CARLYLE

Rules of relevance



Executive summary

Everyone's heard of confirmation bias. Literary theorist Paul Fry takes things a step further: he argues that everything we perceive is preselected based on our background, training, and analytical habits. Bias implies distortion, spinning data we've already seen. Fry describes an earlier operation, in which our minds build "rules of relevance" that render some information functionally invisible before we ever get the chance to interpret it.

The AI investment boom illustrates the problem. An engineer at an AI lab views the explosive growth in compute capex as a rational response to a binding technical constraint; a statistician sees an accelerating series with no precedent in the sample, and a distribution of outcomes that widens by the day. Neither is wrong. They were simply trained to notice different things.

In *Rules of relevance*, our newest whitepaper, we explore how such “learned blindness” can become a major source of market risk in periods of rapid technological and geopolitical change. It may not be changes in the data that trigger market volatility ahead, but a change in the lens through which investors interpret that data.

Key takeaways:

- **AI optimism may be obscuring risk.** Markets largely reflect the technologist’s view that unprecedented AI investment is rational and necessary. A different analytical lens sees an accelerating trend with little historical precedent and a much wider range of potential outcomes.
- **AI is also helping reset the outlook for interest rates.** Investors spent years expecting rates to return to pre-pandemic levels even as the forces that kept them low disappeared. The enormous capital requirements associated with AI are making the connection between capital demand and borrowing costs harder to ignore.
- **The unwinding of globalization has a hidden cost for the US.** Global trade did more than lower the cost of goods. It created significant demand for dollar-denominated assets, helping finance US deficits and mortgages more cheaply. As global trade retreats, that financing benefit retreats with it.
- **Europe may have paid a hidden price for the “peace dividend.”** The decline of Europe’s domestic defense-industrial base coincided with its waning technological relevance, while defense investment in the US, China and Israel generated significant commercial technology spillovers.
- **The bigger investment risk may be a change in perspective, not a change in the data.** In periods of rapid technological and geopolitical change, markets can move sharply when investors abandon an established framework and begin interpreting the same facts through a different lens.

Rules of relevance

THE "PRESELECTIVITY OF ALL PERCEPTION"

Surface level readings are encouraging – strong market performance, robust economic activity, record earnings growth. But we feel the rumbling below our feet and wonder what seismic changes in technology and geopolitics portend for the economy and markets.

Everyone's heard of confirmation bias, but literary theorist Paul Fry takes things one step further.[1] He argues that everything we perceive is preselected based on our background, experiences, and analytical methods or intellectual discipline. Bias implies distortion, or efforts to "spin" new data; Fry suggests an earlier operation, where our minds create "rules of relevance" that render certain information functionally invisible. Analysis does not begin with the conscious interpretation of a fact, but in the act of noticing one fact rather than another.

Fry's framing seems especially apt for our current moment. When someone brings up "AI," it's not immediately obvious whether they're referencing its capabilities, stock market impact, or underlying economics. Interest rate discussions often hinge on whether the interlocutor focuses on fiscal variables – fiscal deficits, debt levels, and their interaction with high-grade corporate funding needs – or metrics of more traditional relevance to monetary policy like prices and employment. And what data are best suited to parse the investment implications of something as nebulous as geopolitical cleavage? Disagreements now seem to turn on which observations count as evidence rather than competing interpretations of the same evidence.

When an interpretive framework is shared among market participants, volatility is bounded; uncertainty attaches to the next realization of a variable, not to which variables matter. But when the framework itself is at issue, valuations disperse and asset prices become susceptible to "jumps" as the same phenomenon gets viewed through a new lens.

RIVAL INTERPRETATIONS OF THE AI CAPEX BOOM

Preselectivity could be understood as a form of "learned blindness" where expertise in a certain discipline or school of thought cultivates an intrinsic sense of what variables matter and which others can be ignored. For example, imagine two people of equally impressive backgrounds trying to make sense of the explosive growth in AI compute capex (Figure 1). One is a scaling engineer at a frontier lab. The other is a time series statistician. Their specialized knowledge leads them to see a different object: the scaling engineer sees a rational effort to relax a technically binding constraint, while the statistician observes an accelerating series without precedent in the sample.

