

**Richard Bernstein**

Global Head of Macro & Customized Investing

About RBA

Richard Bernstein Advisors (RBA) specializes in longer-term, top-down, macro-driven strategies that blend macroeconomic research with quantitatively guided portfolio construction. Founded in 2009 and led by renowned strategist Richard Bernstein, RBA provides clients with tailored asset allocation solutions and thematic strategies focused on long-term structural shifts, all embedded with their intellectual capital.

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Could the U.S. be the frog in the pot?



What if the debt crisis investors have feared is not still ahead, but already here, unfolding in plain sight? In his June insight, Richard Bernstein, Global Head of Macro & Customized Investing, makes the case that the market may already be penalizing U.S. fiscal excess, not through a dramatic collapse, but through a slow burn with real consequences for investors and the broader economy.

Key Takeaways

- Rather than a single shock event, U.S. debt concerns are showing up as an insidious increase in borrowing costs tied to weaker fiscal credibility.
- Since the U.S. lost its AAA sovereign credit rating, markets have increasingly priced Treasuries as riskier than debt issued by most AAA-rated countries.
- Higher Treasury yields can ripple through the economy by increasing financing costs across mortgages, corporate borrowing, and other private-sector credit.

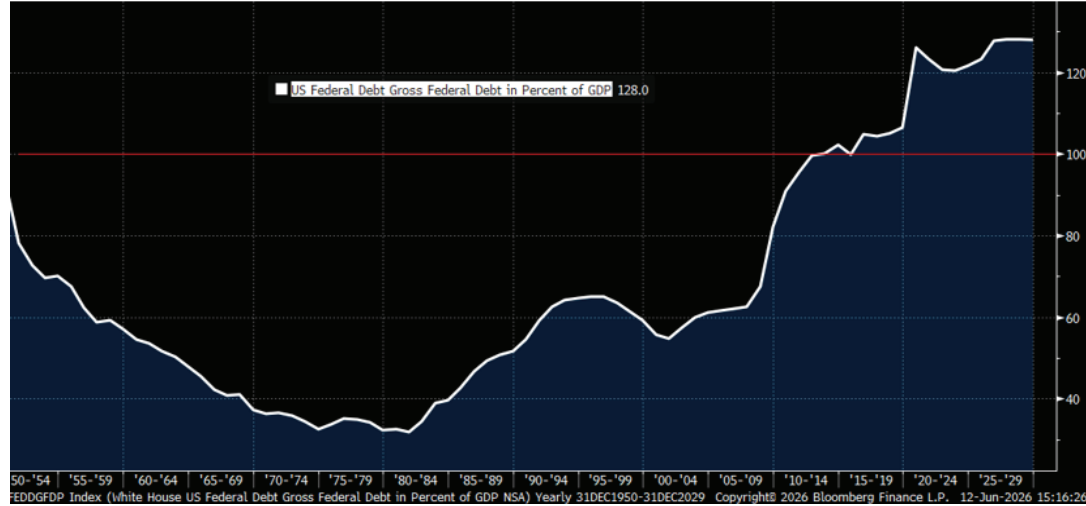
The old saying is that a frog will jump out of a pot of boiling water but will sit and cook if one turns up the heat slowly. The idea is that slow, insidious temperature increases go unnoticed relative to massive shocks.

Some investors have been worried for years about a day of reckoning for U.S. debt. Consensus has been that investors will wake up one day and the financial market will be unwilling to hold the ever-increasing amount of U.S. government debt (Exhibit 1).

EXHIBIT 1:

U.S. federal debt as a percent of GDP

(Dec. 1950 – Dec. 2025, with projected ratio to Dec. 2029)



Source: RBA/JHI, Bloomberg Finance L.P.

The day of reckoning analogy seems wrong to us. In our view, the markets have been slowly penalizing the U.S. for its fiscal imprudence. The U.S. economy has been punished for more than a decade (importantly, through both Democratic and Republican administrations). The result is that corporations, municipalities, and individuals have been paying higher interest rates than they otherwise might have paid.

