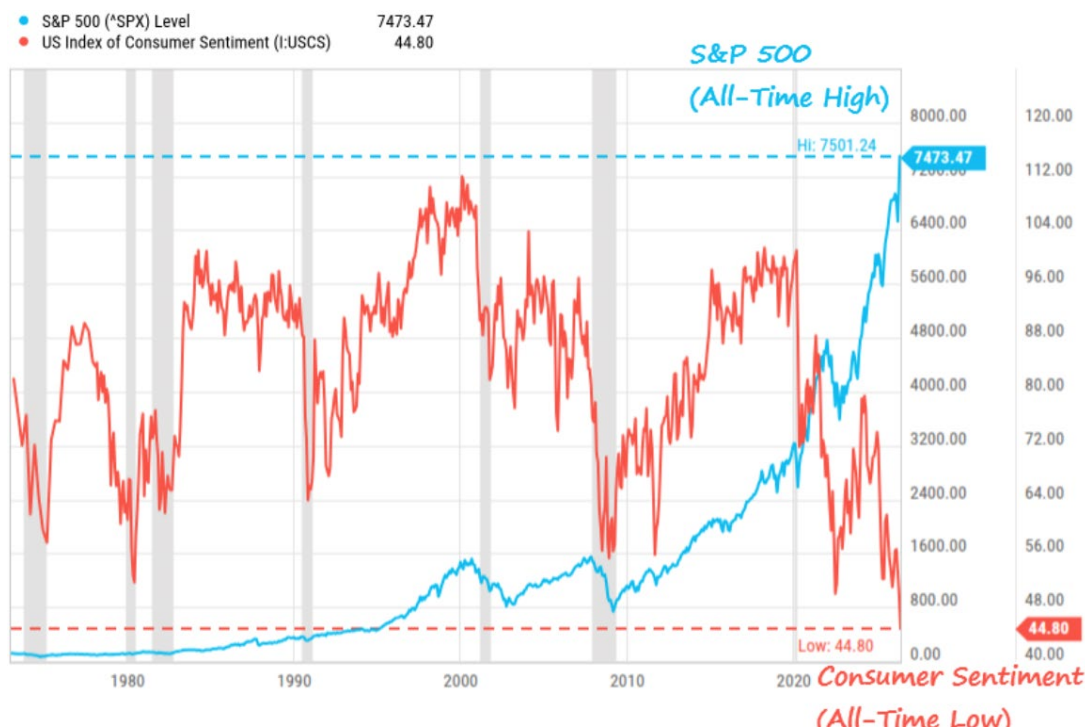
Against this already extreme backdrop, we have an AI arms race among the largest of the hyperscalers to outdo each other for future compute power. As part of this arms race, we have large upcoming IPOs to look forward to from the likes of SpaceX, OpenAI, and Anthropic. To complicate matters even further, the U.S. bond market is currently enduring its longest and most severe drawdown in U.S. history (70 months and counting).

As if the above were not enough, we have a brand-new Federal Reserve chairman, as well as upcoming midterms in the fall, which are bound to have many twists and turns given the evenly divided Congress and high-stakes nature of the outcome. The unsustainably large wealth gap has become a defining issue in U.S. politics. Are Fed rate hikes bullish or bearish against the current backdrop of record levels of U.S. debt, as well as record levels of money market funds? Arguably, rate hikes are bullish for the top of the K and bearish for the bottom of the K. Can an already strained bottom of the K take additional rate hikes?

If anyone claims to know exactly how this witch’s brew is going to play out, be skeptical! Perhaps it is wise for all of us to approach what lies ahead with “radical open-mindedness,” a saying attributed to successful hedge-fund manager Ray Dalio.

They often say, “a picture is worth a thousand words,” thus my goal with this strategy update is to present relevant pictures that define the current investing backdrop with as few words as possible to distract from the importance of the pictures. What a fascinating time to be alive!

## Exhibit 1: S&P 500 vs. U.S. Consumer Sentiment



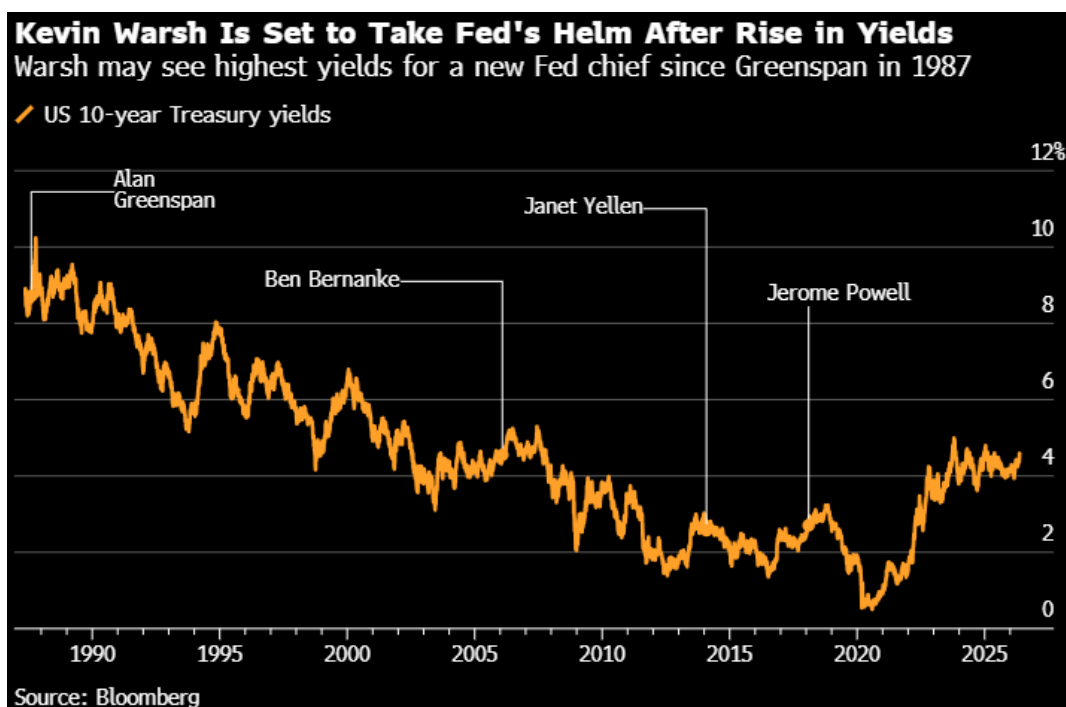
Source: Creative Planning

## 10 Important Topics w/ Relevant Pictures

### 1) Kevin Warsh is now the Fed Chair

In addition to being “central casting” according to President Trump, given his boyish good looks and ability to communicate well on television, when one thinks of Kevin Warsh, the first thing that comes to mind is that he is a supply-sider who has stated he would like to reduce the Fed’s balance sheet. It should be noted that he walks into a Fed that is currently expanding its balance sheet through “reserve management or QE.” Warsh importantly views AI in a positive light as potentially increasing our productivity levels to drive supply-side output. He is also a proponent of using trimmed mean or median PCE as a better measuring stick than traditional Core PCE to filter out extreme or outlier price movements from the inflation data. At his White House swearing-in ceremony, Warsh strategically referenced Greenspan (the last Fed chair to be sworn in at the White House) and not Bernanke (the chair Warsh served under for all five years as a governor). This is key as it aligns with Trump and Bessent’s view that we are in a period most like the 1990s. Historically, new Fed chairs have always been tested by the markets, and it seems reasonable to assume that Warsh will be as well.

## Exhibit 2: New Federal Reserve Chairs and Associated 10-Year Treasury Yields



Source: Bloomberg

## Exhibit 3: S&P 500 Performance Under New Federal Reserve Bank Chairs

### Stocks Can Have Trouble With New Fed Leadership

S&P 500 Performance Under New Federal Reserve Bank Chairs

Fed Chair	Date Appointed	Max 3-Month Drawdown	Date Of 3-Month Drawdown Low	One Year Off 3-Month Drawdown
Eugene Meyer	9/16/1930	-32.2%	12/16/1930	22.9%
Eugene Black	5/19/1933	-20.9%	7/21/1933	29.5%
Marriner Eccles	11/15/1934	-8.0%	2/6/1935	15.4%
Thomas McCabe	4/15/1948	-3.8%	5/14/1948	-6.0%
William Martin	4/2/1951	-7.8%	5/25/1951	-45.1%
Arthur Burns	2/1/1970	-11.0%	4/28/1970	15.4%
William Miller	3/8/1978	-3.0%	5/26/1978	11.1%
Paul Volcker	8/6/1979	-10.1%	10/25/1979	63.8%
Alan Greenspan	8/11/1987	-33.2%	10/19/1987	29.5%
Ben Bemanke	2/1/2006	-2.2%	2/7/2006	-2.8%
Janet Yellen	2/3/2014	-4.0%	4/11/2014	13.5%
Jerome Powell	2/5/2018	-7.3%	4/2/2018	3.8%
Average		-12.0%		12.6%
Median		-7.9%		14.4%
% Positive				75.0%

Source: Carson Investment Research, FactSet 05/21/2026  
@ryandetrack



Source: Carson Investment Research

## 2) Public Sentiment Toward Data Centers is Souring Quickly Against a Widening Wealth Gap in America

While data centers and associated AI CAPEX spending are bullish for all the companies benefiting from the spending: construction companies, energy infrastructure, and AI tech hardware providers, it is important to note that this spending carries significant political risk and is not perceived to benefit all. Data centers provide benefits to communities in the construction phase but come with tremendous resource costs once they are “turned on” and the construction is over. They also do not leave many jobs behind relative to the future costs on communities. These costs come in the form of water usage as well as significantly higher utility costs. Are these data centers net positive or are they a dangerous Trojan Horse for communities? Will SpaceX allow for data centers to just orbit the universe in the future? Time will tell, the important point is that public sentiment is quite negative, and AI companies are going to need a better message as to how this massive CAPEX spending is going to benefit the greater good once complete.

### Exhibit 4: Samples of Data Center Public Sentiment



**unusual\_whales** ✓  
@unusual\_whales

X.com

"The only thing growing faster than the artificial-intelligence industry may be Americans' negative feelings about it," per WSJ



**Bannon's WarRoom** ✓ @Ba... · 2m ...  
The American People Outright Reject the Oligarchs and Their Data Centers —Zero to do with Chinese Influencers



**Joe Schad**  @schadjoe · 22m  ...

I am seeing college commencement speakers BOOED when mentioning AI

Does this surprise you?



**The Washington Post** 

**X.com**

@washingtonpost

A Gallup poll found that seven out of 10 Americans said they would oppose a data center being built near them.

Opposition is so intense, the poll found, that more Americans would rather live near a nuclear power plant than a data center.



**Jeffrey Gundlach** 

**X.com**

@TruthGundlach

AI energy, materials and water needs might be the catalyst for the 4th turning kicking into high gear. Might turn out that human workers will be cheaper than AI, given resource limitations.



**Nobody Special**  @JG... · 49m  ...

“AI is going to make almost everything cost less.” Yup, just like:

Copper

Electricity

Memory

Water

Gas Turbines

*Source: X*

### **3) Party Like It's 1999?**

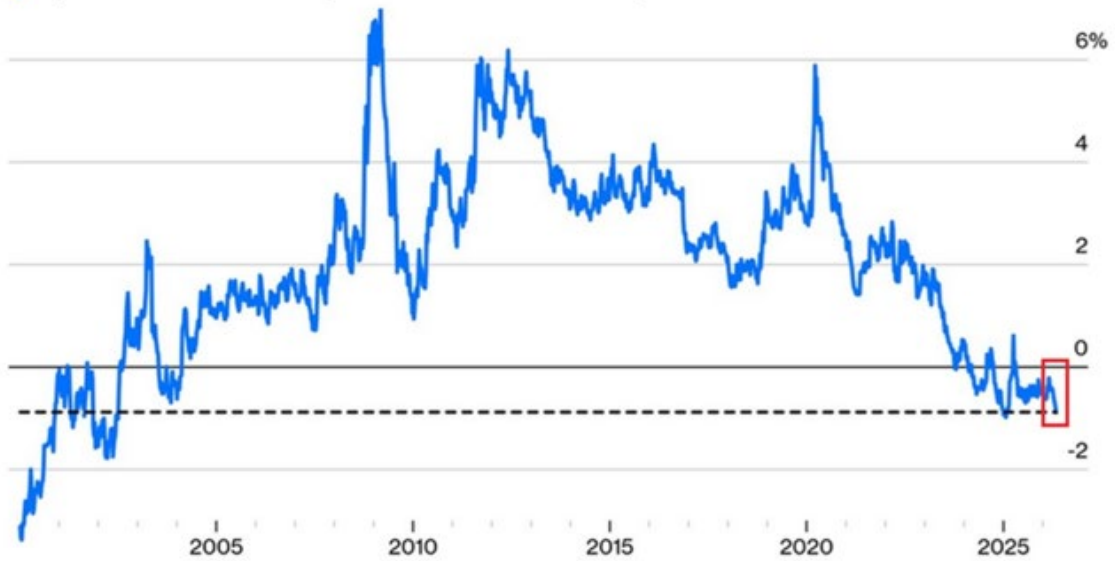
While Prince is unfortunately no longer with us, there is just no doubt that the U.S. stock market is starting to feel more and more like the late 1990s era. After all, this is the era Trump and Bessent would like to imagine that we are in, as by the end of this era, we had a federal government surplus for a short period of time! This backdrop presents its challenges for investors as the equity market is very expensive on almost all measures, but it can certainly go much higher than a rational investor could ever imagine.

