



The Rising Cost of Money: Time to Pay the Bill?

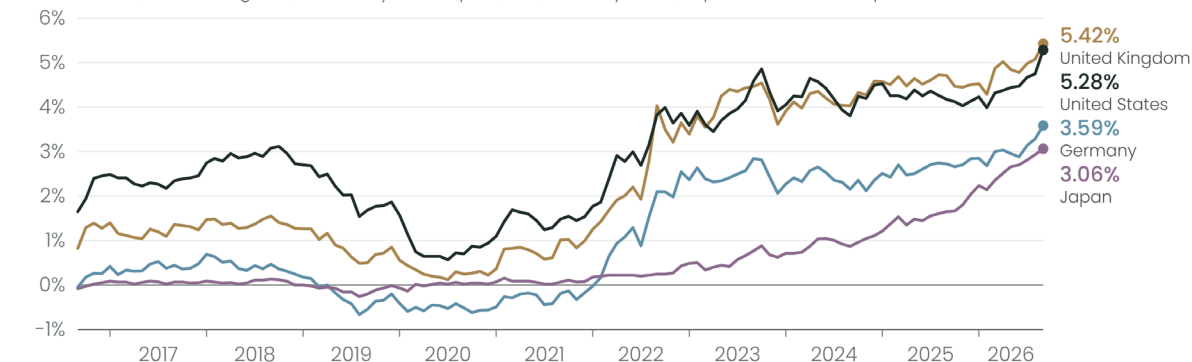
For more than a decade, money was cheap and borrowing was easy. That era was already fading, and the market moves of the third quarter of 2026 have given this shift new weight. The yield on the 10-year US Treasury rose by 54 basis points in September alone and closed the quarter at 5.29%, its highest level since 2007. The move was global: the 10-year German Bund reached 3.59%, its highest in more than fifteen years, the 10-year UK gilt 5.42%, and the 10-year Japanese government bond 3.06%, a level last seen in 1996. The average yield of the Bloomberg Global Treasury Index exceeded 4% for the first time since 2007. Central banks reinforced the message: in September, the Federal Reserve, the European Central Bank and the Bank of Japan each raised rates by 25 basis points. The Fed's decision – unanimous, and its first hike since 2023 – lifted the policy rate to 3.75%–4.00%, and most committee members currently see at least one further increase this year.

With the conflict around the Strait of Hormuz unresolved, Brent crude rose by more than 10% in September and traded again above 100 US dollars per barrel. Yet the bond market tells a more precise story and, in our view, a more important one. A nominal bond yield has two components: the real yield, which is the true price of money, and a compensation for expected inflation. Inflation-linked Treasuries allow us to separate the two. Since March, the 10-year real yield has risen by about one full percentage point, from 1.90% at the March auction to around 2.9% at quarter-end, the highest since 2008. Ten-year inflation expectations, by contrast, have barely moved and remain anchored at around 2.35%. Only at the short end of the curve do we see the imprint of oil.

This distinction defines the quarter. Core inflation remains persistent. The Federal Reserve continues to describe it as elevated, and the AI buildout is adding to price pressures. But why did long-term money become so much more expensive? That rise reflects a higher price of money itself: tighter monetary policy, a rising term premium as investors demand more compensation for holding long-dated debt amid fiscal and geopolitical uncertainty, and, above all, an appetite for borrowing from governments and the AI buildout that is without precedent in history. This, more than oil, explains why long-term rates shot up. It also carries an uncomfortable implication. A rise in inflation expectations can, in part, be inflated away by borrowers. A rise in real rates cannot. The bill is real, and it falls on those who borrow. Governments face the largest share, and for investors the key question is which borrowers can carry it.

