

Weekly CIO Letter

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The Rate Shock Has Moved – It Has Not Disappeared

Growth has absorbed more monetary tightening than expected. The adjustment is increasingly appearing in inflation risk, sovereign interest costs, bond returns and future refinancing – rather than in a broad economic contraction.

**ASTRO
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Executive Summary

The central macroeconomic surprise of 2026 is becoming clearer: high interest rates have produced less damage to private-sector activity than conventional monetary transmission would have suggested.

U.S. payrolls increased by 162,000 in August, compared with an average monthly gain of only 31,000 over the previous twelve months. Unemployment remained at 4.1%, while average hourly earnings increased 3.1% from a year earlier. June and July payroll growth was also revised upward by a combined 55,000 jobs.

Business surveys reinforce the message. The ISM Services PMI rose to 55.4, with new orders at 60.9 and business activity at 61.7. Manufacturing also remained in expansion at 54.6. Yet the same surveys reveal the constraint: prices paid reached 72.6 in services and 71.1 in manufacturing.

This combination matters.

Monetary tightening has not failed. Its transmission has been delayed and redistributed.

Many corporations refinanced or extended debt when borrowing costs were extremely low. Their interest burden has therefore remained

surprisingly contained. Governments did not enjoy the same protection, while long-duration bond investors absorbed substantial mark-to-market losses.

Meanwhile, inflation is proving harder to extinguish than expected.

Europe provides a parallel example: euro-area GDP expanded 0.6% quarter over quarter in Q2, while August inflation accelerated from 2.9% to 3.3%, largely because energy inflation jumped to 14.3%.

The investment implication is not simply “rates stay high.”

It is more precise:

The cost of capital remains restrictive, but the burden is appearing in different balance sheets at different times.

That favors quality, liquidity and income over portfolios built around the assumption that long-duration bonds must rally simply because policy rates are high.

1. Why the Private Economy Has Withstood Higher Rates

Federal Reserve Chairman Kevin Warsh recently described broad U.S. financial conditions as difficult to characterize as restrictive.

Corporate credit spreads remain near the low end of their historical range, issuance has been strong, bank lending standards are relatively easy, real consumer spending has remained healthy and private domestic final purchases have grown at nearly 3% so far this year.

That resilience appears inconsistent with several years of elevated interest rates.

Apollo offers an important explanation.

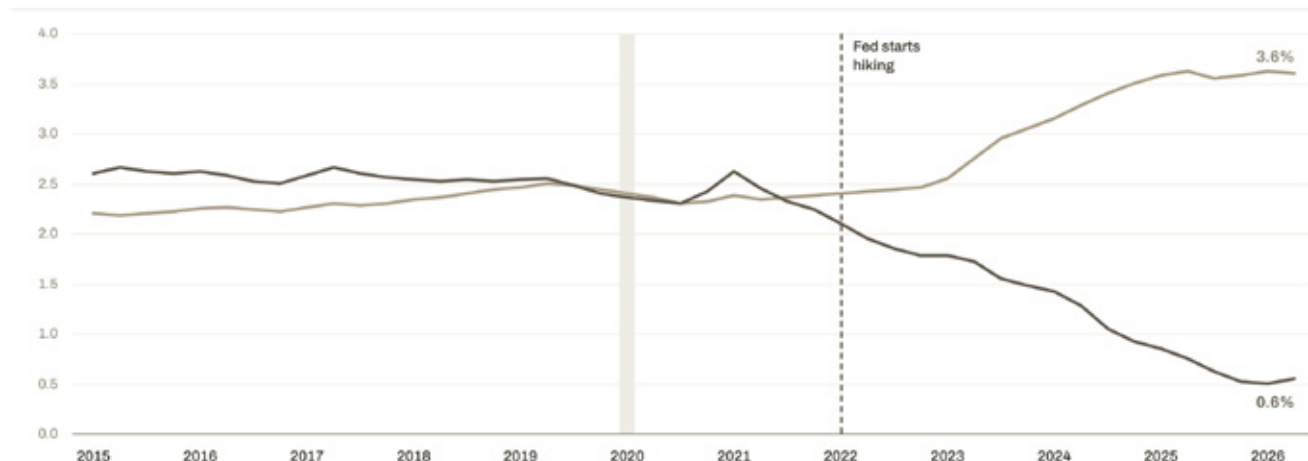
Apollo Chief Economist Torsten Slok estimates that corporate net interest payments have fallen to approximately 0.4% of GDP, because many businesses locked in low fixed-rate borrowing during the pandemic. U.S. government net interest payments, by contrast, have climbed to approximately 3.6% of GDP.

UNITED STATES

Corporates locked in low rates during the pandemic, the U.S. government did not

Net interest payments, % of GDP, 2015–2026.