## Exhibit 5: We Now Have an Equity Risk Discount vs. the 10-Year Treasury

### Equity Risk Discount

The bond market is no longer giving US stocks any support

Spread of S&P 500 Earnings Yield Over 10-Year Treasury Yield



Source: Bloomberg

Bloomberg Opinion

Source: Bloomberg

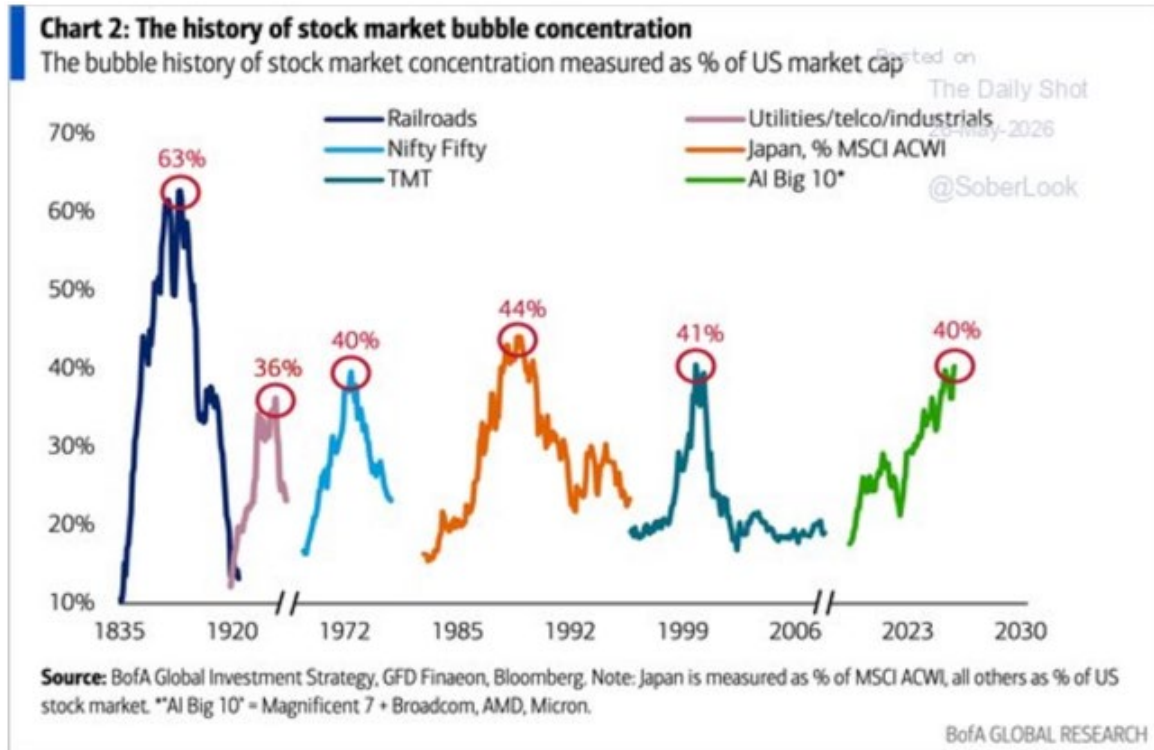
## Exhibit 6: Semiconductor Stocks Have Exploded Higher in Late 1990s Fashion

**Barchart**  @Barchart · 12h  
Semiconductor Stocks are now trading above their 200-day moving average by the largest margin since the Dot Com Bubble Burst 🚀🚀🚀



Source: Barchart/X

## Exhibit 7: Bubble Concentration Risks Are Present



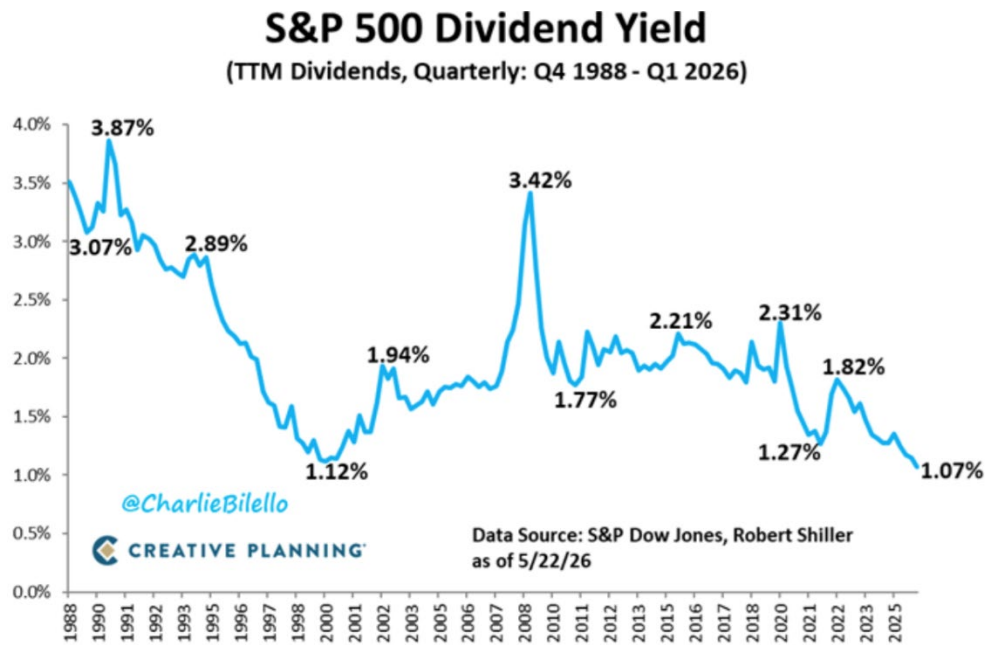
Source: BofA Global Research

## Exhibit 8: Shiller P/E Rarely Been This Expensive



Source: Robert Shiller

## Exhibit 9: We Have Reached an All-time Low Dividend Yield for the S&P 500

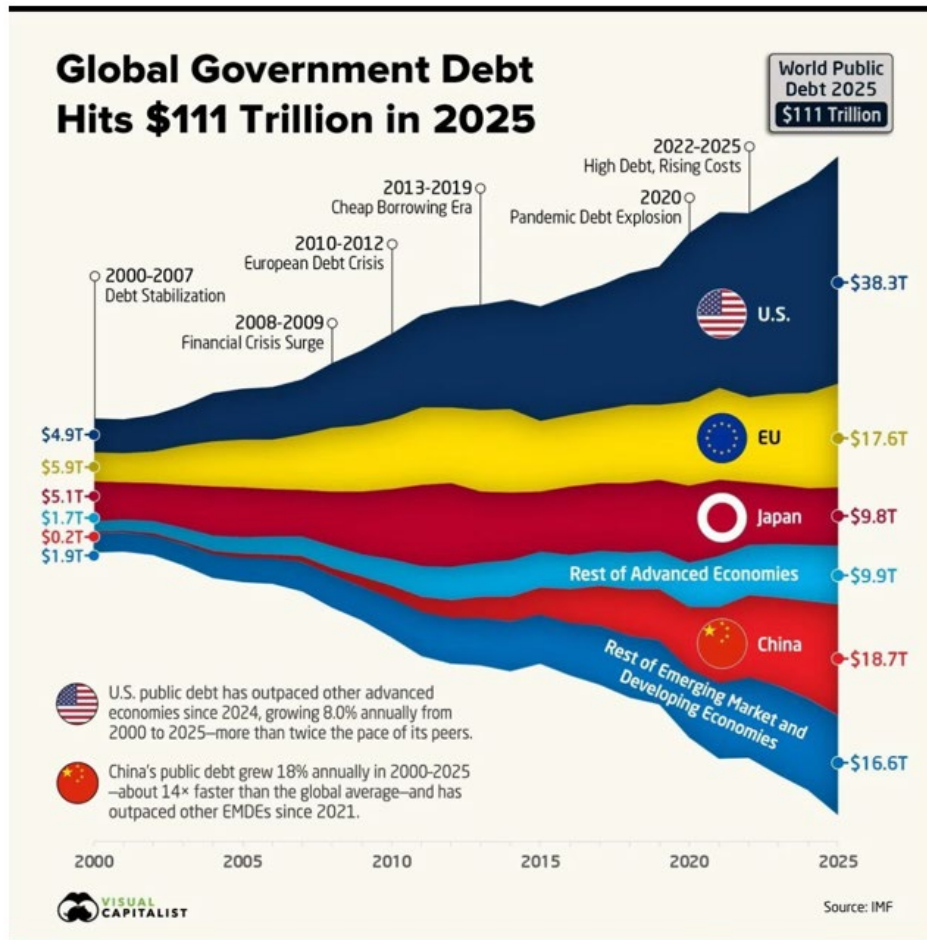


Source: Creative Planning

#### 4) The Global Debt Bugle and U.S. Debt Snowball

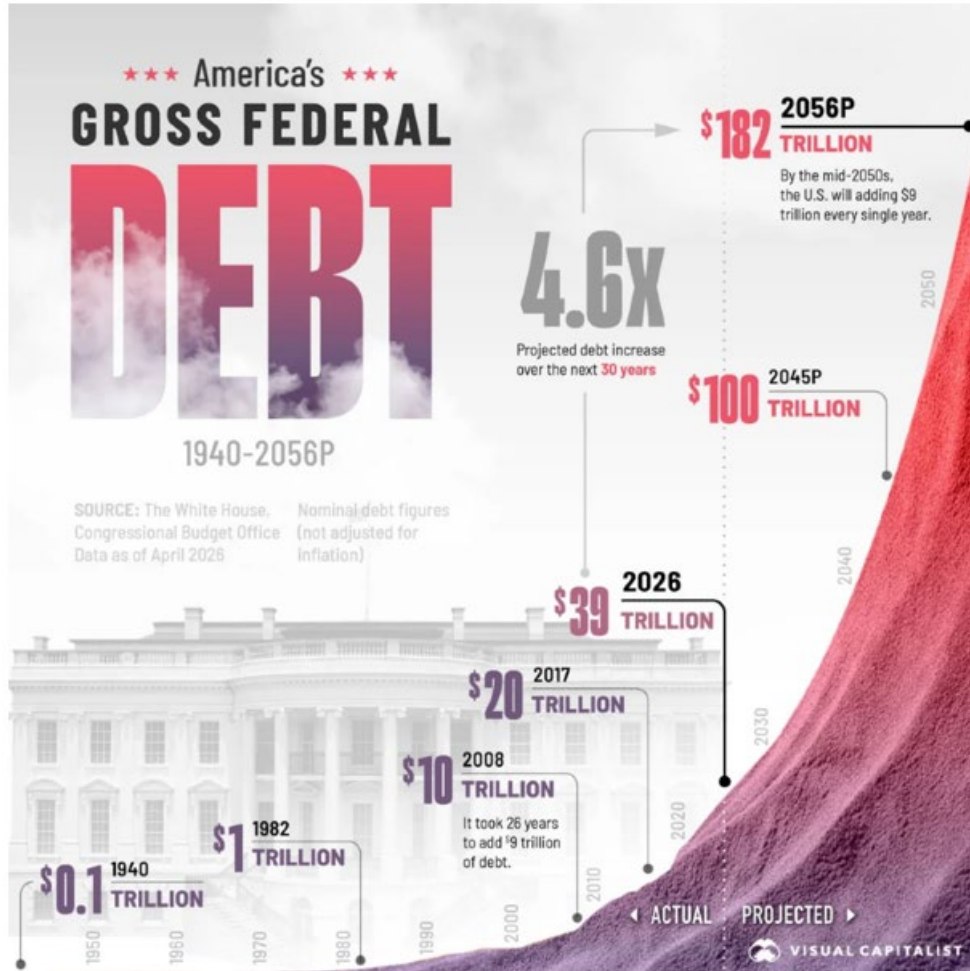
Both global and U.S. debt have been increasing at an exponential pace with no sign of an ending point. We have often written about a “nothing stops this train” situation. This expanding level of debt will likely face its limits at some point and will most certainly be a cornerstone issue to contend with as one models out what the future might hold.

**Exhibit 10: The Global Debt Bugle – Public Debt Explosion is Global**



Source: IMF/Visual Capitalist

**Exhibit 11: U.S. Federal Debt Snowball is Building and Picking Up Steam**



Source: White House Congressional Budget Office/Visual Capitalist

**5) FOMO (Fear of Missing Out) vs. FEMO (Fabulous Earnings Momentum)**

The current investing backdrop has an element of “FOMO” combined with strong earnings momentum “FEMO” providing underlying support to the bullish price action.

