

GRANT'S

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AI monetary use case

It was 9:30 A.M. on Tuesday, Sept. 17, 2019, and the Federal Reserve Bank of New York was in a tizzy. Normally tightly controlled money-market interest rates were suddenly airborne, and the open-market desk was powerless to bring them back down to Earth.

The subsequent official cover story assigned the blame to “technical difficulties,” which was correct but uninformative. Rumor had it that senior New York Fed officials, in Washington for a meeting of the Federal Open Market Committee, had left behind them juniors who lacked the knowledge, or the tools, or the passwords with which to activate the software to mount the scale of intervention required to drag the flyaway rates back to where they belonged (an immense and unfamiliar scale; the previous \$1 billion-plus operation had occurred in December 2008).

What the public record shows is that the open-market desk was effectively out of commission that morning from 9:30, the customary intervention time, until 9:55. Before the restoration of “smooth market functioning,” the overnight repurchase rate on collateralized loans (i.e., the “repo” rate) had shot to 10%, up 8 percentage points from 2%, where it had previously traded and where the Fed was determined it should obediently return.

We revisit this long-ago episode because, in the first place, artificial intelligence has made it possible to draw easy comparisons between what the officials were saying to each other and what they were telling the public. The differences are striking. In the second place, we want to alert the readers of *Grant's* to a vast, new AI-powered monetary archive that permits all comers to conduct their own research into de-

cadecades of Federal Reserve activity for the unbeatable price of free.

As for the autumn of 2019, the Fed picked itself up and resolved to do better. In the record, we see no introspection about a federally controlled interest rate regime that left the major commercial banks, money-market funds and pension funds as ineffectual as Gulliver staked to the ground on the island of Lilliput. They were bystanders, not participants, in a market in urgent need of the liquidity they possessed but (for whatever reasons) chose not to deploy.

What the central bankers rather did was reverse the so-called quantitative tightening in force between October 2017 and August 2019 with a new program of quantitative easing. They would inject \$60 billion dollars a month into the market, mainly through Treasury-bill purchases, to assure a level of reserve provisioning that would meet the quantitatively undefined definition of “ample.”



“Let’s put this money to work now—and check up on the borrowers, too. You know, time permitting.”

Did the new program not sound a lot like quantitative easing, that program installed in November 2008 to quell the panic caused by the fall of Lehman Brothers? It sounded exactly like QE, down even to the scale of the purchases, but on no account must the mandarins acknowledge it as QE.

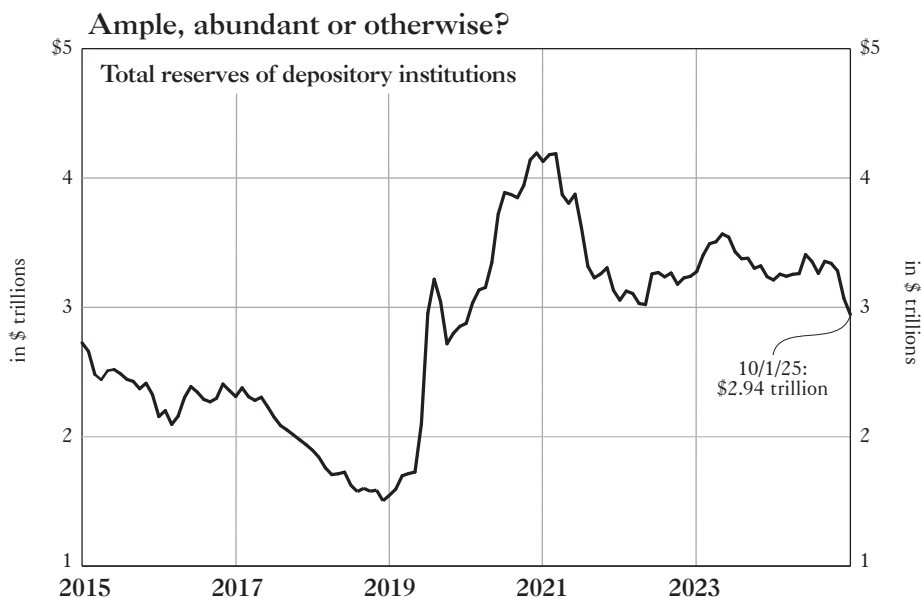
The FOMC pondered the matter during a specially arranged Oct. 4 conference call. There was no dissent from the decision to implement the program and no considered speculation about the inflationary risks of implementation. The question was rather how to sell a program that smacked of crisis.

Said Thomas Barkin, president of the Federal Reserve Bank of Richmond:

I do worry that a message of \$60 billion a month will be misinterpreted as a return to QE, as it does appear to be comparably scaled. Our communication needs to emphasize that this is about liabilities, not about assets. It’s a reserves-maintenance program, not a balance-sheet expansion. In line with the options presented in the communication, I would just communicate that we will maintain reserves at a minimum level, perhaps consistent with early September, and to do that we will conduct a limited-time technical adjustment as necessary.

Said Charles L. Evans, president of the Federal Reserve Bank of Chicago:

I’m uncomfortable with communicating a message that our balance-sheet goal is merely reserves at the level of early September. We’ve got to make sure we’ve got a large margin for error, and that’s why I asked about other assessments of what those numbers might be.... So we need a larger margin for error. I don’t know what that number should be. I’d err on the



source: Federal Reserve Board of Governors

side of making sure we had plenty. The cost of another failure could be really immense, and I'm not sure how many mulligans we have in our pocket if we don't get this right next time.

Said Robert Kaplan, president of the Federal Reserve Bank of Dallas:

So I agree with the objectives as stated of returning to a sustainable level of ample reserves, and I think the other objective I would have in assessing these options is erring on the side of preempting volatility in the future versus reacting to it.

Said Lael Brainard, governor of the Federal Reserve Board:

We're going to have to just "repetitively repeat"—that seems to be the phrase of the day—that it's not QE.

"This is not QE," declared Chairman Jerome Powell on Oct. 8 at the annual meeting of the National Association of Business Economists in Denver. "In no sense is this QE."

"Beginning on Oct. 15," colleague James Robertson, Jr. observes, "'not-QE' lasted almost five months, adding \$362 billion to the balance sheet, until March 11, 2020, when the arrival of the Covid pandemic provoked an outpouring of Reserve Bank credit that threw the repo-induced operation into the shadows."

The Federal Reserve operates under three explicit mandates—maximum employment, stable prices and mod-

erate long-term interest rates—but it does not neglect an unofficial fourth. This is the imperative to suppress the volatility of interest rates, to provide liquidity (in whatever volumes are necessary) to promote "smooth market functioning" in the cause of financing the public debt (*Grant's*, Nov. 7).

To many, the Fed is a mystery wrapped in an enigma, but it's an open book to Konstantin Milevskiy, 58, who emigrated to this country from Russia 10 years ago. He is the inventor of FOMC Insight Engine, the 7,733-document digital museum of primary Federal Reserve source material spanning the years 1936 through 2019 (and from which Robertson collected many of the preceding facts). "A no-nonsense, data-driven retail risk professional and data scientist," begins Milevskiy's autobiographical note on LinkedIn, but he neglects his just claims to the laurels of intellectual philanthropy.

He tells Robertson that he built his monetary engine, which came online on Nov. 24, not exactly as a hobby but as an outgrowth of his solo investigation into the functioning of America's economy. The main merit of his creation is its focus on the single topic of the Federal Reserve.

"It's highly specialized," Milevskiy explains. "There is no contamination of irrelevant information, especially that which came later than when the archive was published."

ChatGPT, in comparison, he contends (and Robertson contends along

with him), "is contaminated by external information, and most of this information is not factual. You cannot verify if it's true or not true. In this system [his own] you can open links and see this information directly in the documents.... If you have the right question, the archive absolutely has the right answer."

