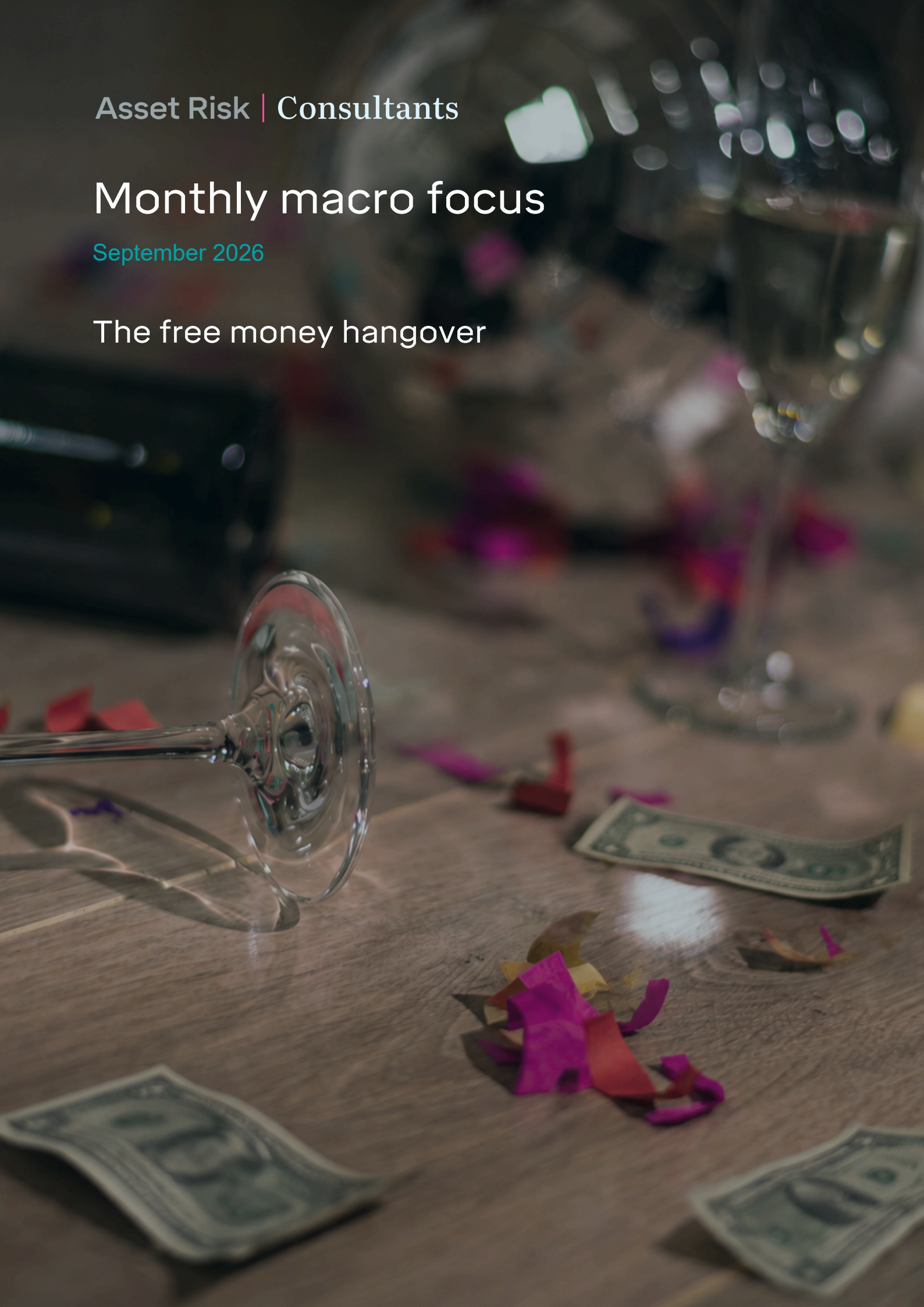


Asset Risk | Consultants

Monthly macro focus

September 2026

The free money hangover



Macro focus

The free money hangover

Fifteen years of cheap money changed how investors thought about risk and return. Now that the tide has turned, valuations, discipline and selectivity matter again.

Long-term developed market government bonds are reaching yield levels not seen for decades. For anyone too young to remember life before the global financial crisis, this is a significant change. Yet the era of extremely low interest rates was the anomaly.

