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# Quarterly Economic Update

March 4, 2026

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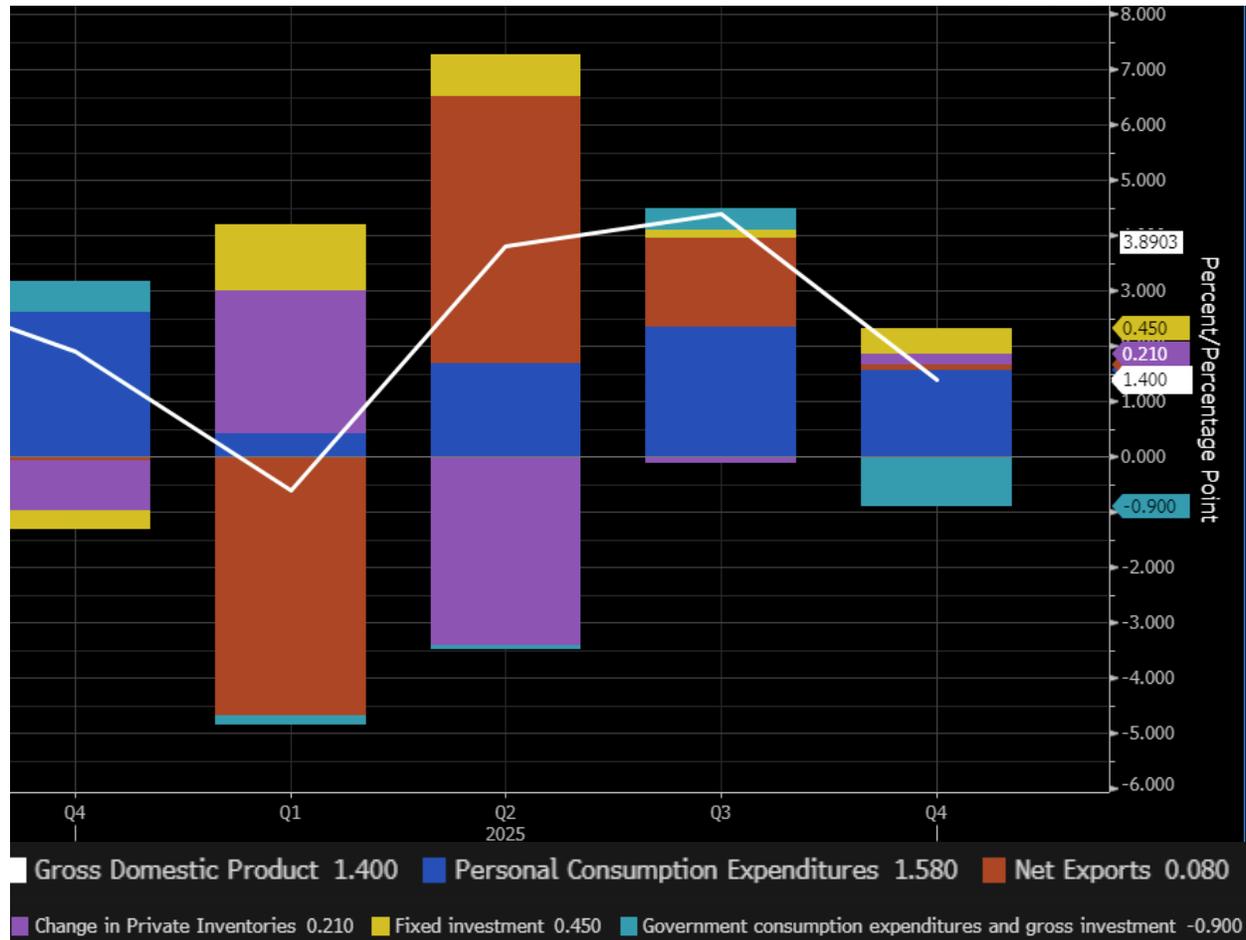
**MACROECONOMIC COMMENTARY**

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# Economic Outlook

By Michael Broadwater

## GDP



Source: Bloomberg

Annualized Real GDP for the 4<sup>th</sup> quarter of 2025 was 1.4%, falling far short of the consensus estimate of 2.8% and the prior quarter's 4.4% rate of growth. Consumer spending remained robust, and fixed investment continued to contribute positively, primarily due to AI-related investment. Net exports and inventories were both slight positives. The only item weighing down Q4's GDP was a steep decline in government spending. Q4 of 2025 included the longest government shutdown in history, lasting 43 days. We view this as the primary contributor to weak government spending and expect a strong reversal in Q1.

Personal Consumption Expenditures contributed 1.6 percentage points of growth to Q4 compared to Q3. Consumer services grew over the month of December, with particularly strong spending in healthcare and other services. The only source of weakness in services was food services, indicating that consumers are eating out less. Spending on

Real PCE Spending MoM%

	12/31/2025	11/30/2025	10/31/2025
<b>Headline</b>	<b>0.07</b>	<b>0.17</b>	<b>0.27</b>
<b>ex Food and Energy</b>	<b>0.01</b>	<b>0.19</b>	<b>0.32</b>
<i>Core Goods</i>	-0.49	0.28	0.09
Motor vehicles	-0.59	1.19	-2.60
Home furnishings	-0.82	0.16	1.03
Recreational goods	-1.82	0.65	1.76
Other durables	0.49	-0.77	0.65
Apparel	-0.89	0.58	1.63
Other nondurables	-0.43	0.05	0.32
<i>Core Services</i>	0.24	0.14	0.33
Housing	0.40	0.02	0.23
Health care	0.53	0.53	0.28
Transportation	0.27	-0.97	0.23
Recreation	0.20	0.08	0.55
Food svcs	-0.71	0.37	-0.17
Financial Svc	0.22	0.00	0.67
Other Svc	0.90	-0.17	0.83

Source: Wolfe Research, Haver Analytics, as of Dec 31, 2025

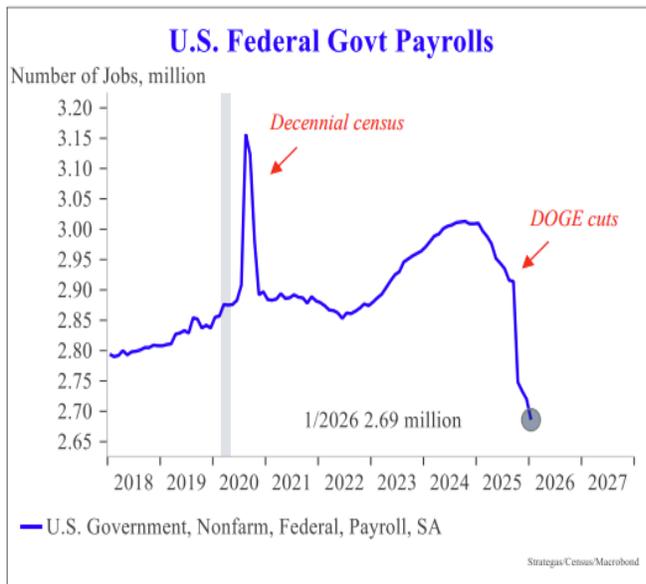
goods was weak, with every segment experiencing real declines in December except other durables. This is following two months of growth in consumer goods spending. On a quarterly basis, the only segment of consumer goods with negative real growth was motor vehicles, mostly attributable to a weak month in October. Despite the rise of policy uncertainty in the US, the consumer has remained resilient. We expect this to largely continue in 2026, as Congress expanded tax cuts for many Americans and the labor market remains steady.

For investment, the increase was primarily due to spending on intellectual property products and information processing equipment. Computers and peripheral equipment spending grew 80% over the quarter, with much of that being attributable to AI and data center related spending. Residential investment fell again for the fourth quarter in a row. Single-family residential investment (new homes) fell 5.2%, and multifamily fell 3.6%. Housing affordability remains a concern for most Americans, and unfortunately, this slowdown in new supply indicates that affordability challenges are likely to continue.

Net exports' contribution was relatively muted compared to the outsized impact in recent quarters. Exports and imports both fell over the quarter, with imports falling slightly more, leading to a modest but positive overall contribution to GDP. Exports grew 9.6% in Q3 but moderated significantly in Q4. On a year-over-year basis (rather than quarterly annualized), exports grew 1.7% in Q4, and imports fell 2%. Both changes increase net exports. The most extreme changes in trade due to the tariffs happened in January, April, and October, with the trade deficit expanding rapidly in the first part of the year before narrowing significantly. October marked one of the smallest trade deficits in years. Later months saw a reversal of this trend, and by December, we were back to a normal level of trade deficit.



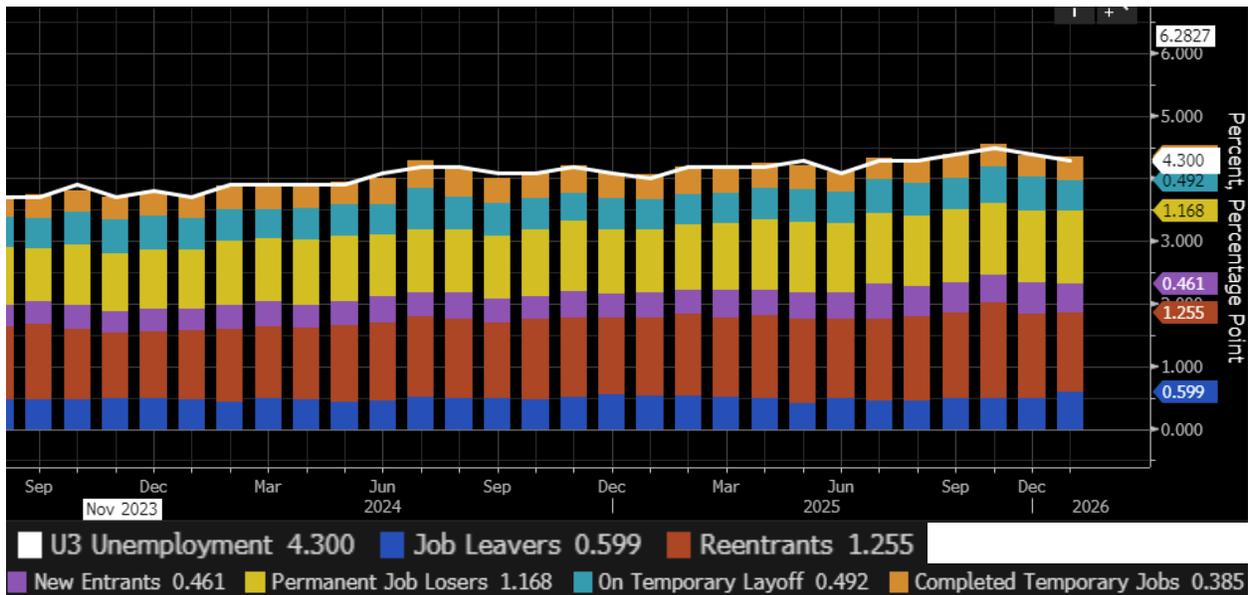
Source: Bloomberg. The trade deficit narrowed significantly in October before expanding back to more normal levels.



Source: Strategas

For government spending, a combination of DOGE cuts and a prolonged government shutdown led to a huge drop in government's contribution to GDP. Q3 was the only quarter of 2025 that saw a positive contribution from federal government spending, although state government spending has been consistently positive. We see a possibility that DOGE cuts continue to weigh on government spending; however, the quarter-over-quarter change is likely to show a huge improvement due to the impact of the shutdown in Q4.