10-year government bond yields

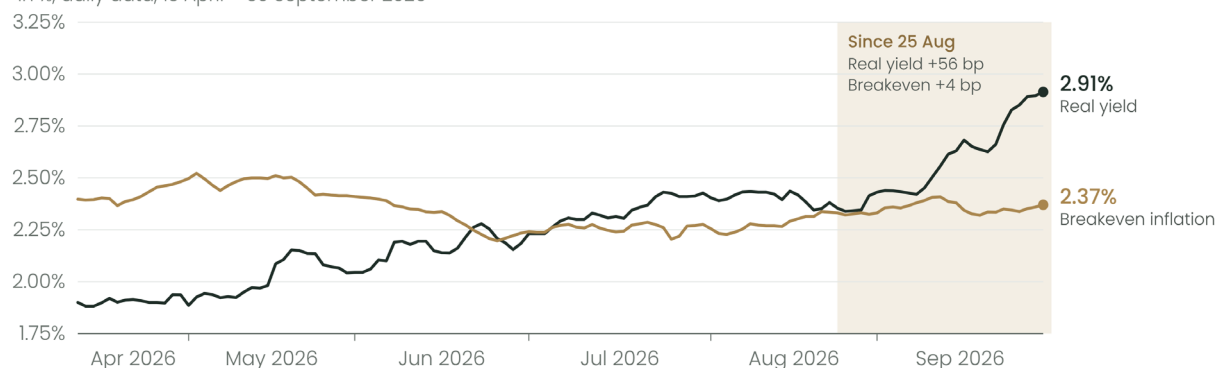
United States, United Kingdom, Germany and Japan, in %, monthly data, September 2016 – September 2026



Source: Bloomberg (USGG10YR, GDBR10, GUKG10, GJGB10 Index); chart by Lotos Asset Management.

US 10-year real yield and breakeven inflation

In %, daily data, 13 April – 30 September 2026



Source: Bloomberg (USGGT10Y, USGGBE10 Index); chart by Lotos Asset Management.



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Governments: the largest borrowers face the largest bill

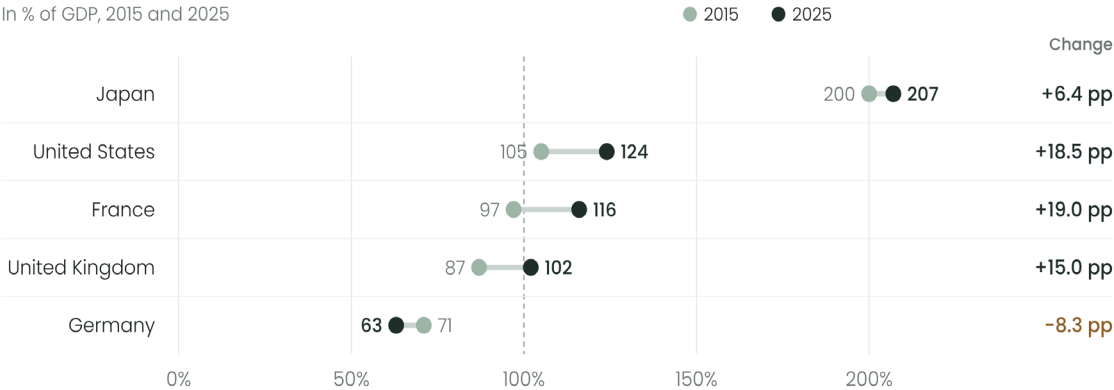
The most direct payer is the sovereign borrower. The United States spent roughly 970 billion US dollars on net interest in fiscal 2025, nearly one-fifth of federal revenue and more than it spends on national defence, and the Congressional Budget Office projects that figure to more than double to 2.1 trillion by 2036. The timing could hardly be less favourable. It is estimated that nearly 10 trillion US dollars of Treasury securities mature and must be refinanced in 2026 alone, and roughly 60% of outstanding debt was issued when 10-year yields were below 3%. Every rollover now locks in a markedly higher cost. The Treasury has leaned increasingly on short-term bills to contain the damage, but this only raises the budget's sensitivity to each Fed hike.

The arithmetic that matters most is the gap between the real interest rate and real economic growth. With 10-year real yields near 2.9% and trend real growth of around 2%, debt ratios rise by themselves unless governments run primary surpluses, which almost no large economy does. Hence this is not sustainable. The IMF expects global public debt, just under 94% of world GDP in 2025, to reach 100% by 2029, one year earlier than it projected only twelve months before, and it has warned explicitly of an erosion of the US Treasury's safety premium.

In the United States, investors are so far demanding a higher price for money, not a premium for default. In Europe, the price of risk is rising as well. France, with public debt of around 118% of GDP and a deficit above 5%, saw the spread between its 10-year bonds and German Bunds cross 100 basis points in September for the first time since the euro crisis, and widen by around 50 basis points over the month as a whole, to around 120 basis points, its highest level since 2012. Difficult negotiations over the 2027 budget and an approaching presidential election have added a political premium that, by some estimates, exceeds what fiscal fundamentals alone would justify. The episode also revealed a stabilising mechanism: as investors sought safety in Bunds, German yields eased, and tighter financial conditions did part of the ECB's work for it. In Japan, a 10-year yield above 3% marks the end of an era of ultra-low rates for the most indebted major economy, with public debt well above 200% of GDP.