An economy doesn't quickly become uncompetitive, and the added interest expense the private sector has had to pay relative to similar borrowers in other countries has almost certainly contributed to the U.S.'s gradual loss of productive market share.

There is no boiling pot of water that will cause the U.S. to suddenly realize its mistake. Rather, the markets are slowly turning up the heat.

The U.S. isn't AAA rated anymore

Regardless of whether a borrower is a country, a company, or an individual, lenders charge higher interest rates to lower-quality, riskier borrowers to offset the risk of potential delinquencies or default.

Investors price lower-quality bonds so the bonds have higher yields to compensate for the additional risk. Generally, AAA rated bonds would have lower yields than BBB rated bonds, which in turn would have lower yields than junk bonds.

Individuals' borrowing is not rated by an agency but by FICO score or VantageScore rating. Lower scores denote riskier borrowers, and those borrowers' higher rates offset the perceived increased risk of default.

Although 2011's initial downgrade of U.S. government debt from AAA was treated by many as a non-event, the markets almost immediately began to re-price U.S. debt as riskier relative to countries that maintained AAA ratings.

Exhibit 2 shows the spread between the U.S. 10-year Treasury and German 10-year notes. German bonds were priced as riskier (i.e., higher yields) in the early portion of the chart because of the spending that was anticipated for reunification between East and West Germany. After that period, the yields of U.S. and German bonds fluctuate back and forth.

However, U.S. bonds began to trade at consistently higher yields once the U.S. was downgraded. German bonds are still rated AAA and continue to offer lower yields than Treasuries (i.e., borrowing costs for the German government are lower than that of the U.S. government).

EXHIBIT 2:
U.S. vs. Germany: 10-year government bond spreads
 (10 Aug. 1988 – 12 Jun. 2026)

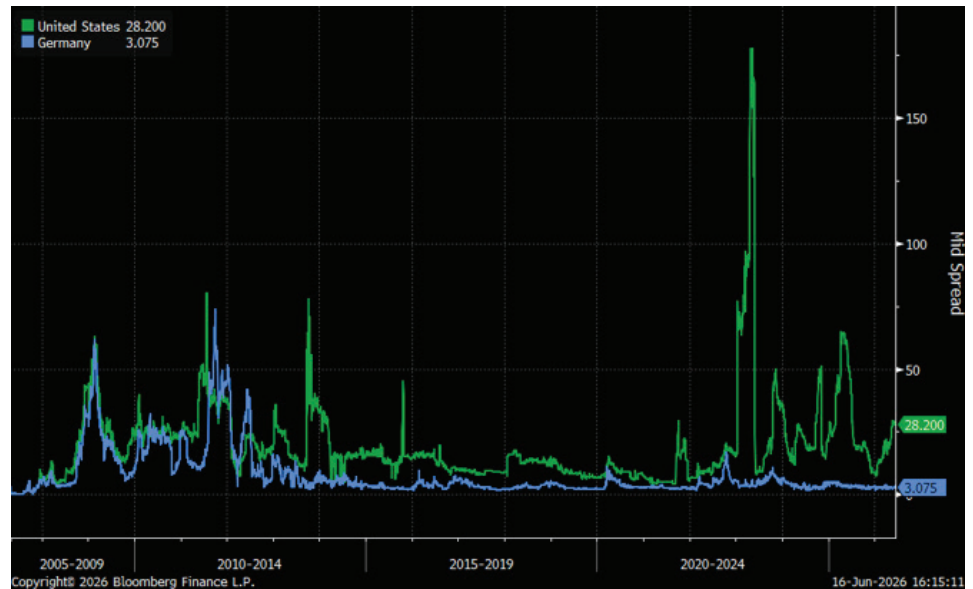


Source: RBA/JHI, Bloomberg Finance L.P.