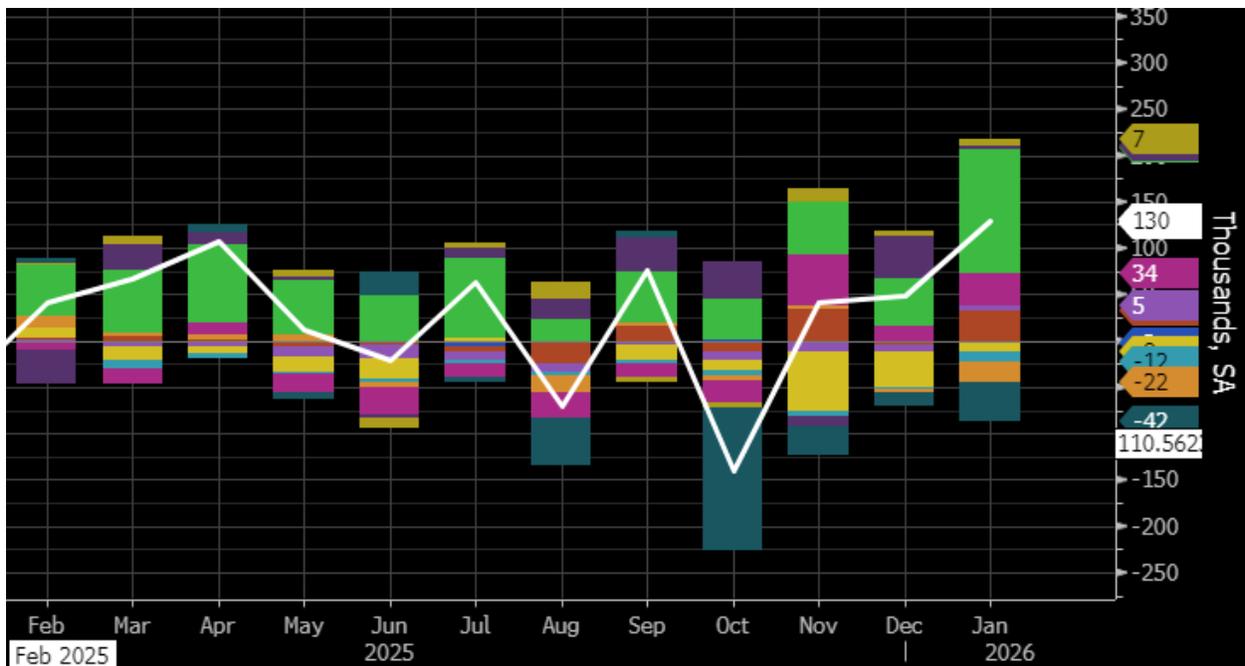
## Unemployment



Source: Bloomberg

The unemployment rate for the month of January came in at 4.3%, lower than December's 4.4% and analyst estimates of 4.4%. The above chart shows the unemployment rate since 2023. Unemployment initially declined to 3.5% in mid-2022 from its peak during the pandemic and has been gradually increasing from there. The unemployment rate has indicated that the labor market remains relatively strong. However, other measures of labor market health show a more complicated story.

Nonfarm payroll additions for the month of January came in at 130,000, doubling the analyst estimates of 65,000. The same release included the benchmark revisions for the prior year, which adjust the monthly survey data to match more comprehensive quarterly census data. These benchmark revisions lowered last year's aggregate payroll number by 862,000. In other words, we added nearly 72,000 fewer jobs per month over the last 12 months than we initially reported. This is the largest downward benchmark revision since 2009. Furthermore, last year saw multiple months with nonfarm payroll prints below 0, which usually isn't seen outside of recessions (the last negative payroll prints were in 2009 and 2020).



Source: Bloomberg. Negative NFP in January, June, August, and October.

What could cause nonfarm payrolls to be so weak but unemployment to remain muted? The simplest answer is a reduction in labor supply rather than labor demand. In the past, when the economy was shedding jobs, it was an indication that businesses were no longer hiring. Therefore, negative payrolls always coincided with recessions. Now, the cause is different. Our economy is losing workers via immigration policies. We are reducing our employed population (the numerator in the unemployment rate), but rather than these people being counted as unemployed and still part of the labor force, they are leaving the labor force and often the country entirely. In an environment where our labor force is shrinking, nonfarm payroll declines won't necessarily coincide with a recession, since the weakness is caused by a low supply of workers rather than low demand for workers from businesses.

Payrolls MoM

	1/31/2026	12/31/2025	11/30/2025
<b>Total NonFarm</b>	129	48	41
<b>Total Private</b>	172	64	72
<i>Goods Producing</i>	36	-12	25
Mining and Logging	-2	0	-1
Construction	33	-4	36
Manufacturing	5	-8	-10
<i>Private Service-providing</i>	136	76	47
Wholesale Trade	0	-5	-6
Retail Trade	1	-35	-1
Transportation	-11	-1	-59
Utilities	1	1	2
Information	-12	-2	-5
Financial Activities	-22	-1	1
Professional and Business Services	34	15	56
Health Care	82	33	50
Social Assistance	42	16	10
Private Educational Services	13	4	-4
Leisure and Hospitality	1	45	-12
Other Services	7	6	16
<b>Government</b>	-42	-16	-31

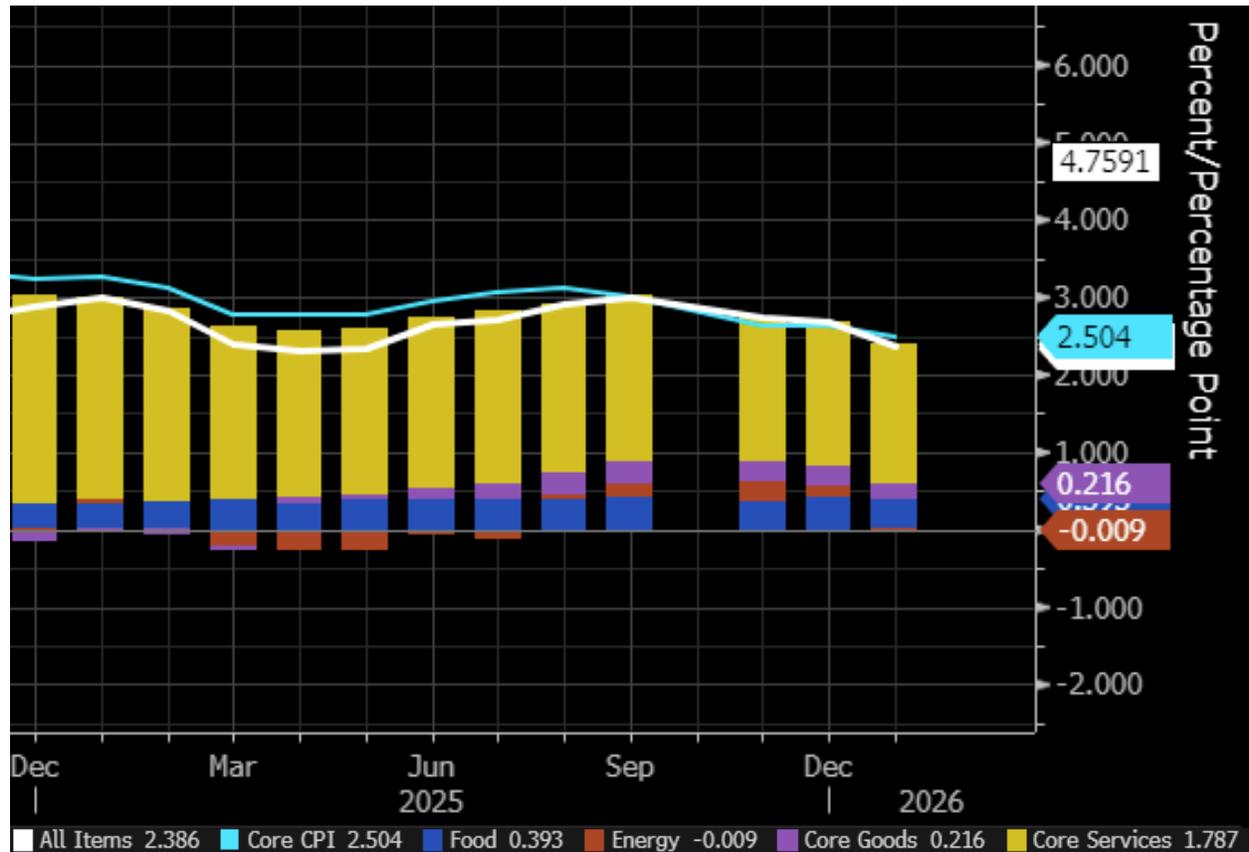
Source: Wolfe Research, Haver Analytics, as of Jan 31, 2026

Looking at January's strong nonfarm payroll print, we see some continuation of previous trends and some surprises. The public sector (i.e., government) continued to shed jobs. This was a trend for almost the entirety of the year, as federal workers were fired due to DOGE cuts and other reorganizations. Healthcare and social assistance continued to comprise nearly all the growth, which has been the case for years as our population ages and healthcare makes up a larger and more important share of the economy. One of the biggest surprises was growth in manufacturing jobs, which had seen negative payrolls for 13 consecutive months prior to December. Another welcome surprise was strong growth in construction employment. Of the 33,000 construction jobs added, 25,000 were nonresidential specialty trade contractors. A lot of the growth in this area is likely due to the AI capital expenditures and data center construction.

Average hourly earnings remained stable in December, matching analyst estimates and growing at a 3.7% rate compared to December of 2024. Initial jobless claims have remained steady around 200,000, and continuing claims have risen gradually from 1.3 million in the summer of 2022 to roughly 1.9 million today. These levels of continuing claims are in line with historical averages pre-COVID. The quits rate is depressed at 2.0%, and the layoffs rate is even lower at 1.1%. These numbers indicate that the employment situation is tenuous from both sides. Employees are cautious to quit, indicating that they view jobs as scarce. Employers feel the same way about workers: slow to lay off, fearing they may struggle to find new workers later if needed. One exception is the tech sector, where several large employers have announced high-profile and wide-ranging layoffs. Although the media and some management teams have attributed the layoffs to AI boosting productivity, we think it could also be the result of certain companies over-hiring during the pandemic and now cutting back on excess employees.

AI replacing entry-level workers remains a risk to the labor market. We will continue to monitor unemployment for new college graduates, which has increased in recent years but remains moderate compared to pre-pandemic history. Replacing entry-level workers will likely be one of the first signs of AI's disruption in the labor market.

## Inflation



Source: Bloomberg. October data missing due to the government shutdown

Inflation has remained steady but is still higher than the Federal Reserve's 2.0% target. January's CPI print showed prices had risen 2.4% compared to a year ago, a slight decline from December's 2.7% rate and lower than analyst estimates. Core CPI for the month of January (excluding volatile food and energy prices) came in at 2.5% annually. Food prices increased 2.9%, and energy prices declined 0.1%. Owners' equivalent rent (OER), the imputed measure that tracks the price of housing, continued to decline from 3.4% in December to 3.3% in January. OER peaked at over 8.0% in early 2023, but as mortgage rates have remained elevated, house prices have seen only modest growth. This deceleration has helped bring the overall price level down, as shelter comprises roughly a third of CPI and 15% of PCE inflation.

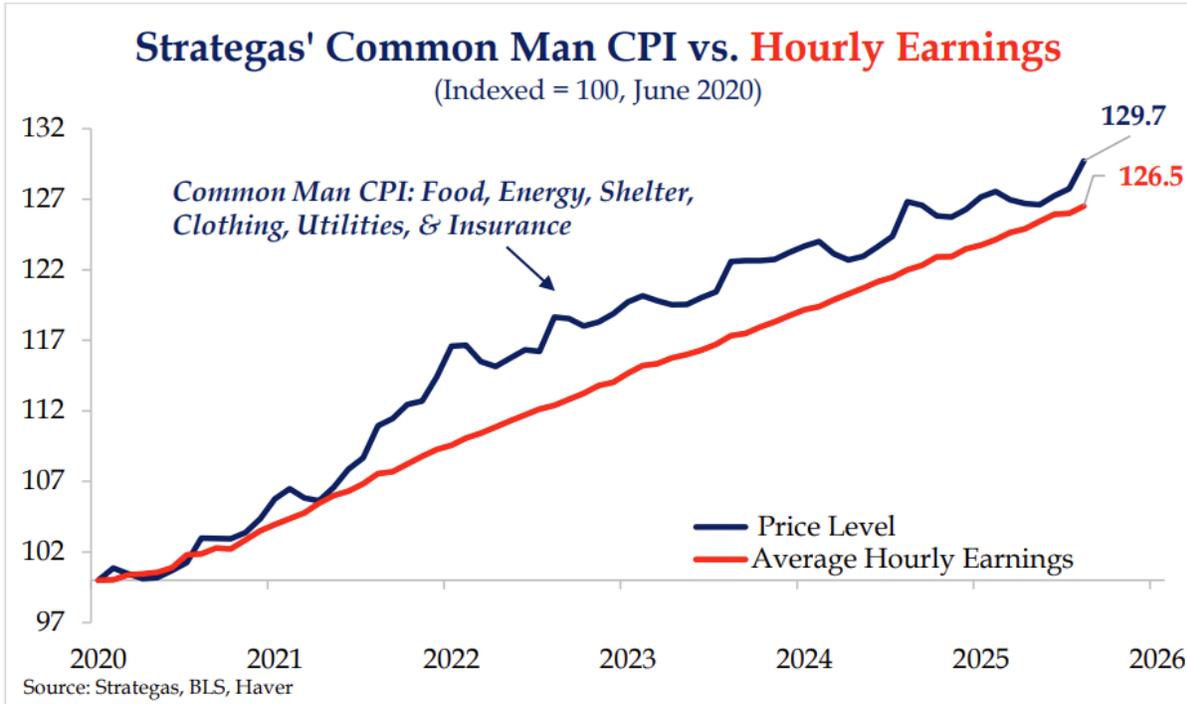
Tariffs have yet to cause a substantial increase in the inflation rate. Many economists and experts believed that the Liberation Day tariff increase would result in a one-time shock to prices, dramatically increasing the price of imported goods for a few months but not

sustainably increasing the rate of inflation. If this shock is the outcome of such a tariff hike, we have yet to see it almost a year after the tariffs took effect. Such a delay is possible under certain circumstances. For instance, given the ever-changing tariff rates, exclusions, and deals, companies may be wary to raise prices until they are more certain about what the true cost to import will be.