Robertson asked how this fine tool of Milevskiy's might help the readers of *Grant's* peer a little bit into the financial future.

"The current state of the tool is backward-looking," the inventor replied. "Maybe the next stage will be forward-looking."

Watch this space.

No senior privileges

James Robertson, Jr. writes:

On Nov. 6, a BlackRock, Inc. private credit fund disclosed plans to fully write down the loans it has extended—\$11 million's worth—to home-improvement company Renovo Home Partners. The fund, BlackRock TCP Capital Corp., had marked that debt at 100 cents on the dollar as recently as October.

Leveraged finance is the subject before the house, and not for the first time. A salvo of corporate blowups has shaken public and private credit markets alike, prompting debt investors to wonder whether a wave of bankruptcies will soon follow. And whether, recalling the 60% losses borne by lenders to auto-parts supplier First Brands Group and auto lender Tricolor Holdings, the wave might wash over them.

In previous credit down cycles, first-lien debt, the most senior loans, provided a refuge for the leveraged-loan creditor. (As to nomenclature: "Leverage" is inherent in every loan, but a "leveraged loan" refers to the senior bank debt extended to p.e. promoters and others conducting financial high-wire acts). In the dark days of 2008, senior loan holders recovered an average of 63% of their principal in bankruptcy proceedings, compared with just 33% for their unsecured-bond peers. But the world turns, and so, in this case, do the tables. First-lien loans are no longer prima facie "safe."

Not that debt investors seem much

concerned with defaults. Loan and bond spreads sit well below their 15-year averages, and the market has paid more attention to rising GDP estimates and anticipated rate cuts than to idiosyncratic blowups, or to blowups a complacent market is happy to deem idiosyncratic.

On the face of things, complacency—or “confidence,” as a bull might see the situation—is indeed warranted. Leveraged loans today rest atop near-record equity cushions, as PitchBook reports, a welcome sign of de-risking, or so a creditor might suppose. Then, too, the default rate for first-lien loans remains below the 10-year average, despite the well-ventilated deterioration of creditor protections afforded by the small print in loan documents.

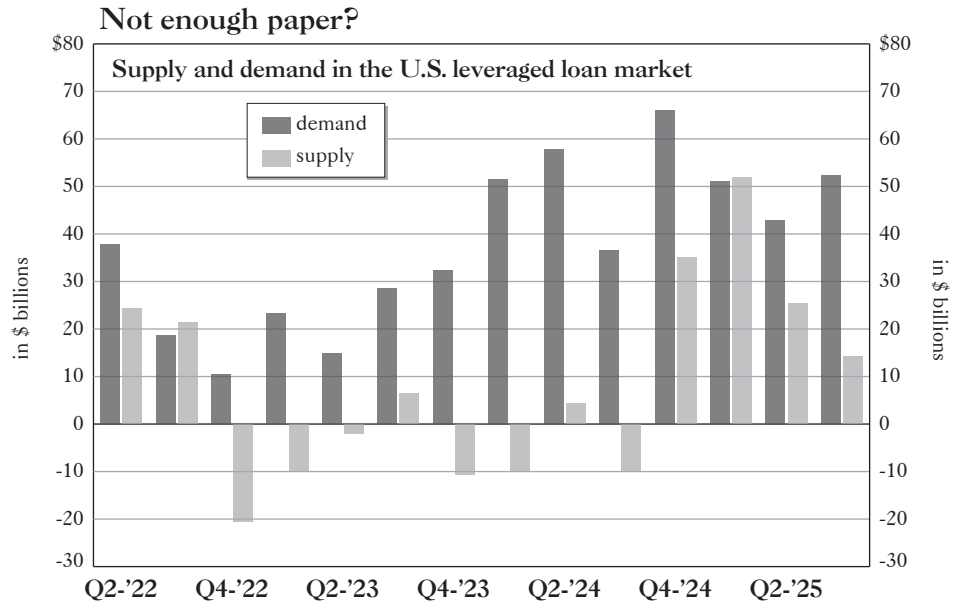
But all is not as it seems. In the year through July 31, the weighted average recovery rate on first-lien loans dropped to 41%, down from an average of 62% over the past decade, according to Fitch Ratings. And that was before the dual collapse of Tricolor and First Brands.

One reason for such severe losses lies in the near disappearance of financial-maintenance covenants. Leading into 2008, roughly 85% of bank-syndicated loans carried hard limits on leverage and minimum levels of interest coverage. At the end of last year, only 8.9% of leveraged loans carried such protections, according to PitchBook LCD.

Recovery rates and financial covenants link together in less obvious ways. When a borrower breaks those strictures, lenders have the right to accelerate repayment of the loan before conditions deteriorate further. And that power also lets creditors trade short-term relief for tougher terms. For their part, lenders can better protect their principal in case of default.

“If a borrower is not hitting their numbers,” Michael Gatto, head of private-side businesses at Silver Point Capital and author of *The Credit Investor's Handbook*, tells me, “the lenders get a seat at the table earlier rather than later.” Without those covenants, “lenders have to sit down and be quiet until there's some type of payment default.”

The loosening of the covenants that remain, including those limiting payouts to shareholders and dealings with affiliates, has promoted a rush to dividend recapitalizations. Such financings—by which companies borrow anew to hand cash back to their private



equity owners—totaled \$27.9 billion in the third quarter, the highest in four years, per Covenant Review. Ten borrowers, the publication noted, have managed this trick twice in 2025 alone.

Another depressant on first-lien recoveries is the dominance of first-lien debt in today's capital structures. S&P Global Ratings notes that the bank-loan market has grown markedly top-heavy: About two-thirds of borrowers now carry capital stacks in which first-lien or other priority claims make up the majority of total debt, up from less than half in 2017.

The ratings agency, in its latest quarterly leveraged-finance report, makes an explicit connection between the paucity of junior debt, on the one hand, and the greater losses borne by senior debt, on the other. Junior debt is the shock absorber that protects—or, we should say, has protected—holders of senior-secured loans from loss. Absent such defenses, lower recoveries and higher losses await today's senior lenders in the next default season.

As noted, private equity sponsors have compensated to a degree by boosting the equity component of leveraged buyouts. Nowadays, equity may account for as much as 50% of the capital structure, compared with an average of 30% before the 2007–09 financial crisis. But in trying to protect their capital, p.e. firms have become more aggressive in preventing defaults from occurring.

Which brings us to so-called liability-management exercises, the growth of which may explain most of the slide in recovery rates for first-lien loans (*Grant's*, Aug. 1). Rather than the LME tag, Gatto prefers the blunter formulation of “land mine.” This is the enabling documentation that allows out-of-court restructurings, typically to the disadvantage of one or more creditor classes.

In one fell swoop, a borrower, aided by a clever legal team, can cut a first-lien borrower's recovery rate by some 30 percentage points. Following the priming loan exchange executed by defense and transportation company Cubic Corp. in July, disadvantaged lenders saw their estimated recovery rates fall to 40% from 70% before the transaction, according to the S&P.

Such a restructuring can extract concessions by pitting majority creditors against their minority brethren. Or the borrower may, through a kind of maneuvering both legal and crummy, move assets once pledged to creditors out of their reach. The company may raise debt on the now unpledged assets.

In self-defense, creditors have begun to unite against their LME-wielding borrowers, even as one borrower, at least, is reacting against the reactions. On Nov. 26, the Wednesday before Thanksgiving, telecom company Optimum Communications, Inc. (née Altice USA) sued Apollo Capital Management L.P., Ares Management, LLC

and BlackRock Financial Management, Inc. for banding together in a so-called cooperation group.