FIG.01

US compute capex, 2000-2026

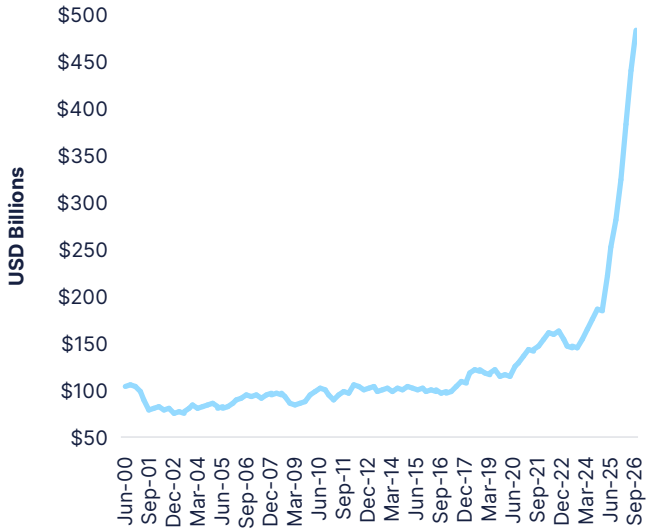


Figure 1. Source: Carlyle Analysis; Bureau of Economic Analysis, September 2026. There is no guarantee any trends will continue.
1. Fry, P. (1983), The Reach of Criticism: Method and Perception in Literary Theory, *Yale University Press. Fry, P. (2010), "Intentional Fallacy," Volume I.* Literary Theory from 1900 to 1966.

To the engineer, the capex serves an identifiable technical purpose: more compute allows for larger experiments, longer training runs, and broader searches over model architectures and data. If the marginal market participant shares her vantage point, asset prices will likely depend on trends in model performance and benchmarking, task success, inference speeds, and scaling properties. The state of technology determines investment demand and the valuations that clear asset markets.

For the statistician, the reasons behind the structural break are less interesting than its mere existence. AI compute spending – and many related time series – appears to have entered a multiplicative growth regime of uncertain duration (Figure 2). The net income growth of the US semiconductor sector has accelerated from a historic trend of 9-10% to 22% in the three years following ChatGPT's debut to more than 150% over the past twelve months.[2] As the divergence between these series' recent trajectory and historic trend widens, the range of future outcomes grows exponentially, implying risk-averse investors should demand substantial compensation for the nontrivial probability of a crash ahead.