## Exhibit 12: Hedging is Out of Favor (FOMO)



Source: Barchart/X

## Exhibit 13: Margin Debt is at Record Levels (FOMO)

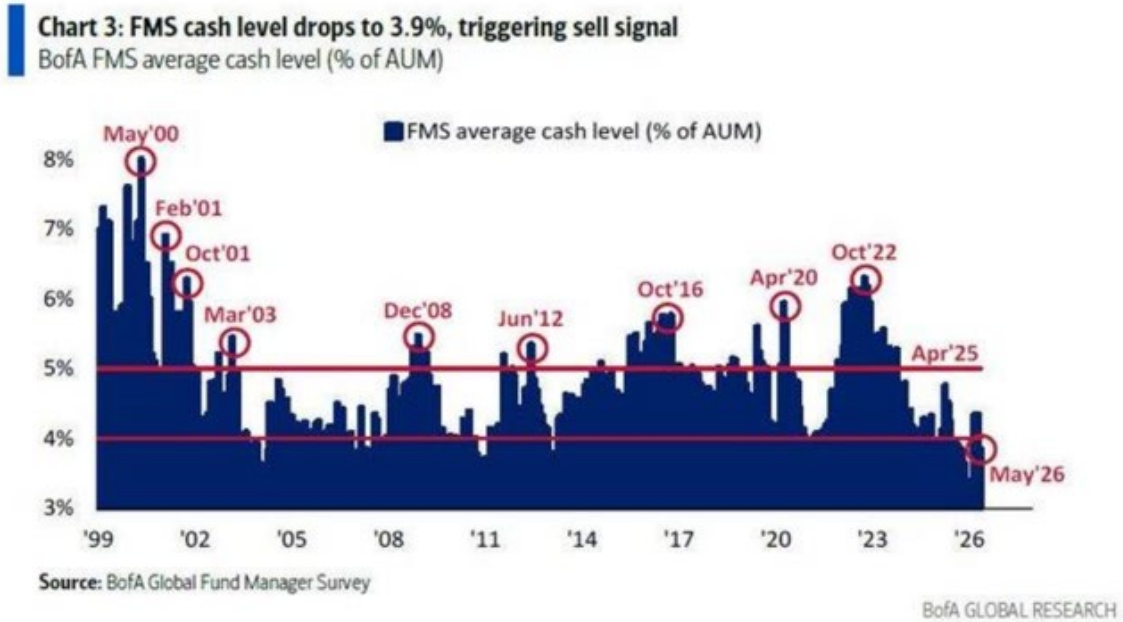
Margin debt provided by broker-dealers at a record-high \$1.304 trillion

SAKONNET RESEARCH



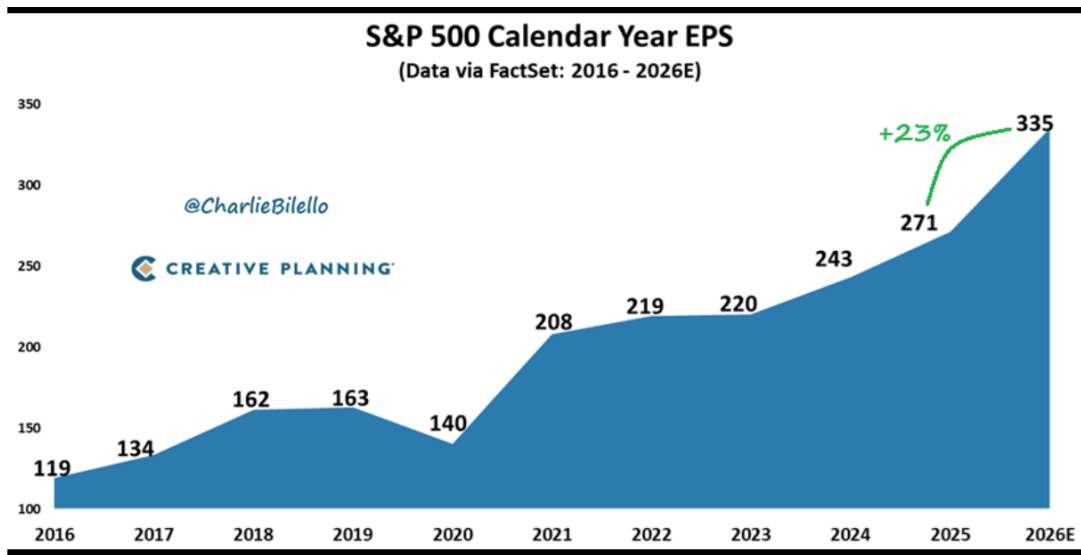
Source: FINRA/Sakonnet Research

## Exhibit 14: Fund Manager Cash Levels are at Record Lows (FOMO)



Source: BofA Global Fund Manager Survey

## Exhibit 15: S&P 500 Earnings Per Share (FEMO)



Source: Creative Planning

## Exhibit 16: EPS Momentum Factor Has Dominated Performance (FEMO)



Source: Factset

### 6) The Average Consumer is Running out of Gas/Buffett is Cautious

There are certainly increasing warning signs that the median U.S. consumer is out of gas, both literally in some cases and figuratively. Warren Buffett is and has been positioned very cautiously against this backdrop and has warned that we are in a gambling type mood, which is undeniable given the explosion in prediction markets and crypto trading.

### Exhibit 17: U.S. Consumer is Struggling at the Bottom of the K



**unusual\_whales**  @unu... · 5h  

13.1% of US credit card balances are now 90+ days delinquent, the highest level since 2011, per NY Fed

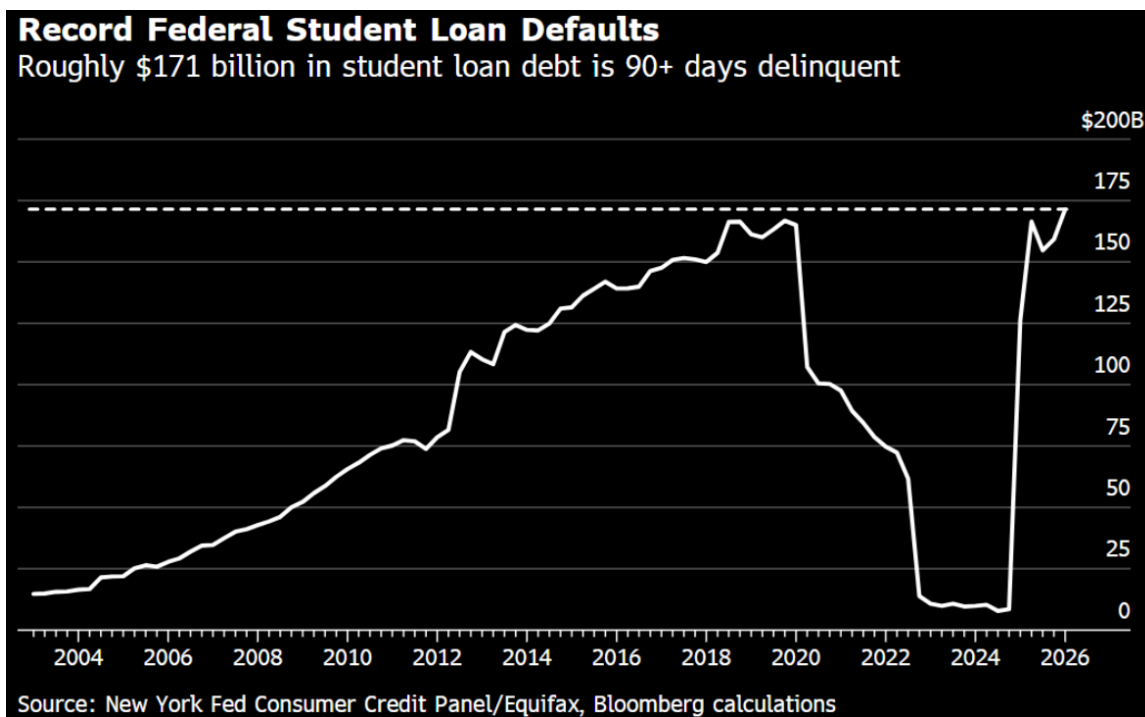


**unusual\_whales**  @un... · 57m  ...

**BREAKING:** Americans are feeling worse about the economy now than they were during the COVID-19 pandemic, the financial crisis, and following the 9/11 attacks, per YF