One could argue that there are many reasons why spreads could be wider, but the credit default swap (CDS) market has also priced U.S. Treasuries as incrementally risky. (A CDS is a hedge against default, and CDS spreads are measured in basis points.)

Exhibit 3 shows one-year CDS spreads for U.S. and German debt. Like the earlier spread chart, CDS spreads are roughly similar between the two countries. However, CDS spreads on US debt are marginally higher after the ratings downgrade and has never been lower than Germany’s since that downgrade.

EXHIBIT 3:
U.S. vs. Germany: 1-year CDS spreads
 (28 Sep. 2006 – 16 Jun. 2026)



Source: RBA/JHI, Bloomberg Finance L.P.

De facto versus de jure “risk-free rate”

The U.S. Treasury market is the deepest and most liquid bond market in the world, and, as such, is often considered to set the “risk-free rate”. U.S. Treasuries were for decades both the de facto and de jure “risk-free rate” for global assets. That isn’t quite true anymore.

Because of the breadth and depth of the U.S. Treasury market versus the bond markets of AAA rated countries, the U.S. Treasury has remained the de facto “risk-free rate”. However, it has lost its status as the de jure “risk-free rate”: Many other countries are rated AAA and are considered less risky than the U.S.

Exhibit 4 (compiled by xAI) shows the credit ratings and 10-year yields of AAA rated countries versus the U.S. Eight of the nine AAA rated countries presently borrow at yields lower than the U.S.

EXHIBIT 4:
U.S. vs. AAA rated countries
 (as of 12 Jun. 2026)

AAA-Rated Sovereign 10-Year Government Bond Yields (Sorted by Spread vs. US)

Country	S&P Rating	10Y Yield	Spread vs. US 10Y (bp)
Switzerland	AAA	0.40%	-408 bp
Singapore	AAA	2.02%	-246 bp
Sweden	AAA	2.84%	-164 bp
Denmark	AAA	2.89%	-159 bp
Germany	AAA	2.99–3.00%	-148 bp
Netherlands	AAA	3.11%	-137 bp
Canada	AAA	3.41%	-107 bp
Norway	AAA	~4.37%	~90 bp
Australia	AAA	4.82%	+35 bp
United States	AA+	4.46–4.48%	Benchmark (0 bp)

Primary data source: *World Government Bonds* (updated June 12, 2026), cross-checked with Trading Economics and Bloomberg. worldgovernmentbonds.com

The entire U.S. economy has suffered

Sovereign debt in most developed markets is generally considered safer than private-sector debt. Because private-sector yields are based on government yields plus a risk premium, an increase in sovereign debt yield accordingly translates to higher borrowing costs for the private sector.

The downgrade of U.S. debt and the resulting higher government borrowing costs has translated into higher borrowing costs for the entire U.S. economy.

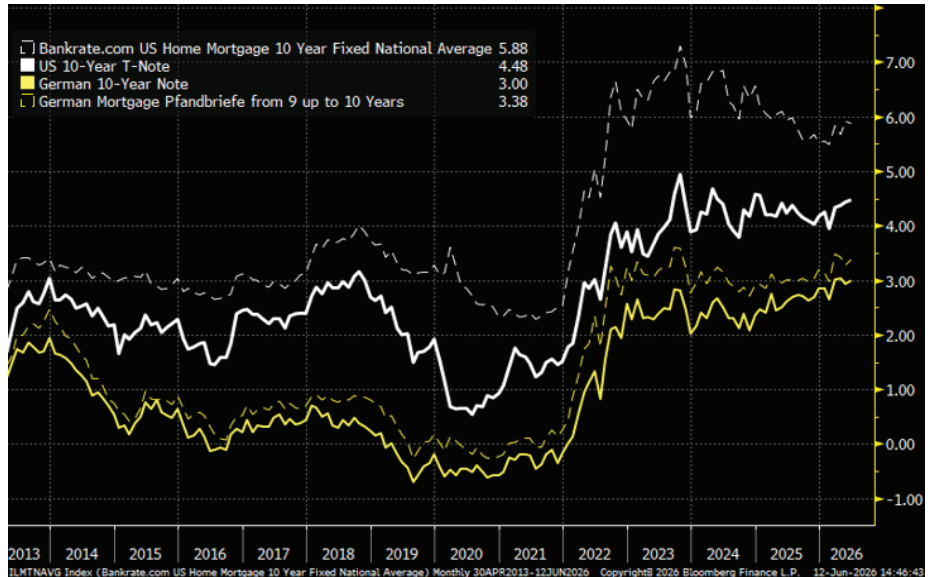
Exhibit 5 compares mortgage rates in the U.S. to those in Germany. Admittedly, these comparisons do not use totally comparable mortgage data, but the story remains important. Mortgage rates in both countries are, of course, higher than government debt yields because individuals are not as creditworthy as the government.

