

Why US Rates Are Rising

Author



Robert M. Almeida
Portfolio Manager and
Global Investment Strategist

In Brief

- Long-term rates are rising because capital demand is surging.
- The 2010s were capital light; today is capital intensive.
- Higher long-term rates reflect a structural shift in the capital cycle, not just changing Fed policy.

Why are long-term US interest rates rising?

The answer is usually framed around the Federal Reserve, inflation data, or the latest policy announcement. Those factors do matter, particularly over shorter periods. But they may obscure the more important structural change taking place beneath them.

The world is demanding more capital

The Fed sets the overnight policy rate and influences financial conditions. It does not, however, independently determine the yield on a 10-year Treasury bond. Long-term rates also reflect expectations for growth and inflation, the balance between savings and investment, and the compensation investors require to commit money for a decade.

From falling to rising capital demand

As we have written before, the 2010s were a period of falling demand for capital. Companies outsourced production, optimized global supply chains, and increasingly transitioned to asset-light business models. Software replaced hardware. Intellectual property replaced factories. Many businesses grew profits without making proportionate investments in physical capacity.

Rather than being invested in new plants, power systems, or supply chains, capital was often returned to shareholders.

In short, the demand for financing remained modest relative to the available supply of global savings, helping suppress real interest rates and long-term bond yields. Central banks reinforced that environment, but they did not create its underlying economics.

Today's environment is almost the reverse.

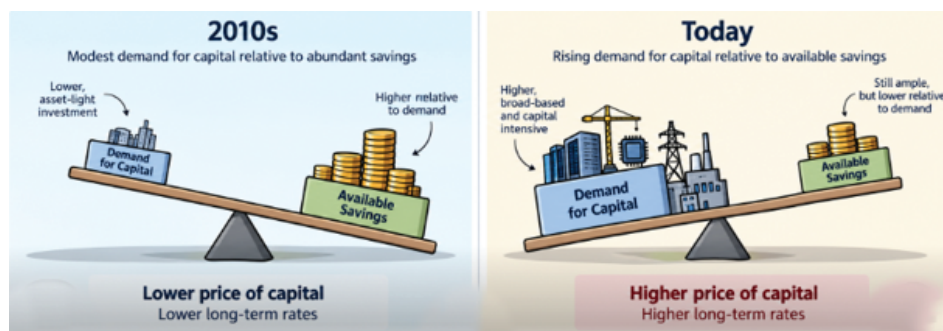
Capital is being poured into datacenters, semiconductor facilities, power generation, transmission systems, defense capacity, manufacturing plants, and fortifying supply chains. Many of these investments are strategically necessary, long dated, and unlikely to reverse quickly — and require enormous amounts of money, labor, energy, equipment, and time.

And they are all occurring simultaneously.



When investment demand rises relative to the available supply of savings, it puts upward pressure on the price of capital. Higher long-term interest rates should therefore not be viewed only as a reaction to the next Fed decision, but also as a market signal reflecting a more capital-intensive economy.

Exhibit 1:



AI sits on both sides

Artificial intelligence is central to this shift, because it is affecting both sides of the capital cycle.

Upstream, building AI requires extraordinary physical investment. The technology may feel weightless, but the infrastructure supporting it is not. Datacenters, chips, memory, power, cooling, and networks are all capital intensive.

Downstream, AI is lowering barriers to entry and enabling new competitors to challenge established profit pools.

Companies may therefore need to commit more capital to grow or simply defend existing profits, even as competition makes the returns on that capital less certain.

What this means for investors

Some companies will earn attractive returns on their investments. Others will spend heavily merely to protect their market share and profit margins. The difference between the two should become increasingly visible.

This is why rising rates, changing market leadership, and the opportunity for active management are not separate stories. They are different expressions of the same regime change.

The last decade rewarded companies that were able grow while using little incremental capital and defending unusually durable profit pools. This next phase may distinguish between companies that can still compound capital at attractive returns and those forced to spend simply to defend against new competitive threats.

Rates are the symptom. The capital cycle is the cause. And this cycle looks fundamentally different from the last. ▲



Keep in mind that all investments carry a certain amount of risk, including the possible loss of the principal amount invested.

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