General government gross debt

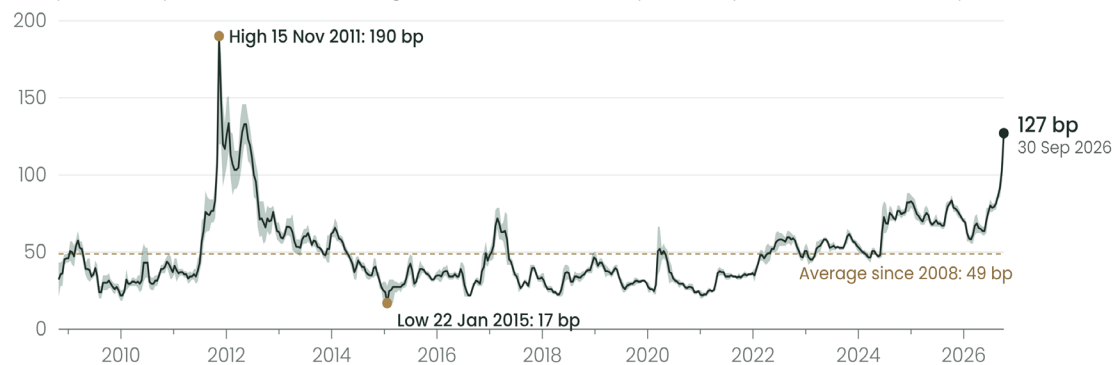
In % of GDP, 2015 and 2025



Source: IMF World Economic Outlook; 2025 figures are IMF estimates. Dashed line marks 100% of GDP.

10-year OAT-Bund spread

Yield spread of 10-year French over German government bonds, in basis points, daily data, October 2008 – September 2026



Source: Bloomberg (10-year OAT vs. 10-year Bund, bid yield to maturity); chart by Lotos Asset Management.



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The AI buildout: from cash flow to the bond market

The second payer is the corporate borrower, and nowhere is the shift more visible than in the AI buildout. Investment shows no sign of slowing: seven leading AI builders spent over 600 billion US dollars over the past four quarters. What has changed is how it is financed. By August, the hyperscalers had issued over 200 billion US dollars of investment-grade bonds this year, lifting their share of US dollar investment-grade issuance from about 2% between 2022 and 2024 to an expected 9% in 2026. Estimates for 2027 point to a new record of around 420 billion US dollars.

The bond market has begun to charge for this. Hyperscaler spreads widened by around 30 basis points this year to August, against just 2 basis points for the broader investment-grade index, and AI-related corporate debt now trades at around 115 basis points over Treasuries, compared with 78 for the market as a whole. New issues require concessions: Amazon paid an additional 18 to 21 basis points on the longest maturities of its 25 billion US dollar offering in July. This is not a verdict on the strength of these companies, whose leverage remains low, but on supply, as each large deal cheapens the bonds already outstanding, and more deals are coming. It is the pace of the buildout, rather than today's balance sheets, that concerns us. Further down the capital structure, the picture is harsher. CoreWeave's 2.6 billion US dollar loan, priced at the end of July, yields above 10% and required maintenance covenants that had all but disappeared from leveraged lending. And on 30 September, spreads on CCC-rated US corporate bonds crossed 1,000 basis points for the first time since March 2023. Defaults have so far remained manageable, but higher refinancing costs are precisely what lift them over time.

Investors: the thinner premium

The third payer is the investor. With the S&P 500 trading at around 19 times forward earnings, its earnings yield of roughly 5.2% now offers almost no premium over a risk-free 10-year Treasury. The cushion that once rewarded investors for taking equity risk has become considerably thinner, leaving returns more dependent on earnings growth. For now, that growth is delivering: earnings are expected to rise by close to 30% in the third quarter. In bonds, September's losses scaled with duration: US investment-grade corporate bonds lost 2.6% and US high yield 2.5%, while short-dated, high-quality paper absorbed the rise in yields far better.