There are other explanations for why we haven't seen tariff-induced inflation. It's possible that, rather than consumers, U.S. businesses have been harmed by tariff increases. They could choose to keep their prices constant and take the added cost as a hit to margins. This could be the case if, as discussed previously, companies are taking a "wait-and-see" approach to price increases. Foreign companies that sell to importers could also be seeing lower margins. Finally, it's possible that we could've seen falling prices in many of these categories that are impacted by tariffs if the tariffs hadn't been enacted. In other words, inflation could have already been at 2.0% or lower if Liberation Day hadn't happened, and the persistence above the target rate could partially be due to the tariffs.

Shelter and energy prices have weighed down the overall rate of inflation. Absent a huge decline in mortgage rates, we see the decline in shelter inflation as likely to continue. Energy prices are harder to predict, but the price of oil has been somewhat unaffected by recent geopolitical events in Iran and Venezuela that would've previously caused it to spike. The AI capex boom and associated data center buildout could serve as a shock to energy demand, as these facilities are very power-intensive. Utility companies are investing heavily to increase capacity, causing supply to grow in tandem. Still, it's a possible source of energy inflation and something to keep an eye on.

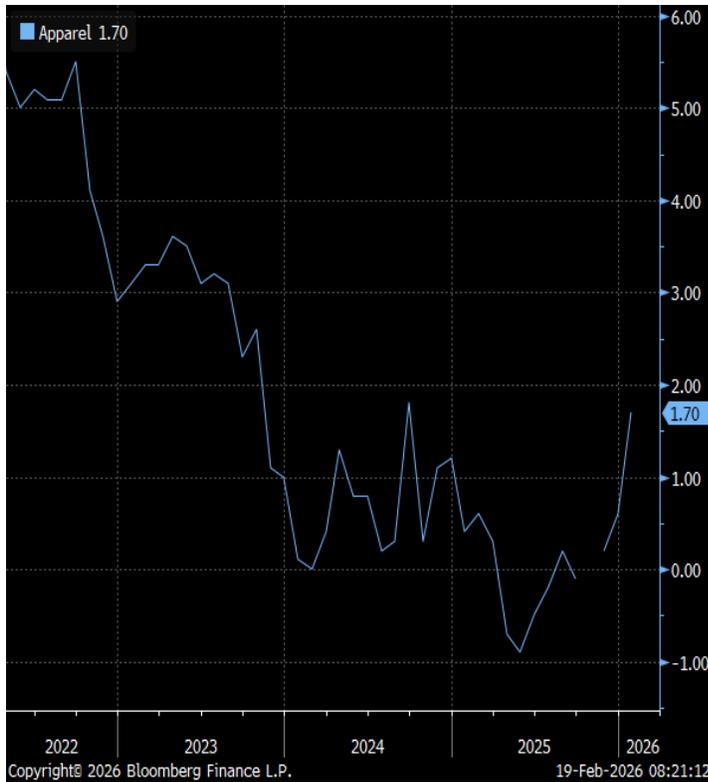
Strategas tracks a measure they call the "Common Man CPI," which looks at food, energy, shelter, insurance, and children's clothing. This is meant to show the most nondiscretionary, or essential, purchases that consumers make, and how those prices change over time. Since 2020, the Common Man CPI has outpaced both the overall CPI and average hourly earnings. This means that the necessities of everyday life have become more expensive than the headline CPI indicates, and people's paychecks are not going as far as they used to.



In January, the Common Man CPI fell below headline CPI for the first time since mid-2023 and was also outpaced by average hourly earnings.

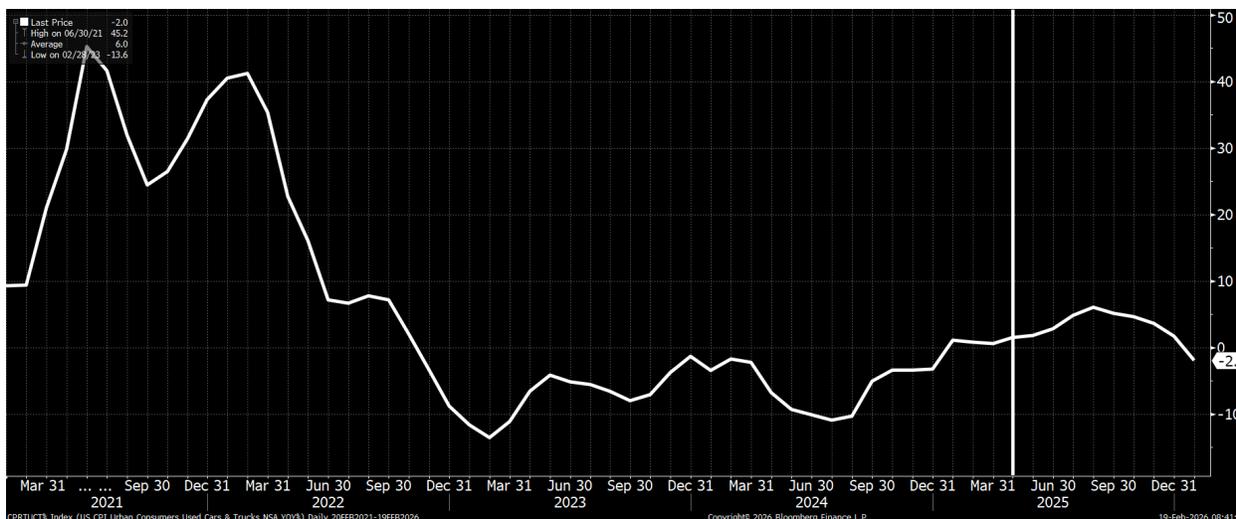
Strategas' Common Man CPI Changes vs CPI Components						
	Sep y/y	Oct y/y	Nov y/y	Dec y/y	Jan y/y	Cumulative June 2020 - Present %
CPI	3.0%	2.9%	2.7%	2.7%	2.4%	27.1%
Common Man CPI	3.3%	3.0%	2.9%	2.7%	2.3%	29.7%
Average Hourly Earnings	3.8%	3.9%	3.9%	3.7%	3.7%	26.5%
<b>Common Man Take-Home Pay</b>	<b>0.6%</b>	<b>0.9%</b>	<b>1.0%</b>	<b>1.0%</b>	<b>1.4%</b>	<b>-3.2%</b>
CPI / Common Man Subsectors						
Food	3.1%	2.9%	2.6%	3.0%	2.9%	28.1%
Energy	2.9%	3.5%	4.2%	2.1%	-0.3%	49.1%
Shelter	3.6%	3.3%	3.0%	3.2%	3.0%	29.7%
Motor Vehicle Insurance	3.1%	3.0%	3.0%	2.8%	0.5%	74.4%
Apparel	-0.1%	0.3%	0.1%	0.6%	1.8%	14.7%
Fuels & Utilities	5.9%	5.9%	6.5%	6.7%	6.2%	40.6%

Source: Strategas, U.S. BLS



Apparel inflation, shown on the left, has accelerated after Liberation Day. Although we can't be sure that tariffs were the main contributor, there is a clear downward trend from 2022 to May of 2025, where the year-over-year rate bottomed out at -0.9% (i.e., clothes were getting cheaper). After May, we saw continued increases in the inflation rate through last month, which saw a 1.7% increase (compared to 0.6% in December). Apparel is one of the most impacted industries by the tariffs, since much of our clothing is made in China and Vietnam, both countries with high tariff rates. We were in a downtrend before the tariffs, and now we are seemingly in an uptrend.

Auto prices paint a different picture. New car prices increased only modestly in January, up 0.4% from January of last year. Used car and truck prices declined 2.0% from this time last year. Autos are heavily imported and have been an industry targeted by specific tariffs. The lack of car price inflation works against the narrative that the tariffs are inflationary. For every industry like apparel where the tariffs seem to have been inflationary, there is an industry like autos where they have had no effect. To be sure, there are more than tariffs impacting auto prices. It's possible that auto inflation is higher than it would've otherwise been without the tariffs, but without a clear counterfactual, it's hard to make that claim.



Source: Bloomberg. Used car prices, with a vertical line denoting April of 2025. There was a brief period of inflation through the summer of last year, but it hasn't persisted.

The inflation situation has changed surprisingly little, given the policy changes over the past year. Headline rates remain higher than the Fed's target but are still manageable. Lagged tariff effects, an increase in home prices, or increased energy prices may reaccelerate inflation, but for now, the trend looks stable.

## Tariff Outlook

On February 20, the Supreme Court decided the Trump administration's use of IEEPA (International Emergency Economic Powers Act) to justify sweeping tariffs was unconstitutional. The effects of this ruling are massive but still uncertain. Critically, the ruling did not specifically rule out the possibility of refunds for tariffs already paid. This would be a huge cost to the government, and it would likely act as a form of stimulus, boosting GDP. However, the Trump administration has many other tools for enacting tariffs and has already imposed a 10% tariff via Section 122 of the 1974 Trade Act. These tariffs are more limited than the IEEPA tariffs and expire in 150 days, after which they'll need Congress's approval to be reinstated. Other legal paths for the president to enact tariffs are also more limited or operationally cumbersome, placing restrictions on the rate, industry, or countries affected. Anything that needs congressional approval is unlikely in our view, as Congress has already voted to terminate Trump's tariffs on Canadian goods. The tariffs are unpopular with many voters, and midterms are right around the corner.

President Trump will still find ways to impose tariffs. They may not ultimately stand up in court, but in the meantime, the uncertainty and additional costs will remain central to businesses' decisions to invest and consumers' decisions to spend. We will closely monitor any developments in trade policy and their impacts on GDP, the labor market, and inflation.

# RSA PORTFOLIO STRATEGY

## Fixed Income Strategy

By Nick Prillaman

At our prior meeting on December 12, the Federal Reserve had just lowered the federal funds rate two days earlier by a quarter point to a range of 3.50% to 3.75%. According to the Fed's dot plot forecast, only one cut was expected in 2026 and one more in 2027. In addition to the rate cut, the Fed announced that it would "initiate purchases of shorter-term Treasury securities as needed to maintain an ample supply of reserves on an ongoing basis." This was a net positive for markets as it would ease liquidity conditions. Overall, December was fairly benign for most asset classes. According to BofA, interest rate volatility fell to the lowest level since 2021 on "the lack of data surprises, particularly on inflation." The most notable exception was the Japanese 10-year bond, which rose 25 bps in yield and tallied its highest level since 1999. This move affected the US bond market and caused the US Treasury curve to steepen.

January was a positive one for risk assets in general, as one can see in the chart below from BofA. However, many investors would probably agree that the month felt way more volatile than the broad returns chart depicts. Rolling geopolitical drama starting initially with the capture of Venezuelan President Maduro, moving to the potential acquisition of Greenland, and finally to rising tensions with Iran, kept uncertainty high among investors. The Greenland issue reverberated through financial markets on January 20 after President Trump said he would impose escalating tariffs "until such time as a Deal is reached for the Complete and Total purchase of Greenland." The S&P 500 fell 2.1%, gold made an all-time high, and the 10-year Treasury yield jumped 7 bps. Market commentators described the move as the "Sell America" trade where, according to Krishna Gua at Evercore, "global investors at the margin are looking to reduce or hedge their exposure to a volatile and unreliable US."

**Exhibit 6: Broad Asset Class Total Return Performance, January 2026**

Monthly total returns for broad asset classes in January 2026. Stocks (1.45%) led, followed by Mortgages (0.58%), HY (0.48%), and IG (0.36%). Treasury (0.05%) and loans (-0.31%) underperformed.



Source: BofA Global Research, ICE Data Indices, LLC

In addition to geopolitics, President Trump shocked the mortgage-backed securities world in early January with the statement that Fannie Mae and Freddie Mac would buy \$200 billion worth of mortgages. This caused mortgage spreads to tighten by 18 bps in a single day and is the primary cause of why MBS outperformed all other broad fixed income asset classes for the month. The final piece of volatility for the month was President Trump's announcement that Kevin Warsh would be his choice to succeed Jerome Powell as Fed Chair. This piece of news triggered a large downdraft in the precious metals space, with silver falling \$30 and gold dropping \$605 in a single day as the dollar rallied.