FIG.02

Persistent acceleration in AI capex growth

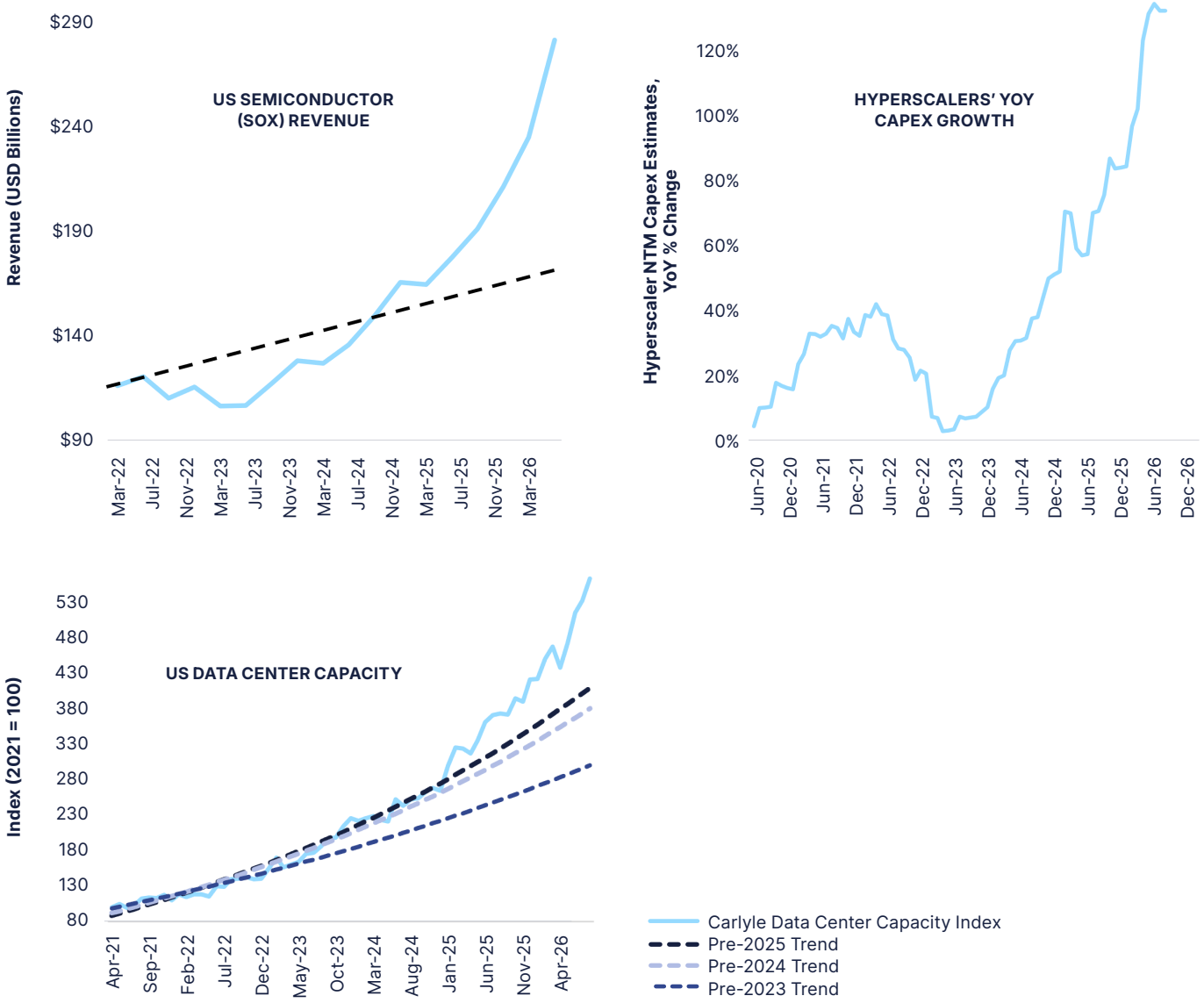


Figure 2. Source: Carlyle Analysis of Portfolio Company Data; Bloomberg, US Census Bureau, September 2026. There is no guarantee any trends will continue.
2. This represents the aggregate across all SOX index constituents.

Technical necessity can explain why a boom begins and continues, but it cannot establish that the claims issued to finance the boom will earn an adequate return. Likewise, statistical instability can explain why returns on this capital are unusually uncertain, but it cannot distinguish an unsustainable trajectory from a legitimate regime shift. Asset prices do not represent a weighted average between these two perspectives; they reflect the framework operative at the clearing price. In today's market, that's the engineer's; asset prices respond to improvements in model capabilities,[3] while required returns and credit spreads have not widened commensurately with the uncertainty created by the scale and duration of the buildout. Indeed, market-wide risk premia have steadily declined since the onset of this capex boom (Figure 3).