Five-year CDS spreads of US hyperscalers

In basis points, daily data, 24 April – 5 October 2026

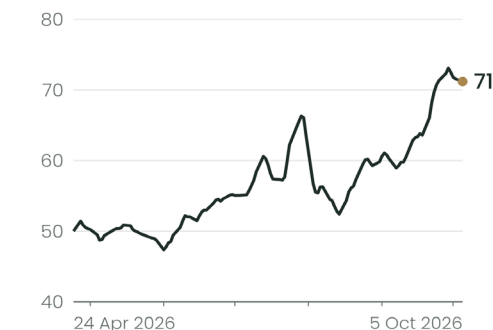
Oracle



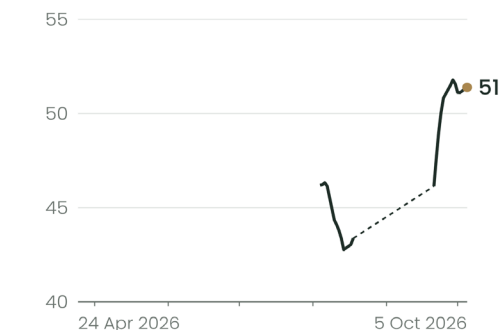
Meta



Alphabet



Microsoft



Microsoft: series starts in August 2026; dashed segment indicates a gap in the data.
Source: Bloomberg; chart by Lotos Asset Management.



The Rising Cost of Money: Time to Pay the Bill?

What history tells us – and what it doesn't

Bond markets have repriced the cost of money abruptly before, and the pattern is instructive. In 1994, the Federal Reserve doubled its policy rate within a year, long-term yields rose by more than two percentage points and Orange County in California went bankrupt on leveraged bond positions. In 2011, doubts about euro-area public finances drove Italian and Spanish yields to unsustainable levels until the ECB pledged in 2012 to do “whatever it takes”. In 2022, an unfunded UK budget triggered a collapse in long-dated gilts that forced the Bank of England to intervene within days.

Three lessons recur. The losses concentrate in long maturities and in leveraged balance sheets. The trigger is often fiscal credibility rather than inflation alone. And investors who hold short-dated, high-quality bonds are not the victims of these episodes but their beneficiaries: they can reinvest quickly at the higher yields that others are forced to accept.

Yet today's situation is not fully comparable. Technology companies, which historically operated with conservative balance sheets, are making unprecedented investments in AI infrastructure that must generate substantial returns. Capital flows between chipmakers, cloud providers and model developers are increasingly interconnected, so a shortfall in expected returns could spread in ways that are difficult to anticipate. And the sectors most directly tied to the AI buildout account for roughly half of the S&P 500, with financials exposed through lending and private credit. This combination has no historical precedent.

Our view

We expect yields to remain high but stabilise: the 10-year Treasury trades in a range of around 4.5% to 5.5%, central banks deliver few more hikes, and tighter financial conditions act as a natural brake on further increases.

Lower energy prices alone would not change this. A meaningful decline in yields would require clear evidence that the AI buildout can monetize and a more disciplined fiscal policy.

The main risk is that AI returns disappoint or fiscal slippage continues, and the market begins to price default risk more broadly – in sovereign spreads beyond France, in investment-grade credit and in leveraged AI financing. A 10-year Treasury yield of 6%, already discussed by some strategists, would then be conceivable.

The asymmetry is clear: long duration pays little in our expected scenario and would be punished severely if the risks materialize.



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Our conclusions for fixed income

We draw three conclusions, and they confirm the positioning we have held through the year.