Optimum's lawsuit represents the first time a borrower has challenged the legality of creditors locking arms to prevent a restructuring. The collective refusal to extend new credit, Optimum alleged in its complaint, violated antitrust laws and constituted an "illegal cartel."

No constant reader will be surprised by the legal challenge to such lender co-ops. David Nemecek, partner and head of the LME practice at Kirkland & Ellis, LLP, told a *Grant's* audience in April that he expected such a blowback this year or the next. The recent challenge may throw yet another roadblock in front of the first-lien investor.

Collateralized loan obligations, receptacles of leveraged loans, have helped drive spreads tighter and standardize cov-lite agreements. Structured in debt tranches ranging from triple-A to single-B, CLOs serve investors their individual appetite for risk. But in so doing, CLOs, which now hold two-thirds of leveraged loans, only buy what the market offers.

Growing past \$1.4 trillion in value outstanding from \$263 billion post-crisis, CLOs have become a major driver of leveraged-loan demand. Since the average CLO is often diversified across hundreds of loans, a manager may not focus on searching for every last land mine hidden in the documentary underbrush. The highest-priority CLO tranche, after all, can absorb 35% losses, on average, before facing any loss.

Today's market is a borrower's market and is likely to remain so absent the lightning bolt that signifies the close of the expansion phase of the credit cycle. Anemic loan issuance to fund a shrunken volume of leveraged buyouts has met strong demand from CLOs. It explains why the market continues to push for even tighter spreads and looser documentation. It explains, too, the collective state of mind that enables such late-cycle conflagrations as First Brands and Tricolor.

"In some of these deals," Gatto relates, "it is surprising that no one did the due diligence." When First Brands approached Silver Point in 2021 for \$1 billion, amber flags were already flapping in the breeze. Gatto pointed to several.

For one, fraud allegations. Lend-

ing credence to claims of wrongdoing were wide discrepancies between the marketed Ebitda and the unadjusted reality. The use of off-balance-sheet financing and supply-chain financing in an aggressive roll-up strategy similarly raised suspicions. And what conclusions were left to be drawn by the prospective borrower's refusal to vouchsafe crucial financial information to its all-too-eager creditors?

But prudence was not an outstanding feature of the zero-percent interest rate (and the immediate post-ZIRP) financial scene. "I think," Gatto tells me, "there are funds out there that just want to grow. They will say, 'I'm going to do whatever due diligence the company allows me to do. If it's virtually no due diligence, so be it.' While this doesn't apply to all credit funds, I do believe there are some lenders pursuing deals that others would likely pass on without the ability to perform more thorough due diligence."

And the losses have not been solely confined to the bank-syndicated loan market. In September, S&P Ratings reported that first-lien, private-credit loan recoveries had fallen to 66% last year, down from the long-term average of 78%. Part of that decline stems from the rapid growth of the asset class. As private credit began to write checks to compete with bank syndicates, looser documentation duly followed, the agency related.

The week before Thanksgiving, BlackRock took the shocking step of waiving some of its management fees to offset the deep losses its investors suffered by the home-remodeling company mentioned in the opening of this essay. Saddled with loans to Renovo, another BlackRock fund—by name, BlackRock Baker CLO 2021-1—also had exposure to software providers Pluralsight, Inc. and Astra Acquisition Corp. Lenders took over the former, after a 2024 LME, while the latter filed for Chapter 11 in September.

Private credit has grown like kudzu in the past five years, and middle-market CLOs have begun to match the pace of that expansion. Issuance of private-credit CLOs in the year through October registers at \$34 billion and is on track to top the \$39 billion record set in 2024, Bank of America reported last month. The new CLOs did not come into the world to sit on their hands. Assuming that they are lending because

the money is burning a hole in their pockets, the recovery rates on private credit loans may yet plunge to match the ones being recorded on bank-syndicated loans

"Private credit has grown very fast," John Kerschner, global head of securitized products and portfolio manager at Janus Henderson, tells me, "and private credit comes with a lot less transparency and liquidity." It is the reason why Kerschner is skeptical of the new private credit CLO exchange-traded funds, which roll illiquid loans into a liquid ETF wrapper.

Unlike customary CLOs, which hold publicly traded bank loans, private-credit CLOs have few avenues in which to exit problem loans. In the case of 48Forty Solutions, a pallet company, private lenders including KKR & Co. intend to swap their loans for equity after the borrower ran into trouble in late November. CLOs typically avoid such swaps as they must carry equity at a punitive discount, not excluding 100%.

In the private market today, a record 61 borrowers carry a triple-C-minus rating, according to the Kroll Bond Rating Agency. Surveying middle-market companies with debt maturing in the next 12 months, KBRA finds that nearly 30% of those borrowers have high leverage or negative Ebitda. The agency's conclusion: more defaults ahead.

For years, investors treated the first-lien status as a shield. Today, with weaker covenants, thinner cushions and more inventive restructurings, seniority offers less and less protection. The losses at First Brands, Tricolor and Renovo may not be anomalies so much as glimpses of what is to come when the cyclical wheel next turns.

Tomorrow's news today

"I expect the vibes out there to be rough for a bit," Sam Altman warned after Google's artificial-intelligence model, Gemini, overtook OpenAI's ChatGPT. The business partners of the AI startup were undoubtedly well aware of it. SoftBank Group Corp.'s share price has slumped by 42.6% since the end of October while the cost to insure against a default by Oracle Corp. has tripled since July.

Nor do the troubles end there. Private equity and debt funds are big

investors in the data centers that power AI chatbots. A bust in the AI boom would surely add to pressures mounting from the slow-moving p.e. default wave. And as the knee bone is connected to the thigh bone, so life insurers are fused to private funds (both as investors in them and as financiers of them). Annuitants and policy holders may soon be reminded of these facts of life and high finance.

A prime example of the interconnectedness of things is Blue Owl Capital, Inc. The private credit lender is financing Hyperion, a Manhattan-sized data center that Meta Platforms, Inc. plans to build in Richland Parish, La. One may wonder why investment-grade-rated Meta is using private credit over the public bond market. Because, by structuring Hyperion as a joint venture with Blue Owl, Mark Zuckerberg's brainchild keeps the \$27 billion cost to build Hyperion off its own balance sheet.

Blue Owl's share price is down 36.8% in the year to date, and the red ink is spreading among alternative managers. Ares Management Corp. is down by 10.6%, Blackstone, Inc. by 15.6% and Apollo Global Management, Inc. by 20.4%.

As to the reasons why, Moody's Ratings issued a pertinent comment on Nov. 17: "As private credit rapidly evolves, debt structures are of ever-greater complexity, with structural innovations reshaping the risk landscape. These innovations also introduce new risks—particularly around transparency, recoveries and structural subordination."

For innovation, think, for instance, of the \$2.3 billion in private credit-funded trade financing that First Brands Group received before it filed for bankruptcy. Or consider covenant-lite structures, "once rare in private credit" but now commonplace.


The paucity of distributions to the investors in alternative assets is one problem that today's financial innovators are actually helping to solve. As a percentage of investor capital, p.e.-fund payouts have dwindled to 15% annually from an average of 23%, Euan Finlay, chief of Europe, Middle East and Africa for Partners Capital, told Bloomberg last month.

So when Hellman & Friedman listed portfolio company Verisure plc in October, the p.e. shop simultaneously raised

THE
Jim & Evan
SHOW

Mark your calendars
for a full-year series of
live, virtual conversations,
with moderated Q&A.

Episode 1 airs on Jan. 28.



