



FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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The Return of Interest Rate Risk

Among all the talk about artificial intelligence, NVIDIA's earnings, the upcoming SpaceX IPO and record highs in the stock market, few may have noticed that interest rates have been on the rise. Most notably, the yield on the 30-year U.S. Treasury bond just rose above 5.2%, the highest since the Summer of 2007, which was just before the Great Financial Crisis.

There are a number of reasons why rates have risen. The nominal national debt of \$39.27 trillion (the total amount, which includes the federal government's massive unfunded liabilities, is far higher) has saturated the market with debt. War is very expensive, as is industrial scale fraud, providing Medicare to nearly 65 million people, Medicaid to nearly 88 million, and Food Stamps to over 37.2 million. Trump's tariffs will raise significantly less revenue than expected. Tech companies have been borrowing lots of money to build out AI and data centers. In the last couple of years, the U.S. personal savings rate has declined to 3.6%. U.S. consumer debt of all types (housing, auto, student loans, credit cards, etc.) is at a record high. Higher energy prices makes everything more expensive; thus, more capital is needed to fund corporate investments. And the money supply has risen sharply in recent years as the Fed continues to print dollars to monetize the national debt.



Higher interest rates increase the cost of capital and the discount rate that's used to calculate the present value of all investments (which makes them less valuable). Higher-yielding bonds become more attractive relative to stocks and precious metals. And interest-sensitive investments such as real estate and utilities take a hit. Historically, the bond market has been about twice the size of the stock market, so higher-yielding bonds can draw a lot of money away from the stock market, especially since bonds are generally less risky than stocks.

Consumers with revolving debt (such as credit cards) immediately experience greater financial distress, and it becomes more difficult to borrow money for a house, a car or a college education.

Debt-laden corporations (especially those that have a lot of debt that matures in the short to intermediate term) are suddenly faced with the prospect of higher interest expense and thus lower earnings, free cash flow and dividends, and lower financial strength.

Many homeowners locked in ultra-low mortgage interest rates between 2011 and 2022, so would be loath to sell their house, which would cause the U.S. housing market to freeze up.

Cars were already prohibitively expensive, so a higher interest rate on car loans would put them even further out of reach for most consumers.

In short, higher interest rates would cause a massive, market-wide repricing (all downward) of all assets except cash (fortunately my clients have about 60% in money market funds, which benefit from rising interest rates). It's been a very long time since investors and consumers have had to deal with interest rate risk. Many of them have never even experienced it since they weren't adults at the time. Rising interest rates were a significant contributing cause of the Great Financial Crisis in 2008. Perhaps it's time for history to repeat (or rhyme).

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Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or personal trainer.