FIG.03

Market risk premia have not risen with uncertainty

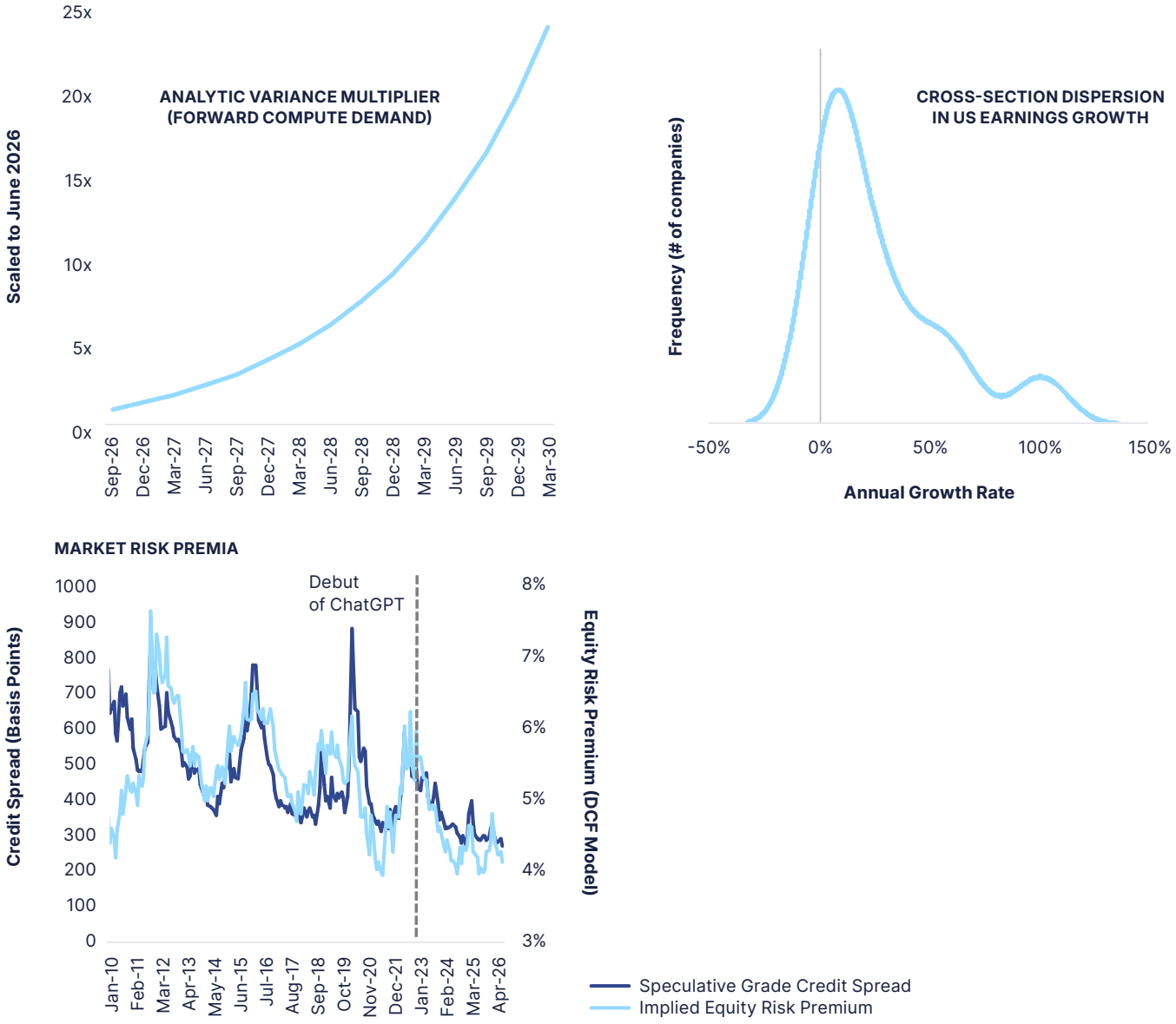


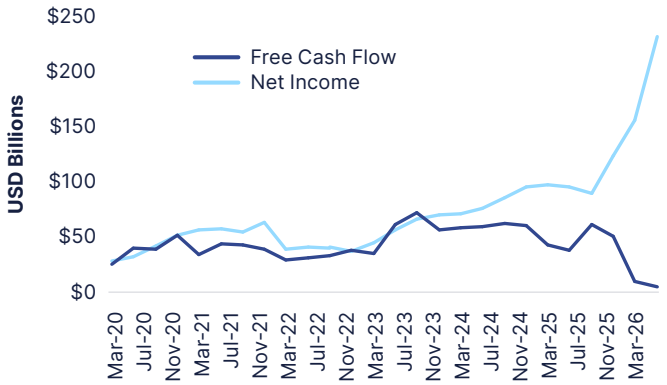
Figure 3. Source: Carlyle Analysis; Bloomberg, S&P Capital IQ, Aswath Damodaran, September 2026. There is no guarantee any trends will continue.

3. Perhaps the best example would be the market response to Anthropic's release of Claude Cowork plugins, Claude Opus 4.6, and the specialized terminal tool Claude Code Security in February 2026, which led to a sharp sell-off in software stocks and a doubling of Anthropic's market value.