*See page 12 for additional
details and our full list of dates.*

€1 billion in debt to boost its payment to limited partners. A newly created company, not Verisure, will stand behind the borrowings. It will hold a minority stake in Verisure and has already taken out the aforementioned loan. It isn't obvious how this holding company, which generates no income, can service the interest on this obligation. Well, it can incur more debt. The facility has the option to pay its creditors in kind (PIK) rather than in cash.

Yes, the headline default rate in private credit amounted to just 1.2% in the 12 months ended September, according to S&P Global Ratings, but that only scratches the surface of p.e. distress. Rather than allow wounded borrowers to default, many private lenders permit them to pay in kind. In the third quarter, 6% of private loans that did not originally have the option to PIK were paying interest with additional borrowings, according to Lincoln International; it's a new shadow default club.

Examining data from 2,287 private credit borrowers last week, Kroll Bond Rating Agency, LLC found that the average company covered its interest expenses with Ebitda by 1.5 times in the 12 months ended September and that

27% of companies showed coverage ratios of less than 1.0. Fully 23% of the private borrowers that KBRA monitors reported net-debt-to-Ebitda ratios of more than 10 times or negative Ebitda in the year ended Sept. 30, an increase of 1.62 percentage points from the start of the year. In 2026, this over-leveraged and/or unprofitable cohort will be responsible for 30% of maturing debt in Kroll's 2,287-company universe.

Such deterioration in credit metrics leads KBRA to predict that defaults will rise gradually next year, assuming no recession. And "[s]hould macroeconomic conditions soften, or policy shifts further compress margins, these and other borrowers under stress are likely to face increased refinancing difficulties and elevated risk of default that we believe will force a reckoning for some," the agency warns.

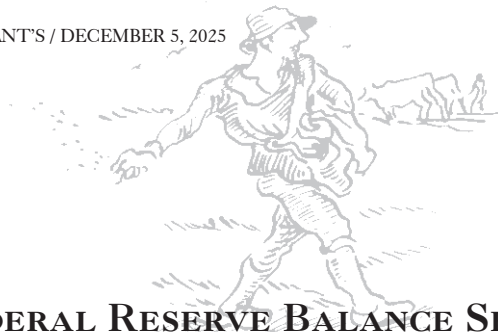
Problems in direct lending travel widely in the marketplace. "Private credit managers have increasingly partnered with insurance companies," the previously cited Moody's report notes. "This strategic pairing allows insurers to invest in higher-yielding private credit instruments that align with their long-term obligations. Private credit managers originate private credit assets, which are then deployed into the insurer's investment portfolio."

As it is, U.S. life insurers have committed roughly one-third of their assets to private credit. And owing to widespread private equity ownership, life insurers are themselves highly leveraged, with 22 out of the top 80 carriers by asset size reporting liability-to-surplus ratios of over 30 times as of year-end 2024 (see the issue of *Grant's* dated Oct. 24).

Insurers magnify investment hazards and leverage by folding in liquidity risks, the Bank for International Settlements observes in an October report. Short-term funding, in the form of Federal Home Loan Bank advances and/or through the issuance of funding-agreement-backed securities (resembling certificates of deposit), has jumped by 137% in the decade ended 2024 to \$370 billion.

Another thing: American life insurers held \$1.3 trillion in notional exposure to interest rate derivatives at year-end 2024. "As fixed-rate receivers," the BIS reminds its readers, "insurers typically face margin calls in periods of rising rates."

(Continued on page 8)



CREDIT CREATION

FEDERAL RESERVE BALANCE SHEET

(in millions of dollars)

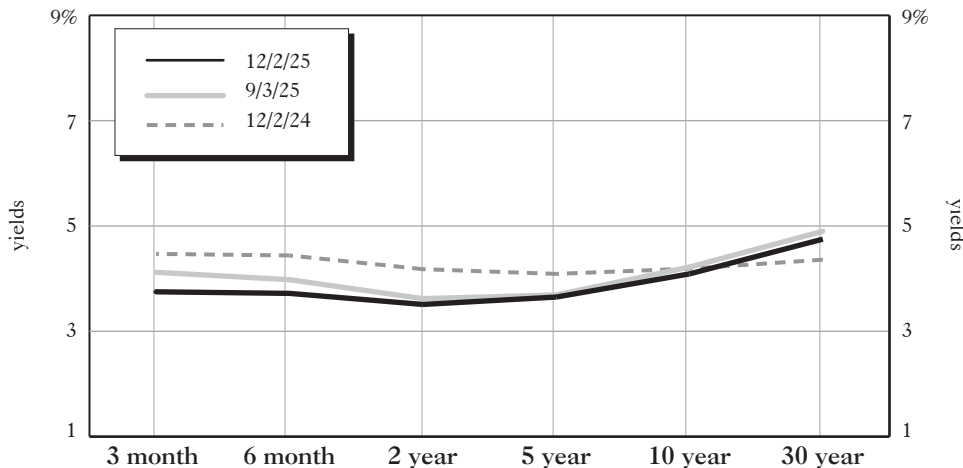
	Nov. 26, 2025	Nov. 19, 2025	Nov. 27, 2024
<i>The Fed buys and sells securities...</i>			
Securities held outright	\$6,265,302	\$6,264,448	\$6,581,977
Held under repurchase agreements	3,515	1,364	6
<i>and lends...</i>			
Borrowings—net	6,895	6,309	2,501
<i>and expands or contracts its other assets...</i>			
Maiden Lane, float and other assets	237,317	249,063	289,314
<i>The grand total of all its assets is:</i>			
Federal Reserve Bank credit	6,504,029	6,521,184	6,873,798
<i>Foreign central banks also buy, or monetize, governments:</i>			
Foreign central-bank holdings of Treasuries and agencies	\$3,057,390	\$3,056,903	\$3,317,682

BANK OF JAPAN BALANCE SHEET

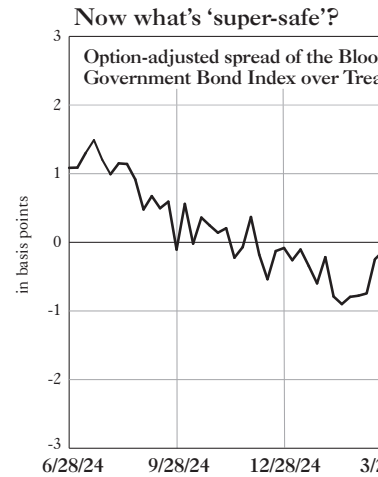
(in billions of yen)

	Nov. 30, 2025	Oct. 31, 2025	Nov. 30, 2024
<i>The BoJ buys Japanese gov't bonds...</i>			
Bonds purchased	¥559,794	¥558,159	¥592,595
<i>and lends...</i>			
Loans and discounts	83,804	83,810	109,913
<i>and expands or contracts its other assets...</i>			
Other assets	54,352	53,279	55,667
<i>Total assets:</i>	¥697,949	¥695,248	¥758,175

MOVEMENT OF THE YIELD CURVE



source: The Bloomberg



source: The Bloomberg

Long-dated yields

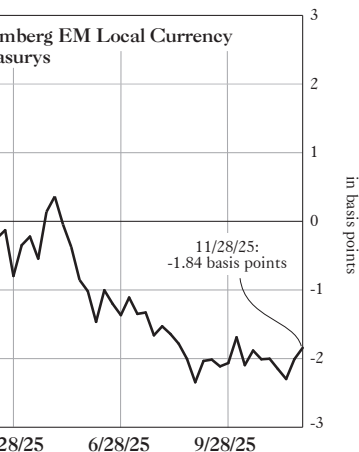
Evan Lorenz writes:

U.S. manufacturing activity fell for the ninth consecutive month in November, with the Institute for Supply Management's purchasing managers' index dropping to 48.2 from 48.7 in October. "It really is all about tariffs," remarks ISM chair Susan Spence.

