

Is It Finally Happening Here? The U.S. Fiscal Mess and Investor Implications

By: Josh Rowe, CFA, PhD, Managing Director of Research & Family Office Investment Strategy, HB Wealth

Executive Summary

This piece explores the growing concerns around U.S. government debt, drawing on Ray Dalio's "Big Debt Cycle" framework. While the U.S. is not on the brink of default or hyperinflation, rising debt levels, political dysfunction, and market fragilities are creating a more volatile and expensive financial environment. The key message: investors should prepare for a world of higher interest rates, tighter fiscal space, and more frequent market stress—not collapse, but discomfort.

Key Points:

- **Debt sustainability** depends on whether economic growth outpaces interest costs.
- **Fiscal crises** are triggered by loss of investor confidence, not just high debt ratios.
- **Market structure fragilities** (e.g., Treasury liquidity, private credit) could amplify shocks.
- **The U.S. dollar remains dominant**, but its privilege is not unlimited.
- **Investors should diversify portfolios**, hedge against inflation, and monitor policy credibility.

Setting the Stage: The Big Debt Question

Do countries that issue debt in the world's reserve currency "go broke"? Or do they simply squander their long-running economic advantage? What happens if everybody stops lending to a deadbeat Uncle Sam (except at usury rates)? Fiscal risks are very real, but investors should beware of too tidy analogies.

"Basically, the Big Debt Cycle works like a Ponzi scheme or musical chairs with investors holding an increasing amount of debt assets in the belief that they can convert them into money that will have buying power to get real things, yet as the amount of the debt assets that are held up by that faith increases relative to the real things, that conversion becomes more obviously impossible until that is realized and the process of selling the debt to get the hard money and real assets begins." – [Ray Dalio](#)

Hedge fund titan Ray Dalio's recently published book is titled *How Countries Go Broke: The Big Cycle*. As with other of Dalio's "big" ideas, this book seeks to explain with simple analogies and frames what Dalio sees as a recurrent pattern in macroeconomics and finance. It is a model without equations that nonetheless makes specific, alarming predictions.

The thesis runs like this: great powers stay great when they maintain fiscal strength, social cohesion, and credibility. Lose those, and your borrowing capacity cracks. Without the ability to roll debt, governments can't fund their promises; the economy and the social contract start to break down. Investment portfolios get punished. Markets, not parliaments, end up disciplining the Treasury.

This pattern has past precedents. Before World War I, roughly 60% of global trade was invoiced and settled in the British pound sterling, reflecting England's centrality within global networks of commerce and finance. By 1945, sterling had given way to a dollar-led system consolidated at Bretton Woods, NH. The pound's share was down to about a quarter. In parallel with the weakened currency, indebtedness exploded. In 1900, the UK's public debt stood at 30% of GDP. After 1945, the burdens of financing two wars and reconstructing a battered country had driven that ratio to 249%, an all-time high.

Dalio, as he has often done, takes big ideas and sets the investing public talking. Much of his framing is correct and useful. But investors should avoid drawing overly simple conclusions or making timing-sensitive forecasts. It's probably not the right time to load 20% of portfolios in physical gold, following a greater than 150% recent run. Bitcoin and imitator cryptocurrencies are fascinating technologies that have recently become much more mainstream and frictionlessly investable. But is an ETF a great way to hedge a financial apocalypse? Should we be monitoring the prices of bunkers in New Zealand?

Key Takeaways

- Dalio's "Big Cycle frames how fiscal excess erodes credibility among great powers.
- Decline usually stems from loss of discipline and investor confidence, not spending alone.
- Today's U.S. fiscal backdrop warrants vigilance, not panic.

How Fiscal Deterioration Happens — and Why the U.S. Isn't There Yet

Hegemonic powers have historically lost economic clout primarily due to war or disaster, not because they spent themselves into ruin. Britain ceded its trading dominance during the First World War. Rome overextended itself

militarily and lost both territory and control of an extractive patronage system. Ming and later Qing China—perhaps most relevantly to the U.S. situation—voluntarily stopped innovating technologically and scientifically and, over centuries, fell behind more nimble and competitive adversaries at the growth frontier. History doesn't offer much evidence of sudden stops for powerful empires without hard catalysts.