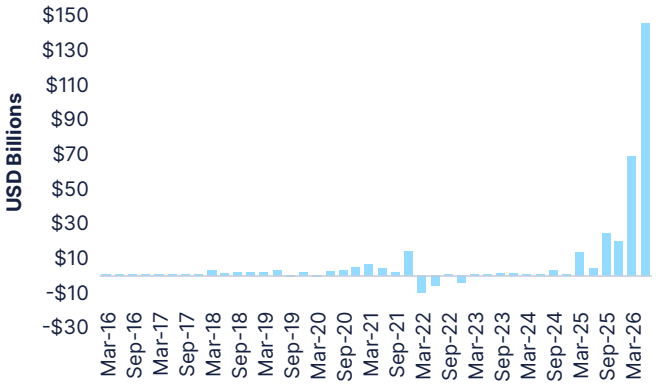
FIG.04

Record tech profits of a decidedly non-cash variety

HYPERSCALERS' CASH VS ACCOUNTING EARNINGS



S&P TECH SECTOR NET INCOME ATTRIBUTABLE TO FAIR VALUE GAINS ON INVESTMENT HOLDINGS



BUILDING IN ADVANCE OF DEMAND

If the capital stock of AI compute could adjust instantaneously to shifts in demand for AI services, the distinction between the engineer's framework and the statistician's wouldn't matter as much. But when capacity is a precondition for the observation of demand, as with the railroads, electrification, and the late-1990s fiber buildout, the stakes are higher. Investors must fund capacity additions in advance of clear signals that the added supply can be absorbed at current price expectations.

When AI capex was mostly internally financed, this risk was "hidden" in the hyperscalers' financials. Free cash flow and shareholder distributions fell as spending ramped, but net income remained strong as the effects of capex were relegated to the depreciation line on the income statement. With AI compute capacity depreciated over a useful life of roughly six years, every $100 credit to semiconductor revenue has been offset by just a $17 debit for purchasers in the year of the sale. In a capex boom, earnings growth is "leveraged" to useful life of the capital acquired. And when adding the record $150 billion of reported profits from paper gains on stakes in frontier labs, it's easy to see why tech sector earnings have soared on the AI buildout (Figure 4).

EXTERNAL FINANCE WITHOUT EXTERNAL DISCIPLINE

Now that operating cash flow no longer covers intended spending, the statistician's perspective may prove harder to ignore. Estimates suggest that over 80% of the anticipated AI capex through 2030 will have to be externally financed through a combination of equity, direct debt obligations, and off-balance sheet financing.[4] Inputs and assumptions once under management's control would now be stress-tested by capital markets, ensuring that the risk embedded in incremental outlays is priced appropriately.[5]

Or so one would think. Thus far, the AI buildout has managed to attract large amounts of market finance – over $500 billion for full-year 2026, more than double last year's total – without much of the normal market discipline.[6] In the off-balance sheet structures,[7] debt service comes primarily from lease income and is secured against the chips' residual value. Yet clear signals of the market's view on the economics have been obscured by credit enhancements like residual-value guarantees and wrappers on senior tranches.[8] Rather than underwrite pre-profitability AI labs' capacity to make good on long-term lease commitments, or the useful life of AI hardware, creditors hold puts written by a handful of investment grade credits.[9]

Figure 4. Source: Carlyle Analysis; Bloomberg, S&P Capital IQ. Hyperscalers' earnings reflect the aggregate across AMZN, META, GOOG, MSFT, and ORCL. Fair value gains includes NVDA. September 2026. There is no guarantee any trends will continue.
4. J.P. Morgan Global Research, midyear outlook, June 2026, estimates $5.5 trillion in cumulative global AI-related capital expenditure through 2030, of which approximately $1 trillion can be financed out of operating cash flow. J.P. Morgan separately raised its estimate of AI-related debt financing to $4.1 trillion.
5. Jensen, M. (1996), "The Agency Costs of Free Cash Flow, Corporate Finance and Takeovers," The American Economic Review.
6. Morgan Stanley, June 10, 2026. Vanguard, "The AI buildout comes to the bond market," August 19, 2026.
7. Some of these obligations are not literally off balance sheet under modern lease accounting but do appear outside the reported debt line.
8. For example, the $35 billion Broadcom-Anthropic financing comprised a $6 billion senior tranche priced at Treasuries plus 100 basis points, a $24 billion senior tranche priced at par with a 5.75% coupon, and a $4.5 billion junior tranche priced at 8.5%. Broadcom's residual value guarantee covers the two senior tranches, or 87% of the capital raised.
9. This situation feels analogous to the mid-2000s, when creditors could underwrite guarantors like Citi rather than the collateral backing their collateralized debt obligations (CDOs).