Wait till next year. For one thing, the Supreme Court will rule on President Donald Trump's import levies, and Polymarket places 73% odds that the taxes will be struck down. For another, the One Big, Beautiful Bill Act is set to goose GDP growth by 0.9 percentage points in 2026, according to the Congressional Budget Office, largely thanks to lower household taxes and provisions to allow businesses to deduct 100% of capital expenses.

America is not alone in ramping up the stimulus in the face of still-elevated inflation (3% in September). Last Friday, Japanese Prime Minister Sanae Takaichi's cabinet approved a supplementary budget, ostensibly to assist in the fight against inflation, which rose by 2.8% in November. The ¥18.3 trillion (\$117 billion) spending package is Japan's largest stimulus program since Covid and includes cash handouts to families and subsidies for electricity and gas bills. Not surprisingly, the yield on the 30-year Japanese government bond jumped to an intraday peak of 3.419% on Tuesday, a new all-time high and a 112 basis-point pickup since the start of the year.

CAUSE & EFFECT



are—stimulated

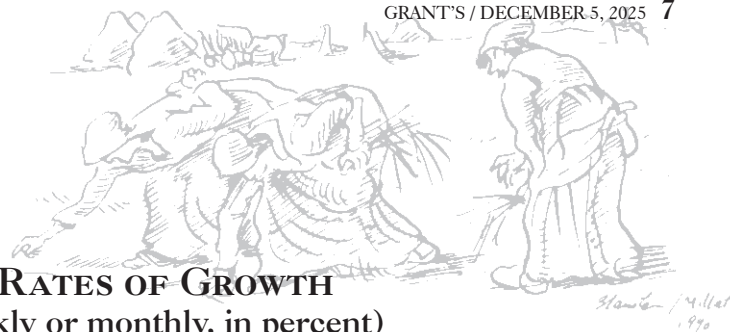
China's slow-moving housing bust continues to weigh on the world. Sales by the country's top-100 developers fell by a whopping 41.9% year over year in October, and state-backed China Vanke Co., once seen as among the mainland's safest builders, warned that it may not be able to repay a pair of domestic bonds due this month.

To bolster the property sector, the Communist Party is turning to its time-tested playbook. First, apparatchiks banned a pair of statistics providers from publishing data on the housing market. Second, officials are mulling a new stimulus program, including the possibility of the government subsidizing mortgage interest costs for new buyers.

Of course, never-ending stimulus doesn't come cheap. The U.S. budget deficit summed to \$2 trillion, or 6.5% of GDP, in the fiscal year ended September and federal debt held by the public towers at \$30.8 trillion, or 101% of output. Both figures are set to rise, as the International Monetary Fund predicts that the American deficit will expand to 7.9% of GDP in calendar 2026.

Bond investors are on the case. Prior to late last year, emerging-market governments had to pay a premium over U.S. Treasury yields to issue local-pay debt. Since then, that relationship has reversed and EM governments now pay 1.9 basis points less than Uncle Sam.

Sad!



ANNUALIZED RATES OF GROWTH (latest data, weekly or monthly, in percent)

	3 months	6 months	12 months
Federal Reserve Bank credit	-3.4%	-3.8%	-5.6%
Foreign central-bank holdings of gov'ts	-14.6	-11.5	-7.7
Bank of Japan assets	-13.6	-9.4	-8.1
Commercial and industrial loans (Oct.)	2.9	1.7	-3.3
Commercial bank credit (Oct.)	5.3	5.5	4.9
Asset-backed commercial paper	-2.8	2.7	13.8
Currency	3.1	3.1	2.7
M-1 (Oct.)	5.6	5.5	4.7
M-2 (Oct.)	6.6	6.2	4.9

REFLATION/DEFLATION WATCH

	Latest week	Prior week	Year ago
FTSE Xinhua 600 Banks Index	18,183.15	18,299.90	15,265.70
Moody's Industrial Metals Index	3,247.62	3,226.65	2,952.56
Silver	\$56.45	\$49.91	\$30.11
Oil	\$58.55	\$58.06	\$68.72
Soybeans	\$11.38	\$11.25	\$9.89
Rogers Int'l Commodity Index	4,156.24	4,065.70	3,806.21
Gold (London p.m. fix)	\$4,191.05	\$4,072.85	\$2,641.85
CRB raw industrial spot index	579.96	575.08	544.34
ECRI Future Inflation Gauge	(Oct.) 108.5	(Sept.) 108.0	(Oct.) 111.6
Factory capacity utilization rate	(Aug.) 77.4	(July) 77.4	(Aug.) 77.9
CUSIP requests	(Oct.) 4,120	(Sept.) 4,030	(Oct.) 3,848
Fed's reverse repo facility (billions)	7.56	2.50	197.63
Grant's Bitcoin Treasury Index*	88.80	69.05	108.50

*Index=100 as of 6/27/2025

AMERICAN DOMINANCE

Dollar Index (left scale) vs. weight of U.S. stocks in the MSCI World Index (right scale)



(Continued from page 5)

And another: Many annuitants have the right to redeem early, with surrender penalties of 10% or less. Annuity holders are most likely to accept that penalty when they can get higher rates of return elsewhere, that is, when rates are rising.

Thinly capitalized insurers can fail when investment losses pick up or on account of a surge in policy surrenders. PHL Variable Insurance Co., a carrier owned by p.e. shop Golden Gate Capital, was declared insolvent in 2024 for the former reason; Italy-based insurer Eurovita, which was controlled by p.e. firm Cinven, entered bankruptcy protection in 2023 because of the latter.

“Financial assets broadly should have a lower allocation than typical,” bond manager Jeffrey Gundlach advised two weeks ago regarding the risks in private markets. “The trouble always comes in financial markets when people buy something that they think is safe. It’s sold to them as safe, but it’s not.”

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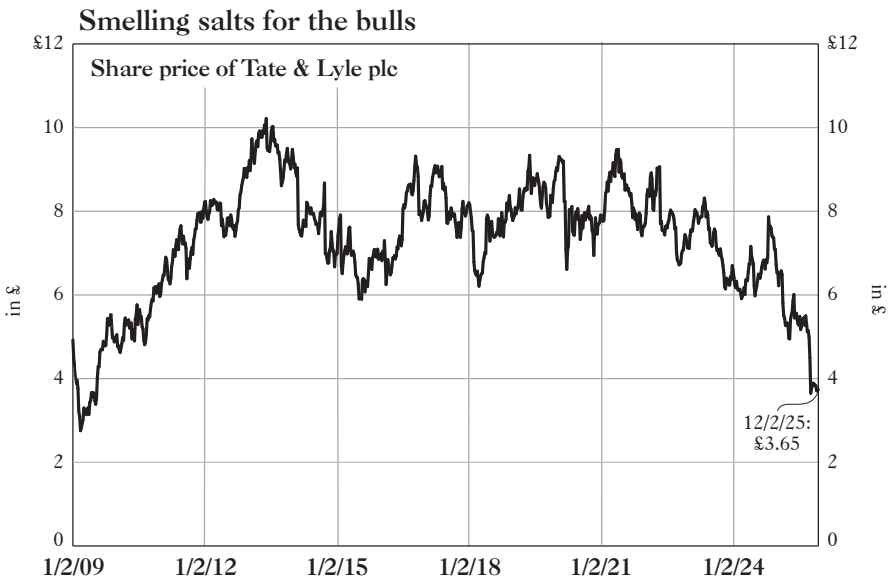
Trust the process

Evan Lorenz writes:

The Wall Street Journal's Nov. 26 Campbell's chicken-soup exposé (“Here's what's really in a can...”) only hints at the troubles of the packaged-foods business. The shares of packaged, or processed, food makers have fallen by 11.6% so far this year against a 16.1% rally in the S&P 500. In preview, *Grant's* is bullish on Tate & Lyle plc (TATE on the London Stock Exchange), a key supplier to the currently unstable staples sector.