That should temper some more apocalyptic narratives—the U.S. is not going to experience a Weimar or Venezuelan-style hyperinflation, at least this year. But it should not breed complacency. Fiscal crises rarely announce themselves when any specific, critical ratio of debt-to-GDP is crossed. They arrive whenever investors lose confidence in future budget behavior, when the compensation they demand for holding long-dated bonds starts rising, and when market structures—the boring plumbing everyone ignores—start to break down, amplifying the stress. The United States issues the world's reserve currency, and thus dollar-denominated assets benefit from enormous network effects. That matters. But the arithmetic of debt matters too, as does the creaking infrastructure of the Treasury market.

What markets are pricing right today is pretty far from a fiscal crisis. They're not pricing collapse. Market indicators, from Treasury futures to TIPS break evens to the S&P 500, imply a world where debt ratios neither accelerate nor spiral, but where debt levels stay high, inflation stays firmer, and certain risk premia stay higher for longer. That's a world of more expensive capital, not Armageddon. Markets aren't omniscient—indeed, they're frequently wrong—but, before we call the 1-800-BUY-GOLD to order a safe full of bars, we should acknowledge that credit spreads are low and equity indices are at all-time highs. Let's think about what *could* happen, how it might happen, and how we can thoughtfully build a portfolio around it.

Key Takeaways

- Fiscal crises are confidence events, not mathematical thresholds.
- Markets still price U.S. Treasuries as the world's safe asset.
- The current environment suggests higher capital costs, not collapse.

The Economics Behind Debt Sustainability

Two ideas underpin most modern thinking about public debt.

The first is the **interest-growth comparison**. It's simple: is the average interest rate the government pays on its debt higher or lower than the economy's growth rate? Economists formalize this in the denominator of the debt valuation equation: $(r-g)$. It's a simple accounting relationship, not an abstract mathematical concept.

Accounting dictates that if interest costs run below trend growth, the debt-to-GDP ratio tends to shrink over time—assuming the primary deficit (that's spending minus revenues, before you count interest) doesn't blow out. This is what's known as the “cheap lunch hypothesis.” We pay interest on our debt and either retire or refinance the current portion of it, all while the economy grows faster than the growth of the debt.

If interest costs run above growth for an extended period, the ratio climbs unless you start running primary surpluses. Olivier Blanchard [has laid this out clearly](#), arguing that the 2010s looked forgiving precisely because rates on safe assets sat below the economy's trend growth rate. He's since warned that the post-pandemic world looks less kind. r is ticking up faster than g . The math is starting to bite again.

The second idea is “**fiscal space**.” Think of it as the room a country has to borrow before investors start to panic. [Work](#) by Jonathan Ostry, Atish Ghosh, and colleagues at the IMF has firmly established that, contrary to [previous received wisdom](#), there's no universal cliff edge at 90 percent or 120 percent of GDP. What matters is whether markets believe policymakers will, over time, adjust the primary balance* when interest costs rise. When politics stops responding—what the IMF calls “fiscal fatigue”—space can vanish alarmingly fast.

Though he is famously associated with “secular stagnation”—the idea that debt, demographics, and excess savings were leading to a period of low productivity, low inflation, and low interest rates—Larry Summers is now issuing clarion calls for [more fiscal caution](#). Summers now emphasizes that running large primary deficits at full employment, combined with rising term premia, will tend to push long rates higher and stress economic conditions, regardless of whether the Fed is currently in a cutting cycle.

One of the most established voices on debt sustainability, Kenneth Rogoff, has recently argued that the era of what he calls “[magical debt thinking](#)” is over now that real safe rates are no longer pinned to the floor. The risk isn't that America stops paying its debts. The risk is that inflation runs warm for the foreseeable future. Most likely is a regime of persistently higher yields and a weaker currency until fiscal plans look credible again.

* A quick glossary:

Primary balance: The budget balance before you count interest payments.

Fiscal space: The distance between today's debt path and the point where markets start doubting that you'll repay at reasonable rates. It is about more than just numbers. Credibility is very important.

Term premium: The extra yield investors demand to hold long-maturity bonds rather than rolling over short-term bills. It moves with supply, liquidity, and perceived risk.

Convenience yield: The safety and liquidity value embedded in Treasuries that pushes their yields below what you'd otherwise expect. When that erodes, long rates can rise without any new inflation news.