However, mortgage rates in Germany are lower than mortgage rates in the U.S. because U.S. mortgages are based on the yield of the U.S. 10-year Treasury, which has a higher yield than Germany’s 10-year bund.

Whether this chart represents a perfect comparison or not misses the point. The chart does reflect higher borrowing costs in the U.S. because of higher Treasury yields, which are directly related to Washington’s fiscal imprudence.

The entire U.S. economy has been paying a penalty.

EXHIBIT 5:
U.S. vs. Germany: Mortgage Rates
 (30 Apr. 2013 – 12 Jun. 2026)



Source: RBA/JHI, Bloomberg Finance L.P.

The frog had a spine

When a company is in financial trouble, a standard route to repair the damage includes increasing revenues and cutting costs. Unless the U.S. actively decides to follow the path of an emerging market and fosters inflation to alleviate debt issues, the standard route to improve the nation’s balance sheet will be increasing revenue and cutting costs.

However, both Democrats and Republicans refuse to admit this reality. Republicans refuse to raise taxes (i.e., increase revenues) and Democrats refuse to rationalize spending (i.e., cutting costs). Both are necessary, but each party blames the other for the country’s debt problems. Each party’s political dogma apparently is more important than lowering borrowing costs for Americans.

Frogs are vertebrates. Their skeletal system aids them in jumping out of pots of hot water. Investors should certainly hope Washington finds its spine and jumps out of the already warming pot – and does so before it reaches the boiling point.

DEFINITIONS:

10-Year Treasury Yield is the interest rate on U.S. Treasury bonds that will mature 10 years from the date of purchase.

Basis point: One basis point (bp) equals 1/100 of a percentage point, 1bp = 0.01%.

Credit rating: A score given by a credit rating agency such as S&P Global Ratings, Moody's and Fitch on the creditworthiness of a borrower. For example, S&P ranks investment grade bonds from the highest AAA down to BBB and high yields bonds from BB through B down to CCC in terms of declining quality and greater risk, i.e. CCC rated borrowers carry a greater risk of default.

Credit default swap (CDS): A form of derivative contract between two parties used to manage the credit risk of a bond. The buyer makes regular payments to the seller, while the seller agrees to pay off the underlying debt if there is a default on the bond. A CDS is considered a hedge against non-payment and is also a tradable security. This allows a fund manager to take positions on a particular issuer or index without owning the underlying security or securities. A CDS may expose investors to counterparty risk, liquidity risk, valuation risk, and the potential for losses that exceed the initial investment. Market disruptions or a counterparty's failure to perform may impact the effectiveness of a CDS strategy or result in unexpected losses. There can be no assurance that the use of CDS will achieve its intended objective.

Credit spread: The difference in yield between securities with similar maturity but different credit quality. Widening spreads generally indicate deteriorating creditworthiness of corporate borrowers, and narrowing indicate improving.

Default: The failure of a debtor (such as a bond issuer) to pay interest or to return an original amount loaned when due.

