



Wit's End

"The world has no room for the man who thinks everything is too little." Juvenal

Financial markets are being reshaped by two powerful narratives that can be seen either as fascinating structural shifts or as an elaborate attempt to keep investors on their toes.

First, there is the long-running "debasement trade", which has finally made its way from niche commentary into the financial mainstream. Second, there is the AI investment boom, whose scale, ambition and costs would make even a Victorian railway magnate raise an eyebrow.

Together, these narratives have created an environment in which nominal asset prices may remain resilient, while real (that is, inflation-adjusted) returns become harder to secure. Valuation disci-

pline and careful portfolio construction are absolutely essential. Put simply: it is an excellent time to keep one's wits about one's wealth.

The term "debasement trade" has recently surged into public discourse, typically alongside charts of risk assets marching upwards. Commentary proclaims that investors are "seeking safety from government overreach, high inflation and weakening currencies". One could be forgiven for assuming this is a wholly new phenomenon. It is not.

Analysts such as Lyn Alden have been pointing out for years that we have been living through a multi-decade erosion of money's purchasing power. US government bonds - once viewed as the safest of all securities - have delivered their worst

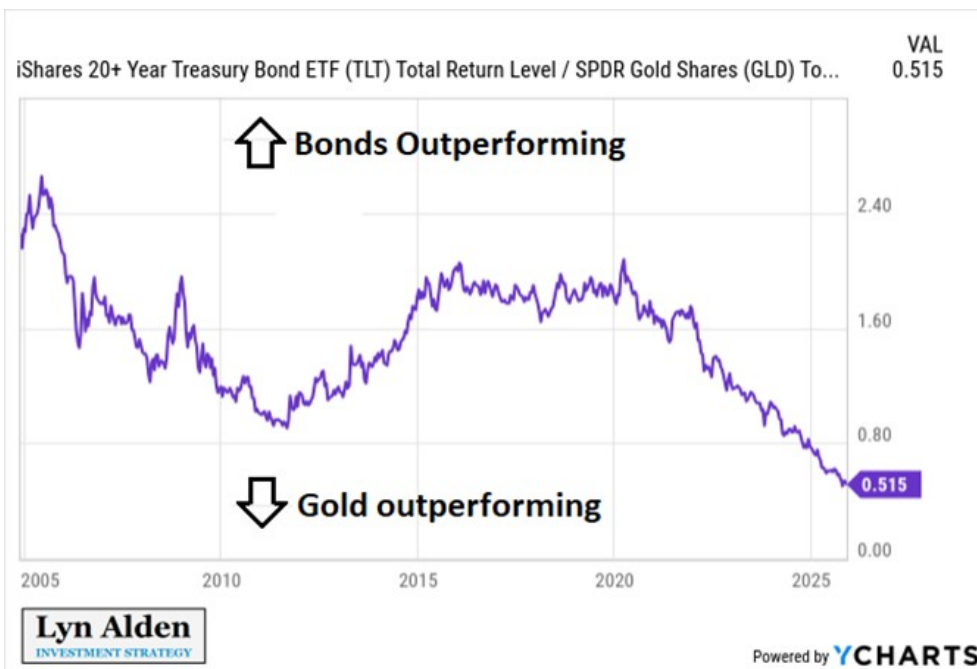
five-year real returns in living memory. Investors who avoided bonds and instead held almost any other risk asset - gold, stocks, property, bitcoin, or fine art - have enjoyed a tailwind.¹ (See chart)

The roots of this debasement stretch back to the abandonment of gold pegs and the embrace of fiat money. Once currencies floated freely and policymakers acquired the flexibility to 'manage' economic cycles, the supply of money began growing far faster than the supply of real goods and productive assets. A humble tin of Campbell's soup illustrates the maths more honestly than any index: what cost 10 cents fifty years ago now sells for \$1.88. Inflation measures can be manipulated; soup prices tend not to lie.

This monetary backdrop coincided with a 44-year persistent decline in interest rates, lifting asset valuations and making borrowing irresistibly cheap. Household net worth surged relative to income and GDP, though disproportionately for those who already owned assets.

But that era is ending. Rates may not rise dramatically from here, but the secular downtrend seems to have been broken. The easy tailwind behind equities, property, and other long-duration assets is fading. Debasement will continue but it is unlikely to be accompanied by ever-falling interest rates.