Atif Mian, working with Ludwig Straub and Amir Sufi, has connected the low-rate era to deeper forces—demographics, inequality, and global savings gluts. For a period, the United States could run and finance higher deficits because exogenous headwinds held interest rates down. This they termed a “Goldilocks” scenario. In short, we could with relative ease outgrow the annual interest cost burden.

Mian, Sufi, and Straub technically restate Blanchard’s relation. In accounting terms, a pile of debt is just a string of payments stretched out over time, discounted by the rate of interest on that debt. So long as year-after-year nominal GDP grows faster than that rate of interest, the numerator (the present value of the debt) shrinks, even while the denominator (GDP) grows. Debt-to-GDP is no longer a worry, even at historically high levels.

COVID-19 disrupted this felicitous feedback loop. For sure, the brakes on inflation and interest rates had been released for some time before the pandemic. Think of an aging working-age population, de-globalization, and increasing energy capex requirements. Meanwhile, U.S. political dysfunction and bipartisan erosion of fiscal discipline have been a long-running trend. But after 2020, destabilizing forces on both sides of the fiscal ledger came unleashed. Rates rose, and the fiscal space tightened.

It's worth pausing here to dispatch a common analogy: countries that borrow in their own currency are not like households. They don't have to balance their books periodically. They can run deficits forever, so long as they can roll their financing. And they don't have to make and sell more than they buy—financial markets like the Treasury market are potentially infinite repositories of the remainder. In short, imbalances can remain imbalanced far longer when we're dealing with sovereigns than with companies or households.

Yes, our government is laden with implicit promises to the elderly and the sick that are held off the books. Some have asked what Washington’s net debt/EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization, a common measure of corporate leverage) is. Well, \$30 trillion of debt held by the public looks high when compared to \$4.9 trillion of 2024 government revenue. Worse, that ratio swells uncomfortably when one adds in the \$75 trillion (present value) of off-balance-sheet entitlement spending. But the ratio itself is meaningless; unlike a company, we never need to default. We can just make more money to pay off creditors.

The U.S. government also benefits from a unique cost-of-debt dynamic. Price-seeking lenders are not comping U.S. bonds against those issued by Microsoft, Apple, or Norway. Treasuries comprise the biggest, deepest, most liquid, and smoothest functioning (more on this later) market in the world. They are, by default, treated as the riskless asset.

Thus, a simplistic analogy to firms or households is misplaced. What defines our borrowing capacity is whether the arithmetic *looks* sustainable and whether investors believe policymakers will respond when it doesn't. When Ray Dalio calls government debt a “Ponzi scheme” – a trade that can only be made on the assumption of someone else refinancing it later—he is expressing this exact worry. At some point, the bond vigilantes will go on strike and coerce a painful rectification. It is this problem, rather than default or hyperinflation, that ought to concern investors.

While nominal debt is growing, the math of sustainability is always conditional. It can change suddenly. If interest costs stay above growth and the primary balance doesn't improve, something has to give. Recent numbers aren't reassuring. The Congressional Budget Office projects that debt held by the public will surpass its post-war record by 2029 and keep climbing. Republicans, formerly the political tent for budget hawks, have been proposing more and more ambitious spending and tax giveaways. Calling for more austerity is not in the Democrats' typical platform. Net interest outlays are therefore projected to rise over the coming decades to levels rarely seen outside wartime. This is not a forecast of a buyers' strike tomorrow. But it's the arithmetic investors will eventually work into Treasury yields.

Key Takeaways

- Debt sustainability depends on whether growth (g) exceeds interest costs (r).
- Rising interest rates post-pandemic make fiscal arithmetic more challenging.
- Fiscal space is determined by policy credibility, not fixed ratios.

Lessons from Abroad

Japan proves that very high debt-to-GDP ratios can coexist with low yields for decades. But Japan has some characteristics the US doesn't share. A very export-oriented, high savings economy with very low birthrates and immigration looks quite different than 2025 America. In addition, three “lost decades” of relatively comfortable stagnation should not exactly give stock market investors cheer.