In the midst of these cross currents, most parts of the Treasury market moved higher for the month in a bear steepener with the 2-year yield rising 5 bps, while the 10-year yield rose 7.5 bps. The Federal Reserve met on January 28 and paused its interest rate cutting cycle after three consecutive cuts. According to the post-meeting statement, the Fed said, "Available indicators suggest economic activity has been expanding at a solid pace. Job gains have remained low, and the unemployment rate has shown some signs of stabilization. Inflation remains somewhat elevated."

February has seen a bull market in most Treasury maturities across the curve. Weaker economic data early in the month drove yields lower. Challenger job cuts rose 117% year-over-year, initial jobless claims of 231,000 increased more than the expected 212,000, and retail sales came in flat for December. Additionally, the risk-off tone in the various parts of the stock market has produced a flight-to-safety trade. There has been a growing concern that AI will disrupt a number of industries, with everything from services to healthcare to logistics. As BofA described it, "the fallout from rapidly improving AI capabilities is engulfing one sector at a time." This combined with 30-year Japanese yields dropping precipitously has helped push US yields lower with the 10-year Treasury falling 17 bps at the time of this writing.

While not contributing to the move lower in rates, an additional level of uncertainty for investors has been provided by the Supreme Court, who struck down President Trump's tariffs on February 20. The president responded with a new 10% level through a different channel. Since he can't use IEEPA, the International Emergency Economic Powers Act, to impose tariffs, "the new import taxes will be based on Section 122 of the 1974 Trade Act, which allows the president to impose tariffs for 150 days without congressional approval under specific circumstances, including 'large and serious' balance of payments deficits" per Malcolm Scott at Bloomberg News. It seems that the tariffs will remain in one form or another though timing and implementation will give investors continued angst.

Going forward, our outlook for the fixed income markets is that front-end rates will probably be range bound for the next few months and then drift lower. According to the fed fund futures market, the Federal Reserve is on hold until the summer and then delivering two cuts the rest of the year, one in July and one in October. The fed funds rate is expected to decline to the low-3% range by the end of the year. This is more aggressive than the Federal Reserve's dot plot projection, which sees the target rate only dropping to 3.375%.

One positive catalyst for lower rates is if Kevin Warsh gets installed as the new Fed Chair. While he is nominated, Republican Senator Thom Tillis has vowed “to hold up any appointments for the central bank until a Justice Department probe into the Fed’s \$2.5 billion renovation of its headquarters is concluded,” per Bloomberg. Jerome Powell’s term as Fed Chair expires in May, and I imagine the issue will be worked out by then. Assuming Warsh is confirmed, he is of the opinion that lower rates, a smaller balance sheet, and less regulation are the optimal choices for the broader economy. According to his op-ed in the *Wall Street Journal* on November 16, he said, “The Fed’s bloated balance sheet, designed to support the biggest firms in a bygone crisis era, can be reduced significantly. That largesse can be redeployed in the form of lower interest rates to support households and small and medium-sized businesses.” On less regulation, he said, “The Fed’s rules and regulations have systematically disadvantaged small and medium-sized banks, which has slowed the flow of credit to the real economy.”

While the Federal Reserve made inroads in reducing its balance sheet over the last few years, financial conditions were beginning to tighten, which made further progress untenable in the short run. With the prospect of Warsh wanting to continue to lower the balance sheet, there has been recent speculation around a Fed/Treasury accord like the one that prevailed during WWII up until 1951. According to Donald Luskin at TrendMacro, the two entities would work in tandem to achieve balance sheet normalization and “allow for a return of the Fed’s \$6.3 trillion asset holdings to the level of currency outstanding, \$2.4 trillion—without any quantitative tightening.” One fear among some market participants is that some form of yield-curve control could ensue where the Fed caps long-term rates to keep interest costs low. A properly structured accord with safeguards like “barring the Fed from direct deficit financing” per LPL Financial would help allay concerns among investors. The upside of a completed accord would be a Fed that looks similar to the one that prevailed for decades prior to the Great Financial Crisis of 2008.

With front-end interest rates pausing in the near term before heading lower, the outlook for the long end of the curve is more opaque. On a technical basis, the 10-year Treasury continues to oscillate sideways in a large range, as can be seen in the chart on the next page. There has been no net movement in 10-year yields since 2022. This makes sense as on one hand, the macroeconomy is doing okay even with a few weaker data points in early February. Continuing jobless claims have remained at the same level as in the summer of 2024, nonfarm payrolls for January handily exceeded expectations, and ISM Manufacturing PMI rose 4.7 points in January, which was the highest since August of 2022. On the other hand, there continues to be persistent concerns over the deficit as well as inflation. At this stage, the inflation forecast is very much uncertain. For example, the core PCE price index for December came in at .4% versus an expected .3% on a month-over-month basis. For the year-over-year number, prices rose 3.0% versus an expected 2.9%. This was a somewhat high print, but it was from December, so it is a little stale. In contrast, CPI for January registered .2% month-over-month while the yearly figure was 2.4%. Both numbers came in below expectations. The wild card in inflation is how the economy responds to President Trump’s fiscal stimulus this spring. According to Dan Clifton at Strategas Research, there will be \$150 billion of tax cuts for consumers and \$200 billion of tax cuts for business investment entering the economy over the coming months. This is part of the president’s intention to run the economy hot with looser

monetary policy combined with high amounts of fiscal stimulus. This fiscal policy action is great for keeping the economy afloat but adding stimulus to a full employment economy can produce inflationary pressures which will help keep long-dated interest rates somewhat elevated. This view, combined with two rate cuts later in the year, would imply a steeper curve. In the terms of RSA activity, we did purchase a 2035 Treasury note to pre-fund an upcoming Treasury maturity. The trade helped reduce our tracking error with the index which seem prudent given the weak employment data at the time.



Source: Bloomberg

In the mortgage-backed securities space, the big news, as we discussed earlier, was President Trump's \$200 billion announcement. According to Morgan Stanley, the market had already anticipated \$100 billion of buying by Fannie and Freddie, but a \$100 billion extra was welcome news for investors. It will essentially offset the MBS runoff by the Fed, which totals roughly \$16-17 billion per month. The buying is basically a mini-QE (quantitative easing) by the GSEs (government sponsored enterprises) rather than the Federal Reserve. A key distinction from Fed-QE programs is that the GSEs cannot create reserves to fund their purchases, which means the program will be less potent to financial markets.

Prior to the announcement, mortgages were trading cheap to IG corporates, which can be seen in the chart below from January. Over the last few years, we as well as other money managers, materially raised our weighting in MBS to take advantage of the opportunity. Post-news release, the trade evaporated, which was great for our existing MBS holdings as spreads compressed, but on a going-forward basis, we will look for opportunities elsewhere to invest fresh capital as our view is neutral on the asset class. We will continue to redeploy prepayments like we did in February when we purchased a 30-year Freddie Mac 5.0% pool at a yield of 4.969% to help maintain the portfolio's weighting.



The present administration appears highly motivated to improve the housing affordability problem in the US. Beyond the \$200 billion, President Trump signed an executive order aiming to stop large institutions from buying single-family houses. Other measures that could be enacted are cutting g-fees which would lower mortgage rates, changing the capital treatment of conventional mortgage-backed securities, making mortgages portable, and letting Americans use their 401(k) to pay for housing though it remains to be seen how much gets done and what the long-term impact is. While these items may help affordability at the margin, the biggest driver is going to be the 10-year Treasury. If it materially falls, the mortgage rate will drop with it and drive mortgage payments lower, which will help more Americans afford homes.

In corporate bonds, we bought multiple bonds to replace securities that had matured or were maturing. These purchases helped maintain our weighting in the asset class. For example, we bought a 10-year Citigroup subordinated note with a yield of 5.376% and a spread of 113 bps. A second was a 3-year Ford Motor Credit security at a yield of 4.975% and a spread of 145 bps.

Investment grade corporates are trading at very rich levels, which can be seen in the chart below. A spread of 79 bps is undeniably tight, though these spreads can persist for a while, like in the mid-1990s. Like mortgages, we view corporate bonds as a neutral at this juncture. We will continue to replace maturing bonds but will refrain from large-scale asset allocation adjustments until value returns to the asset class. Corporate bonds should outpace Treasuries as long as an economic upheaval doesn't occur. Given the upcoming large fiscal stimulus, which we discussed earlier, spreads should remain contained for the time being as the economy holds up.

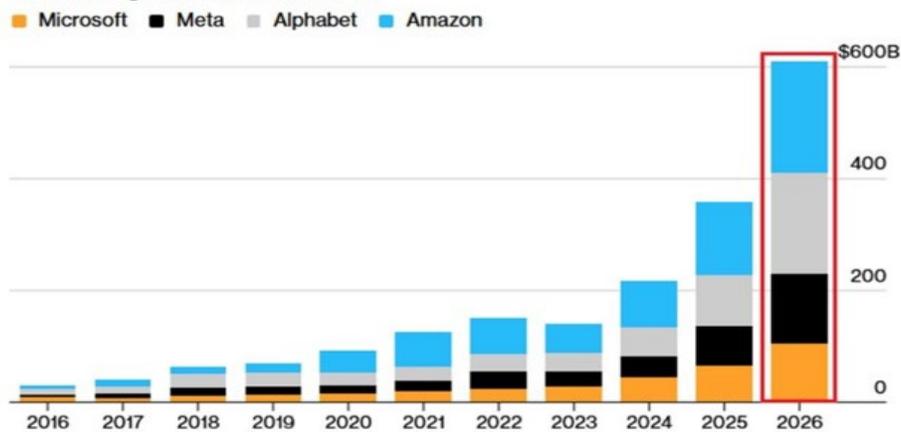


Source: Bloomberg

One specific area of the corporate bond market that we will be paying close attention to over the coming months is the tech sector where some companies are diving headlong into the AI-capex buildout. The chart below shows 4 tech behemoths planning to spend \$600 billion in 2026 with much of it related to AI. Traditionally, companies like Alphabet operated a very asset-light business with little debt and high free cash flow. With the advent of the AI arms race, companies will need to invest considerable sums in capital expenditures. This will require them to tap the bond markets to fund a portion of the buildout which should put upward pressure on spreads as bond supply increases. Their financial health will deteriorate at the margin as operating cash flow is used for investment. Just in early February, Alphabet issued almost \$32 billion worldwide while Oracle issued \$25 billion. Hopefully, bond markets will continue to absorb the new supply with no issues.

### Hyperscaler Capex Explodes Higher

2026 estimates based on mid-point of guidance (META, GOOGL, AMZN), Bloomberg consensus (MSFT)



Source: Bloomberg

Note: Capex based on fiscal year-ends, Dec. (AMZN, GOOGL, META), June (MSFT)

# Domestic Equity Strategy

*By Allan Carr*

Since our last meeting in December, the S&P500 is dead flat. According to Barclays, the index has traded in the narrowest range to start a year since the 1960s. It should come as no surprise at this point that headlines under Trump 2.0 have been plentiful. Just on the FOMC alone, there have been legitimate worries over Federal Reserve independence, the DOJ announced a criminal investigation into current Fed Chair Jay Powell, and after months of toying and teasing, Trump finally named a new Fed Chair in Kevin Warsh. On the world stage, geopolitical tensions continue to escalate with another strike on Iran seemingly imminent, and last week, Trump's IEEPA tariff policy was ruled illegal by the Supreme Court. While those headlines have caused some ripples in markets, they have taken a backseat to the foremost topic for markets recently: "A.I. disruption."