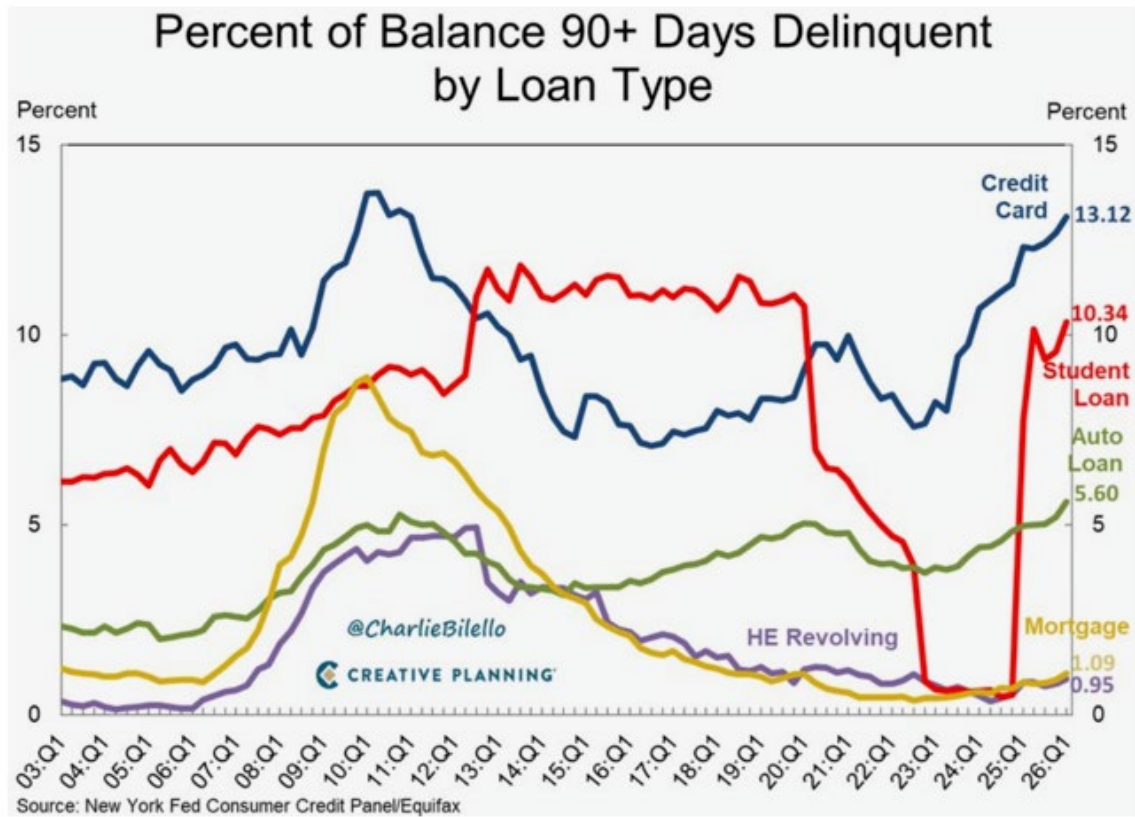
Source: X

### Exhibit 18: Record Federal Student Loan Defaults



Source: Equifax

**Exhibit 19: Consumer Loan Delinquencies Showing Major Stress on Median Consumer**



Source: New York Fed/Equifax

Exhibit 20: Warren Buffett is Concerned

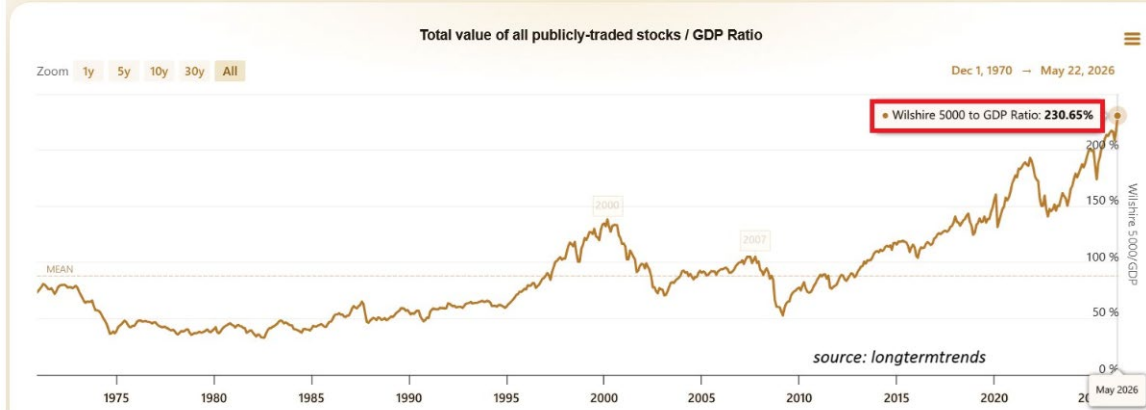


Source: X

**Exhibit 21: Buffett Indicator (Market Cap to GDP) is Off the Charts in the U.S.**

## The Buffett Indicator: Market Cap to GDP

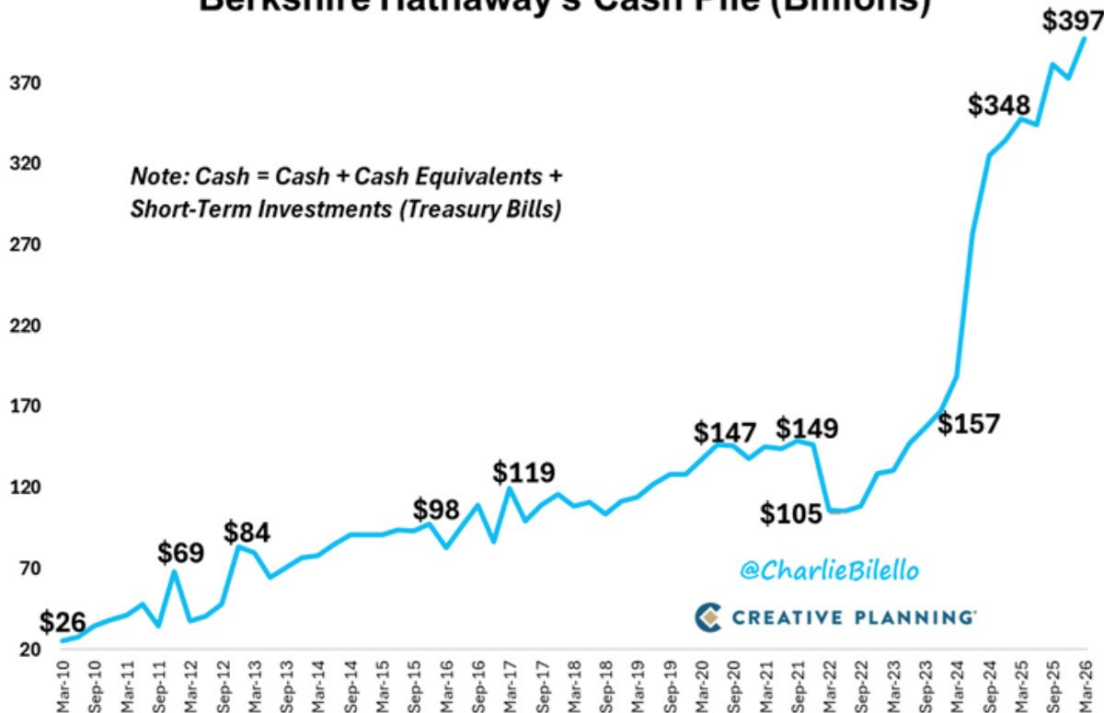
Wilshire 5000 to GDP Ratio



Source: X/longtermtrends

**Exhibit 22: Buffett Cash Pile is Building and Building (Owns 5% of U.S. T-Bills)**

## Berkshire Hathaway's Cash Pile (Billions)



Source: Creative Planning

## 7) Can the U.S. and China Avoid Thucydides Trap? Trump and CEOs Visit China

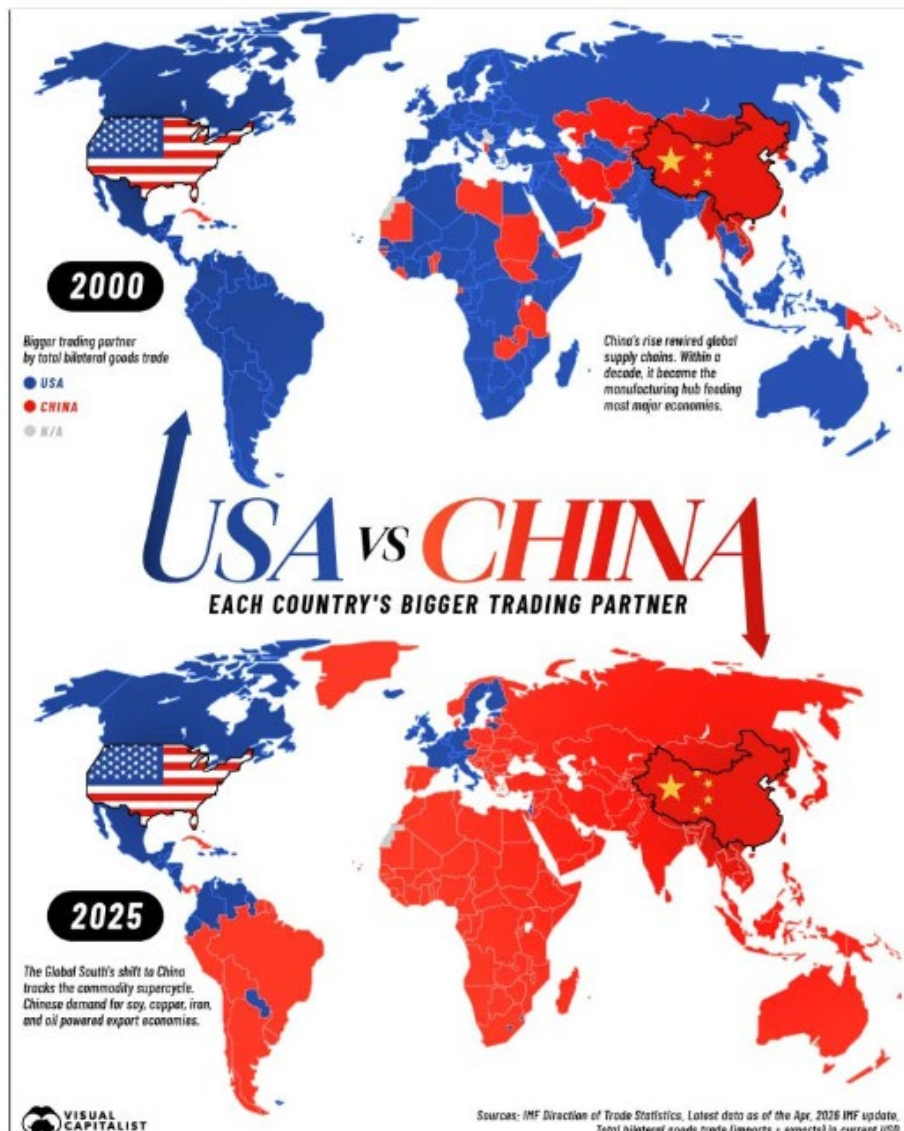
The Thucydides trap is a political theory stating that when a rapidly rising power threatens to displace an established ruling power, the resulting structural stress makes violent conflict the rule rather than the exception. Interestingly, President Xi referenced this trap during Trump's recent state visit to China, so it is clearly something that is on his mind.

### Exhibit 23: Thucydides Trap Case Studies

Thucydides Trap Case Studies						
	Period		Ruling Power	Rising Power		Result
1	First half of 16th century		France	Hapsburgs		War
2	16th–17th centuries		Hapsburgs	Ottoman Empire		War
3	17th century		Hapsburgs	Sweden		War
4	17th century		Dutch Republic	England		War
5	Late 17th–early 18th centuries		France	Great Britain		War
6	Late 18th–early 19th centuries		United Kingdom	France		War
7	Mid-19th century		United Kingdom, France	Russia		War
8	19th century		France	Germany		War
9	Late 19th–early 20th centuries		Russia, China	Japan		War
10	Early 20th century		United Kingdom	United States		No war
11	Early 20th century		Russia, U.K., France	Germany		War
12	Mid-20th century		Soviet Union, U.K. France	Germany		War
13	Mid-20th century		United States	Japan		War
14	1970s–1980s		Soviet Union	Japan		No war
15	1940s–1980s		United States	Soviet Union		No war
16	1990s–present		United Kingdom, France	Germany		No war

Source: X

## Exhibit 24: China is Rapidly Growing in Trade Influence Around the World



Source: X

### 8) SpaceX IPO – Valuation is Astronomical – Signs of a Top Approaching or an Amazing New Frontier or Both?

There is expected to be a lot of equity supply coming to market this summer in the form of SpaceX, Anthropic, and OpenAI. Index providers are scrambling to rewrite their inclusion rules to accommodate the expected demand for these issuances. Oftentimes, large IPOs can be challenging for markets as they must be funded from somewhere.

## Exhibit 25: Largest 10 IPOs of All Time and Market Reaction

<b>Largest 10 IPOs of all Time and Market Reaction</b>						
Alibaba and ICBC were the “rocket fuel” IPOs						
Company	IPO Date	IPO Size	3M %Chg*	6M %Chg*	9M %Chg*	12M %Chg*
Aramco	Dec. 2019	\$26b	-5%	-8%	0%	+10%
Alibaba	Sept. 2014	\$22b	+32%	+51%	+119%	+38%
SoftBank	Dec. 2018	\$21b	-1%	-2%	0%	+10%
NTT	Oct. 1998	\$18b	-2%	+17%	+30%	+23%
Visa	Mar. 2008	\$18b	+2%	-6%	-34%	-43%
AIA Group	Oct. 2010	\$18b	+3%	-1%	-8%	-22%
Enel	Nov. 1999	\$17b	+22%	+36%	+29%	+26%
Facebook	May 2012	\$16b	+8%	+5%	+16%	+25%
GM	Nov. 2010	\$16b	+13%	+13%	0%	+7%
ICBC	Oct. 2006	\$14b	+54%	+102%	+118%	+237%

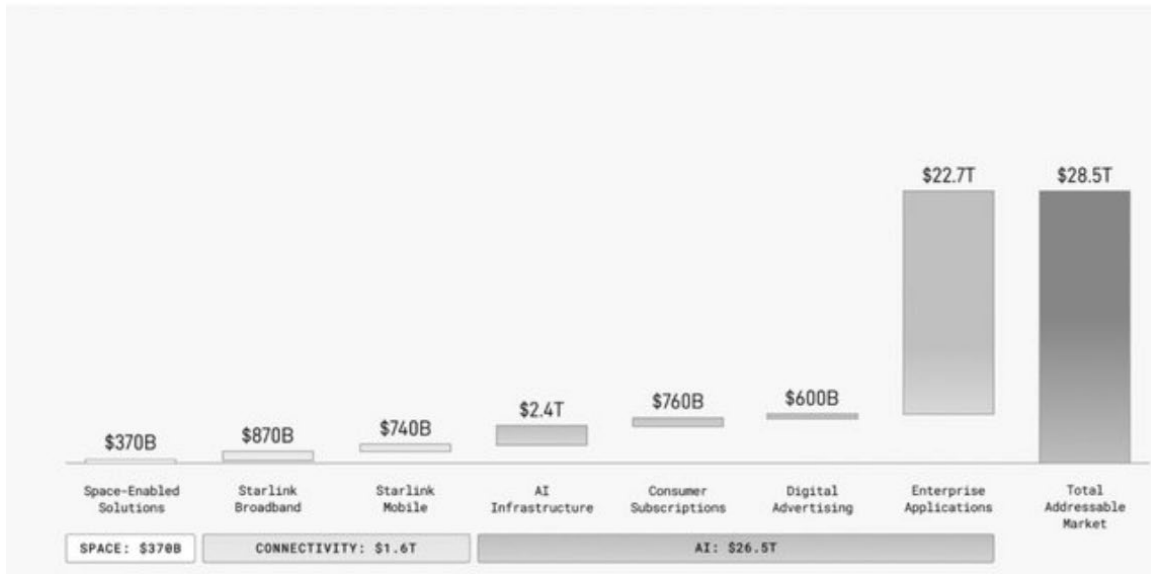
Note: \*Tadawul (Saudi Aramco), Shanghai Composite (Alibaba, ICBC), Hang Seng (AIA Group), Nikkei (SoftBank, NTT), S&P 500 (Visa, Facebook, GM), Euro Stoxx 50 (Enel)  
Source: Bank of America

**Bloomberg**

Source: Bloomberg

## Exhibit 26: SpaceX's Estimated TAM by Segment

*SpaceX's Estimated TAM by Segment*



Source: Company filings

## Exhibit 27: SpaceX's Projected to Join the Mega Market Caps

**SpaceX's Potential Spot Among Heavyweights**  
Company's IPO ambitions would rival some of the largest S&P 500 firms

	Market Cap
Nvidia Corp.	\$5.46T
Alphabet Inc.	4.79T
Apple Inc.	4.41T
Microsoft Corp.	3.13T
Amazon.com Inc.	2.84T
Broadcom Inc.	2.01T
<b>SpaceX</b>	<b>2T</b>
Tesla Inc.	1.59T