Japan's mix was distinctive: domestic ownership of government bonds, the Bank of Japan's (BOJ) active yield-curve control, and long stretches of disinflation. That's why nominal yields remained anchored at zero despite debt ratios rising to the highest levels in the rich world. Recent JGB auction trouble, as the BOJ has stepped back, however, shows that the equilibrium can shift quickly. The lesson isn't “debt never matters.” It's that the policy regime and the investor base shape outcomes—and those differ sharply in the United States.

The UK's mini-budget own goal: A recent case study in investor expectations mismanagement.

Britain's 2022 gilt crisis is instructive. It shows how funding stress happens in a rich country with its own currency and no chance of outright default. An unfunded fiscal package landed at precisely the wrong moment. Leveraged pension funds running liability-driven investment strategies had to dump long gilts to meet margin calls. The Bank of England stepped in with temporary purchases to stop a fire sale in what should be the safest assets in the market. Forensic analysis suggests forced LDI selling explained roughly half the price collapse; the rest was the fiscal news itself.

The United States doesn't run UK-style LDI leverage at scale. But the British experience highlights how market events—a Fed press conference, a failed auction—can suddenly cause hidden fragilities to emerge and cascade throughout the system.

We “are going to see a crack in the bond market,” forecast Jamie Dimon, CEO of JPMorgan. “It is going to happen.” The world’s largest debt market has seen well-documented fragilities in Treasury market plumbing—the 2014 “flash rally,” the 2019 repo squeeze, the 2020 dash-for-cash. All clear reminders that liquidity in the world's deepest market can vanish when everyone needs balance-sheet capacity or cash at once.

Treasury liquidity depends on dealer balance sheets, market design, and clearing capacity. The official Inter-Agency Working Group—Treasury, the Fed, the SEC, the CFTC, the New York Fed—has a multi-year program to harden this infrastructure. Central clearing, buybacks of off-the-run bonds, and standing facilities. These reforms can reduce the odds that a fiscal wobble becomes a market dysfunction event. But they also were initiated before the expectation that the “One Big Beautiful Bill Act” would add \$3 to \$4 trillion in new supply to an already creaking infrastructure.

Dollar dominance and why Argentina is the wrong analogy.

“Our currency, but your problem,” is how Treasury Secretary John Connally described the dollar in 1971.

America’s exorbitant privilege has helped fund a nation of consumers; flat screen TVs and two SUVs in every garage, all financed by the proverbial Mrs. Watanabe. The U.S. managed a five-decade consumption boom *despite* a secular decline in manufacturing capacity and stagnation in real wages. The cheap cost of debt made this tricky balance possible.

But does the dollar's central role as the global index of trade and repository of global savings guarantee successive governments the freedom to perpetually increase the nation's debt load?

Somewhere, there *are* limits. The dollar's network effects are vast—in trade invoicing, in financing, in central bank reserves. [IMF data](#) still show the dollar with by far the largest reserve share; recent quarter-to-quarter shifts have been driven mostly by exchange-rate swings rather than deliberate portfolio moves. Research on the "[dominant currency paradigm](#)" explains the stickiness: a handful of currencies, especially the dollar, anchor global pricing and habits adjust slowly, and are reinforced by history and the consensus behavior of millions of different counterparties. It's a network effect, like Facebook or Uber: the more friends or drivers use the app, the more convenient it is for the marginal user to sign up.

None of this makes the dollar bulletproof. Network effects unwind in an accelerating fashion, just as they snowball. It does make a Venezuelan-style currency collapse a fantasy. Argentina is a serial fiscal basket-case running an 80-year experiment in feckless populism (interrupted by the odd bout with market realism). Our populist ascendancy is barely ten years old. A more realistic risk is higher real yields combined with occasional dollar weakness when hedging costs or [policy uncertainty deters foreign buyers](#). Higher yields, higher floors, a trendline dollar weakening (at least against a basket of commodities), but in unpredictable episodic bursts.

The Mechanics of Rising Yields

Supply and term premium. Obviously, supply and demand affect prices (yields) of Treasuries. A lot of issuance in a relatively short period of time carries a risk of indigestion. Perhaps paradoxically, the enormous float of U.S. debt is one of the features that *suppresses* yields, by making Treasuries liquid and convenient currency. The [so-called "convenience yield"](#) is the premium that Treasuries command because they are used by brokers, dealers, and traders as a form of money.