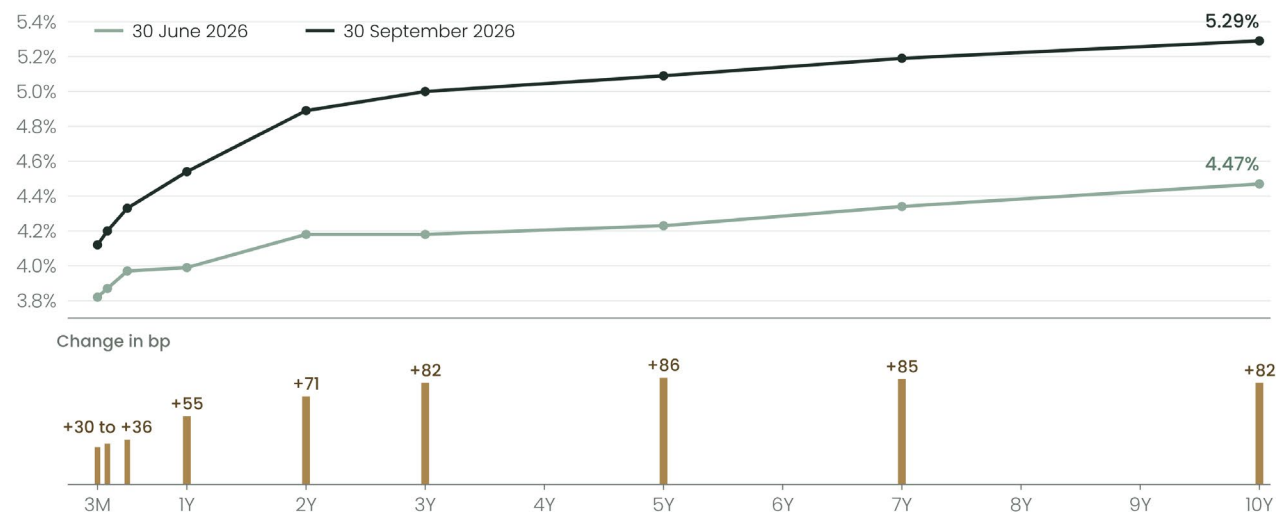
First, we stay short in duration. The yield curve offers remarkably little reward for lending long: at quarter-end, a 10-year Treasury yielded only around 40 basis points more than a 2-year note, while carrying roughly four times the interest-rate risk. A rise of around five basis points in 10-year yields over twelve months would erase that extra income. With a term premium driven by fiscal and geopolitical uncertainty, unprecedented borrowing by governments and AI builders, and a Federal Reserve whose new chair leaves it to the market to interpret the data rather than relying on central bank signalling, we do not see lower yields in the near term. Short-dated, high-quality bonds now yield close to 5% in US dollars, and patience is being paid. We will extend duration when the evidence turns: when it becomes clearer that the investments in the AI buildout have a real chance to monetise, and when fiscal policy becomes more stringent.

Second, we stay with quality. September showed where the bill arrives first: US high-yield spreads widened by around 50 basis points while investment-grade spreads barely moved, and CCC-rated debt crossed the distress threshold. When refinancing costs rise for every borrower, balance-sheet strength is not a defensive luxury but the core of the investment case. We favour issuers whose debt is serviced from cash flow rather than from refinancing, and sovereigns whose fiscal paths do not depend on the goodwill of the bond market.

Third, we avoid technology exposure in fixed income where possible. This is a deliberate choice rather than a cautious one. We remain constructive on the AI buildout and continue to own it where its upside accrues: in equities. A bondholder in the same companies bears the full risks of the buildout, from rising leverage and heavy, growing supply to complex off-balance-sheet structures and the dual maturity mismatch we described in July, while the return is capped at the coupon. With record issuance expected in 2027, the supply overhang that has pushed hyperscaler spreads wider is likely to persist. As long as that asymmetry holds, we prefer to own the growth and avoid the debt.

US Treasury yield curve

Yield to maturity in %, 30 June and 30 September 2026; change in basis points



Source: Bloomberg (US Treasury actives curve, mid yield to maturity; tenors 3M, 4M, 6M, 1Y, 2Y, 3Y, 5Y, 7Y, 10Y); chart by Lotos Asset Management.

When we would extend duration

- AI investments show a real chance to monetise
- Fiscal policy becomes more stringent



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Key takeaways

- The price of money has returned. In the third quarter of 2026, 10-year government bond yields reached their highest levels in at least 15 years in the US, Germany, the UK and Japan, and the Fed, the ECB and the Bank of Japan all raised rates in September.
- The rise is real, not inflationary. The 10-year US real yield climbed by about one percentage point since March to around 2.9%, while long-term inflation expectations stayed anchored near 2.35%. Unprecedented borrowing by governments and the AI buildout explains the long end, and real rates cannot be inflated away.
- Governments pay first. US net interest already exceeds defense spending, around 9.7 trillion US dollars must be refinanced in 2026, and real rates above real growth push debt ratios higher unless budgets improve. In Europe, France shows the price of risk rising, with the spread of French over German bonds at levels last seen in the euro crisis.
- AI financing has moved into the bond market. Hyperscalers account for an expected 9% of US dollar investment-grade issuance this year, with record issuance of around 420 billion US dollars expected in 2027. Their spreads have widened by around 30 basis points this year against 2 for the market; weaker AI borrowers pay double-digit yields.
- Today's situation has no historical precedent: the sectors most directly tied to the AI buildout account for roughly half of the S&P 500, financed through increasingly interconnected structures.
- Frontier AI developers such as Anthropic and OpenAI, together with the hyperscalers, are the key test: whether their AI revenues meet projections deserves close monitoring.
- Investors face a thinner premium: the earnings yield of the S&P 500 roughly matches a risk-free 10-year Treasury, and September's bond losses were concentrated in long duration, while spreads widened most for lower-quality borrowers.
- In fixed income, we stay with short duration, high-quality issuers and as little technology exposure as possible. We own the AI buildout through equities, not its debt.
- We can extend duration once AI investments show a real chance to monetise and fiscal policy becomes more stringent.