After years of Quantitative Easing



Wit's End (cont'd)

(QE) and fiscal largesse, the Federal Reserve has been shrinking its balance sheet. This month, the Fed is set to discontinue quantitative tightening altogether by reinvesting maturing mortgages into Treasuries rather than letting them run off. Cutting interest rates to ease financial conditions while simultaneously shrinking the balance sheet was always walking a fine line. These two policies work at odds with one another, so a pivot was inevitable.

Moving the balance sheet from \$9 trillion in mid-2022 to \$6.5 trillion today while simultaneously raising rates by 500 basis points, without a crash, is about as graceful a monetary manoeuvre as one could reasonably hope for. Yet this equilibrium is likely to be short-lived.

Plumbing issues are emerging in money markets. Recent corporate tax payments and Treasury settlements have drained cash from the banking system, pushing bank reserves below the level at which the overnight repo market functions smoothly. The gears of the credit system tend to operate best when reserves exceed roughly 10 per cent of nominal GDP. We have now dipped below that threshold.²

Should these gears start to grind, the Fed will have little choice but to begin adding to its balance sheet in the months ahead. If strains persist, QE may return sooner rather than later. The key question will be whether GDP growth keeps pace with that expansion, maintaining the ratio that ultimately anchors financial stability. Thus, even as the Fed aims for a period of balance-sheet neutrality, the system may not allow it for long.

Meanwhile, U.S. regulators have begun relaxing capital constraints on large banks. By easing the enhanced Supplementary Leverage Ratio, institutions such as JPMorgan and Goldman Sachs will be able to expand their balance sheets more freely. Whether this is reassuring depends on one's view of

the private sector's historical driving record. Whenever private credit creation takes the lead, cycles tend to become more volatile and valuations matter more. It is an environment that rewards prudence over exuberance - an unpopular stance in certain corners of the financial media, but a necessary one nonetheless.

Overlaying all of this is the astonishing surge in AI-related investment. Hundreds of billions are being poured into data centres, GPUs, electrical infrastructure, and cooling systems. The scale of this spending is remarkable; the economics, less so. These are not long-lived assets, and require constant reinvestment. To justify current levels of capital expenditure, AI revenues must rise dramatically. Some industry figures argue that once depreciation is accounted for, required revenues must exceed two trillion dollars annually. Even the most enthusiastic Silicon Valley optimist might wish to sit down after hearing that number.

Yet AI risks abound. These days there are significant bottlenecks in AI data centre power generation, in high bandwidth memory and in fibre optics. Leverage adds another layer of risk: companies are now borrowing heavily to fund expansion; suppliers are extending credit to customers; customers are extending promises to shareholders. AI companies are also investing in suspect circular deals - conduct suggestive of an increasingly risky market.

With all the excitement surrounding AI, US mega-cap valuations have accelerated to stratospheric levels reminiscent of the late 1990s telecom boom (minus the dial-up modem noise). Expected long-term returns from American large-cap equities are correspondingly slim. Meanwhile opportunities, in Europe, Asia and Latin America, and in energy and other commodities offer more reasonable prospects.

Consumer sentiment in the US remains lacklustre despite record-high equity

indices. This peculiar combination is characteristic of fiscal dominance, in which nominal asset prices rise while households feel poorer in real terms.

A benign interlude without a major downturn has also fostered 'disaster myopia': a creeping belief that bad things simply do not happen anymore. Households across the developed world have poured more than \$3 trillion into equities in recent years - the largest inflow on record - with over 30 pc of American household assets now fully exposed to the stock market. A prolonged market correction would be painful indeed.³

We are entering a period in which debasement persists but the structural tailwinds of falling rates and rising valuations no longer provide effortless gains. Private-sector balance sheets will once again drive credit creation, bringing sharper cycles and greater sensitivity to price. The AI revolution will unfold, but its profits may arrive more slowly than its bills. All the while, excitable investors have been displaying speculative behaviour.

In such an environment, three interdisciplinary actions matter above all: valuation discipline, as enthusiasm is not a substitute for cash flow; diversification, particularly towards assets priced for genuine long-term returns; and risk management, because market volatility tends to increase when the private sector is back at the wheel.

It's all fun and games ... until the narratives meet the maths. Keeping one's wits is more important than ever.

Sources:

1. Lyn Alden, "The So-Called "Debasement Trade", [Lyn Alden Investment Strategy](#), 3 December 2025
2. David Bahnsen, [Dividend Café](#), 4 December 2025
3. [The Economist](#), "Recessions have become ultra-rare", 10 November 2025
4. Chart: Lyn Alden, "The So-Called "Debasement Trade", [Lyn Alden Investment Strategy](#), 3 December 2025