And these puts may be closer to the money than some suppose. AI capital accumulation depends on the compute demand of AI labs, which contract for data center capacity from hyperscalers and "neoclouds" at pre-specified rates under take-or-pay terms. By Q2-2026, the top AI compute providers had disclosed more than $2.5 trillion of contracted backlog and "remaining performance obligations" tied to these agreements. But those backlogs can only be converted into recognized revenue if the provider first acquires the GPUs, networking equipment, data-center shell, power, cooling, and operating capacity required to deliver the contracted compute – generating upfront cash obligations that trigger the capex, borrowing, and associated finance and operating lease commitments.

When the present value of the promised revenue is measured against the present value of the obligations required to produce it, the $2.5 trillion backlog leaves only about $375 billion of net economic value, or roughly 15% of the nominal contract base (Figure 5). That margin could compress quickly if construction or grid-connection delays defer service availability, or if the AI lab counterparty experiences a cash crunch from slowing revenue growth and a loss of capital markets access. Both the wrapped leases and the providers' backlogs depend on pre-profitability labs' ability to keep paying for compute. And the more contracted capacity expands, the less certain that becomes.

The scaling of interest to the engineer ignores the scaling of grave concern to the statistician: the exponential widening of the distribution of probable outcomes. Should the marginal buyer come to judge the next increment of AI compute capex less on its technical merits than on its implications for statistical stability, the market repricing could prove both sudden and sizeable.

FIG.05

Thin implied equity layer in $2.5 trillion of compute backlogs

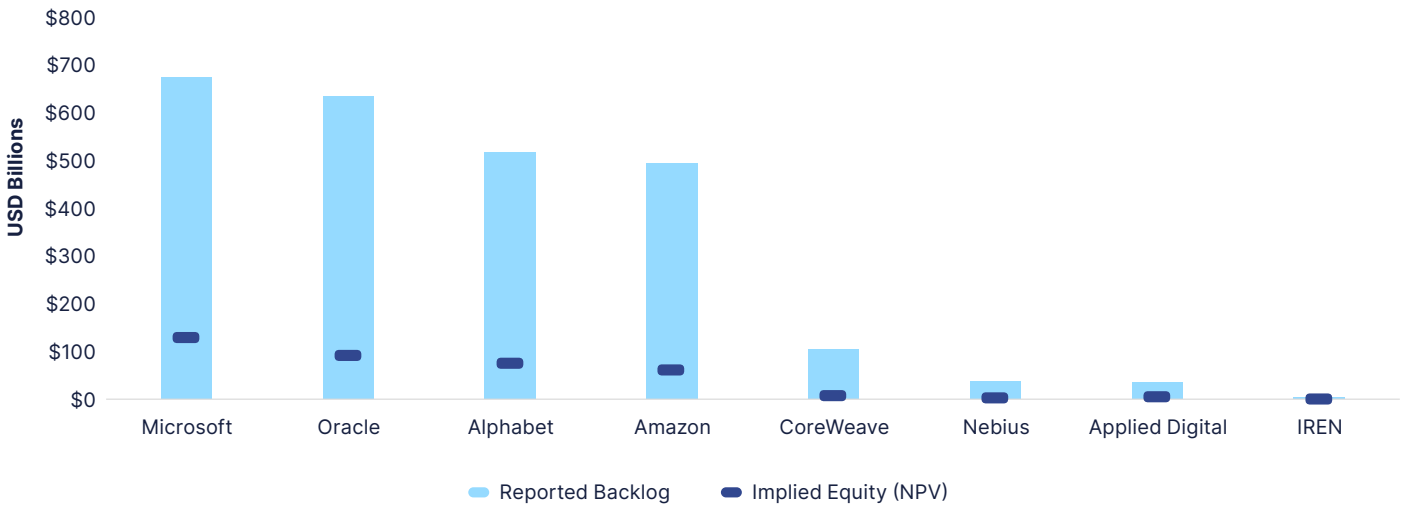
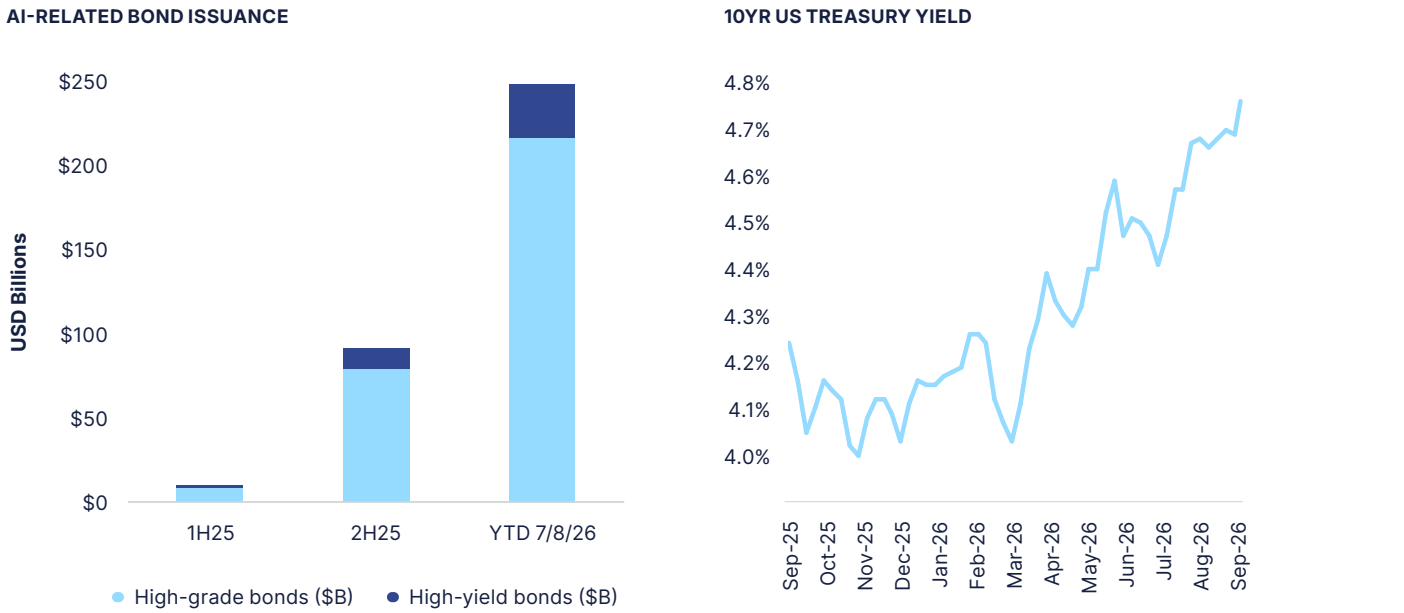