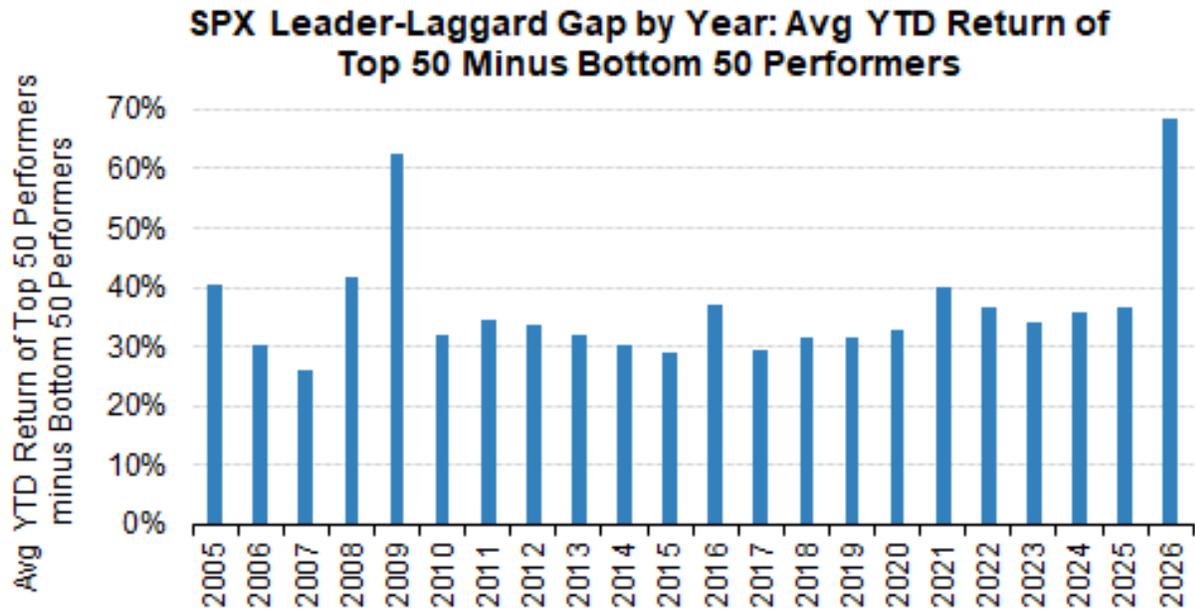
The A.I. story has been a topic for years now, but had mostly been a positive theme in trying to identify the winners and assess the long-term benefits to productivity, etc. That changed quickly as events have led to fears that A.I. applications could severely threaten traditional business models. Anthropic's release of a program update at the beginning of February caused investors to fear A.I. could automate highly complex tasks, causing a broad-based software selloff. In the second week of February, it became a daily occurrence of "who's next" as reports spread to other sectors: insurance brokers on February 9 (WTW -12%, AJG -10%), wealth-management stocks on the 10<sup>th</sup> (RJF -9%, SCHW -8%), real-estate services stocks on the 11<sup>th</sup> (CWK -14%, CBRE and JLL -12%).

Then, on Monday, February 23, a thematic research firm called Citrini put out a fictional scenario in which A.I. causes a massive market crash and double-digit unemployment by 2028. IBM was down over -13%, Amex over -7.0%, and Visa -5.5%.

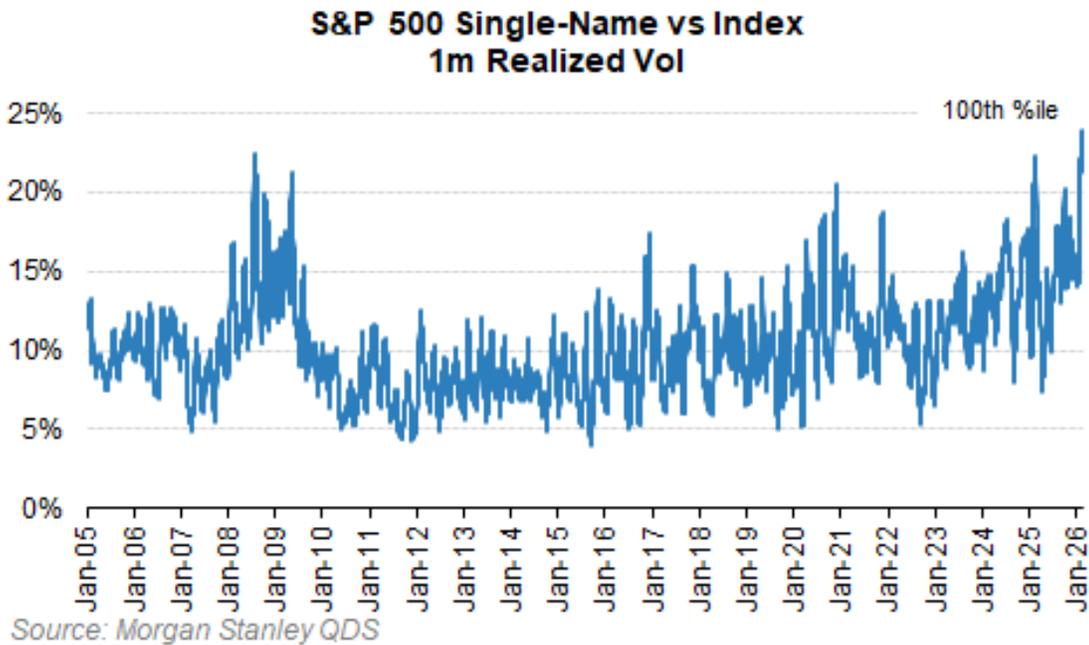
In addition to the fallout from A.I. disruption fears, there were some historic moves in commodities and crypto as well. Gold is up over 75% in the last year. Bitcoin hit an all-time high last October, only to be cut in half by early February.

So, while the S&P index has been historically rangebound, the moves underneath the hood have been violent. In the 75 days between our last update and February 24, Gold was up 21.5%, Bitcoin down 30%, software down 30%, and semis up 20%. In the Nasdaq-100, half the names were up, the other half down. In the S&P 500, there were 92 names in the index that were up over 20% and 51 names that were down more than 20%. The spread between the top 50 and bottom 50 performers in the S&P is at roughly 68% calendar year to date per Morgan Stanley (Exhibit 1), and single-stock volatility versus the index is the widest it's been in over 20 years (Exhibit 2). This extremely low correlation/high dispersion market has kept the index insulated despite the vicious single-stock action.

**Exhibit 1**



**Exhibit 2**

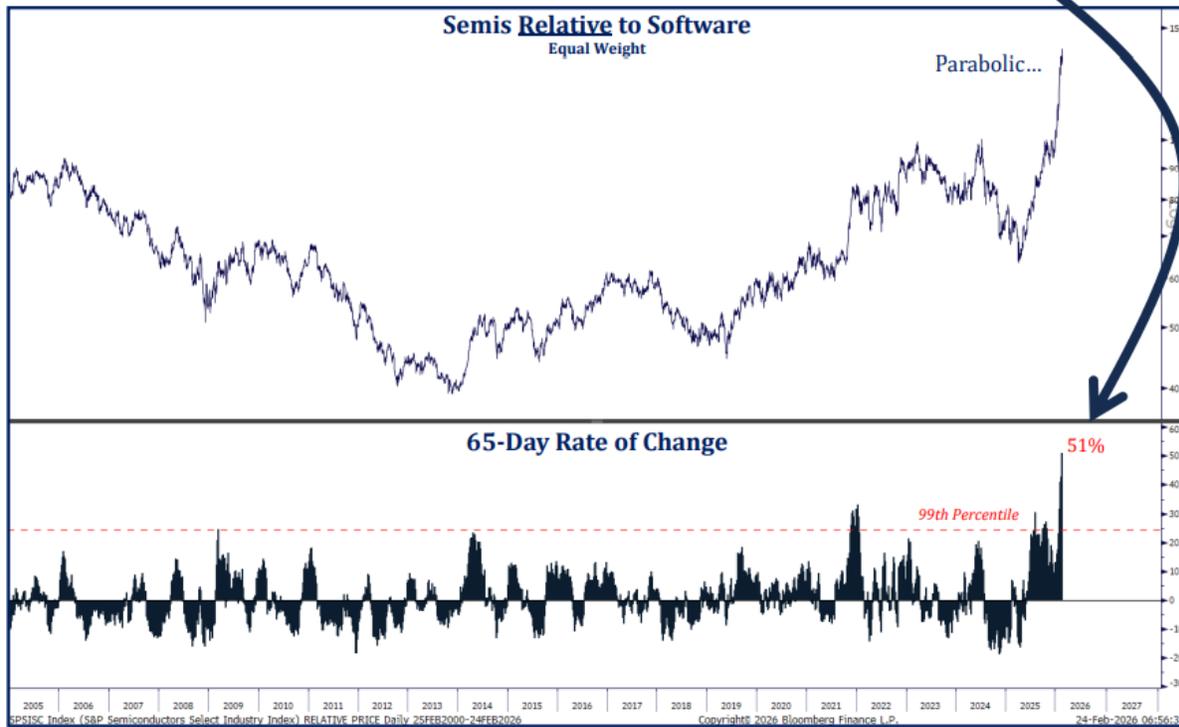


It quickly became a “shoot-first, ask questions later” environment of fear begets fear. The carnage in software led to private credit concerns, causing panic in the alternative manager stocks (OWL & ARES -30% since mid-December) as private credit is a huge player in software. Blue Owl, which has a disproportionate amount of loans (~70%) to software companies, briefly halted redemptions to unload a chunk of loans to meet the withdrawal requests and free up liquidity.

Just last September, Oracle had possibly the most impressive day ever from a large, established company when their quarterly report sent shares soaring as much as 43% intraday. The stock ended the day at \$328 (+36%), adding nearly \$250B in market cap over optimism around A.I./Cloud and its partnerships with OpenAI, xAI, and Meta. Fast forward to February 5: the stock had sold off nearly 60% in just under five months, showing just how quickly sentiment and perceptions can change. The software complex has had over a \$1T rout, and semis have outperformed software by a staggering 72% over the last six months (Exhibit 3, Strategas).

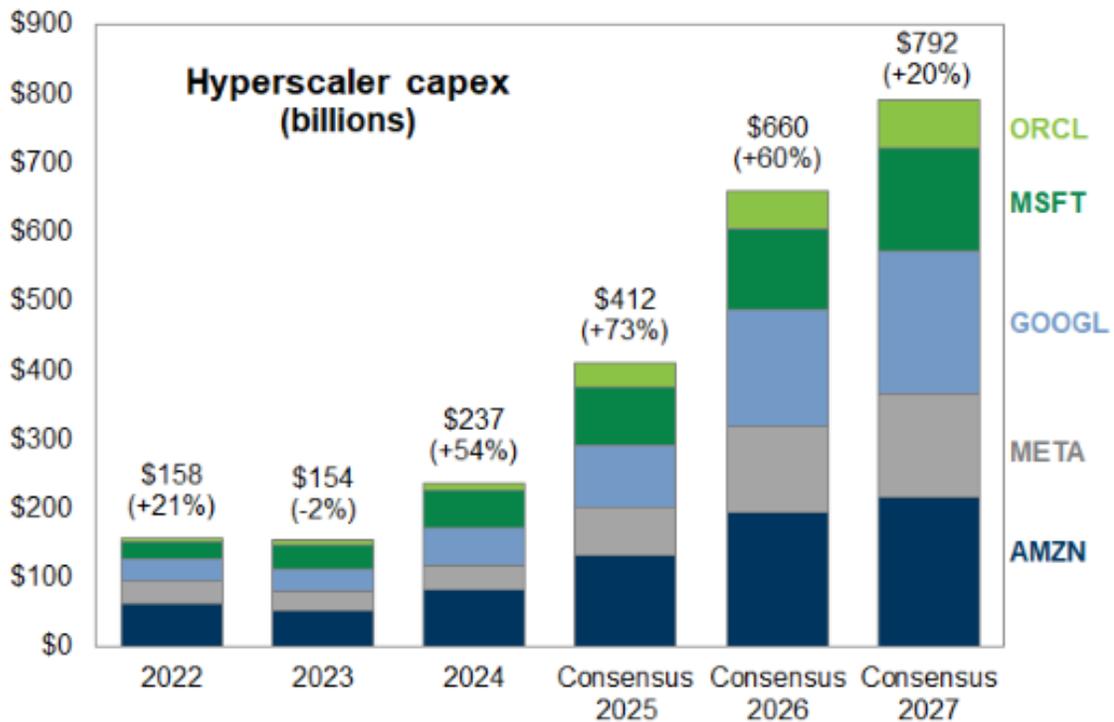
**Exhibit 3**

**BE MINDFUL HOW EXTREME SEMI/SOFTWARE SPREAD IS...**



Another area of angst in the A.I. space has been the hyperscalers. They had been enormous winners in the A.I. race until recently, when focus turned to their level of capex spending on A.I. Over the past few years, capex announcements on A.I. from these companies had been celebrated due to the excitement and potential of the technology. Additionally, investors were comfortable as the companies were flush with cash and easily able to fund capex through operating cash flows. However, 4Q earnings calls revealed much higher capex than expected, with combined spend of \$660B announced for 2026 (Exhibit 4, GS).