Source: Bloomberg

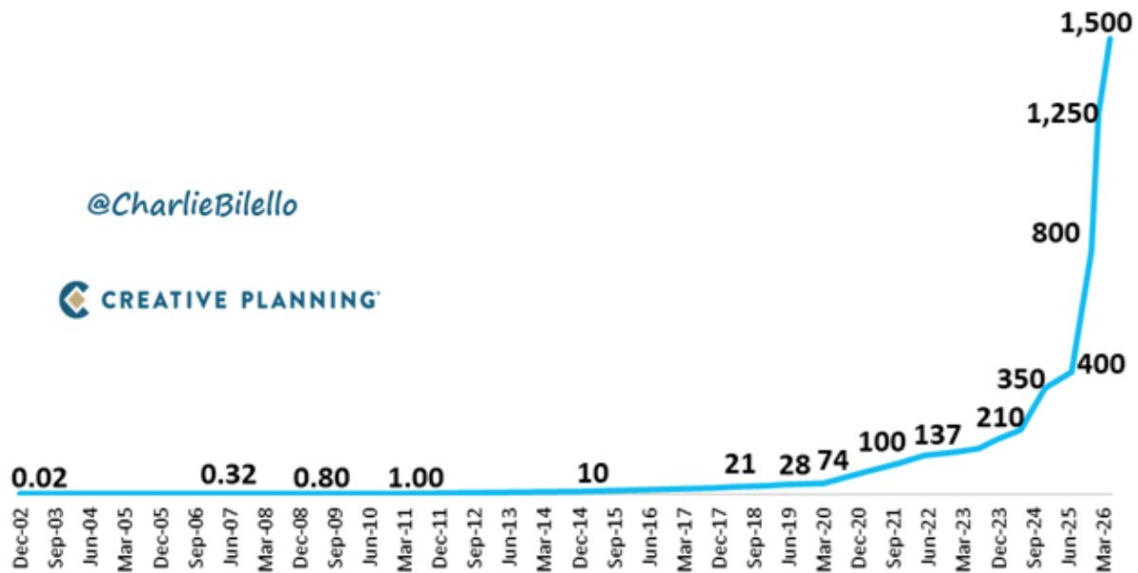
**Bloomberg**

Source: Bloomberg

## Exhibit 28: SpaceX's Valuation History – Blast Off!

### SpaceX Valuation History, \$ Billions

(December 2002 - May 2026)



@CharlieBilello

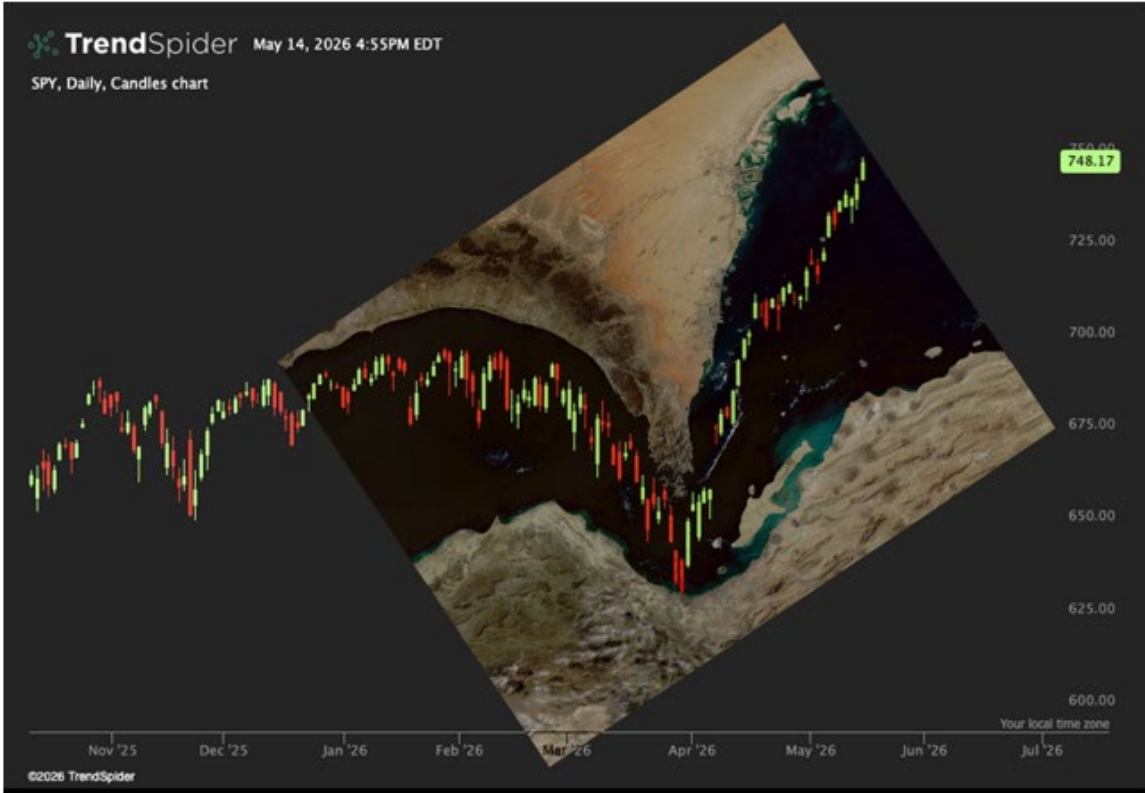
CREATIVE PLANNING

Source: Creative Planning

## 9) Iran Conflict Has Not Slowed Down U.S. Equity Markets

The Iran War has certainly been part of the headlines, driving equity markets, but has not slowed the SPX earnings momentum yet. The data center CAPEX spending continues to drive the investment side of the GDP equation, while the overall U.S. consumer has remained resilient to this point.

**Exhibit 29: S&P 500 Has Shaken off the Iran Conflict**



Source: Trend Spider/X

## 10) Trennert Top Checklist

### Exhibit 30: Strategas Top Checklist

	2000	2007	Current	Comments
1. Blow-off top	✓	✓	X	While there are pockets of the market like semiconductors that are stretched, the market is within a reasonable level above its 200-day moving average.
2. Heavy inflows into equity market funds	✓	✓	X	Flows into Equity ETFs reflect not only broad optimism but also a structural transition away from mutual funds. Trailing 12-month inflows are currently in the 69 <sup>th</sup> percentile.
3. Big pick-up in M&A activity	✓	✓	X	M&A activity was strong in 2025 but well off the frothy levels witnessed in 2021. Deal growth seems consistent with greater strong earnings, tight credit spreads, and greater regulatory certainty. <b>WATCH!</b>
4. IPO activity	✓	✓	X	IPO has been frothy to start 2026 but remains significantly below the euphoric levels of 2021. This seems likely to change with the IPOs set to price later in the year – SpaceX and OpenAI. <b>WATCH!</b>
5. Rising real interest rates	✓	✓	X	Both long and short-term interest rates for Uncle Sam and corporate America remain restrained but persistent and potentially growing inflation due to the war may render real interest rates too low rather than too high.
6. Weakening upward earnings revisions	✓	✓	X	It looks like earnings for 1Q are likely to be 28% versus an expectation at the start of the season of 14%. Upward earnings revisions have been robust. Future returns may be challenged as a result but earnings support for the rally has been strong.
7. Erosion in number of new highs	✓	✓	X	New high data was strong through early-February, but have since weakened. The correction in March reset the internals. The next rally will be a key test. <b>WATCH!</b>
8. Shift towards defensive leadership	✓	✓	X	Sector leadership thus far in 2026 – Energy, Materials, and Industrials – has been highly cyclical.
9. Widening credit spreads	✓	✓	X	High-yield and investment grade credit spreads have risen recently but remain tight by any historical standard.

Source: Strategas

### Equity Strategy Moving Forward

The “buy the dip” mentality is very much alive and well in the current U.S. equity market, as every dip in the QE era following the Great Financial Crisis has been buyable. U.S. equity markets are broadly expensive at the very top of the market, pockets of euphoria and gambling certainly exist in the current markets, equity markets are very concentrated at the index level, and earnings revisions and momentum are very much dominating factors. Against this current investing backdrop, tail risk exists on both sides of the equity market, which makes this a challenging backdrop for a professional investor. 401(k)s and foreign investment flows have continued to provide a strong liquidity tailwind for the large U.S. indices such as the S&P 500 and the NASDAQ 100.

Recently, I heard Jeff DeGraff, who does a great job with market technicals, recommend investors consider “dollar-cost selling” the U.S. equity market and rotating the funds to rebalance. You rarely hear the thought of selling from a Wall Street strategist, but the idea of dollar cost selling made a lot of sense. This strategy can be accomplished via the options market or simply taking some profits off the table as they come on a U.S. equity market, which has performed relatively well in the QE era.

### Exhibit 31: Buyable Corrections in the QE Era

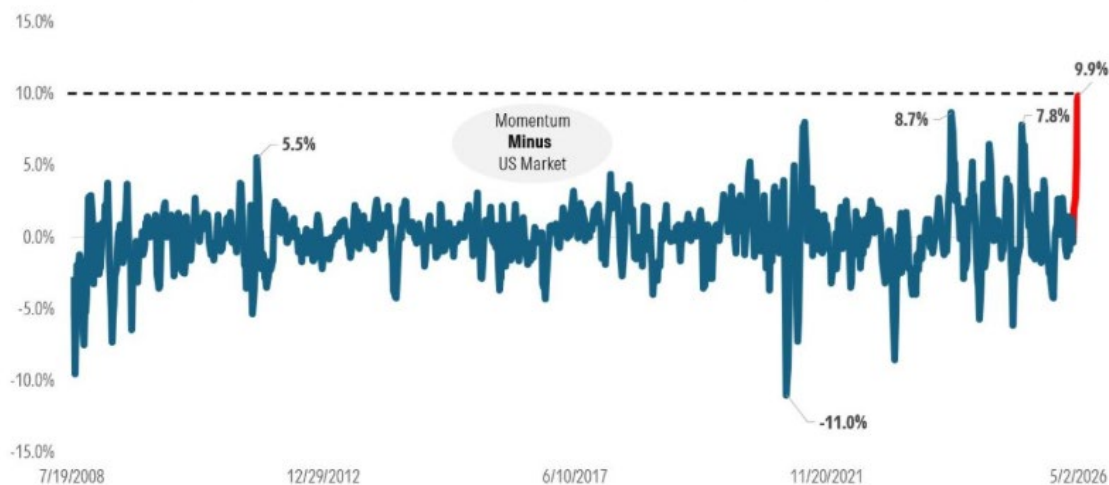
@CharlieBilello		S&P 500 Corrections >5% since March 2009 Low				“Stocks Fall On...”
Correction Period	# Days	S&P High	S&P Low	% Decline		
2026: Jan 28 - Mar 30	61	7002	6317	-9.8%	Iran War, Crude Oil Spike, Private Credit Turmoil, AI Disruption Fears	
2025: Oct 29 - Nov 21	22	6920	6522	-5.8%	AI Bubble Fears	
2025: Feb 19 - Apr 7	47	6147	4835	-21.3%	Tariffs, Trade Wars and Global Recession Fears	
2024: Jul 16 - Aug 5	20	5670	5119	-9.7%	Recession Fears, Fed Behind Curve, Nikkei Crash	
2024: Mar 28 - Apr 19	22	5265	4954	-5.9%	Stubborn Inflation, Fed Pushing Back Rate Cuts, Iran/Israel Conflict	
2022: Jan 4 - Oct 13	282	4819	3492	-27.5%	Inflation, Rising Rates/Fed Tightening, Russia/Ukraine War, Recession Fears	
2021: Nov 22 - Dec 3	11	4744	4495	-5.2%	Covid Omicron Variant, Fed Taper Fears	
2021: Sep 2 - Oct 4	32	4546	4279	-5.9%	China Contagion Fears, Fed Taper Fears, Covid Delta Variant	
2021: Feb 16 - Mar 4	16	3950	3723	-5.7%	Inflation Fears, Rising Rates	
2020: Sep 2 - Sep 24	22	3588	3209	-10.6%	Coronavirus, No New Stimulus Deal, Election Fears	
2020: Feb 19 - Mar 23	33	3394	2192	-35.4%	Coronavirus, Global Depression Fears	
2019: Jul 26 - Aug 5	10	3028	2822	-6.8%	Trade War, Tariffs, Yuan Devaluation, Recession Fears	
2019: May 1 - Jun 3	33	2954	2729	-7.6%	Trade War, Tariffs, Inverted Yield Curve, Global Slowdown/Recession Fears	
2018: Sep 21 - Dec 26	96	2941	2347	-20.2%	Rising Rates, China Slowdown, Trade War/Tariffs, Housing Slowdown	
2018: Jan 26 - Feb 9	14	2873	2533	-11.8%	Inflation Fears, Rising Rates	
2016: Aug 15 - Nov 4	81	2194	2084	-5.0%	Election Fears/Concerns/Jitters	
2015/16: May 20 - Feb 11	267	2135	1810	-15.2%	Greece Default, China Stock Crash, EM Currencies, Falling Oil, North Korea	
2014/15: Dec 29 - Feb 2	35	2094	1981	-5.4%	Falling Oil, Strong Dollar, Weak Earnings	
2014: Dec 5 - Dec 16	11	2079	1973	-5.1%	Falling Oil, Strong Dollar	
2014: Sep 19 - Oct 15	26	2019	1821	-9.8%	Ebola, Global Growth Fears, Falling Oil	
2014: Jan 15 - Feb 5	21	1851	1738	-6.1%	Fed Taper, European Deflation Fears, EM Currency Turmoil	
2013: May 22 - Jun 24	33	1687	1560	-7.5%	Fed Taper Fears	
2012: Sep 14 - Nov 16	63	1475	1343	-8.9%	Fiscal Cliff Concerns, Obama's Re-Election	
2012: Apr 2 - Jun 4	63	1422	1267	-10.9%	Europe's Debt Crisis	
2011: May 2 - Oct 4	155	1371	1075	-21.6%	Europe's Debt Crisis, Double-Dip Recession Fears, US Debt Downgrade	
2011: Feb 18 - Mar 16	26	1344	1249	-7.1%	Libyan Intervention (Civil War), Japan Earthquake/Nuclear Disaster	
2010: Apr 26 - Jul 1	66	1220	1011	-17.1%	Europe's Debt Crisis, Flash Crash, Growth Concerns	
2010: Jan 19 - Feb 5	17	1150	1045	-9.2%	China's Lending Curbs, Obama Bank Regulation Plan	
2009: Oct 21 - Nov 2	12	1101	1029	-6.5%	Worries About The Recovery	
2009: Sep 23 - Oct 2	9	1080	1020	-5.6%	Worries About The Recovery	
2009: Jun 11 - Jul 7	26	956	869	-9.1%	World Bank Neg Growth Forecast, Fears Market Is Ahead Of Recovery	
2009: May 8 - 15	7	930	879	-5.5%	Worries That Market Has Gotten Ahead Of Itself	
<b>Median</b>	<b>26</b>			<b>-8.3%</b>		

Source: Creative Planning

## Exhibit 32: Most Extreme Momentum Outperformance in Almost 20 Years

### Most Extreme Momentum Outperformance in Almost 20 Years

Weekly returns: Morningstar US Momentum Factor Index minus Morningstar US Market Index (July 2008–May 2026)



Source: Morningstar Direct. Time period reflects July 2008 - May 2, 2026. Momentum = Morningstar US Momentum Factor Index. US market = Morningstar US Market Index. Past performance no guarantee of future results. Investments can't be made directly into an index.