A little over five years ago I fixed my mortgage at 1.49%. This was an extraordinarily good deal. So good that I took the longest fixed term available. In Jersey, that meant five years. Had someone offered me 25 years, I would have signed the paperwork before they had finished printing it. At the time, others did not find this cost of borrowing unusual. Many had become accustomed to zero central bank rates, quantitative easing and ever-cheaper borrowing costs. Some had known little else in their adult lives. Even "unconventional monetary policy" came to seem conventional.

The age of free money left behind more than expensive assets. It left behind a world in which future returns may be harder to earn and selectivity matters once again.

On reflection, the decade and a half following the global financial crisis increasingly feels like a financial binge. Interest rates collapsed. Central bank balance sheets ballooned. Debt became cheaper. House prices rose. Equity valuations expanded. Private markets flourished. Governments borrowed heavily. Investors searched relentlessly for returns. Every problem seemed solvable with another dose of liquidity.

Like most binges, it was tremendous fun while it lasted.

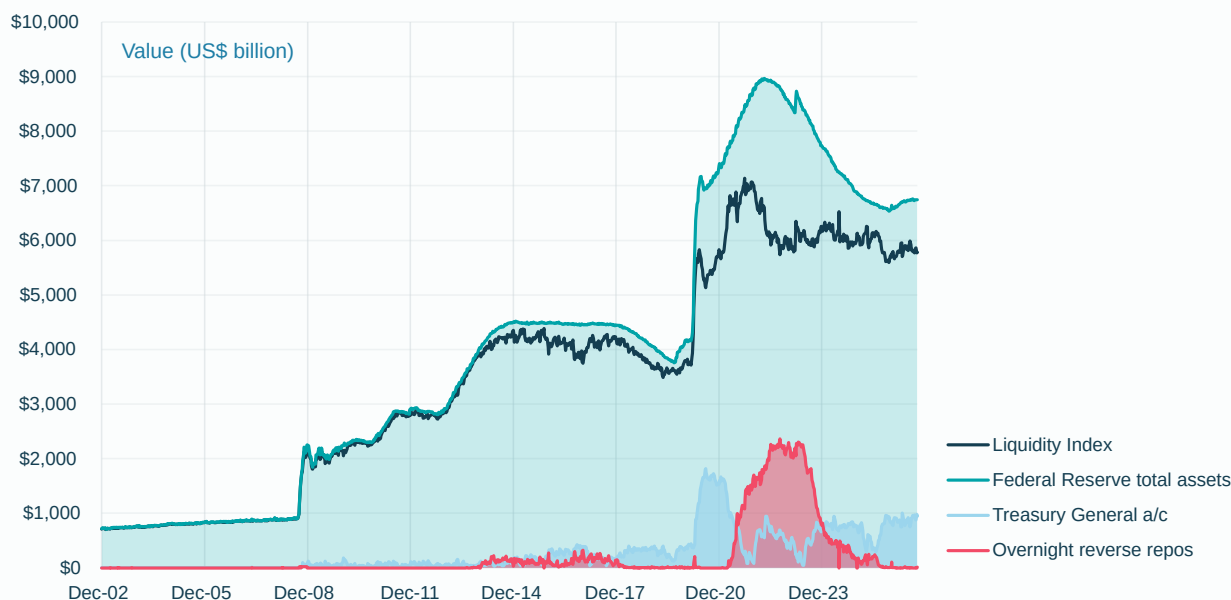
The period even developed its own mythology. The "magic money tree" started life as a political insult before slowly becoming a serious policy debate. Governments appeared able to borrow extraordinary sums without obvious consequences. Central banks created money electronically on a massive scale. Inflation remained subdued, leading many to conclude that the old economic constraints no longer applied. Yet low rates were sustainable only while inflation stayed under control. Once inflation returned, central banks lost the freedom to support growth, asset prices and government borrowing simultaneously.

Then came the pandemic.

Stimulus cheques landed directly in bank accounts. Furlough schemes appeared almost overnight. Fiscal and monetary policy measures were deployed at a scale few would previously have thought possible. Milton Friedman's famous concept of helicopter money moved from academic thought experiment to something that looked uncomfortably close to reality. The quantitative easing in response to the pandemic was larger, and far faster, than that deployed after the financial crisis.