**Exhibit 4**

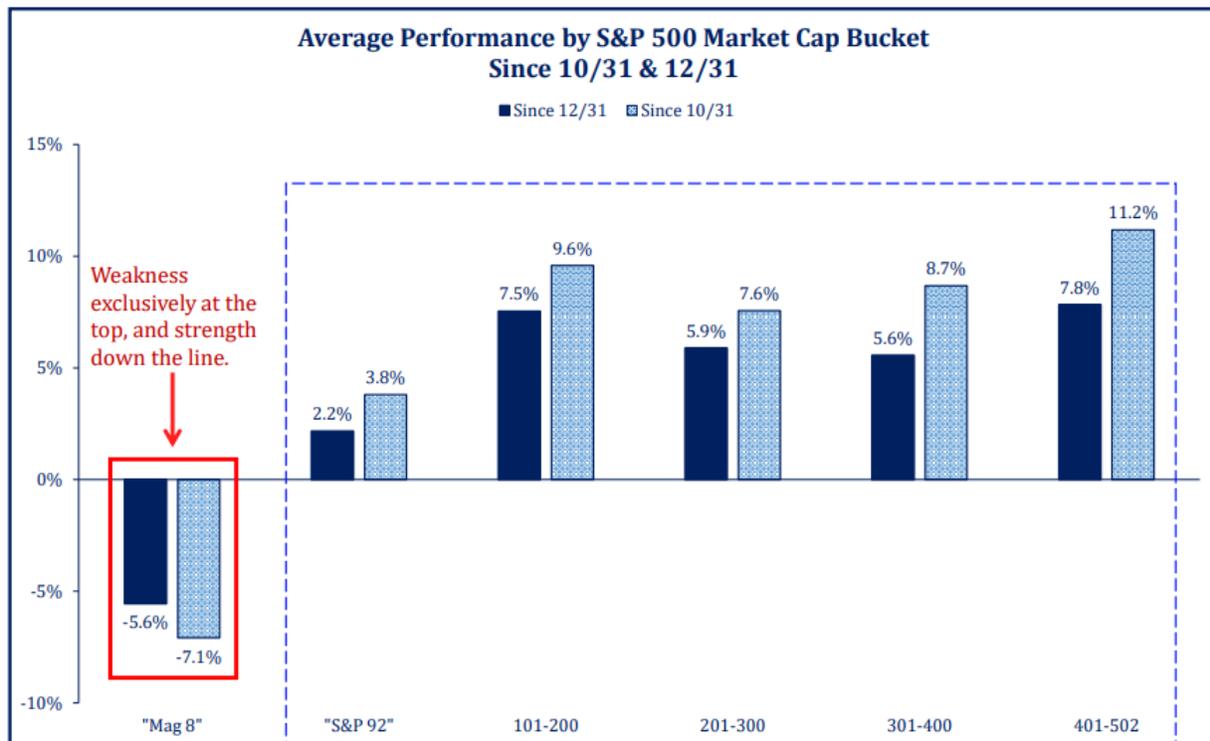


Source: FactSet, Goldman Sachs Global Investment Research

For context, \$660B is just shy of the GDP of Argentina and larger than the economies of Sweden and Singapore. Cumulatively, U.S. banks grew loans \$700B last year. The concern is that the capex budgets now represent north of 90% of cashflows from the hyperscalers, and investors are becoming impatient with when they will see commensurate payoffs. During earnings season, Microsoft and Amazon fell roughly 18% and 15%, respectively, in the week after they announced results.

On the positive side, despite all the mayhem, the S&P sits just 1.0% below its all-time high. It's always encouraging from our view when the market hangs in when speculative areas are getting beat up. Seeing sustained market breadth and participation in old economy sectors has been a welcoming development. Recall the lynchpin of the bear camp over the past few years has been a lack of breadth, and that a handful of mega-caps were carrying the index. Last week, the S&P equal-weight index made an all-time high at the same time the Nasdaq was hovering around three-month lows. As money has moved out of the mega-cap complex and software, it's been redistributed into other sectors (Exhibit 5, Strategas), small caps, and international stocks.

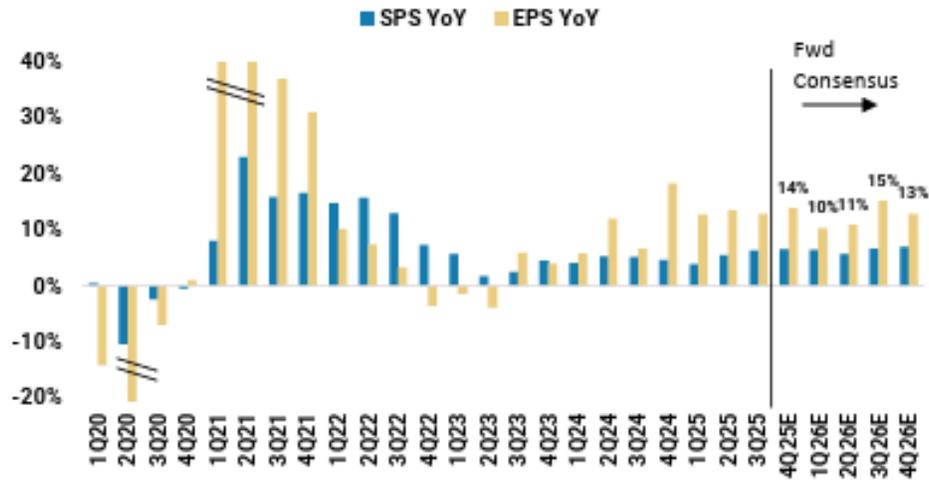
### **Exhibit 5**



Source: Strategas

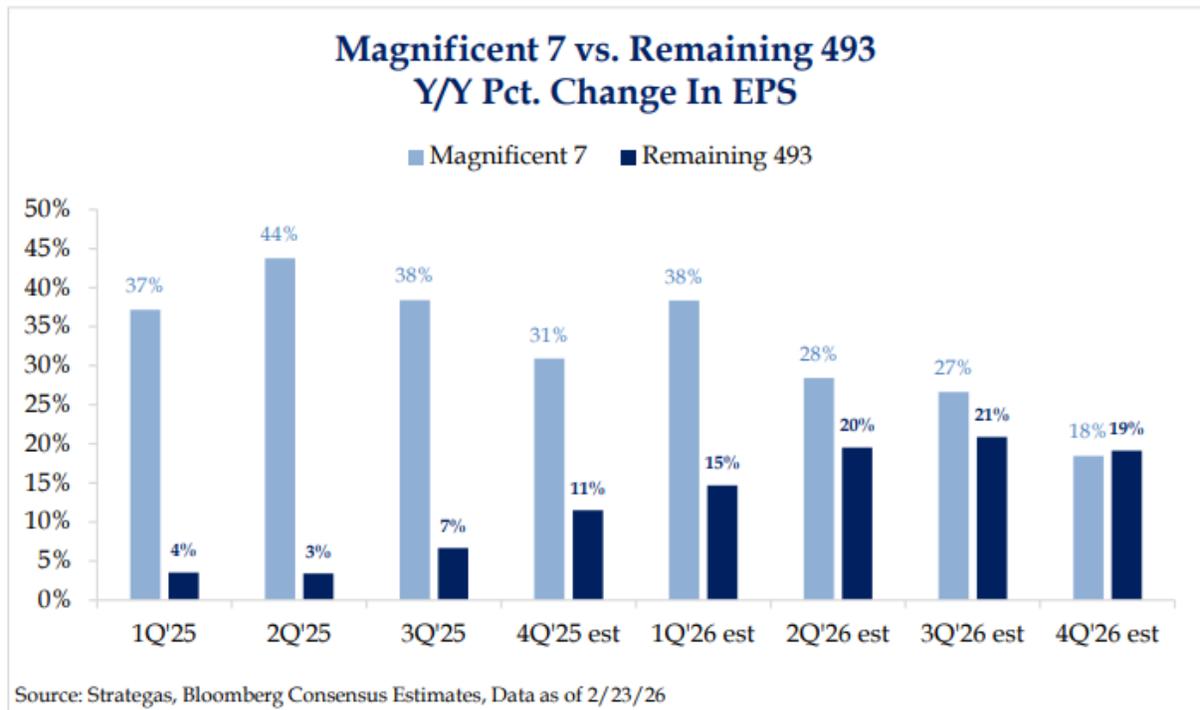
Stepping back from all the speculation of what might happen in the future with A.I. disruption, corporate earnings once again delivered strong results. With earnings season just about wrapped up, 4Q 2025 earnings are on pace to deliver 12% growth year over year, the fifth consecutive quarter of double-digit growth. Unlike prior periods where mega-cap tech carried the load, the median S&P company grew earnings 9.0% (the strongest in four years), and north of 75% of companies beat expectations due to better-than-expected revenue, a weaker USD, and margin expansion. Looking at 2026, expectations call for double-digit EPS growth in all four quarters (Exhibit 6, MS) and estimates for the "other 493" look impressive (Exhibit 7, Strategas).

**Exhibit 6**



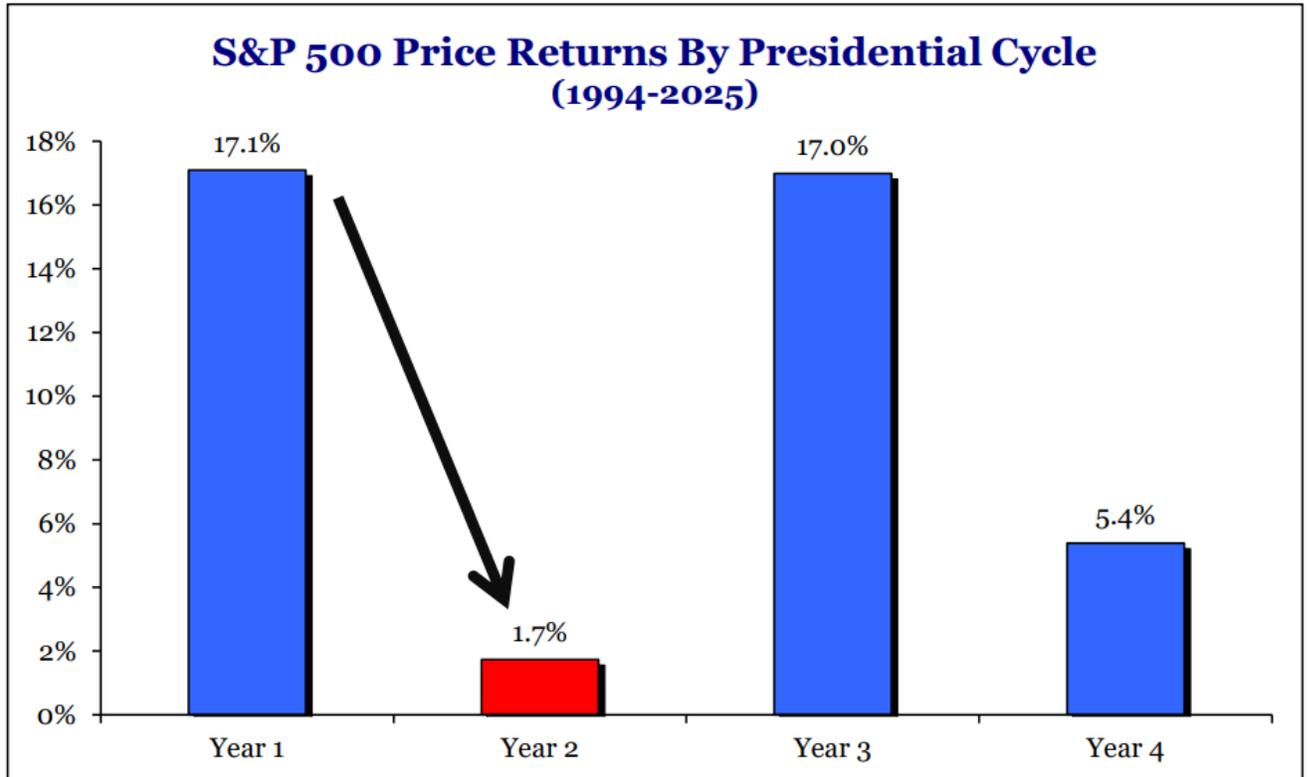
Source: FactSet, Morgan Stanley Research

**Exhibit 7**



Looking ahead, we do not expect volatility to subside anytime soon. We are in a seasonally weak period ahead of midterms, and year 2 has been the worst year of the presidential cycle since the start of the Clinton era (Exhibit 8, Strategas).