Fiscal policy: Refers to government policy relating to setting tax rates and spending levels. It is separate from monetary policy, which is typically set by a central bank. Fiscal austerity refers to raising taxes and/or cutting spending in an attempt to reduce government debt. Fiscal expansion (or 'stimulus') refers to an increase in government spending and/or a reduction in taxes.

High yield bond: Also known as a sub-investment grade bond, or 'junk' bond. These bonds usually carry a higher risk of the issuer defaulting on their payments, so they are typically issued with a higher interest rate (coupon) to compensate for the additional risk.

Inflation: The rate at which the prices of goods and services are rising in an economy. The Consumer Price Index (CPI) and Retail Price Index (RPI) are two common measures.

Investment grade bond: A bond typically issued by governments or companies perceived to have a relatively low risk of defaulting on their payments, reflected in the higher rating given to them by credit ratings agencies.

Sovereign bond/government bond: Bonds issued by governments to pay off debt or finance spending. They are typically backed by a country's capacity to levy taxes on its citizens and/or capacity to print money.

Treasuries/US Treasury securities: Debt obligations issued by the US government. Treasury bills and US government bonds are guaranteed by the full faith and credit of the US government. They are generally considered to be free of credit risk and typically carry lower yields than other securities.

About Richard Bernstein Advisors

Richard Bernstein Advisors (RBA) specializes in longer-term, top-down, macro-driven strategies that blend macroeconomic research with quantitatively guided portfolio construction. Founded in 2009 and led by renowned strategist Richard Bernstein, RBA provides clients with tailored asset allocation solutions and thematic strategies focused on long-term structural shifts, all embedded with their intellectual capital. RBA's investment insights as well as further information about the firm and products can be found at www.RBAdvisors.com.



IMPORTANT INFORMATION

Alternative investments include, but are not limited to, commodities, real estate, currencies, hedging strategies, futures, structured products, and other securities intended to be less correlated to the market. They are typically subject to increased risk and are not suitable for all investors.

Derivatives can be more volatile and sensitive to economic or market changes than other investments, which could result in losses exceeding the original investment and magnified by leverage.

Equity securities are subject to risks including market risk. Returns will fluctuate in response to issuer, political and economic developments.

Fixed income securities are subject to interest rate, inflation, credit and default risk. As interest rates rise, bond prices usually fall, and vice versa. High-yield bonds, or “junk” bonds, involve a greater risk of default and price volatility. Foreign securities, including sovereign debt, are subject to currency fluctuations, political and economic uncertainty and increased volatility and lower liquidity, all of which are magnified in emerging markets.

Financials industries can be significantly affected by extensive government regulation, subject to relatively rapid change due to increasingly blurred distinctions between service segments, and significantly affected by availability and cost of capital funds, changes in interest rates, the rate of corporate and consumer debt defaults, and price competition.

Technology industries can be significantly affected by obsolescence of existing technology, short product cycles, falling prices and profits, competition from new market entrants, and general economic conditions. A concentrated investment in a single industry could be more volatile than the performance of less concentrated investments and the market as a whole.

Private debt/credit refers to direct lending or debt financing outside of traditional banking, typically involving non-publicly traded companies, and comes with increased risk including limited liquidity, reliance on the borrower’s financial health, and less regulatory oversight compared to traditional bank lending.

Private equity investments are speculative and involve a high degree of risk. These strategies are typically illiquid, rely on estimated or unaudited valuations, and may be sensitive to shifts in financing conditions. Returns often depend on access to debt or equity markets, which can be constrained during periods of stress. Regulatory scrutiny of private markets continues to evolve, potentially increasing compliance burdens and limiting flexibility. Long holding periods, limited transparency, and reliance on manager execution further contribute to the elevated risk profile.

Swap agreements are derivative contracts that provide synthetic exposure to a reference asset or index and may introduce counterparty default risk, valuation uncertainty, and leverage effects. Returns may differ from the reference exposure due to fees, collateral requirements, or imperfect correlation. Swap exposures may be less liquid or more volatile during periods of market stress.

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