The ebbs and flows of supply can raise or lower that premium; with heavy supply stretching the absorption capacity of dealers, or when dealers prefer to park cash at the Fed, Treasuries trade more like a risk asset. This causes yields to rise in secondary trading.

"Term premium" is the name for the [excess yield demanded on longer-maturity Treasuries](#) beyond what would be implied by the expected path of interest rates. In some sense, the term premium is a cost of uncertainty or friction in the Treasury market. When inflation expectations become unmoored, it simply costs more to insure holders of long-term bonds against losses. Economists of the rational expectations school have often worried about the

“crowding out” effect of government bond issuance—private borrowers looking to invest in their businesses simply find less room to place their debt with savers when government debt is rising. Effectively, there is a finite capacity in the market to warehouse debt—government, corporate, or securitized. Too much of one type will either inflate spreads or the term premium. When there are a lot of recently issued Treasuries sloshing around, longer-run yields go up.

Credibility of the fiscal reaction. The revenue-generating capacity of the U.S. government is virtually infinite. Arthur Laffer may quibble, but there is probably lots of room for the IRS (if fully funded) to collect a greater share of the person's fortunes from the swelling ranks of America's plutocrats. Similarly, the greatest income-generating machines in the history of the world reside in the S&P 500. Yet their effective tax rate hovers somewhere around 25%; many of the top-performing companies pay none. Surely, where there is will, there is an opportunity for lawmakers to tax more and borrow less. Finally, there are bipartisan plans that could address the biggest source of U.S. fiscal strain: long-run entitlement promises. Budget cuts and entitlement reforms beyond what any recent administration has achieved are doubtless possible. Importantly, many of these can be safely enacted without choking off the consumer-led growth that has made America the economic envy of the rich world in the decades since the GFC.

So why do we continue to pile on the national debt? Incentives and political economy relating to each of the two parties' electoral machines is certainly an issue, but one beyond the scope of this note. What concerns us is that markets have, thus far, been very accommodating of fiscal irresponsibility. The U.S. gained a lot of credibility on fiscal matters in the 1990s, when both parties worked together toward balanced budgets.

Markets may now be beginning to unlearn the lesson. Yields on longer-dated Treasuries reflect aggregate sentiment on how committed future U.S. leaders will be toward addressing fiscal issues. In the IMF's terms, the fiscal space is starting to shrink. This is a self-reinforcing process; as more debt is issued at higher coupons, the interest cost facing the Treasury rises as a percentage of total expenditure. This “dead money,” of course, limits the room for growth-enhancing infrastructure investments or tax cuts.

Market structure. Finally, as documented above, the U.S. financial system has never absorbed such an enormous volume of Treasuries. At the same time, dealer balance sheets post the Dodd-Frank reforms of 2010 have tended to be much smaller. The amount of Treasury liquidity warehoused by banks and brokers is lower than in the pre-2008 period. When issuance is light, we hardly notice it. When issuance ramps up or fear starts to trickle

through market networks, these frictions can materially increase yields on less liquid and longer-run securities. Contagion spills outward from the Treasury market to every other one, since virtually all debt is priced as a spread to the Treasury curve.

Key Takeaways

- Increased Treasury supply and limited dealer capacity push yields higher.
- Rising term premia reflect market concern over fiscal credibility.
- Liquidity constraints amplify volatility across financial markets.

Potential Pressure Points in the Financial System

The nature of market contagion is such that it can be ex ante hard to predict the first causes. The butterfly effect rules in complex networks.

If the fiscal narrative deteriorates and term premia reprice sharply, who feels it first? Four channels matter. In the recent past, we have seen cracks in state pensions, regional banks, providers of venture debt, municipal bonds, commercial paper, and money market funds, not to mention complex securitized bonds. The rule is, the more opaque the market structure, the more likely risk is to build up in unforeseen places, and liquidity is to suddenly shut down. Nevertheless, here are a few areas where rapid growth or regulatory changes have stressed potential fault lines.

Private credit and nonbanks. The fastest-growing corner of credit is largely floating-rate, often funded by bank credit lines or wholesale markets. Of course, the shadow banking sector, rebranded as private credit, has been on a tear since COVID. Suddenly expanded participation in an illiquid and complex asset class can be a recipe for liquidity panics—recall the role of subprime MBS, CDOs, and CDOs squared in the 2008 financial meltdown.