MORNINGSTAR Wealth

Source: Morningstar

## Exhibit 33: Thematic ETF Inflows are Growing (Similar to Late 1990s)

### WE'RE SENSING A THEME...

Recent ETF Filings			
ETF	File Date	ETF	File Date
Amplify Top 10 Robotics ETF	5/21/2026	ProShares AI Computing Power ETF	5/14/2026
Amplify Top 10 Space ETF	5/21/2026		
Amplify Top 10 Semiconductors ETF	5/21/2026	REX AI Compute Power ETF	5/21/2026
Amplify Top 10 Quantum ETF	5/21/2026		
Amplify Top 10 Asia Memory ETF	5/22/2026	Roundhill Compute	5/19/2026
		Roundhill Photonics & Optics	5/20/2026
Defiance Korea AI Semiconductor Top 10 ETF	5/21/2026	Roundhill Quantum Computing	5/21/2026
Defiance Korea Semiconductor Top 10 ETF	5/21/2026		
Defiance China Semiconductor Top 10 ETF	5/21/2026	Tema Memory ETF	4/13/2026
Defiance AI Magnificent 10 ETF	5/13/2026		
Defiance Pure Play Memory ETF	5/20/2026	VegaShares AI Inference ETF	5/13/2026
Defiance Inference AI Chip ETF	5/20/2026	VegaShares AI Metals, Miners & Materials ETF	5/13/2026
Defiance AI Packaging & Testing ETF	5/20/2026	VegaShares Junior AI ETF	5/13/2026
Defiance Memory and Photonics ETF	5/20/2026	VegaShares AI Storage ETF	5/13/2026
Defiance DRAM Income ETF	5/13/2026	VegaShares AI Thermal, Cooling & Power Mgmt ETF	5/15/2026
Defiance Nvidia Ventures ETF	5/22/2026	VegaShare AI Networking ETF	5/15/2026
Defiance Google Ventures ETF	5/22/2026	VegaShares AI Rack Hardware ETF	5/15/2026
		VegaShares AI Fab Equipment ETF	5/15/2026
GraniteShares Autocallable SpaceX ETF	5/20/2026	VegaShares AI Compute ETF	5/15/2026
GraniteShares YieldBOOST SpaceX ETF	5/20/2026		
GraniteShares Autocallable DRAM ETF	5/18/2026	Anthropic AI Lab ETF	5/22/2026
		Google DeepMind AI Lab ETF	5/22/2026
KraneShares Public-Private AI Energy Demand ETF	5/12/2026	Meta AI Lab ETF	5/22/2026
KraneShares Optical AI Infrastructure ETF	4/21/2026	OpenAI Lab ETF	5/22/2026
KraneShares High-Bandwidth Memory ETF	4/20/2026	SpaceX AI Lab ETF	5/22/2026

Source: Strategas

### Exhibit 34: Foreign Capital Inflows into U.S. Equities Have Been a Large Tailwind



Source: Federal Reserve data/Topdown Charts

HAPPY 250<sup>th</sup> BIRTHDAY AMERICA! We live in interesting times!

# A Surplus of Confusion About America's Deficits

By Michael McNair

## Intro

Maurice Obstfeld recently published a piece arguing that the dollar's global role is not a primary reason the United States runs a large and persistent current account deficit. The piece went viral, with a number of high-profile economists praising it. That was concerning because it was a deeply flawed argument that should have been immediately evident to these economists. But it shows just how much confusion still surrounds this subject.



## Don't blame America's current account deficit on the dollar

But stablecoin imperialism won't help

Maurice Obstfeld (PIIE)

Obstfeld is one of the most prominent international economists in the world, a former IMF chief economist, a former member of the US Council of Economic Advisers, and a leading textbook author in international economics. When someone with that background publishes a piece like this, it carries weight in policy circles, which is why it is important to address.

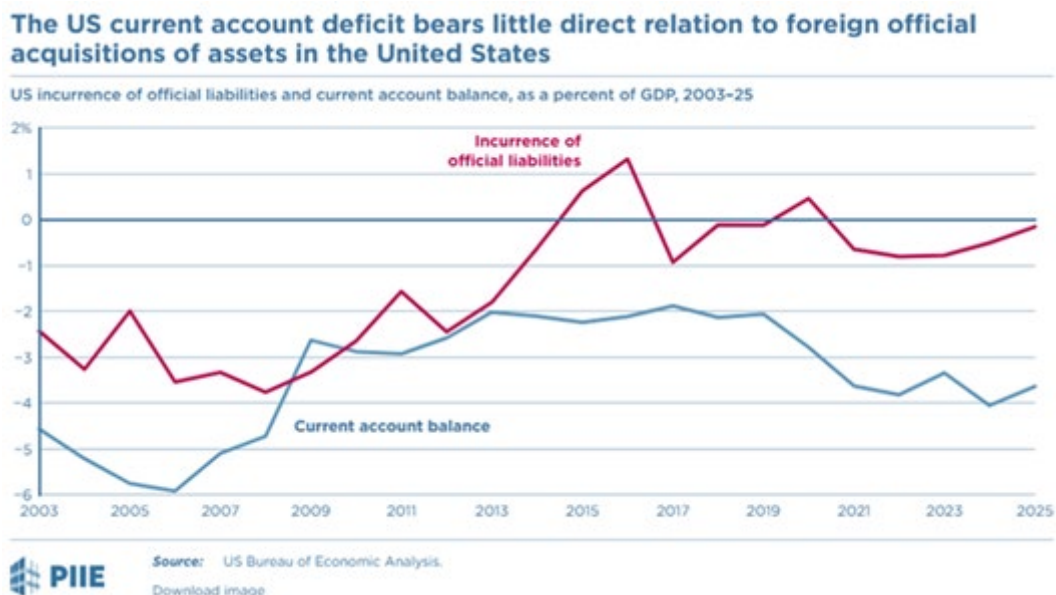
But Obstfeld's piece is actually useful, and not just as a target. Because the errors he makes are the same errors I consistently hear in debates about the dollar and global imbalances. He conflates the dollar's role in payments with its role as a reserve asset. He treats official reserve accumulation as though it were the whole of the reserve currency argument. He uses a historical episode that actually supports the position he is trying to refute. And he ends by prescribing fiscal austerity as the solution without asking why the fiscal deficit got so large in the first place.

Almost every time someone pushes back on the reserve currency argument, they reach for one of these moves. So rather than just saying Obstfeld is wrong, I want to walk through his claims one at a time and show exactly where each one breaks down. If you've ever been in a debate about the dollar's role in global imbalances and weren't sure how to answer the other side, this piece is meant to give you that answer.

In what follows, I will go through the main claims Obstfeld makes and explain why they are confused. The core issue is that surplus country policies suppress domestic demand relative to production, generate excess savings, and force those savings to be placed somewhere as net claims. In the modern system, the United States has been the main absorber of those claims. That is the actual reserve-asset argument. But it is a different argument from the one Obstfeld keeps attacking.

### Claim 1:

**Obstfeld: “As noted above, critics of the dollar’s global role have argued that foreign official dollar purchases (labeled US incurrence of official liabilities in the figure below) feed one-for-one into US current account deficits. To illustrate the true loose relationship between these two variables, the figure shows both of them over the 2003–25 period, as percentages of GDP. US net incurrence of liabilities to official holders, reported with a minus sign as in standard balance-of-payments methodology, is usually far too small to mirror the US current account deficit. And since roughly 2014, net official financial inflows have fluctuated around zero as the current account deficit has widened.”**



The issue here is that Obstfeld misunderstands what the actual argument is. He treats the reserve currency argument as though it were just a narrow claim about the role the dollar plays as an official reserve asset on central bank balance sheets. But the real argument is about the special role the United States plays in supplying the financial assets the rest of the world wants to hold net claims in the aggregate. In other words, the issue isn't that central banks are buying Treasuries for official reserves. The issue is that the rest of the world, taken as a whole, has domestic imbalances that require a persistent need to generate net claims on its trading partners. And in the modern system, the bulk of those claims ends up in US financial assets. It doesn't matter whether the foreign holder is official or private. What matters is capital flows in the aggregate.

It's essential to understand why the rest of the world has this persistent need to hold net claims in the first place. A number of major economies have adopted policies that deliberately raise the competitiveness of domestic industry and increase its share of global output. They do this by transferring income from households to producers through policies like currency undervaluation, financial repression, wage suppression, and industrial subsidies. Those policies raise the producer share of the domestic economy but lower the household share. The country becomes more competitive internationally, but domestic consumers no longer receive enough income to absorb all that the country produces at home. That creates a structural imbalance between production and domestic demand.

Savings are the part of output that is not consumed. So, when domestic demand is held down relative to production, savings rise. Over a century ago, John Hobson explained that when income is shifted away from consumers and toward producers, demand for consumption goods grows too slowly relative to productive capacity. The result is a structural excess of savings over what can be absorbed domestically.

For a while, that excess can be hidden by high domestic investment. That was the story in Japan, then China, and in a different form elsewhere. But every investment growth model eventually runs into the same problem: an unbalanced economy that lacks the ability to absorb its excess savings as productive investment. And the consequence is misallocated capital and rapidly rising bad debt. Once savings outpace profitable domestic opportunities, the imbalance has to go somewhere. John Maynard Keynes and Joan Robinson explained that if the surplus country doesn't rebalance by raising domestic consumption, then the adjustment is pushed outward. If surplus countries refuse to absorb more of their own output at home, the burden of adjustment has to fall on trading partners. Robinson called these beggar thy neighbor policies because they allow one country to relieve its own demand imbalance by exporting it to others.

Not all current account deficits are the same. A deficit can reflect healthy intertemporal trade, where a savings-constrained economy attracts foreign capital, finances productive investment, and creates a plausible path to rebalancing. In that case, the inflow is genuinely beneficial. But that's not the kind of deficit Keynes and Robinson were describing. They were describing a deficit that gets forced onto trading partners when surplus countries refuse to raise the domestic consumption share of the economy. If those savings flow into an advanced economy like the United States, where investment is usually constrained by demand and expected profitability rather than by a shortage of savings, they do not automatically produce more productive investment, but simply displace domestic funding. The inflow doesn't arrive because the deficit country needs the capital but because the surplus country needs somewhere to put the savings. And in the modern system, the United States has been the country absorbing that displacement at scale.

No one is forcing surplus countries to hold dollar assets. But they do so because no other viable alternative exists at the required scale. For a time, flows went into Southern Europe, but that ended in a classic balance of payments crisis. After a 30% devaluation in the euro, the Southern periphery now runs surpluses along with Northern Europe. So Europe

as a whole is part of the problem, rather than a destination for the surplus. Japan and China both run chronic surpluses and repress interest rates. China also maintains extensive capital controls. The Gulf states are also surplus economies recycling commodity revenues. Emerging markets are too small and volatile. EM economies have become a destination for at least some flows during different periods in history. But in every case, it ends in a bad debt cycle. That leaves the United States as the only destination that combines deep and liquid capital markets, a large stock of safe financial assets, and a willingness to leave its capital account wide open and let the rest of the world accumulate claims against it. The US doesn't run persistent deficits because it is short of savings and needs foreign capital to finance productive investment. It runs them because the rest of the world needs somewhere to place its excess savings, and the United States is the only destination that is willing and able to absorb them at scale.

So, when people say the dollar's reserve role forces the United States to run current account deficits, the argument is not that any deficit is inherently bad or that the US should never borrow from abroad. The argument is that the deficits the US has actually been running for the past four decades are not the welfare-maximizing kind. They are the structural kind, created by surplus country policies that suppress domestic demand and export the resulting savings glut onto trading partners. The US doesn't absorb those excess savings because it needs them, but because the system needs somewhere to put them. And the reserve currency role is what makes the United States the default destination. That is the actual reserve-asset argument. And it's a different argument from the one Obstfeld keeps attacking.