British merchant Henry Tate founded what would become Tate & Lyle in 1859 when he formed a partnership with John Wright to refine sugar in Liverpool. Following the merger with Abram Lyle & Sons 62 years later, Tate controlled half of the sugar-refining capacity in the United Kingdom. The company successfully fought off nationalization in the post-World War II era with speeches extolling the free market by an anthropomorphized, pro-sugar Mr. Cube.

More recently, Tate has sworn off sugar. In 2010, it sold its European sugar operations to American Sugar Refining, Inc. Last year, it finished disposing



source: The Bloomberg

of its primary products division, which makes high-fructose syrup, starches and other products derived from corn, to private equity firm KPS Capital Partners, L.P.

Sugar-free, Tate has nonetheless retained a leading place in the overall ingredients industry. Its products that change the texture and sensation of food and drink—pectins, gums, starches, etc.—are grouped in the corporate division denoted “mouthfeel.” It’s the premier division, delivering 66% of pro forma revenues in fiscal year 2025, ended March 31. The sweetening segment (27%) comprises a collection of low-calorie sugar replacements, including sucralose, stevia, monk fruit and allulose. The fortification unit (8%) makes dietary fibers and plant-based proteins.

Tate is broadly diversified across geographies and product categories. In the six months ended Sept. 30, the Americas accounted for 50% (or the top line), Europe, the Middle East and Africa 31% and Asia the remainder. More than two-thirds of sales wind up in four broad food categories: beverages; dairy-based products; soups, sauces and dressings; and baked goods and snacks.

Investors cheered when Tate announced the completion of its exit from the high-fructose corn-syrup business in May 2024. At the time, the balance sheet showed net debt of just £153 million (\$203 million), or 0.5 times Ebitda, and investors expected the £279 million in proceeds from the sale to pay for share repurchases.

A £215 million repurchase announcement one month later validated that assumption, but Tate simultaneously announced the acquisition of CP Kelco from J.M. Huber Corp. for £1.4 billion. The acquiree is the world leader in pectin, a gelling agent derived from citrus peels, and other specialty gums. Buying CP Kelco enhanced Tate’s ingredient portfolio and increased its exposure to faster-growing emerging markets, but investors did not fail to notice a step backwards in capital structure. The deal added £905 million in debt as well as 75 million new shares issued to Huber, an 18% expansion in the share count that more than offset the buy-back program.

Nor was Tate’s rationale for doing what it did easy to comprehend. First, CP Kelco had suffered a 13% decline in volumes in 2023. Second, the deal valued Kelco at 13.7 times trailing Ebitda (or 10.3 times, giving Tate credit for anticipated deal-related synergies, of which more later) when Tate itself was trading at 8.7 times trailing Ebitda. Why pay a premium for a shrinking business?

Could it have been to cover up a looming problem at Tate itself? On May 22, management guided for pro forma sales growth, including CP Kelco, of around 4% in the fiscal year ending March 31, 2026. After posting a 3% slip in pro forma top-line growth in the six months ended Sept. 30, Tate slashed fiscal 2026 sales guidance to a low-single-digit contraction. This was

on Nov. 6. It came as small consolation that Kelco had returned to growth following the acquisition.

Tate's sales slump fed into other worries about the food sector. Have miracle weight-loss drugs like Ozempic and Wegovy permanently shrunk the market for baked goods, snacks and other packaged foods? Has competition in the ingredient market, especially from manufacturers based in mainland China, hotted up?

To top it all, former Food and Drug Administration commissioner Dr. David Kessler filed a citizen petition on Aug. 6 asking the FDA to downgrade the safety designation that refined carbohydrates now enjoy. "Generally Recognized as Safe" may not sound like much of an encomium, but its loss could hurt Tate & Lyle's U.S. sales of emulsifiers, stabilizers, gums and other products derived from corn. A bull may hope that the FDA, asked to choose between Kessler's arguments and the president's wrath (with 2026 midterm elections approaching, the administration is cultivating the tariff-wounded farmers), wouldn't dare take Kessler's side, but it's only a hope.

Anyway, it's small wonder that the Tate share price has slumped by 54.7% over the past 14 months to a post-2009 low. Value seekers will be interested to know that the stock is priced at 8.8 times estimated fiscal 2026 earnings to deliver a 5.5% dividend yield. For comparison, ingredient-making peers Kerry Group plc and AAK A.B. are quoted at 16.3 times and 19 times their respective earnings estimates for calendar-year 2025.

As to Tate's shrinking top line, it appears to be more of an industry-wide problem than a change in the level or quality of the competition. General Mills, Inc. and Campbell's Co. each reported a 3% decline in sales in the three months ended August while Kraft Heinz Co. reported a 2.5% decline in the quarter ended September (all figures adjusted for acquisitions, divestitures and foreign-currency movements). Consumers are paring back their spending on packaged foods after years of elevated inflation.

Weight-loss drugs may very well prove a long-term threat to the ingredients makers, but they also create opportunities. Replacing sugar in a baked good with a lower-calorie alternative, like sucralose or monk fruit, is one such

business opening. And because those sugar substitutes change the texture of the final product, a sales opportunity for ingredients from Tate's mouthfeel and fortification divisions also presents itself. Reducing the fat in soups and dressings creates a similar cascade of opportunity.

Semaglutides like Ozempic suppress appetites, meaning that users need nutritionally dense foods to obtain a balanced diet. However, no one wants to buy food that has the taste—and more importantly for Tate—the texture of pemmican.

To help food manufacturers address these matters, Tate offers packages that combine ingredients from its mouthfeel, sweetener and fortification portfolios. Recent wins include "a solution for a customer in the U.S. using a base of pectin and starch to create a high-protein yogurt and a solution for a customer in Europe for a low-fat, no-egg mayonnaise using a base of citrus fiber, xanthan gum and starch," Tate & Lyle CEO Nick Hampton informed dialers-in on the Nov. 6 earnings call. As pectin, citrus fiber and xanthan gum are products manufactured by CP Kelco, these micro-triumphs demonstrate "the power of the combination," said Hampton.

To capture business like this, Tate & Lyle opened its Automated Laboratory for Ingredient Experimentation (ALFIE) in Singapore in October 2024. With ALFIE, Tate's worldwide workforce, logging in remotely, can test new product formulations 10 times faster than before. And to get the Tate rank and file to push multiple ingredients, the company has revised its sales incentives to encourage product cross-selling.

Bundling ingredients into a single package has financial benefits beyond a stronger customer relationship, Veronica Cueva, senior vice president of research, development and solution innovation, told attendees at an event at Tate & Lyle's July 1 Capital Markets Day. "The value of our ingredients in a solution tends to be higher, an average of two times the value of that ingredient.... I can tell you that builds a stronger innovation partnership and, more often, [leads to] more projects in our pipeline."

While the messaging around the CP Kelco acquisition perhaps left something to be desired, Tate may

not have overpaid for the pectin producer after all. For one thing, Kelco had just completed a three-year, \$400 million capital-spending program to expand production capacity. For another, the acquiree's Ebitda margin had contracted by 5.6 percentage points, to 17%, between 2021 and 2023. There were several culprits behind that profitability slump, including Covid-era disruptions, which caused customers to over-order and then to destock inventories, a soft consumer-spending environment and disruptions from CP Kelco's factory-expansion program. With the exception of a weak consumer, the problems have fixed themselves.