The Fed's April 2025 Financial Stability Report also highlights rising linkages between banks and nonbanks. Private credit is, at its inception, a regulatory dodge. In theory, it may be good to diversify credit risk away from retail depositors and onto the balance sheets of sophisticated, long-horizoned investors. In practice, the risk is increasingly being born by insurance policyholders and mom-and-pop retail traders. Ironically, much of this risk could boomerang back onto banks when conditions tighten. Goldman Sachs and JPMorgan have recently made significant commitments to private credit out of their investment banks. The phenomenon carries an echo of when Wall Street banks transferred assets off-balance-sheet (OBS) to opaque counterparties called Structured Investment Vehicles (SIVs). Ultimately, banks and their depositors/creditors *were* on the hook for these promises.

We don't have to use too much imagination to consider how a sudden shift upward in Treasury yields could induce ruptures across this mountain of floating-rate private debt. Resetting borrowing costs would exacerbate questions about credit quality. Already, the proportion of private credit borrowers struggling to meet current cash interest is ballooning. In a world where private credit is increasingly no longer a sideshow but the main attraction, it's not hard to see how volatility and dislocation in this market would radiate to other parts of the financial system.

Banks, especially regionals. In 2023, higher long yields precipitated major unrealized losses on banks' securities portfolios. If a repeat of that experience coincides with deposit outflows or rising credit costs, bank balance sheets will face renewed scrutiny. Two years ago, regulators tweaked available-for-sale vs. held-to-maturity accounting rules to delay banks' recognition of capital impairment while the Fed agreed to indemnify banks on their Treasury losses. These losses haven't gone away; shareholders and depositors could renew their anxiety.

Public pensions and state and municipal budgets. Higher discount rates reduce the present value of liabilities, but they can also bruise asset values and complicate cash flows. Revenues tied to markets—especially capital-gains taxes—can fall just as borrowing costs rise. The UK's LDI crisis is a reminder that leverage plus duration can cause forced selling at the worst possible moment.

Equities. When yields rise for unpleasant reasons—supply, term premium, policy uncertainty—rather than because growth is booming, equity valuation multiples face a double hit. The discount rate is higher, and investors start pricing in future tax or spending adjustments that could weigh on corporate profit growth. High starting valuations circa 2025 imply very robust earnings growth. But higher borrowing costs and necessary fiscal retrenchment would not be a great environment for corporate profits. If earnings expectations and valuation multiples simultaneously ratchet down, much of the recent AI-inspired lift in the S&P 500 could be at risk.

Key Takeaways

- Private credit and regional banks are key transmission points for stress.
- Pension funds and leverage can magnify instability.
- Higher yields expose vulnerabilities in nonbank credit markets.

Four Plausible Market Scenarios

Slow-boil repricing. Coupon auctions clear, but with bigger tails. The money supply expands without a major recession, and inflation fails to settle at the Fed's 2% target. The 10-year term premium drifts higher. Equity multiples compress, especially for long-duration growth stocks. Primary issuance in private credit slows; exits get

scrapped. A handful of rate-sensitive banks face market pressure. Financial conditions tighten without the Fed having to hike. It's gradual, but it's real.

Fiscal surprise meets leverage. Perhaps in a presidential election year, a deficit-widening package lands just as a big, levered strategy begins to unwind. Forced selling hits on-the-run Treasuries. Liquidity fades. Official backstops restore order, but only after a price gap. Financial and economic recovery is slow but steady, though confidence in American markets' exceptionalism is dented. Long-term yields and spreads settle at higher levels. The shape echoes the UK's 2022 episode, even if the causes differ. This would be, unambiguously, a self-inflicted wound and a careless surrender of the unchallenged global gravity of U.S. financial markets over the last hundred years.

Yields up, dollar down. Foreign demand gradually softens as dollar hedging costs rise, and policy uncertainty grows. Treasury yields climb, and the dollar slips against the currencies of major trading partners. That mix is awkward for U.S. risk assets and anyone importing inputs. Inflation and dollar weakness enter a feedback spiral. The Treasury continues to finance deficits at higher and higher rates, while Treasury market plumbing springs more frequent leaks. Foreign stocks outperform in USD terms, and the upward lift on Treasury yields bottles up stock price appreciation in the U.S.