The bounce back in the economy and in asset prices was impressive. Liquidity reached its high-water mark towards the end of 2021. Central banks then began to reverse quantitative easing and raise interest rates.

The liquidity tide has turned



Federal Reserve Bank of St. Louis, Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York. Weekly data in USD. ARC calculation.

Fed total assets The total value of investments and loans held by the US central bank. When this grows, more money is generally flowing through the financial system.

Treasury General account The US government's bank account at the Federal Reserve. Money held here is not circulating in the wider economy, so a rising balance usually reduces available cash.

Overnight reverse repos A facility where financial institutions temporarily park cash with the Federal Reserve, usually overnight. While parked, that money is not available elsewhere in financial markets.

Liquidity Index A simple estimate of the cash available to financial markets: Fed assets minus government cash and cash parked overnight at the Fed. A rising index suggests liquidity is increasing; a falling index suggests it is tightening.

The hangover from the age of free money has been felt in different ways. Consumers discovered that super-cheap mortgages were not a permanent feature of life. Governments found that debt servicing costs matter again. Public equity investors were reminded that valuations can fall as well as rise. Bond investors experienced a drawdown that many had considered almost impossible.

Many published long-term capital market assumptions now point to lower future returns from listed shares, largely because valuations remain elevated.

That may seem counterintuitive when risk-free rates are materially higher than they were a few years ago. Simple capital market theory suggests expected returns should also have risen.

Private markets face a related problem: the hangover has been slower to appear. I recently attended several private equity conferences and spoke at one of them. The discussions repeatedly returned to the same conclusion. Experienced practitioners generally expect returns over the next decade to be lower than those achieved during the previous two decades.

With hindsight, 2021 appears to have been an unusually favourable year for exits and a much harder environment in which to deploy new capital. The consequences of deals completed at the height of the post-Covid liquidity boom have yet to be fully recognised.

Private equity benefited from three powerful tailwinds: operational improvement, cheap borrowing and rising valuation multiples. Operational improvement remains available. The other two can no longer be assumed. Strong historical returns have attracted substantial capital to private markets. As competition for assets increases, the illiquidity premium may be eroded.

In other words, the tide is no longer doing as much of the work.

For much of the post-crisis era, investors benefited from a remarkably supportive backdrop. Falling discount rates, abundant liquidity and rising valuations provided a tailwind across a wide range of asset classes. It was not impossible to make mistakes, but markets were often forgiving.

Despite September's setback, equity markets remain buoyant. Credit spreads remain relatively tight. Risk appetite is generally healthy. Much of the enthusiasm centres on what increasingly looks like a generational investment cycle around artificial intelligence infrastructure.

The scale of spending on data centres, semiconductors, power generation and digital infrastructure is extraordinary. Future historians may look back on this period much as we look back on the construction of railways, electrification or the internet.

For much of the previous decade, investors looked to ever-cheaper money. Today they are looking to productivity, innovation and technological progress. This is probably healthier, though as we've written before, [today's diet might be overly focused on chips](#). When liquidity was abundant and valuations were rising, selectivity sometimes appeared overrated. Rising markets have a habit of flattering both investments and investors.

Capital is scarcer, cash once again provides a return and debt carries a meaningful cost. The distinction between good assets and mediocre ones therefore matters more.

Opportunities remain plentiful. We may be in the middle of one of the largest technological investment cycles in modern history. This spending could provide a powerful tailwind, but it is unlikely to benefit every investment equally.

The age of free money rewarded broad exposure. The next phase is more likely to reward judgement, discipline and selectivity.



Dr James R Cooke, CFA
Director of Research
james.cooke@assetrisk.com

Market commentary

Energy markets returned to the forefront in September after damage to Saudi Arabia's East-West Pipeline raised concerns about the security of Middle Eastern oil exports.

Oil prices rose back above USD 100 a barrel, reviving fears that inflation could prove more persistent than investors had hoped. Rising inflation expectations contributed to higher government bond yields as markets priced in further interest rate increases. Equity markets struggled against this backdrop, although gains among the largest technology companies and continued optimism surrounding artificial intelligence provided some support for headline indices.