Figure 5. Source: Carlyle Analysis; Company filings available as of September 2, 2026. RPO/backlog figures are not directly comparable across companies: reporting definitions and contract durations differ. Alphabet's figure reflects a Q1 2026 change to include contracts with an original expected term of one year or less (approximately $7.3 billion of the $467.6 billion total, per its Form 10-Q); the remainder of the cross-company comparability caveat relates to differing contract durations and segment definitions. Contracted backlog/RPO is discounted at an 11% nominal required return. Required fulfillment obligations are discounted at a 7% nominal financing cost. Residual asset value is haircut for obsolescence and redeployability risk and discounted at 15%. The resulting difference between the present value of the backlog and the present value of the required obligations is the estimated net economic value, or equity tranche. There is no guarantee any trends will continue.

FIG.06

Is the sharp rise in AI-related issuance driving Treasury yields higher?



IS AI BORROWING DRIVING TREASURY YIELDS HIGHER?

The sharp rise in AI-related debt issuance has also been blamed for the recent backup in Treasury yields.[10] That's a reasonable supposition; an increase in demand for "loanable funds" could be thought to increase the price/yield that clears the investment grade market, especially for issues of comparable duration (Figure 6). But it seems at odds with the "rules of relevance" that have governed bond pricing over the past few years, which assume interest rates reflect the interaction between discretionary Fed policy and a "neutral" rate, conventionally estimated as a moving average of past fed funds rates net of realized inflation.[11] Yields may not be responding to new facts so much as reassessing which facts count as evidence.