Please refer to the section "How are we invested and why" for further details.



1-Year Performance of Major Asset Classes as of end Q3 2026 (in Local Currencies)



Total return in local currency, in %. Source: Bloomberg; chart by Lotos Asset Management.



Q3 2026 Performance of Major Asset Classes (in Local Currencies)



Total return in local currency, in %. Source: Bloomberg; chart by Lotos Asset Management.

Performance major asset classes Q3 2026

- **Equities:** Equity markets delivered a muted and highly dispersed quarter, with leadership largely inverting the prior quarter's pattern as a renewed energy shock and hawkish central banks reshaped the backdrop. Last quarter's laggards led: the Bovespa gained +8.3%, supported by Petrobras and expectations of further Selic cuts, while the Hang Seng and MSCI China rose +7.6% and +3.0%, as attractive valuations drew investors back. US large caps advanced modestly, with the Nasdaq up +2.5% and the S&P 500 +2.0%, lifting MSCI World +1.8%, but these headline gains masked considerable fragility. Concerns over the debt financing of the AI build-out added volatility, as AI-related bonds sold off in July and investors penalised the hyperscalers funding it, while breadth deteriorated sharply: by late September only around a quarter of S&P 500 stocks traded above their 50-day average, despite the index sitting near its record high. In Europe, the FTSE 100 (+1.0%) and DAX (+0.8%) edged higher, the former helped by its energy weighting, while the Euro Stoxx 600 fell 1.1% as ECB tightening lifted euro yields, and the SMI declined 2.6%, weighed down by setbacks at heavyweights Nestlé and Novartis. The Russell 2000 fell 7.5% as rate-hike expectations rebuilt, the Nikkei 225 declined 4.7% as currency intervention strengthened the yen, and MSCI EM lost 2.9%, dragged lower by a roughly 19% slide in Korean equities, where the forced unwinding of leveraged ETFs popular with retail investors amplified a sell-off in chipmakers. With Korea having grown to close to a quarter of the index, EM was highly exposed to swings in AI-related chip stocks.
- **Fixed Income:** Fixed income markets endured a difficult quarter, with losses across nearly every segment as the renewed oil shock revived inflation concerns and prompted a synchronized hawkish turn: the ECB and the Federal Reserve both raised rates in September, the Fed for the first time since 2023, and the Bank of Japan lifted its policy rate to the highest level since 1995. Yields rose sharply, with the US 10-year moving above 5% for the first time since 2007. Floating-rate exposure offered the only shelter, with leveraged loans returning +2.0%. High yield held up comparatively well, with European High Yield down 1.5% and US High Yield down 1.8%. The Swiss Bond Index slipped 1.7% and short-dated US IG fell 2.3%. Duration-heavy segments bore the brunt: the Global Aggregate declined 2.5%, the FTSE World Government Bond index and global corporate credit each lost 3.1%, emerging market debt and the US Aggregate both fell 3.5%, the Euro Aggregate dropped 3.8% and global green bonds were weakest at -3.9%.
- **Commodities:** Commodities were the clear outperformer this quarter, as the energy shock that had unwound in the second quarter returned with force. Hopes for a full reopening of the Strait of Hormuz in the near time faded. Copper extended its advance, gaining +6.9%, as AI-related data centre and power grid demand continued to meet constrained mine supply. Gold posted a more modest gain of +2.9%, caught between safe-haven demand and the headwind of sharply higher yields, which raised the opportunity cost of holding the non-yielding metal.
- **Currencies:** Currency markets were driven by monetary policy divergence. The Swiss franc weakened broadly, with USD/CHF up +3.4% and EUR/CHF up +2.6%, as the SNB held rates at 0% while the Fed and ECB tightened. The yen was the notable exception, with USD/JPY falling 3.2% after record currency intervention by Japan, partly coordinated with the US, and expectations of faster Bank of Japan tightening.
- **Alternative (Real Estate):** Global listed real estate lost some ground, with the NAREIT Global Developed index declining 6.1%. As one of the most rate-sensitive asset classes, listed property suffered from the sharp rise in long-term yields, which lifted financing costs and pressured valuations.



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