Looking ahead, markets may increasingly focus on the political consequences of sustained energy inflation. With US midterm elections on the horizon, rising gasoline prices are unlikely to be welcomed in Washington. History suggests voters are often more attentive to prices at the pump than developments in distant conflicts, creating an additional incentive for policymakers to seek stability in energy markets.

In the US, CPI rose by 0.4% in August and 3.4% over the previous 12 months. The Federal Reserve raised interest rates for the first time since 2023, increasing them by 25 basis points to a range of 3.75% to 4.00%, and indicated that further policy tightening may be required. The US 30-year Treasury bond yield rose to 5.6%, its highest level since June 2002. Labour market conditions softened, with nonfarm payrolls rising by just 29,000 in September, below expectations, and the unemployment rate rising slightly to 4.2%.

Higher inflation pushes bond yields higher

In the UK, investor attention increasingly focused on fiscal policy ahead of Chancellor John Healey's first Budget on 28 October. Inflation rose to 3.1% in the 12 months to August, up from 2.9% in July, with motor fuel prices providing the largest contribution to the increase. The Bank of England maintained the Bank Rate at 3.75% during September, whilst investors continued to price in interest rate increases. The global selloff in the fixed income markets pushed the 30-year bond yield to its highest level since 1998, at close to 6.0% by the end of the month.

Emerging markets outperform as developed equities retreat

In the eurozone, inflationary pressures increased during September, with the flash estimate putting inflation at 3.8% in September, the highest in three years, up from 3.2% in August. Labour market conditions remained relatively stable with the euro area unemployment rate holding at 6.4% in August. European bond markets faced a challenging month as the European Central Bank raised its three key interest rates by 25 basis points. Sentiment was further weighed down by concerns over German fiscal spending and rising sovereign debt levels. European equities also lagged their global peers.

Glossary of terms

This glossary explains selected investment and economic terms used in this publication. The descriptions are simplified and may not cover every technical meaning.

Basis point (bp)	One-hundredth of a percentage point. A rise of 25 basis points means an increase of 0.25 percentage points.
Capital market assumptions	Estimates of the future returns, risks and relationships between different types of investment. They are used to support long-term investment planning and are not guarantees.
Credit spreads	The additional yield offered by a corporate or other higher-risk bond compared with a government bond of a similar maturity. Narrow or “tight” spreads usually indicate that investors perceive relatively little additional risk.
Discount rate	The rate used to express the present value of money expected to be received in the future. Higher discount rates generally reduce the present value placed on future income.
Equity valuation	An assessment of what a company or share market is worth, often measured by comparing its price with earnings, assets or expected cash flows.
Fiscal policy	Government decisions about taxation, spending and borrowing.
Government bond yield	The annual return indicated by the market price of a government bond. Bond yields generally rise when bond prices fall, and fall when bond prices rise.
Illiquidity premium	The additional return investors may expect for holding an investment that cannot easily or quickly be sold. This premium is not guaranteed.
Inflation expectations	The rate of inflation that investors, consumers or businesses expect over a future period. These expectations can influence interest rates and bond yields.
Liquidity	The availability of money and credit in the financial system. It can also describe how easily an investment can be bought or sold without materially affecting its price.
Monetary policy	Actions taken by a central bank to influence inflation and economic activity, principally through interest rates and the supply of money.
Multiple expansion	An increase in the price investors are willing to pay for a given level of company earnings or other financial measure. It can lift investment returns even when the underlying business has not grown at the same rate.
Quantitative easing (QE)	A policy under which a central bank buys financial assets, usually government bonds, to increase liquidity and reduce borrowing costs.
Risk appetite	Investors’ willingness to accept uncertainty and the possibility of loss in pursuit of higher returns.
Risk-free rate	The theoretical return available from an investment with negligible risk of default. Government bond yields are commonly used as a practical reference point.
Sovereign debt	Money borrowed by a national government, usually through the issue of government bonds.
Tailwind	A condition that supports investment performance, such as falling interest rates, improving profits or rising valuations.
Valuation multiple	A measure comparing an investment’s price with a financial measure such as earnings, revenue or cash flow. A higher multiple means investors are paying more for each unit of that measure.
Yield	The income generated by an investment, usually expressed as a percentage of its price. For bonds, yield reflects the relationship between the bond’s price, interest payments and repayment value.

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