And Obstfeld's chart is not evidence refuting the reserve currency argument. There are two problems with using official reserve accumulation as a proxy for the reserve currency effect on the current account.

The first is that official reserves are only one channel through which foreign surplus savings flow into US assets. The current account is matched by the capital account, and the capital account includes both official and private flows. A surplus country's excess savings can just as easily enter the United States through private portfolios, state-directed insurance companies, sovereign wealth funds, or bank lending as through central bank reserve accumulation. Showing that official purchases no longer track the current account one-for-one doesn't show that foreign demand for US assets has weakened. It just shows that the channel has shifted.

The second is that official reserve accumulation is not a clean exogenous variable that can be plotted against the current account and used to make a causal claim. It has increasingly functioned as a policy tool used to offset other forces, especially private capital flows that would otherwise drive unwanted currency appreciation and weaken the current account surplus. When private capital is already flowing out of a surplus country, the central bank doesn't need to accumulate reserves as aggressively (or at all now that most countries have ample FX reserves). When private capital flows inward and threatens appreciation, official accumulation picks up to lean against the pressure. So official reserve accumulation rises most when the current account would otherwise weaken, and fades when private outflows are already doing the work. That makes it endogenous and

stabilizing, which means a weak simple correlation with the current account tells you almost nothing about the underlying system.

That is exactly why the weak correlation Obstfeld points to doesn't show that official intervention is unimportant. It is exactly the kind of relationship you should expect when a policy tool is being used to offset underlying pressures.

Obstfeld's mistake is taking a variable that often functions as a control mechanism and treating it like an independent explanatory force. But once a variable is being used to offset shocks, a weak simple correlation with the outcome tells you very little. It certainly doesn't prove the variable is irrelevant to the broader system.

This is a common error people make studying complex systems. For centuries, doctors observed that fever accompanied severe illness and assumed the relationship was causal. So, they focused on bringing it down. But fever doesn't cause the disease. It is the body's immune response to infection. It is correlated with infection because it is responding to the same underlying pressure you are trying to measure, but its effect runs in the opposite direction from what a naive correlation suggests.

Too many economists are far too comfortable with this type of single-variable inference in a system that is inherently multi-causal. Their ex-post regressions routinely confuse "not sufficient" with "doesn't matter". But if you can't explain how the entire system adjusts, those first-order explanations are worthless. Any systems analyst would know that intuitively. Obstfeld's analysis is a case study in this type of error.

Obstfeld points to the slowdown in official reserve accumulation and then infers from that that the dollar's global role is not an important cause of the US current account deficit. But for that claim to work, he would need to show that foreign demand for US financial assets more broadly is not keeping the dollar stronger and the US current account weaker than otherwise. Looking only at official reserve data can't establish that. The mechanism he is trying to dismiss runs through total foreign demand for US assets and the exchange rate, and those do not care much whether the buyer is a central bank, a sovereign fund, an insurer, a pension, a state bank, or a private household.

Countries also don't need to rely on visible official reserve accumulation to ensure net capital outflows. A central bank can generate the same external effect by lowering domestic interest rates enough to push private capital abroad in search of higher yields. In both cases, the macro result is similar. Foreign acquisition of dollar assets is supported, the home currency is kept weaker than it otherwise would be, and the US current account is pushed in the opposite direction.

The PBOC doesn't need to recycle every surplus dollar itself to sustain this system-level outcome. By suppressing domestic yields, it can encourage Chinese private capital to hold foreign assets instead. The holder changes, but the storage of excess savings in foreign claims does not. The BOJ's interest rate repression has long helped ensure net private capital outflows. The ECB did something similar after the euro crisis. Policymakers in many Asian countries have also leaned on domestic insurance

companies. Countries like Taiwan, Japan, and Korea actively encouraged, and in some cases mandated, their life insurers to accumulate foreign assets. Taiwan's life insurers alone now hold about \$700 billion in foreign bonds, of which roughly \$460 billion is unhedged (more than 60% of Taiwan's GDP). These insurers effectively became state proxies for currency management, keeping dollars bid and their home currencies weak without the political baggage of official reserve accumulation.

None of this is some new heterodox theory about how the world works. The risk that capital flows could overwhelm trade adjustment was well understood at Bretton Woods. Keynes and Harry Dexter White disagreed about plenty, but one view they shared was that international adjustment should not be left at the mercy of unconstrained capital flows. Their concern was that large cross border financial flows, public or private, could overwhelm trade adjustment, distort the real economy, and force domestic policy to respond to external financial pressures rather than domestic economic needs. They understood that once capital flows become large enough, they stop accommodating trade and start driving it. In other words, capital becomes the tail that wags the trade dog. If that was already a serious concern in the 1940s, when global financial flows were modest relative to today, it is even more relevant in the current environment, where capital flows dwarf trade flows many times over.

So, Obstfeld's chart doesn't show that the dollar's reserve asset role is irrelevant to the US current account deficit. It only shows that official reserve accumulation is no longer the sole or even primary channel through which foreign surplus savings are placed into US assets. The channel may shift over time, from central bank accumulation to private flows through interest rate repression, state-directed insurance portfolios, or sovereign funds. But the structural pattern remains. Surplus countries keep exporting excess savings into US financial assets, propping up the dollar and forcing adjustment onto the US economy. Whether the buyer is a central bank, or a Taiwanese life insurer does not change the macro outcome.

#### **Claim 2:**

**Obstfeld: "It has been a common belief that somehow these offshore dollars, including the dollar reserves held by non-US authorities, have to 'leave' the United States through US current account deficits. This belief is dead wrong.**

**For one thing, the world outside the United States can get dollar assets such as Treasuries by selling assets rather than goods to Americans. Contrary to Miran's account above, the United States can "import" foreign assets rather than foreign products with the proceeds of its asset sales to foreigners. In many cases, such exchanges allow both parties to diversify financial risks; in others, US financial institutions act as intermediaries between lenders and borrowers in different countries. In these examples, the current account balance doesn't change because the US financial account registers offsetting balance-of-payments credits and debits.**

**To take an example presaging current events, the Iranian revolution of 1979 led to global oil-price hikes and large surpluses by members of the Organization of the Petroleum Exporting Countries (OPEC). They wished to accumulate dollars, but rather than responding with a bigger current account deficit, the United States, through its banks, recycled these “petrodollars” into loans to developing countries. America exported dollar assets to OPEC but imported developing-country loans. While the episode did not end well — many developing-country borrowers ended up defaulting in a debt crisis that started in 1982 — the example shows that big increases in desired foreign dollar investments need not force the US current account balance to fall correspondingly.”**

To support his claim that reserve currency status doesn't force the US to run current account deficits, Obstfeld writes that the world can get dollar assets by selling financial assets rather than goods to Americans, and he uses the recycling of OPEC petrodollars after 1979 as an example. But there are two different questions here. One is whether the US financial system can intermediate cross-border financial flows. Of course it can. The other is where the net claims generated by persistent surplus countries ultimately land, and which countries absorb the mirror-image deficits. Obstfeld's example answers the first question, but the argument he is trying to refute is about the second.

In Obstfeld's OPEC example, the United States is mainly playing the role of financial intermediary. OPEC was running the surplus and acquiring net claims, but the developing countries were the ones absorbing those claims through borrowing and external deficits. US banks just sat in the middle transforming the claims. That is nothing more than a capital account round trip through the US financial system. It's not the reserve asset absorption role the United States currently plays.

No one is arguing that surplus country net claims can't land elsewhere in theory, or that there have not been historical episodes when they did. But the argument from people like Stephen Miran is that for the past forty years, the bulk of persistent net surplus savings has landed overwhelmingly in US financial assets, forcing the United States to run the counterpart current account deficit.

The OPEC episode has two important lessons, though neither is the one Obstfeld seems to draw from it. The first is that large and persistent inflows into the countries absorbing those surplus savings do not end well and create financial instability. As Obstfeld himself notes, much of the petrodollar recycling into developing countries ended in bad debt and default. That is what happens to the absorber. The role the United States has played over the last forty years is not the intermediary role it played in his 1979 example. It is the absorber role that the developing countries played in that example. And the reason that capital flows are now predominantly directed to the United States is that so many of the previous alternative absorbers repeatedly broke down under the strain. The failure of those recycling episodes is what helped make the United States the residual destination, and why it's not some privilege conferred by reserve currency status but a burden.

The second lesson from his OPEC example is that it highlights how persistent surpluses are often maintained by resisting the normal adjustment mechanism. When a trade

surplus country experiences excess demand for its goods and services, this should cause either its currency to appreciate or its relative inflation rate to rise. An appreciating currency rebalances trade flows through two channels: it increases the production costs of the surplus country relative to its trading partners, while simultaneously raising real household disposable income. Since savings equals production minus consumption, this combination of higher relative production costs and increased household purchasing power reverses the trade surplus over time. That was the whole logic behind flexible exchange rates. Once the dollar broke from gold in 1971, the point was to let trade imbalances trigger currency adjustment that helps reverse the imbalance. But many surplus countries resisted that adjustment by creating inelastic demand for US financial assets.

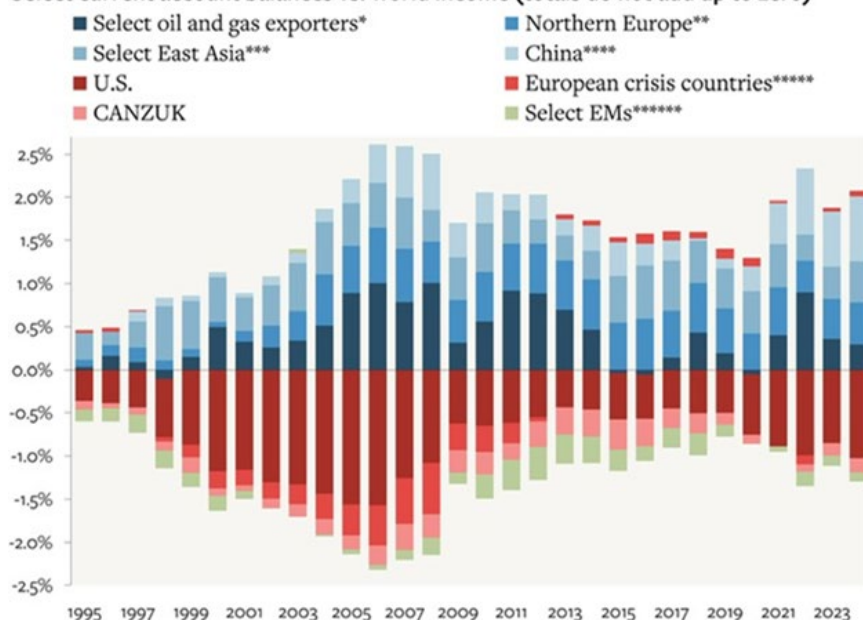
The OPEC countries pegged to the dollar and recycled their surpluses into dollar assets, preventing the appreciation that would have raised domestic purchasing power and reduced the surplus over time. That is the same playbook surplus countries have run ever since. And when the adjustment mechanism is blocked, the surplus has to go somewhere. It lands on whichever economy is big enough and open enough to absorb it. For the past four decades, that has been the United States.

So, Obstfeld is right that countries can get dollars by trading financial assets. And it's possible for the dollar's international role to grow without an ever-rising US current account deficit. But it's not possible for large parts of the world to run persistent net surpluses and accumulate net claims, and nobody runs the mirror image net deficits.

## Globally Unbalanced, Again

The exit from the pandemic marked the return of large global imbalances, principally driven by China's soaring surplus and the corresponding increase in the U.S. deficit.

Select current account balances vs. world income (totals do not add up to zero)



\*Algeria, Angola, Azerbaijan, Bahrain, Bolivia, Iran, Iraq, Kazakhstan, Kuwait, Libya, Nigeria, Norway, Oman, Qatar, Russia, Saudi Arabia, Trinidad and Tobago, Turkmenistan, UAE, and Venezuela \*\*Denmark, Germany, Netherlands, Sweden, and Switzerland \*\*\*Japan, Korea, Malaysia, Singapore, Taiwan, and Thailand \*\*\*\*Goods trade balance and income balance adjusted \*\*\*\*\*Bulgaria, Croatia, Cyprus, Estonia, Greece, Hungary, Iceland, Italy, Latvia, Lithuania, Poland, Portugal, Slovenia, and Spain \*\*\*\*\*Argentina, Brazil, India, Indonesia, Mexico, South Africa, and Turkey  
Source: International Monetary Fund, Matthew Klein's calculations

### Claim 3:

**Obstfeld: "Britain had surpluses up until World War I despite issuing the world's premier global currency and hosting its leading financial center."**

Obstfeld then tries a different approach. Instead of arguing about mechanics, he reaches for a historical counterexample. But reserve currency status doesn't mean you always have to run a current account deficit. It means the issuer becomes the residual adjuster, so the sign of its external balance depends on what the rest of the world needs, and not what its domestic economy requires.

In the 19th century, countries like the United States were industrializing and needed British capital, so Britain exported savings and ran current account surpluses. In the 1950s, Europe and Japan were rebuilding after the war and needed US savings. So, the US exported capital and ran the mirror image current account surpluses.

