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The Buildup in the National Debt Is Unsustainable

The United States recently surpassed $40 trillion in national debt, a milestone that attracted significant attention from both policymakers and financial markets. While the Treasury Department has taken steps intended to improve liquidity and ease pressure on long-term interest rates, investors remain focused on a more fundamental issue: the trajectory of federal deficits and the implications for future debt issuance.

Following the 30-year Treasury yield reaching 5.31% on August 17, its highest level since 2004, the Treasury Department announced an expansion of its bond repurchase program. The program, initially introduced to support liquidity in older Treasury securities, was expanded in an effort to improve market functioning at the long end of the yield curve.

While Treasury yields briefly declined following the announcement, the move highlighted an important reality: market participants remain focused on the long-term supply-and-demand dynamics of the Treasury market rather than short-term liquidity measures.

Federal budget deficits are currently running near 6% of nominal GDP, a historically elevated level outside of recessionary periods or national emergencies. At the same time, inflation has remained above the Federal Reserve's long-term target, the economy continues to operate near full employment, and the national debt has more than doubled over the past decade.

From an investment perspective, these developments matter because they influence the future path of interest rates. With annual Treasury issuance expected to remain substantial for years to come, investors may increasingly demand higher yields to absorb the growing supply of government debt. Higher borrowing costs can affect everything from mortgage rates and corporate financing costs to equity valuations and economic growth.

The national debt itself is not an immediate crisis. The United States continues to benefit from deep capital markets, a resilient economy, and the dollar's role as the world's reserve currency. However, the current trajectory raises important questions about the long-term balance between fiscal policy, economic growth, inflation, and interest rates.

For investors, the key issue is not the debt level alone but how markets respond to it. If deficits remain elevated, Treasury yields could face continued upward pressure, creating a fundamentally different investment environment than the one experienced during much of the past fifteen years. After a prolonged period characterized by exceptionally low interest rates and abundant liquidity, investors may need to adapt to a world in which capital carries a higher cost.

Such an environment presents both challenges and opportunities. Higher yields increase borrowing costs but also provide more attractive income opportunities across fixed income markets. Bonds can once again serve as a meaningful source of portfolio income, while equity investors may place greater emphasis on companies with durable cash flows, pricing power, and strong balance sheets.

Ultimately, the growing national debt deserves attention not because of its political implications, but because of its potential impact on financial markets. The interaction between fiscal policy, inflation, economic growth, and interest rates is likely to remain one of the most important drivers of investment returns in the years ahead.

Sincerely,

The Private Capital Management Team

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