In addition to the rebound in Kelco's business, Tate says it hopes to cut more than \$50 million's worth of costs at the acquiree, in categories including procurement, supply-chain and general and administrative expenses, by March 31, 2027.

Of course, the rationale for acquiring Kelco was not just cutting costs; it was to sell more higher-margin ingredient combinations. When Tate closed on the transaction, Kelco sold 58% of its products through distributors, who have no incentive to push other Tate or Kelco products, and one-third of Kelco's customers had no prior relationship with Tate & Lyle. By replacing third-party distributors with company sales personnel, Tate will have the opportunity to cross-sell more products to more customers.

Some \$70 million in revenue synergies from the Kelco acquisition are in management's sights by March 31, 2029—incremental sales that would not have been rung up except for that transaction. The long timeline may disappoint some, but new product formulations typically don't hit the shelves before one to two years of preparatory work is completed. The value of the cross-selling pipeline more than doubled, to \$60 million, between June 30 and Sept. 30, with the proportion of multiple-ingredient wins almost doubling to 39% of the pipeline.

On top of this, Tate boosted the savings it expects to get from an existing, five-year productivity plan by \$50 million to \$200 million on Nov. 6. So far, the company says that it has achieved \$112 million of those gains through Sept. 30 and expects to deliver on the remainder by March 31, 2028.

To be sure, after more than a year's worth of disappointment, Tate is a show-me story, with the consensus expecting Ebitda to rise by just £48.3 million, or \$64.3 million at current exchange rates, to £466.4 million between fiscal years 2026 and 2028. Without even giving Tate full credit for its anticipated cost savings, shares are priced at 7.2 times the guesstimate for fiscal 2028 earnings and 5.6 times consensus 2028 Ebitda.

The Tate & Lyle C-suite is buying into the story, with insiders purchasing 114,275 shares over the past 12 months at a cost of £528,995 and not one executive selling stock. The Street is skeptical but not unfriendly towards the ingredients-maker, with eight of the 14 analysts following the company rating shares a buy versus only one saying sell.

As a result of the CP Kelco acquisition, Tate's balance sheet is moderately leveraged with net debt of £952 million, a sum equal to 2.3 times trailing Ebitda, as of Sept. 30. In the first half of fiscal 2026, operating income covered interest expenses by 4.1 times. According to S&P Global Ratings, that makes Tate lower-investment-grade (triple-B).

Tate is not repurchasing shares today, but CFO Sarah Kuijlaars says it plans to initiate a buyback once leverage falls below 2 times. The recent sales slump notwithstanding, Tate remains a prodigious cash generator and the Street expects free cash flow to sum to £207.8 million in the 12 months ending March 31, 2027. After deducting the cost of the dividend (£89 million per year), that would leave £118.8 million, or 7.1% of the current market capitalization, for potential buybacks.

"Our performance is not where we want it to be," Hampton acknowledged on the Nov. 6 call. "But we're incredibly encouraged by the strength of customer engagement and the strength of our pipeline. That gives me confidence that we are moving in the right direction."

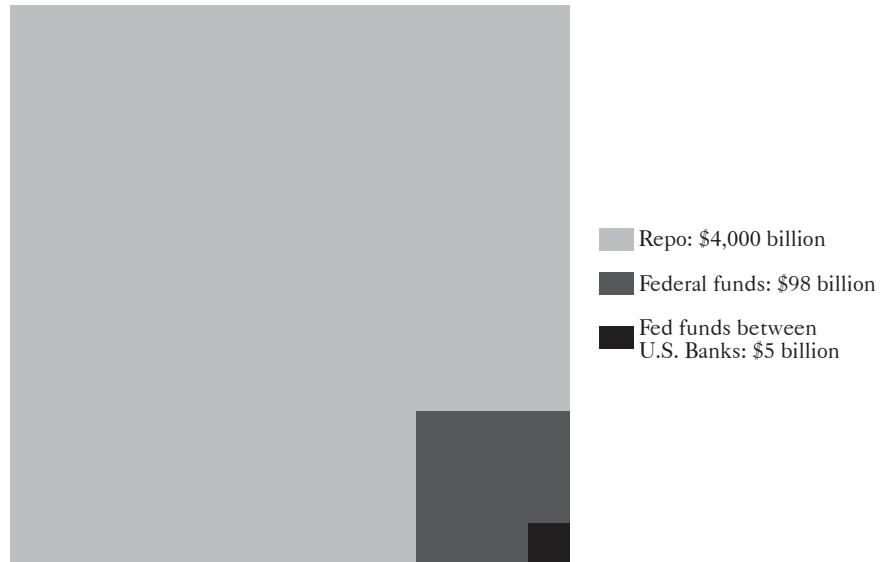
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Monetary morality shifts

The 50th anniversary of the founding of the Shadow Open Market Committee has come and gone, but the 584-

Wither the funds market

Daily money-market transaction volumes in \$ bns



source: *Fifty Years of the Shadow Open Market Committee*

page volume* commemorating that notable achievement deserves a long life both in the hand and on the shelf.

The official unofficial backseat driver of American monetary policy, the Shadow got its start by blasting the inflation-mongering Fed of the 1970s. "The Committee," to quote from the preface to the newly published anthology, "promoted the idea that the high inflation of the period was a monetary phenomenon and not caused by an eclectic array of factors, which, at the time, was the consensus view."

And it was the consensus view once more, inauspiciously, only a half-decade ago, at the start of the not-so-transitory inflation that persists to this day. "Right now...M-2...does not really have important implications," Chairman Jerome Powell told Senate committeemen in February 2021. "It is something that we have to unlearn, I guess."

Monetarism was the shared doctrine of the three SOMC founders, Karl Brunner, Anna Schwartz and Allan Meltzer, but the more than three dozen contributors to *Fifty Years of the Shadow Open Market Committee* are doctrinally eclectic. The economist John Cochrane contends that inflation is a fiscal phenomenon, while the English economist Charles Goodhart, author of Goodhart's law ("When a measure becomes a target, it ceases

to become a good measure"), is a little bit of a monetarist and, to his monetarist detractors, a little bit of a Keynesian. Michael Bordo, professor of economics at Rutgers University and one of four editors of this volume, produced a fascinating paper in 2012 speculating what might have been if the gold-standard Second Bank of the United States (which Andrew Jackson destroyed in the early 1830s) had lived, and if the Federal Reserve had therefore not been born. To summarize Bordo's conclusion, it wouldn't have been all bad.

Andrew T. Levin and Christina Parajon Skinner, respectively professor of economics at Dartmouth College and associate professor of legal studies and business ethics at the Wharton School of the University of Pennsylvania, contribute an especially incisive essay on the Fed's accountability (or lack thereof) to Congress.

It's Congress in which the Constitution, Article 1, Section 8, vested 100% of the government's monetary powers: "To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures." Then Congress went delegating roughly 100% of its monetary powers to the Fed.

Certainly, the economists acknowledge, Congress was within its rights to pass the buck, but the solons have not so much delegated as abnegated, and

their dereliction has created a “constitutionally impermissible” fourth branch of government.

The authors’ bill of complaints against the all-too-independent central bank include the following:

- The Fed is authorized to issue interest-bearing obligations that are not subject to the federal debt ceiling.
- The Fed sets its own accounting rules, in contrast to other federal entities subject to GAAP.
- The Fed’s inspector general is a federal employee, whereas a fully independent IG is in place at other major government entities (i.e., offices and agencies with operating budgets exceeding \$5 billion).

As for the Fed’s deeply negative net worth, Levin and Skinner observe that “a private institution in such circumstances might well be faced with the prospect of a takeover, bankruptcy or liquidation. By contrast, the Fed is covering its operating losses by expanding its interest-bearing liabilities: In effect, the Fed is borrowing those funds directly from the public without congressional authorization.”