In the modern era, the pattern reversed. Surplus countries began suppressing domestic demand and generating excess savings, and those savings were stored in US financial assets. In that regime, the US, as the global reserve issuer, had to run the mirror-image current account deficits.

So, the burden is not that the reserve issuer must always run deficits. The burden is that its external balance is set by the adjustment needs of the rest of the world rather than by the needs of its own domestic economy. Today, that requires the US to run persistent current account deficits.

#### **Claim 4:**

**Obstfeld: “One aspect of US policy — the promotion of global use of dollar stablecoins — may lend limited support to the theory that increased demand for the dollar requires a larger US current account deficit. Intended to enhance the dollar’s primacy and substantially ease the US Treasury’s borrowing costs, thereby shrinking the federal budget deficit, more demand for dollar stablecoins around the world may not be a game-changer for either objective. But it could marginally raise US net external borrowing.”**

Obstfeld turns to stablecoins and dismisses them because he is still reading the issue through the wrong framework. A great deal of confusion in these debates comes from treating the dollar’s international currency role and its reserve-currency role as though they were the same thing when they are not. The international currency role is the plumbing of global trade and finance. It is invoicing, payments, settlement, and collateral. That role carries real geopolitical benefits for Washington because it underpins the global payments system, the sanctions architecture, and America’s broader financial influence. The reserve-currency role is about the asset in which countries accumulate net claims when they run persistent surpluses and export savings on a net basis. The burden on the United States comes from that second role. The problem is not that trade is invoiced in dollars. It is that the system uses dollar assets to absorb and store persistent global imbalances.

He actually acknowledges earlier in his piece that the dollar’s role as a reserve asset is different from its other international roles as vehicle currency, invoicing currency, funding currency, and anchor currency. But then he turns around and uses arguments about those other roles to refute the reserve asset argument. That’s a bait and switch. The fact that foreigners can borrow, sell assets, or swap existing dollar claims into stablecoins without automatically changing the current account just shows that the dollar’s payments role can grow without mechanically forcing a larger US current account deficit. But that tells you nothing about the separate question of who absorbs the mirror-image deficits when the rest of the world runs persistent net surpluses and accumulates net claims.

Obstfeld calls stablecoins gimmicks. But they only look that way if you fail to see the larger strategy. Their purpose is not to create some giant new source of demand for US debt. Their purpose is to help unbundle the dollar’s international currency role from its reserve asset role. If Washington wants to put more friction on foreign reserve hoarding through capital-flow taxes, user fees, or other tools, it needs a way to do that without blowing up the dollar payment rails. Stablecoins solve that problem. They allow global users to keep transacting in dollars and preserve the geopolitical benefits that come from the dollar’s dominance in global payments, even as the United States becomes less willing to absorb

the world's excess savings. Stablecoins are the infrastructure you build before you pull the capital-controls lever.<sup>1</sup>

To be fair, Obstfeld is probably right about one narrow point. Stablecoins are unlikely to lead to a huge increase in demand for US Treasuries. The dollar is already the dominant global payments rail. If most trade is already settled in dollars, stablecoins are unlikely to push that share dramatically higher. They will mostly modernize existing dollar payments usage. But creating incremental Treasury demand was never the primary purpose. Stablecoins were never meant to stand alone. Paired with capital-flow tools, they become the plumbing for a system in which the US keeps the dollar's global payments role while attacking the reserve asset role that forces persistent US external deficits.

<sup>1</sup> The logic behind a capital-flow tax is that every US current account deficit is matched by a capital account surplus. All dollars spent abroad must return either to purchase US goods and services or to purchase US financial assets. For decades those dollars have returned overwhelmingly through the second channel. A withholding tax or similar capital-flow tool would tilt that choice by making US financial assets somewhat less attractive relative to actual purchases of US output.

#### **Claim 5:**

**Obstfeld: “The dollar’s global role is not a primary reason that the United States has a big and persistent current account deficit, although dollar dominance does strengthen the dollar to a degree and so helps make the US balance lower than it would be otherwise. Reducing the US fiscal deficit materially and sustainably is the most important US policy prerequisite for global current account rebalancing. Doing so will be good for the United States.”**

Obstfeld ends by saying the most important step toward rebalancing is for the United States to reduce its fiscal deficit. That only makes sense if the fiscal deficit is the main driver of the US current account deficit.

But the twin-deficits story gets the direction of causality wrong. The fiscal deficit is often a symptom of absorbing excess foreign savings, not the original cause of those inflows. Kindleberger made this exact point in the 1980s when he argued it was a mistake to lay all the blame for the US external deficit on the federal budget deficit: “Here as in Marshall’s famous general-equilibrium balls in a bowl, the position of each determines the position of all the others, and vice versa... it is a mistake to lay all the blame for the US deficit vis-à-vis Japan on the U.S. government budget deficit.” His point was that the budget is itself an outcome of the system’s adjustment.

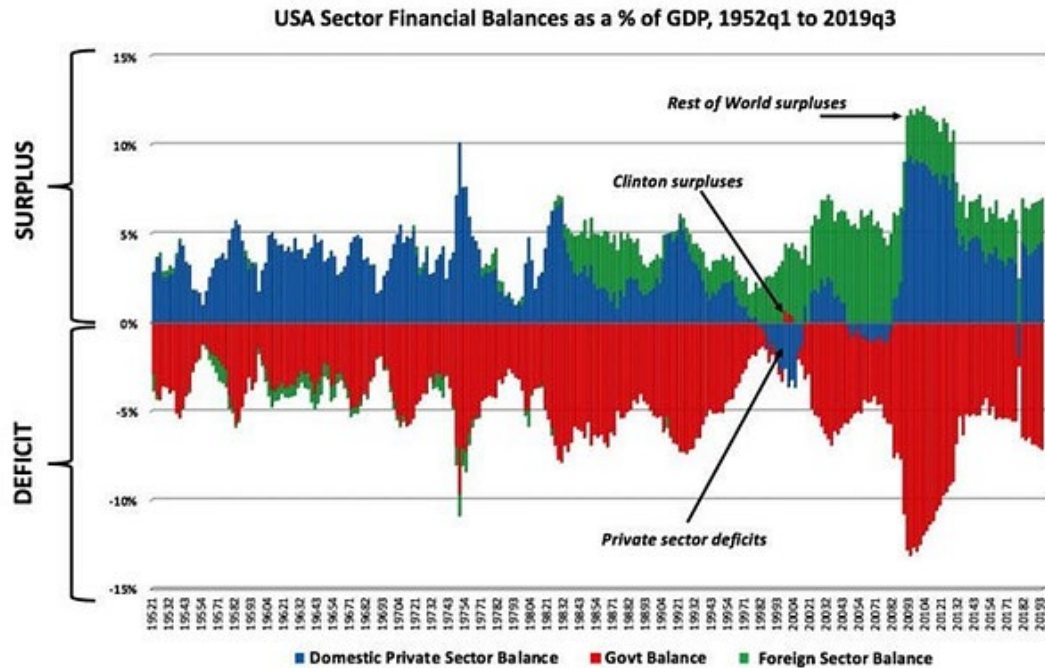
When one group of countries runs persistent surpluses and refuses to rebalance by raising domestic demand, some other group of countries has to run the mirror image deficits and absorb the shortfall in global demand. Keynes explained that the deficit country only has three ways to do that: the government can run fiscal deficits, the private sector can lever up, or output and employment can fall. There is no fourth option. For much of the post-financial crisis period, the United States relied on fiscal deficits to offset the demand leaking out through the trade account (average 3.5% current account

deficit over the past two decades). That wasn't ideal, but it was the best choice relative to the alternatives.

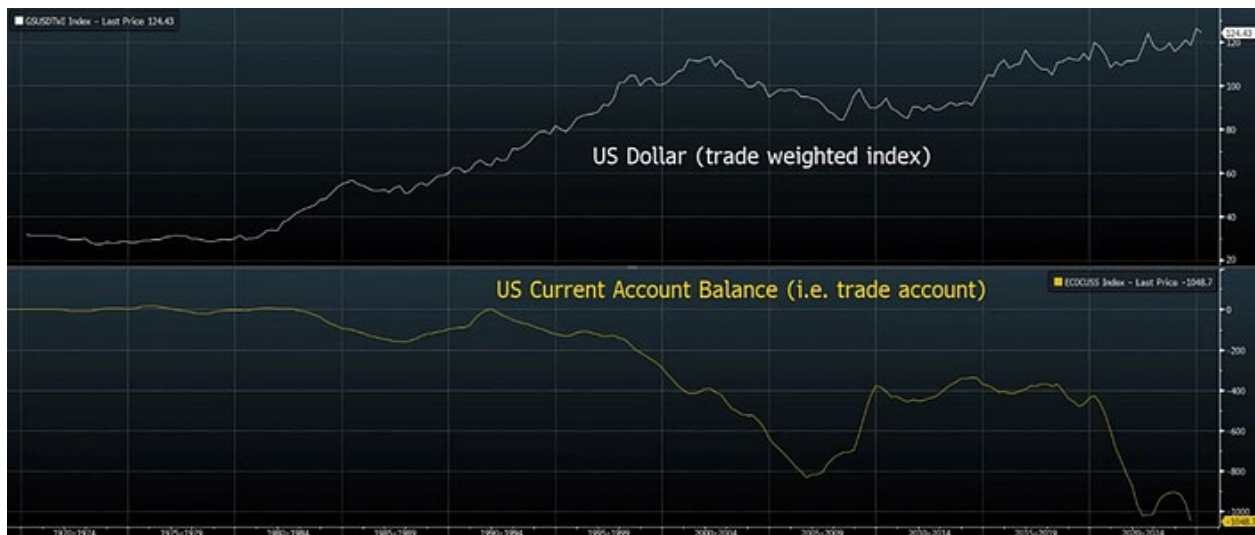
It's true that the rise in US fiscal deficits after 2008 was not just the result of automatic stabilizers. A large part of it reflected deliberate legislative choices. But that doesn't mean the deficits were exogenous to the system. Policymakers spent the previous decade learning through repeated fiscal cliff episodes that when fiscal support was withdrawn while the external drag remained in place, growth slowed sharply. So yes, the higher deficits were a deliberate legislative choice. But they were a choice between higher public deficits on one side and weaker growth or another private sector leverage cycle on the other. Policymakers chose the least bad option.

The European experience offers a cautionary tale of what happens when governments attempt to reduce fiscal deficits without addressing these fundamental imbalances. Southern European countries, operating with overvalued and pegged currencies relative to their Northern European trading partners, implemented austerity under IMF and EU guidance. The result was not healthy rebalancing but painful adjustment through declining real wages, higher unemployment, and stagnant growth. That is what happens when governments tighten fiscal policy without changing the underlying external constraint.

Obstfeld has pointed out elsewhere that in 2000 the United States ran a federal budget surplus and 4% unemployment despite a trade deficit of 3.7% of GDP. He treats this as evidence that fiscal deficits are the driver and that fixing them would fix the current account. But look at the sectoral balances. The government surplus during the Clinton years was not achieved by eliminating the external drag. It was achieved by shifting the adjustment onto the private sector. The private sector ran enormous deficits during that period, fueled by the dot-com credit cycle. That is the third option in the framework. If the government won't absorb the demand shortfall created by persistent capital inflows, and if you don't want unemployment to rise, then the private sector has to lever up to fill the gap. And that's exactly what happened. And it ended exactly how you would expect. The difference between the public sector and the private sector is that the private sector has hard balance sheet constraints, while the government can run deficits for a long time. Households and firms cannot. When the dot-com bubble burst, it triggered widespread bankruptcies, household and corporate balance sheets contracted, and the private sector was forced to retrench. The fiscal balance swung right back into deficit because there was no one else left to absorb the shortfall. The Clinton surplus showed that when you push the adjustment onto the private sector, you get a credit cycle that ends in a crisis.



The balance of payments presumes no direction of causality, but market prices help us infer the likely direction. Countries that truly need to attract foreign capital to fund their deficits see currencies in freefall, sky-high interest rates, and very low asset valuations. That is Latin America in the 1980s, Asia in the 1990s, Turkey today. The US experience is the opposite. American financial assets have been among the best performing and most highly valued in the world. The dollar appreciated 350% over four decades of persistent deficits. That only makes sense if foreign demand for US assets is driving the flows, not if the US is desperately pulling in scarce capital to fund excessive borrowing.



Keynes warned that persistent imbalances are dangerous because they leave the deficit country with no good options. The external drag has to be absorbed somewhere. If the government absorbs it, you get rising public debt. If the private sector absorbs it, you get credit bubbles and an eventual financial crisis. If nobody absorbs it, you get deflation and unemployment. The Clinton years were the private sector option. The post-2008 period was the public sector option. Southern Europe chose the third path and got a depression. There is no fourth option where everyone tightens and the economy is fine, because the external imbalance does not disappear when the deficit country contracts. It just forces the adjustment through more painful channels. That is why Keynes insisted that persistent surpluses create financial instability. And that is why reducing the US fiscal deficit without addressing the underlying imbalance isn't a solution. It's just a decision about which form the damage takes.

The same policy establishment that recommended austerity for Europe is now recommending the same prescription for the United States. In Europe, the result was a lost decade. The United States should not repeat that mistake.