Growth disappoints; deficits persist. Tax receipts miss. Discretionary tightening stalls. Issuance tilts toward bills, and the curve steepens. Equity risk premia widen as investors assume eventual fiscal adjustments. Public pension plans and municipalities juggle valuation hits with rising funding costs. Plumbing reforms keep the market functioning, but financing costs remain structurally higher. This looks like stagflation. Perhaps both parties begin to campaign on fiscal rectitude, proposing their own flavors of austerity budgets for 2028 (Democratic tax hikes, Republican cuts to Social Security and other Biden-era social and environmental spending initiatives).

Navigating What Comes Next

After the Second World War, America's debt burden fell thanks to rapid nominal growth, some inflation, financial repression—rate caps and a peg—and primary surpluses. The difference today is the starting point and the trajectory. The CBO's baseline has debt rising, not falling, under current law. The demographic profile of 1950s America, and its industrial leadership across sectors from cars to computers, could hardly be more different. Populations are shrinking, and rivals have caught up. Trade barriers are stiffening, not loosening, taxing growth. The ability to squeeze more growth from government spending on infrastructure, clean energy, or even

semiconductor fabs is butting up against a ceiling imposed by the market. The "low-rate cushion" of the 2010s has thinned considerably.

Could a productivity boom save us? Maybe, but unlikely. In the decades since the Internet and telecom-led growth spurt of the 1990s, economic productivity has consistently disappointed. An AI-driven boost to productivity would raise growth and revenues, easing the arithmetic. Forecasters see upside but warn about timing and how widely benefits spread. Fiscal plans shouldn't bank on windfalls. Demographic headwinds, regardless, reduce the productivity benefit to both entitlement funding and growth.

Simply to keep markets calm, lawmakers can get by without massive ambition. Markets remain forgiving. The calculus of r minus g still allows room for a high *structural* level of debt to be refinanced (albeit with an increased risk of a blowup) when the economy is good. You don't need a grand bargain. You just need credible movement.

What does credible movement look like to the market?

Sensible, consensus recommendations exist: Hold real primary spending growth slightly below trend GDP. Broaden the tax base. Allow automatic stabilizers to work. The result is a primary balance that improves as interest costs rise. The CBO and the Committee for a Responsible Federal Budget lay out many combinations that meet this test. Economists who have worked for Republican and Democratic administrations agree on many of the same remedies.

Entitlement and tax reforms will show with compounding benefits. Slowing health-care cost growth—through payment reforms, competitive bidding, clearer drug-pricing rules—does more than avoid cuts. Social Security can be stabilized with indexing adjustments and base broadening. On taxes, fewer narrow preferences and stronger enforcement raise revenue with less drag on growth than big rate hikes.

Improved market-structure hygiene is an almost costless remedy. Continue regular buybacks to support off-the-run liquidity. Push forward on central clearing and broader market access where appropriate. Keep standing facilities robust. These steps reduce the chance that fiscal noise turns into a market-functioning crisis.

Just as cryptocurrency advocates have called for a more consistent regulatory playing field, it should be possible to enhance private credit oversight without poisoning financial innovation in private markets. Implement the FSB's recommendations on leverage in nonbank financial intermediation. Watch bank credit lines to private-credit funds and basis-trade leverage. The goal should not be to shrink nonbanks. It must be rather to remove amplifiers that can convert a shock into a spiral.

What markets are saying now—and how to hedge sensibly

Market prices imply a base case of moderately higher inflation and risk premia for longer. Ten-year break evens sit in the mid-twos. The New York Fed's ACM model shows a positive term premium after years of near-zero. Core markets are not pricing panic, but the most likely regime facing the government and businesses is one with a higher cost of capital. Unless policymakers show uncommon bipartisan leadership, the likelihood of stagflation is increasing.

There are many potential ways to hedge a portfolio for a stagflationary backdrop.