— Corporate — Government



Source: Apollo Chief Economist / BEA, 7 September 2026. Quarterly data; shaded band marks the 2020 recession.

The implication is significant. Traditional monetary transmission assumes that higher rates increase

debt-service costs, constrain investment and eventually weaken demand.

That process depends on when borrowers actually refinance.

A company with fixed-rate five-, seven- or ten-year debt does not suddenly pay the new market rate because the Federal Reserve raises overnight rates.

Its adjustment comes later.

This helps explain why monetary tightening could coexist with resilient corporate margins, strong capital expenditure and relatively robust employment.

But it also means that part of the tightening cycle has been postponed rather than avoided.

As pandemic-era debt matures, companies will increasingly refinance into coupons that are materially higher than the debt being replaced.

Apollo therefore argues that the eventual impact should be greatest among highly leveraged borrowers.

For investors, leverage is becoming a more important dividing line.

The question is no longer simply whether a company can service its debt today.

It is:

At what rate will that company refinance its balance sheet tomorrow?

2. Resilient Demand Is Keeping the Inflation Constraint Alive

A delayed rate shock would be relatively benign if inflation were already converging convincingly toward target.

The latest evidence is less comfortable.

The U.S. services economy strengthened in August.

New orders reached 60.9, their strongest reading in years, while business activity reached 61.7. But the ISM Services Prices Index climbed to 72.6, its fifth reading above 70 in six

months and its highest twelve-month average since April 2023.

Manufacturing prices were also elevated at 71.1.

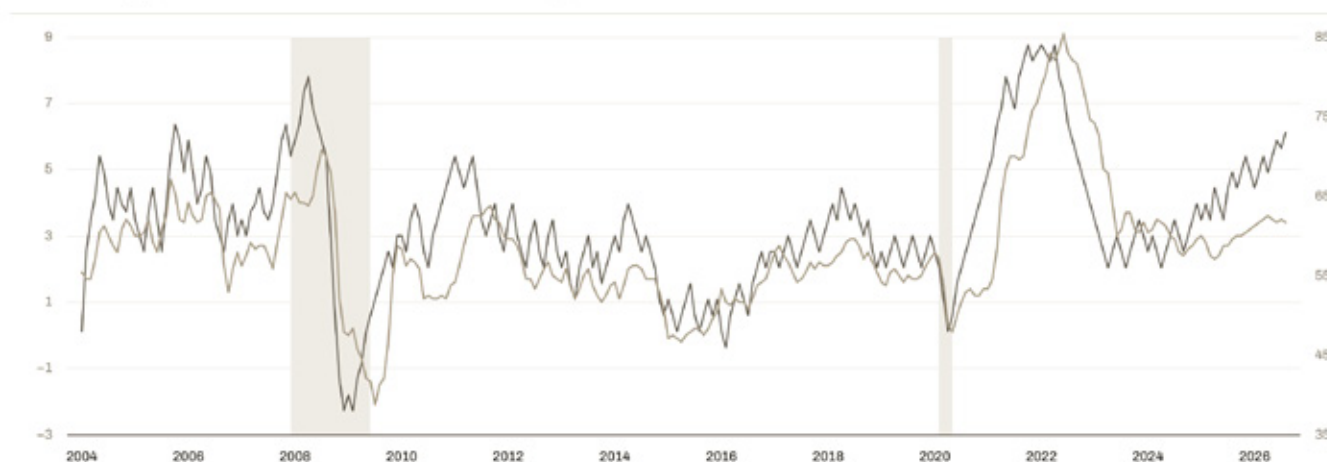
Apollo highlights the historical relationship between services input prices and consumer inflation.

UNITED STATES

ISM Prices Paid is a leading indicator for CPI

CPI year over year against the ISM Services Prices Paid index, pulled forward six months.

— US CPI, % yoy (left) — ISM Services Prices Paid, index, 6m lead (right)



Source: Apollo Chief Economist / ISM / BLS / Macrobond, 5 September 2026. Monthly data; shaded bands mark recessions.

The chart shifts ISM Services Prices Paid forward by approximately six months and compares it with U.S. CPI inflation.

The relationship is not mechanical and should not be treated as a forecast.

But the current direction matters.

Apollo interprets the recent rise as an upside risk to inflation and now expects the Federal Reserve to raise rates at its September meeting. That is Apollo's house view, not an established consensus.

Oil adds another complication.

Brent was trading around US\$97.5 per barrel on September 7, roughly 35%

above February levels, as renewed tensions around the Strait of Hormuz intensified concerns about energy supply.

The risk is increasingly that strong demand and renewed supply pressure coexist.

That is more difficult for central banks than conventional demand-driven inflation.

Higher rates can weaken spending.