This is a nerd’s book—by economists, for economists—but there’s lots for the lay reader, too. A nifty graph on page 335 shows how inconsequential the federal funds market has become in relation to the repo market. And Christopher Waller, one of the candidates tipped to succeed Chairman Powell, fielded a question in a transcribed discussion panel about the still-elevated level of prices (as distinct from the rate of rise in prices). He responded, in the first place, with an expression of sympathy for frustrated shoppers. Then he said this: “But the price level is what it is. It’s going to be very hard to try to say, ‘I want to go back to 2019 prices,’ without doing some pretty dramatic, drastic monetary tightening.”

The text is organized into 10 topical sections, including “Rules Versus Discretion,” “The Evolution of Monetary Policy,” “The Fed’s Evolving Mandate,” “Monetary-Fiscal Issues” and “The Search for a Nominal Anchor.”

You don’t have to search far for the long-reigning “nominal anchors” of gold and silver, but the ancient monetary metals draw short shrift in these pages. “Today,” an essayist quotes the Federal Reserve itself on the concep-

tual anchor that has succeeded the tangible ones,

the nominal anchor in the United States is the Federal Open Market Committee’s explicit objective of achieving inflation at the rate of 2% per year over the longer run. This goal is supported by a policy strategy by which the FOMC responds to economic developments in a way that systematically aims to return inflation to 2% over time.

And so forth. We have not yet returned to 2% inflation, but the Fed has nonetheless started trimming its policy interest rates. Maybe Levin and Skinner could add a line or two to their indictment about the Fed’s institutional self-awareness (or absence of the same).

Fifty Years of the Shadow Open Market Committee holds a mirror up to the Fed’s loyal opposition. The critics chiefly dwell on the central bankers’ technical shortcomings. Rarely do they question the morality of the paper-money system—the manipulation of interest rates and monetary aggregates to promote a very specific kind of financial prosperity.

Reading this new book, we thought of an old one. *A History of American Currency* by William Graham Sumner (1840–1910) was published in 1874. Sumner was one of the 19th century’s foremost intellectuals, a Yale professor whose interests spanned the social sciences and whose students included none other than Irving Fisher, widely remembered as one of the greatest American economists.

Sumner wrote his history in the wake of the Supreme Court’s ruling in support of the constitutionality of the legal tender laws, which held that a creditor must accept the government’s scrip in payment of a debt (as opposed to the gold or silver into which that currency was, or had been, legally exchangeable).

Who today pauses to question the anodyne notice stamped on the face of dollar bills, “This note is legal tender for all debts, public and private”? Yet to Sumner, such a governmental edict was tyranny itself, and he called the Court’s judgment “as great a wrong as the Dred Scott decision.”

As great a wrong as the 1857 ruling by which the Court lent its sanction to the nationalization of slavery? So Sumner wrote, to which he added, “It will not probably take a war to overthrow

the principle of the legal-tender act, but it may take a national bankruptcy.”

We bring this up because Sumner was renowned for his brains and his empathy alike (he coined the phrase “the forgotten man”). Yet perhaps not one of the participants in the Shadow’s golden-anniversary proceedings shares that long-departed thinker’s view of paper money or of the government’s right to force it on the money-using public.

Query: Fifty years from now, which of today’s established monetary doctrines will strike thoughtful people as unspeakably wrong-headed—or worse?

**Fifty Years of the Shadow Open Market Committee: A Retrospective on its Role in Monetary Policy*, edited by Michael Bordo, Jeffrey M. Lacker, Mickey D. Levy and John B. Taylor; Hoover Institution Press, \$49.95.

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EPISODE 2 | FEB. 25 | Jim Chanos, *Chanos & Co.*

EPISODE 3 | APRIL 22 | Tim Sloan, *Fortress Investment Group*

EPISODE 4 | MAY 20 | Tom Gober, *Thomas Gober Forensic Accounting Services*

EPISODE 5 | JUNE 17 | Steven Bogden, *investment and geopolitical strategist*

EPISODE 6 | SEPT. 17

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DECEMBER 5, 2025

Long-dated yields are—stimulated

Evan Lorenz writes:

U.S. manufacturing activity fell for the ninth consecutive month in November, with the Institute for Supply Management's purchasing managers' index dropping to 48.2 from 48.7 in October. "It really is all about tariffs," remarks ISM chair Susan Spence.

Wait till next year. For one thing, the Supreme Court will rule on President Donald Trump's import levies, and Polymarket places 73% odds that the taxes will be struck down. For another, the One Big, Beautiful Bill Act is set to goose GDP growth by 0.9 percentage points in 2026, according to the Congressional Budget Office, largely thanks to lower household taxes and provisions to allow businesses to deduct 100% of capital expenses.

America is not alone in ramping up the stimulus in the face of still-elevated inflation (3% in September). Last Friday, Japanese Prime Minister Sanae Takaichi's cabinet approved a supplementary budget, ostensibly to assist in the fight against inflation, which rose by 2.8% in November. The ¥18.3 trillion (\$117 billion) spending package is Japan's largest stimulus program since Covid and includes cash handouts to families and subsidies for electricity and gas bills. Not surprisingly, the yield on the 30-year Japanese government bond jumped to an intraday peak of 3.41% on Tuesday, a new all-time high and a 112 basis-point pickup since the start of the year.

China's slow-moving housing bust continues to weigh on the world. Sales by the country's top-100 developers fell by a whopping 41.9% year over year in October, and state-backed China Vanke Co., once seen as among the mainland's safest builders, warned that it may not be able to repay a pair of domestic bonds due this month.

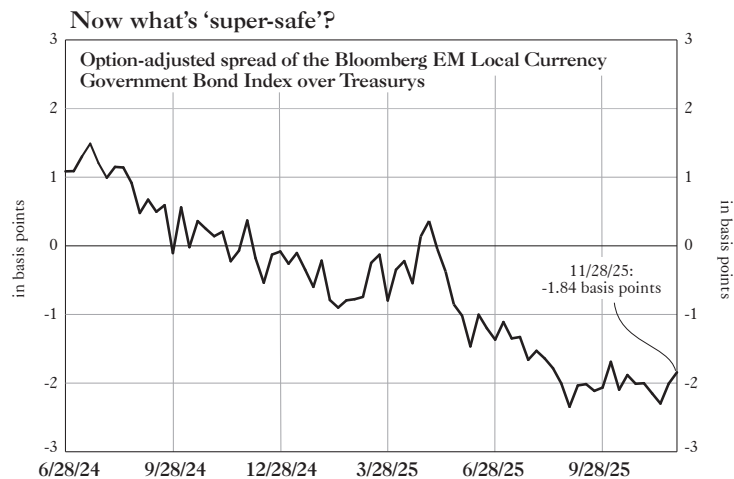
To bolster the property sector, the Communist Party is turning to its time-tested playbook. First, apparatchiks banned a pair of statistics providers from publishing data on the housing market. Second, officials are mulling a new stimulus program, including the possibility of the government subsidizing mortgage interest costs for new buyers.

Of course, never-ending stimulus

doesn't come cheap. The U.S. budget deficit summed to \$2 trillion, or 6.5% of GDP, in the fiscal year ended September and federal debt held by the public towers at \$30.8 trillion, or 101% of output. Both figures are set to rise, as the International Monetary Fund predicts that the American deficit will expand to 7.9% of GDP in calendar 2026.

Bond investors are on the case. Prior to late last year, emerging-market governments had to pay a premium over U.S. Treasury yields to issue local-pay debt. Since then, that relationship has reversed and EM governments now pay 1.9 basis points less than Uncle Sam.

Sad!



source: The Bloomberg

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