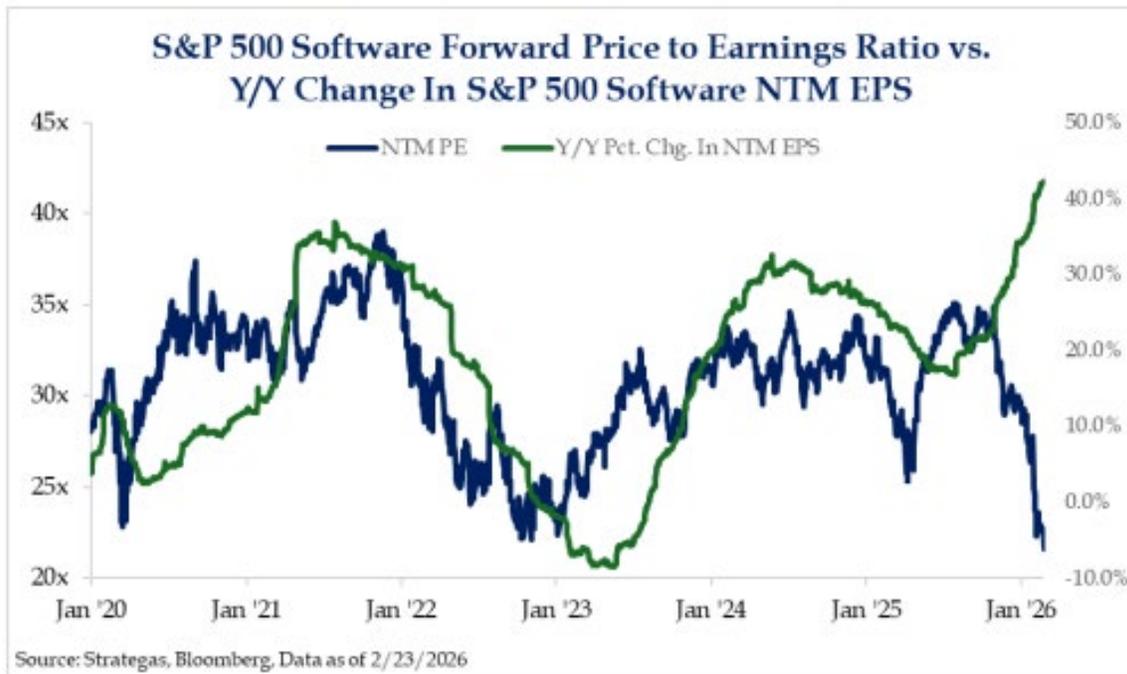
**Exhibit 8**



Source: Strategas

Regarding A.I. disruption, it seems that worst-case scenarios are being baked into a lot of assumptions. Perhaps this time is different, but over the course of history technological advances have proven to be overwhelmingly positive for productivity. It seems more plausible that existing companies can utilize the technology to improve their business models versus the Altruist CEO's lofty statement of "usually these are jobs done by entire teams. And they'll be done with A.I. effectively for \$100 a month." The bloodbath in the software space has been driven entirely by the numerator of the P/E equation (Exhibit 9, Strategas).

**Exhibit 9**

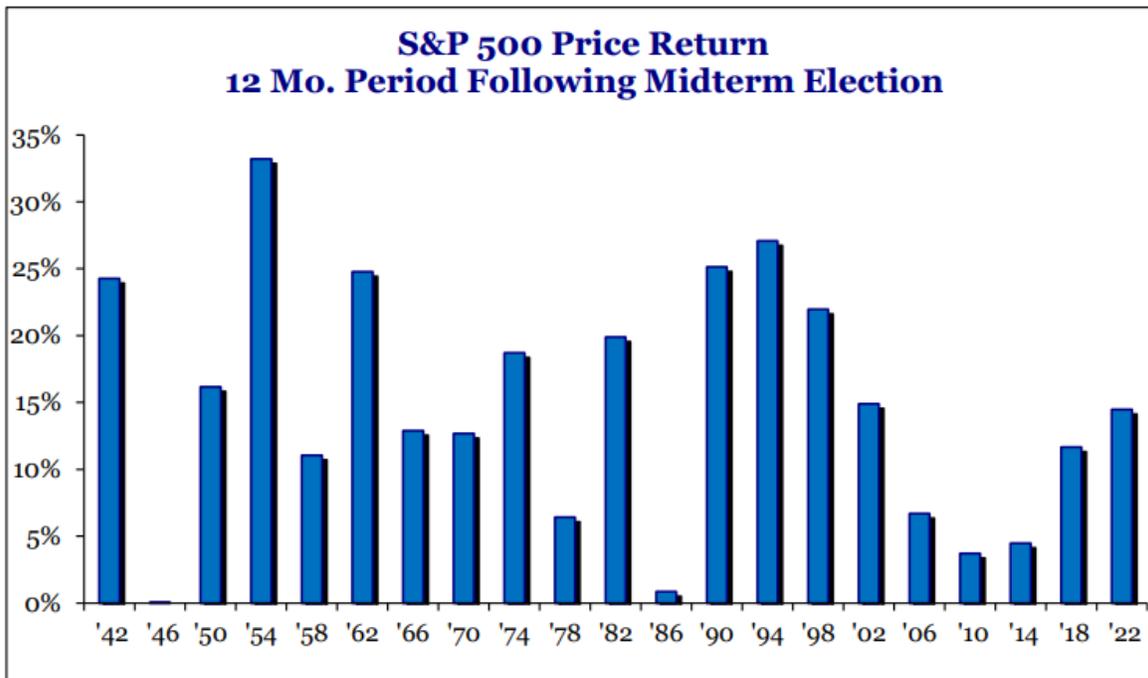


Refer to the Economic portion of this update for details, but in sum, the economy continues to chug along despite some bifurcations and pockets of weakness. It should come as no surprise that the lower-income cohort is still struggling with inflation above the Fed's target, while the upper-income cohort is thriving in large part due the wealth effect. GDP growth looks promising, the labor market outlook has improved recently, credit spreads are behaving despite equity market stress, and financial conditions remain easy. Strategas has a list of 8 things they follow on their recession checklist, and only 2 of the 8 are in "worry" territory. Goldman Sachs echoes the same with a 1/5 chance of a recession in the next 12 months.

In closing, it is hard to make a high conviction call today, especially given the outsized returns of prior years. We don't expect headlines to die down anytime soon given recent development around tariffs, geopolitical tensions rising, the Fed transition, midterm elections, and A.I. disruption. Despite the dispersion and volatility in the equity markets, as well as the recent scare in private credit, the bond market has remained relatively calm. This will be an area we monitor very closely to see if it holds. We are near-term cautious as we wait for the above to play out, but it is hard to be overly bearish given the GDP and earnings outlook and low recession odds. Hopefully, we can muddle through the next few months and then ride a wave of positive equity returns that have historically followed midterm elections (Exhibit 10, Strategas).

**Exhibit 10**

**S&P 500 HAS NOT DECLINED IN THE 12-MONTHS FOLLOWING A MIDTERM ELECTION SINCE 1938**



Source: Strategas

# Reverse Sallents and the Investment Growth Model

**By Michael McNair**

The United States and the broader West have a deterrence problem, and it is not primarily about strategy documents or even budget levels. It is industrial throughput.

We spent decades pushing critical production offshore. Not just low-end commodities but upstream inputs. And we pushed a meaningful share of those upstream nodes into the hands of our primary geopolitical rival.

This matters because economies can be constrained by capacity in specific bottlenecks. One or two missing inputs can hold back everything else, even if the rest of the system looks fine. The concept is sometimes called a reverse salient. A complex system cannot advance past its weakest, most rate-limiting piece. You can have the best engineers, the best designs, the best funding, and still be stuck because one critical upstream node has no slack.

We have already lived through the proof of concept. COVID and the shortage period that followed were a live-fire demonstration that the US economy can slow down or seize up because we lack capacity in a handful of critical inputs. And one of the biggest drivers during that period was not some mysterious pandemic psychology. It was energy. Chinese coal shortages led to widespread power rationing and shutdowns of manufacturing facilities. Factories sitting at the bottom of every global supply chain went offline, and shortages cascaded around the globe.

When a bottleneck appears in a critical node, it does not stay local. It cascades. You get shortages that show up far away from the original problem, in industries and products that seem completely unrelated to the initial disruption.

Now, if that can happen because of a power squeeze and logistical chaos in peacetime, imagine what it looks like in a conflict scenario where those inputs are cut off deliberately.

## **The Reverse Salient in Action**

The cleanest historical example of what a reverse salient looks like in war is the WWII oil story.

In WWII, oil was not just another input. It was the binding constraint that sat upstream of everything modern war required. Airpower, mechanized movement, logistics, industrial production. If you were oil poor, you did not just have higher costs. You had fewer strategic options. The constraint did not just weaken you. It steered your decisions.

This is so instructive because it shows how a single missing input can push a country into actions that look reckless or irrational from the outside, but make perfect sense once you see the underlying constraint.

Take Japan for instance. The United States cut off Japan's access to oil before Pearl Harbor. Japan's entire imperial strategy depended on imported fuel, so once the US used its leverage to restrict oil shipments, Japan's war plan hit a wall. They could keep fighting for a short period, but they could not sustain a long campaign. Their ambitions in Asia were not just slowed. They were functionally crippled. Without oil, the Japanese Navy and Air Force became paper tigers.

Once oil was cut off, the only way for Japan to continue its expansion was to secure new sources by force. The nearest meaningful source was the Dutch East Indies. But to seize that oil and ship it home, Japan had to believe it could operate freely across the Pacific long enough to take and hold the resource zone. That meant one overriding problem had to be solved first. The US Pacific Fleet stationed at Pearl Harbor.

So, they made a strategic gamble. They did not attack Pearl Harbor because it was the best way to win a long war. It was a desperate attempt to remove the Pacific Fleet as a constraint long enough to go seize the Dutch East Indies and replace lost US oil supplies. That is supply constraint logic forcing a time-compressed gamble.

Germany had a parallel problem. The Reich relied heavily on synthetic fuel, and that constraint did not just make Germany weaker. It affected campaign design. The drive toward the Caucasus and the Baku oil fields was not just a geographic preference. It was an attempt to solve a binding upstream constraint in the middle of a war. And it helped produce the kind of operational overreach and strategic dispersion that ultimately proved fatal.

The lesson is that when a country is missing a critical input, it is forced to gamble, escalate, and take risks earlier than it otherwise would. The point is not that oil was important. The point is that a binding constraint changes behavior. It forces escalation. It pulls decisions away from the optimal plan and toward the necessary plan.

Now translate that into modern supply chains.

Today, the reverse salient is not one commodity. It is a portfolio of upstream conversion nodes. Processed materials, high-spec components, machine tools, precursor chemicals, power-intensive refining, and the logistics infrastructure that makes the whole thing dependable.

And the West has allowed too many of those upstream nodes to consolidate outside our control. In many cases, inside the industrial system of the very rival we are planning to deter.

So, the lesson is not that we might have shortages. The lesson is that in a real confrontation, the side that controls the upstream bottlenecks controls tempo, choices, and escalation ladders. If we do not control the bottlenecks, we may find ourselves forced into bad decisions, or unable to execute good ones, for the exact same reason Germany and Japan were pushed into gambles.

## The Rare Earth Elements Trap

Now, the question people are going to ask is how did we allow ourselves to become dependent on a rival for critical upstream inputs.

The US relied on free markets to allocate capital into these supply chains. But free markets will not deliver capacity when a foreign state is willing to subsidize losses for years in order to capture upstream control. When that happens, the market outcome is not free. It is engineered. Decades of state support helped China gain a stranglehold on critical supply chains, and those subsidies drove down the expected returns needed to attract private investment in the West.

Projects get years into development, financing nearly in place, and then foreign supply floods in, prices collapse, and the project dies. It's a price weapon. And as long as that weapon exists, private capital can't solve the problem; no investor will commit to a decade long project if China can always dump and destroy your economics.

The rare earths supply chain is a perfect example. China did not win rare earths just because it had ore deposits. It won because it was willing to aggressively subsidize processing and refining capacity long enough to drive out competitors that needed to earn a return on invested capital.

And once it had dominance, it could use that dominance as leverage. It did exactly that in 2010 in a dispute with Japan over territorial waters, and it has been willing to signal that leverage again since. It is doing it again right now.

This is why the usual reassurance that "if it matters, the market will produce it domestically" is dangerously naive when it comes to strategic inputs.

Because for many of these inputs, what matters is not just mining. It is the whole conversion chain. Refining, processing, chemical precursors, specialized tooling, and the industrial workforce that knows how to do it. Once that ecosystem is gone, it is not something you rebuild on a normal business cycle.

You saw this play out with Molycorp, whose mine and production facilities are now owned by MP Materials. The West tried to restart rare earth production, but the company was forced to compete against state-backed actors receiving substantial subsidies who could manipulate the price environment long enough to break it. It is nearly impossible to compete when you have to buy equipment that your rivals receive for free.

If a rival can dominate an upstream conversion node, it can weaponize pricing, regulation, and scale to keep you dependent.

That is how the West got pushed into a position where it thinks it is buying cheap components, but what it is actually doing is handing a rival control over rate-limiting inputs that sit upstream of military power and economic resilience. We were not buying efficiency. We were buying subservience at a discount.

And once you understand that, it is clear why the administration is not treating this like a normal free trade debate. They are treating it like a strategic vulnerability that markets alone will not fix in time.

### **The Investment Growth Model**

The administration is fully aware of this vulnerability. They have stated it explicitly in speeches and in official documents, including the 2026 National Defense Strategy. The US is strategically exposed after decades of offshoring, the industrial base is thin, and deterrence now depends on industrial capacity and supply chain control, not just platforms and budgets.