They cannot directly produce more oil, expand shipping capacity or remove geopolitical constraints.

3. Europe Confirms That This Is Not Only an American Problem

The same tension is increasingly visible across the Atlantic.

Eurostat's latest estimate shows euro-area GDP expanding 0.6% quarter over quarter in Q2, after no growth in Q1. Household consumption contributed 0.2 percentage points, while net exports contributed 0.9 points. Employment also increased modestly.

At the same time, inflation moved in the wrong direction.

Euro-area HICP accelerated from 2.9% in July to 3.3% in August.

The composition is important:

- energy: 14.3%
- services: 3.0%
- non-energy industrial goods: 1.2%
- inflation excluding energy: 2.2%

The energy shock explains much of the headline acceleration, which argues against treating the entire increase as domestically generated inflation.

But that does not make the policy problem disappear.

Europe is experiencing better growth at exactly the moment when imported energy inflation is reducing the

ECB's room to support that growth.

Market expectations have shifted accordingly. By September 7, investors broadly expected another ECB rate increase at the September meeting, while Deutsche Bank raised its terminal-rate forecast to 2.75% under a scenario of persistent energy pressure.

This matters for global portfolios because the old assumption of synchronized monetary easing is becoming increasingly difficult to defend.

The United States has strong employment and price pressure.

Europe has stronger-than-previously-estimated growth and an energy shock.

Japan faces its own normalization pressures.

Interest-rate exposure should therefore be treated regionally rather than as one global duration trade.

The world can slow eventually.

But central banks may need evidence of lower inflation before they are able to respond.

4. Bonds Have Become the Pressure Valve

If higher rates have not yet broken private-sector activity, where has the adjustment occurred?

One answer is the bond market.

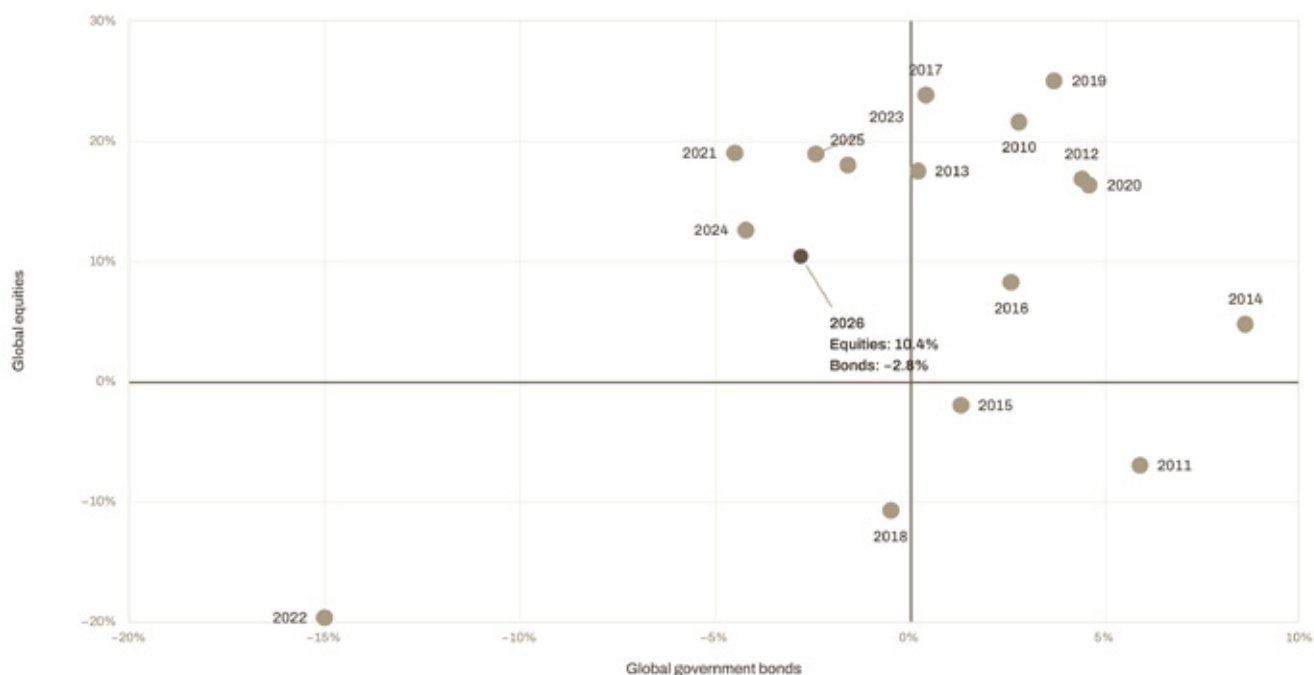
BlackRock Investment Institute estimates that global equities have returned approximately 10.4% more

than three-month Treasury bills in 2026, while global government bonds have returned approximately 2.8% less than cash.