- **Core stance:** Modestly shorter duration. Keep room to add duration tactically into disorderly selloffs when official backstops seem likely. Treasury Inflation Protected Securities (TIPS) can act as first-line insurance, but they tend to trade sloppily—bond traders have nicknamed them “Totally Illiquid Pieces of S**t”. Market depth and inflation triggers are not predictable.
- **Equities:** Tilt toward cash-generative, quality, value stocks. Durable companies producing high cash ROIC, owned at reasonable prices, will tend to sell off less dramatically in periods of valuation pressure. Don't ignore international markets: add exposure to non-U.S. earnings streams so future fiscal adjustments don't fall entirely on domestic profit margins.
- **Alternatives:** It's hard to argue that an environment that pressures stocks, bonds, and credit would be *good* for large private equity and private credit. Of course, in less liquid markets, there are more inefficiencies and alpha opportunities, but one should not underestimate the fundamental beta of private markets. They may price with a lag, but private credit is among the most vulnerable sectors to interest rate and credit spread instability. Low net hedge funds tend to shine in rangebound markets. Managed futures or macro strategies have potential as diversifiers when stocks and bonds become correlated.
- **Real assets:** Be selective. Strategic assets like data infrastructure, energy, transportation, and some real estate can perform well. But they can also be highly cyclical and levered to volatile interest rates. For commodities, look to broad baskets. When using futures, as most ETFs do, be careful of negative roll yield. Size currency hedges such as metals or cryptocurrencies carefully; these assets rarely behave as predicted.
- **Tail hedges:** When affordable, use option-based index or credit hedges funded by carry elsewhere. Collars or risk reversals can work well when markets are expensive, as today, for those willing to trade upside for protection.

Key Takeaways

- Moderate inflation and elevated yields are the most likely base case.
- Investors should emphasize quality, diversification, and liquidity.
- Fiscal credibility and market resilience will define long-term outcomes.

Conclusion: Credibility Is the True Currency

America is not Greece. It's not Argentina. The dollar system's network effects are substantial and slow to reverse. Yet low rates provided a cushion for so many years. Some even went so far as to deny that countries like the U.S. face any fiscal ceiling at all. That world is gone. The “Deficit Myth” is meeting cold reality.

The UK's gilt shock demonstrated how market mechanics can turn policy surprises into a run on a big market, and perhaps the long-term forfeiture of fiscal credibility. Potential risk amplifiers hide in the market infrastructure and shadow banks.

Ray Dalio crystallizes many of the varying threads of deficit concerns into a Big, Simple Model. The track record of these sorts of models is not great. “Dow 36,000”, 2009-era hyperinflation worries, and Modern Monetary Theory are recent examples. The U.S. does not *need* to inflate away its debt; it is not inevitable that the currency is debased. Nor should declinist narratives cede the future to China, to crypto, or to AI. Choices are required. Markets will help determine the shape of those choices. But on balance, for U.S. investors, the attractiveness of diversification—geographical, asset class, even good old-fashioned stock-bond diversification—has rarely been higher. Hedges have some role to play in most portfolios that may need to harvest cash in the next decade. And every investor, just like every citizen, should be watching Washington with a skeptical eye on the fiscal space. Economists have been thoughtfully diagnosing our mounting fiscal challenges for many years. Thank you, Dalio, for cogently bringing these issues to the New York Times bestseller list. But selling books is one thing; designing portfolios that are robust to geopolitical and macroeconomic headwinds but can still participate in growth—that's much harder.

Key Takeaways

- U.S. fiscal credibility remains strong, but not unlimited.
- Diversified portfolios best protect against policy and rate shocks.
- Great powers endure not by reacting late, but by adapting early.

If you have any questions or would like to discuss your contingency plans further, please reach out to your client service team, visit us at hbwealth.com, or call 404.264.1400.

Important Disclosures

This article may not be copied, reproduced, or distributed without HB Wealth's prior written consent.

All information is as of the date above unless otherwise disclosed. The information is provided for informational purposes only and should not be considered a recommendation to purchase or sell any financial instrument, product, or service sponsored by HB Wealth or its affiliates or agents. The information does not represent legal, tax, accounting, or investment advice; recipients should consult their respective advisors regarding such matters. This material may not be suitable for all investors. Neither HB Wealth nor any affiliates make any representation or warranty as to the accuracy or merit of this analysis for individual use. Information contained herein has been obtained from sources believed to be reliable but are not guaranteed. Investors are advised to consult with their investment professional about their specific financial needs and goals before making any investment decision.