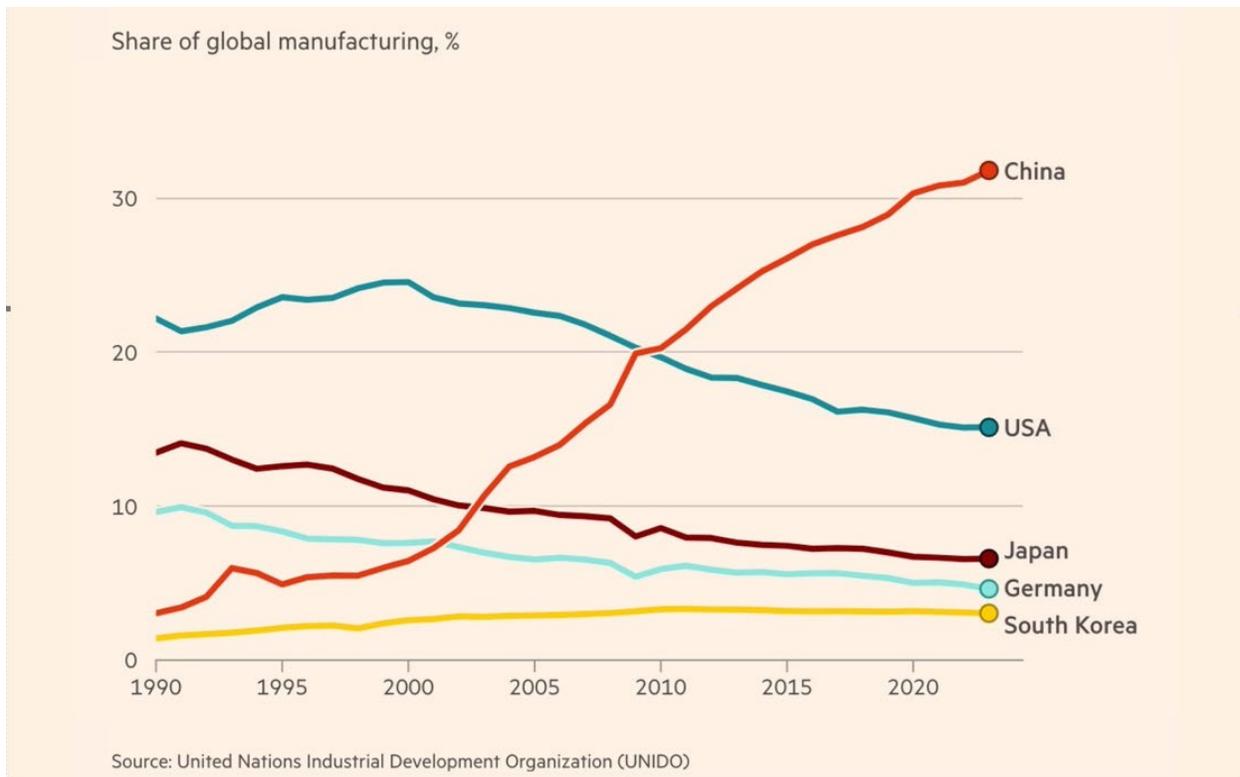
The national security vulnerability and the economic fragility are not separate problems. They share the same root cause. The US spent thirty years running a growth model that leaned heavily on consumption, credit expansion, and asset prices while offshoring the upstream capacity that underwrites both economic resilience and military power. The trade deficit, the deindustrialization, and the strategic exposure are all symptoms of the same structural imbalance.

And because the root cause is the same, the administration is not running two separate programs. They are running one integrated framework. The objective is to shift the US from a consumption-led growth model to an investment-led growth model.

An investment growth model is a set of policies that incentivizes production relative to consumption and ensures that higher savings get recycled into fixed investment rather than financial asset inflation ( $\text{Savings} = \text{Production} - \text{Consumption}$ ). More capex, more plant and equipment, more conversion capacity, more tradable goods. Not investment instead of consumption, but a shift in the mix. The goal is an economy that builds things, not one that finances the consumption of things other countries build.

This is not a new idea. Read Jamieson Greer's Davos speech, and you will see the intellectual logic underneath the entire program. He frames the strategy as a return to the American System. Hamilton, Clay, Carey, Lincoln. The United States built itself into an industrial power using exactly this playbook. Protective tariffs, internal improvements, directed credit, and state support for strategic capacity. Every major industrial power that came after us learned the Hamiltonian model from us and never stopped using it. We are the ones who forgot it. For about thirty years, we ran an experiment in hyper globalization that was the historical aberration, not the norm.

China is the most obvious example. China took the investment growth model and ran it aggressively for decades. State-directed credit into industrial capacity, investment over consumption, managed exchange rates, and strategic subsidies to capture upstream nodes in global supply chains. That is how they cornered critical minerals, rare earths, and processing capacity. That is how they overtook the US as the global manufacturing leader. They used our old playbook against us while we told ourselves that free markets would sort it out.



So, what the administration is doing is not importing some foreign economic philosophy. They are resuming the American one. And once you understand the model, every policy tool they are reaching for makes sense as an instrument serving that objective.

Start with the forcing functions. You do not rebalance a thirty-year equilibrium gently. If you try, the private sector arbitrages around you, and nothing structural changes. That is why tariffs show up. That is why export controls show up. That is why you see friend-shoring requirements, procurement preferences, and targeted restrictions. These tools are not primarily about punishment or symbolism. They are about time compression. They make it rational for companies to move supply chains and build capacity sooner than management teams would otherwise choose to do. Tariffs are disruptive, but that disruption serves a vital purpose. It forces companies to rebuild resilient, secure supply chains before a crisis makes orderly transition impossible.

But a forcing function alone is not enough. You run immediately into a physical constraint. You cannot will an industrial base into existence. The bottlenecks are permitting, energy, skilled labor, tooling, time, and financial incentives. So the forcing function has to be paired with policies that make long-duration projects actually financeable. Direct investment, guaranteed offtake, national stockpiles that serve as demand signals, subsidies for conversion capacity, faster siting and permitting, and abundant power where it matters. The administration announced two primary rare earth smelters last month, the first built in this country since 1980. It's not just rhetoric. That is capex hitting the ground.

The defense reindustrialization push is the anchor for the entire investment model. It is the capex engine. It forces factories to get built, it anchors demand for years forward, and it creates export demand from allies who are rearming. When you guarantee demand at scale and duration, you solve the problem that killed every previous attempt to reshore critical capacity. Private capital will not commit to a decade-long project if the demand signal is uncertain. The defense budget makes the demand signal certain.

Now, within an investment growth model, trade tools and industrial policy alone do not permanently rebalance the US if the rest of the world keeps running surplus models and recycling the proceeds into US financial assets. That recycling is the machine that keeps the dollar structurally strong and keeps the US absorbing the world's excess savings. And this is where you need to understand one piece of simple plumbing logic that ties the whole model together.

All dollars earned abroad must ultimately come back to the United States. A dollar is a claim on the US economy. It comes back either to buy US financial assets or to buy US goods and services. For decades, those dollars have primarily been recycled into US financial assets. Treasuries, real estate, equities. That recycling produces a structurally strong dollar, persistent trade deficits, and a domestic economy tilted toward consumption and away from production. It is the opposite of an investment growth model. It is a consumption growth model sustained by foreign savings.

But if you disincentivize foreign accumulation of US financial assets, you redirect those dollars toward US goods and services instead. That is what rebalancing means in practice.

Now, the common objection is that redirecting foreign dollars away from US financial assets will crush asset prices. But that rests on a misconception. It assumes those dollars only support US asset prices if they come back as direct purchases of financial assets. That is not true.

Dollars that come back through US goods and services do not disappear. They hit US incomes and earnings first. Higher revenues, wages, and profits. That raises domestic income, and those same dollars flow into US financial assets through Americans saving and investing. The dollars still reach financial markets. They just pass through the real economy on the way there.

When foreigners buy US financial assets directly, the US has to issue new claims to satisfy that demand. Mostly new debt. The dollars still circulate and eventually support spending, but the initial impulse runs through balance sheets and leverage rather than income and production.

So, the question is not whether the dollars ever reach financial assets. They always do. The question is whether the path runs through higher domestic income and production first, or through higher debt and leverage first. The US does not have to make a tradeoff

between asset prices and reducing the trade deficit. It is choosing a healthier transmission mechanism.

This is why you are seeing a shift in the tone around capital flows. They have not announced formal capital controls yet, but the direction is clear. Some form of friction on foreign reserve hoarding is coming, because you cannot run an investment growth model while simultaneously absorbing unlimited foreign savings into your financial assets. The two are incompatible. That friction can be taxes on reserve hoarding, withholding on certain inflows, penalties on official accumulation, or incentives to recycle into real investment rather than passive asset parking.

And this is where stablecoins stop looking like a random crypto topic and start looking like critical infrastructure for the investment growth model.

If you want to apply friction to foreign accumulation of US assets, you immediately hit a constraint. You do not want to break the dollar's role in global payments. You want to separate two things that are currently bundled together. The dollar as a payments rail, and the dollar as a store of value for foreign surplus savings.

Stablecoins help unbundle those functions. They allow global users to keep transacting in dollars even as the US becomes less willing to absorb the world's excess savings in Treasury form without consequence. Dollar-denominated tokens circulate globally for payments but carry no yield, so no one parks savings in them. They're held for transactions and not accumulation. The balance of payments problem comes from foreigners accumulating dollar assets as savings, not from foreigners using dollar rails for payments. Zero yield solves the hoarding problem. And critically, it does this without distorting domestic monetary policy. The Fed could discourage foreign accumulation by cutting rates to zero, but that would crush domestic savers and distort the whole economy. Stablecoins separate the two. Foreign users get zero yield (no hoarding incentive). Domestic rates stay wherever the Fed needs them for inflation and employment. You get the benefit of discouraging foreign reserve accumulation without sacrificing domestic policy autonomy.

The result is the dollar maintains its position as a medium of exchange without the burden of being the default parking lot for every surplus country's excess savings, and the matching trade deficit that comes with it.

The stablecoin push is infrastructure you build before you pull the capital controls lever. It is a prerequisite. And that is why it is a tell.

Then you have to manage the transition, because shifting growth models is not frictionless. Changing the regime creates volatility in rates, foreign exchange, risk premia, and asset prices. Which brings us to the piece most people miss entirely.

You cannot run this shift if monetary policy is acting like it operates in a vacuum, while fiscal and industrial policy are trying to redirect the economy's demand mix.

That is why the fight over Fed independence matters. It is not just personality or politics. It is an implementation requirement for the investment growth model.

Lower interest rates do not have to be inflationary. They are inflationary when they mainly fuel consumption demand, asset inflation, and credit growth into housing and financial markets while the supply side is constrained. That is what lower rates do inside a consumption growth model. But if you pair lower rates with fiscal tools, credit guidance, and supply-side incentives that push incremental credit into investment instead of consumption, you can get the opposite outcome. More capex, more throughput, more capacity, and therefore less inflation pressure over time.

Investment is different from consumption because investment changes tomorrow's supply. It expands the economy's ability to produce. If you can engineer a regime where the marginal dollar of credit and fiscal support goes into capacity-building, you loosen the constraint that actually causes inflation, which is inadequate supply relative to demand.

So, the real question is not whether rates are high or low. The question is what the credit creates. If the credit creates more consumption against a fixed supply base, you get inflation. If the credit creates capacity, you get disinflationary supply expansion, even if rates are falling.

That is why it is not contradictory to argue that the administration wants lower rates and also wants reindustrialization. The lower-rate environment is the lubricant for a capex cycle. But it only works if you also build the channels that steer credit into investment. Tax incentives and accelerated depreciation for capex. Guaranteed offtake and long-duration contracts that make factories financeable. Targeted subsidies for conversion capacity. Permitting and energy policy that reduces the real cost of production. You are not just changing the price of money. You are changing the direction of money.

And once you see it that way, the fight over Fed independence reads differently. It's about aligning the monetary authority with an industrial mobilization program. Because if you are trying to rebuild industrial capacity at speed while also rebalancing the trade account and managing the debt path, you cannot have monetary policy fighting fiscal policy. You need monetary policy keeping financing conditions supportive enough to fund the capex cycle and avoid a disorderly spike in term premia, while fiscal and industrial tools prevent that easier money from spilling into consumption and housing inflation, and instead pull it into investment that expands supply.

Every piece points at the same objective. Rebuild the defense industrial base so that deterrence rests on actual production capacity, not platforms we cannot replace. Make long-duration projects financeable through price support and demand guarantees. Shift the growth model from consumption to investment. Shrink the external deficit. Eliminate China's leverage over the chokepoints. And coordinate monetary policy so the transition does not blow up along the way.

This is not a collection of random policies. It is one integrated, coherent project. Economic security is national security. And the investment growth model is the strategy.