GLOBAL MARKETS

The bond trade-off

Annual returns in excess of cash, 2010–26. Each point is one calendar year.



Source: BlackRock Investment Institute / LSEG Datastream, August 2026.

BlackRock argues that the global rate reset has restored income to fixed income, but weakened the traditional diversification role of long-duration government bonds.

More than 80% of the global bond universe now yields above 4%, according to its analysis. BlackRock therefore favors short- and medium-term government bonds over long-duration exposure.

There is an important distinction here.

Higher yields are good for the future income generated by new bond investments.

They are painful for the market value of existing long-duration bonds.

J.P. Morgan reaches a related conclusion from another angle. Its Sep-

tember analysis estimates that the recent increase in the U.S. 10-year yield has been driven predominantly by term premium and resilient economic demand, rather than simply by expectations of a more hawkish Federal Reserve.

This means long-term yields can remain elevated even if the policy-rate cycle is near its eventual peak.

Fiscal issuance, energy scarcity, private capital demand and term premium can keep the long end under pressure independently of the next FOMC decision.

For fixed-income investors, the opportunity is increasingly income without unnecessary duration.

Portfolio Implications

Equities

Higher rates become increasingly discriminatory as refinancing approaches.

We favor the characteristics most capable of absorbing expensive capital:

- low leverage;

- strong free cash flow;
- high interest coverage;
- pricing power;

internally funded investment.

The rate shock may be delayed for many corporations, but the refinanc-

Fixed Income

The opportunity in bonds has improved materially because starting yields are higher.

But that does not imply that investors need to extend aggressively into long maturity.

Short- and intermediate-duration securities can capture substantial income with less sensitivity to term-premium shocks.

Long duration becomes more attractive when investors are compensated not only for expected policy easing, but also for fiscal, inflation and supply risks.

That threshold is higher than it was in the previous economic regime.

Credit

Current spreads remain relatively tight even as future refinancing costs rise.

This increases the importance of issuer selection.

Highly leveraged borrowers whose debt matures over the next several

years face a different economic reality from companies that can refinance from internal cash flow.

Credit quality should therefore be evaluated on forward refinancing economics, not simply trailing default rates.

Liquidity

Cash and short-term securities now offer meaningful nominal income.

That changes the cost of maintaining liquidity.

Liquidity is more valuable when macroeconomic uncertainty is high

and the opportunity cost of holding it is relatively low.

It provides both income and the ability to deploy capital when higher discount rates create mispricing.

Risks to the Thesis

The first risk is that the upcoming U.S. inflation data are substantially softer than leading price indicators suggest. In that case, market expectations could move quickly back toward easing.

The second is that oil prices reverse sharply if geopolitical tensions subside, removing an important source of current inflation pressure.

The third is that August payroll strength overstates underlying labor demand. The 162,000 gain was concentrated partly in restaurants and local-government education, and

labor-force participation remains below its January level.

The fourth is delayed corporate transmission itself. If a large refinancing wave arrives faster than expected, today's economic resilience could weaken materially.

The fifth is Europe: much of its inflation acceleration is energy-related, while July retail sales already declined 0.6% month over month. A prolonged energy shock could ultimately weaken demand faster than current GDP data imply.

Our Perspective

At Astro Wallenius, we believe the key mistake would be to conclude that monetary tightening has been ineffective simply because the economy has remained resilient.

The evidence suggests something different.

Companies locked in cheap debt.

Governments absorbed more of the interest burden.

Bond investors absorbed duration losses.

Consumers and businesses continued spending.

And inflation therefore remained difficult to extinguish.

The rate shock has moved.

It has not disappeared.

The next stage of the cycle will increasingly expose the difference between borrowers who secured cheap capital when it was available and those who must refinance after that era has ended.

For portfolios, this argues for a relatively simple discipline:

quality over leverage; income over unnecessary duration; liquidity over forced positioning; and diversification across different sources of cash flow rather than dependence on a single forecast for central-bank policy.

Final Thoughts

Growth is still resilient.

Employment has strengthened.

Services demand remains firm.

Inflation risks have reappeared.

And bonds are offering more income precisely because capital is no longer cheap.

The question for investors is no longer

simply:

When will central banks cut rates?

It is:

Who still has to refinance if they do not?

That is where the next phase of monetary transmission is likely to become visible.

Glossary

Term premium: Additional compensation investors demand for holding longer-maturity debt.

Refinancing risk: Risk that debt must be replaced at materially less favorable rates or conditions.

Duration: Sensitivity of a bond's price to changes in interest rates.

Interest coverage: Ability of a company's operating earnings to cover its interest expense.

Prices Paid Index: ISM survey measure of prices businesses report paying for inputs.

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