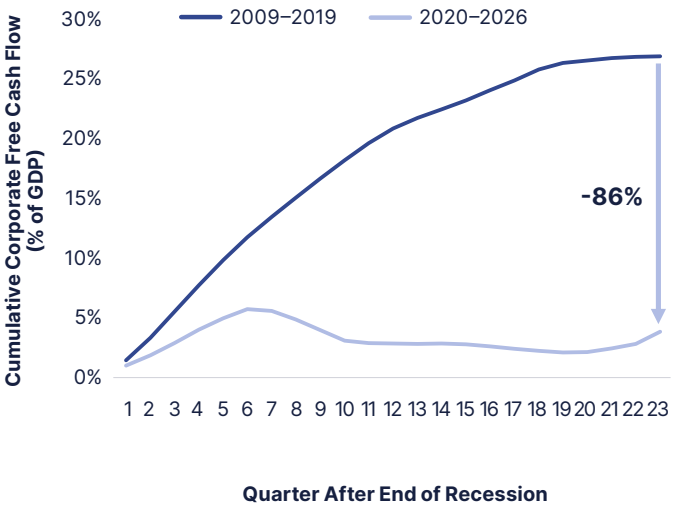
Since 2023, bond yields had been anchored by market expectations that short-term rates would settle below 3%, a process thought to reflect "normalization."[12] But what was normal about the interest rates that prevailed between 2009 and 2019? Rates reached such low levels because a massive savings glut emerged in the corporate sector.[13] Banks contracted, traditional businesses conserved cash to rebuild balance sheets after the crisis, and "asset light" software companies and digital platforms could scale revenue without adding property, plant, or equipment. Lenders far outnumbered borrowers, easily accommodating large fiscal deficits.

Figure 6. Source: Carlyle Analysis; PitchBook, Federal Reserve Board of Governors, September 2026. There is no guarantee any trends will continue.
10. "How the A.I. Borrowing Binge Helps Drive Up Government Bond Yields," The New York Times, *August 20, 2026.*
11. "Measuring the Natural Rate of Interest," Federal Reserve Bank of New York.
12. Carlyle Analysis; Bloomberg, Federal Reserve Board of Governors, September 2026. There is no guarantee any trends will continue.
13. Gruber, J.W. and S.B. Kamin (2015), "The Corporate Saving Glut in the Aftermath of the Global Financial Crisis," Federal Reserve International Finance Discussion Papers 1150.

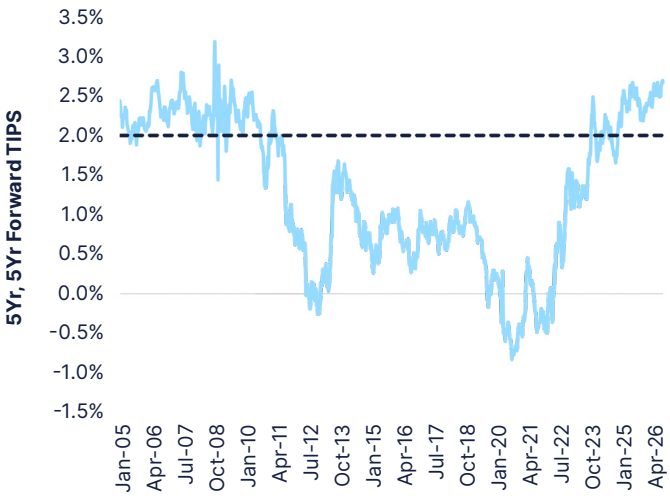
FIG.07

Corporate savings glut vanishes as operating cash gets channeled to AI capex

US CORPORATE SECTOR NET SAVINGS AS A SHARE OF GDP



FIVE-YEAR TIPS YIELD, 5 YEARS' FORWARD



Since the pandemic, those trends have reversed: the net savings of the US corporate sector is down 86% relative to the same point in the last cycle (Figure 7). And much of that shift is attributable to the (formerly "asset light") hyperscalers, which transitioned from the economy's largest providers of liquidity to its largest users of it. Now that AI data centers consume the savings once channeled to banks (via deposits), governments and other corporates (bill and bond purchases), and shareholders (massive buyback programs), remaining lenders drive a harder bargain.

A market once convinced that rates could only move down has opened its eyes to the possibility that higher real rates may be required to fund the AI capex boom and large fiscal deficits at something approximating price stability. Six months ago, forward rates were priced at a discount to three-month SOFR, reflecting market expectations that the Fed would be cutting *en route* to a 2.75% terminal rate. Since then, forward rates have steadily increased, with one-year-ahead rates now 130 basis points above March levels and roughly 50bps (i.e. two hikes) above SOFR (Figure 8).

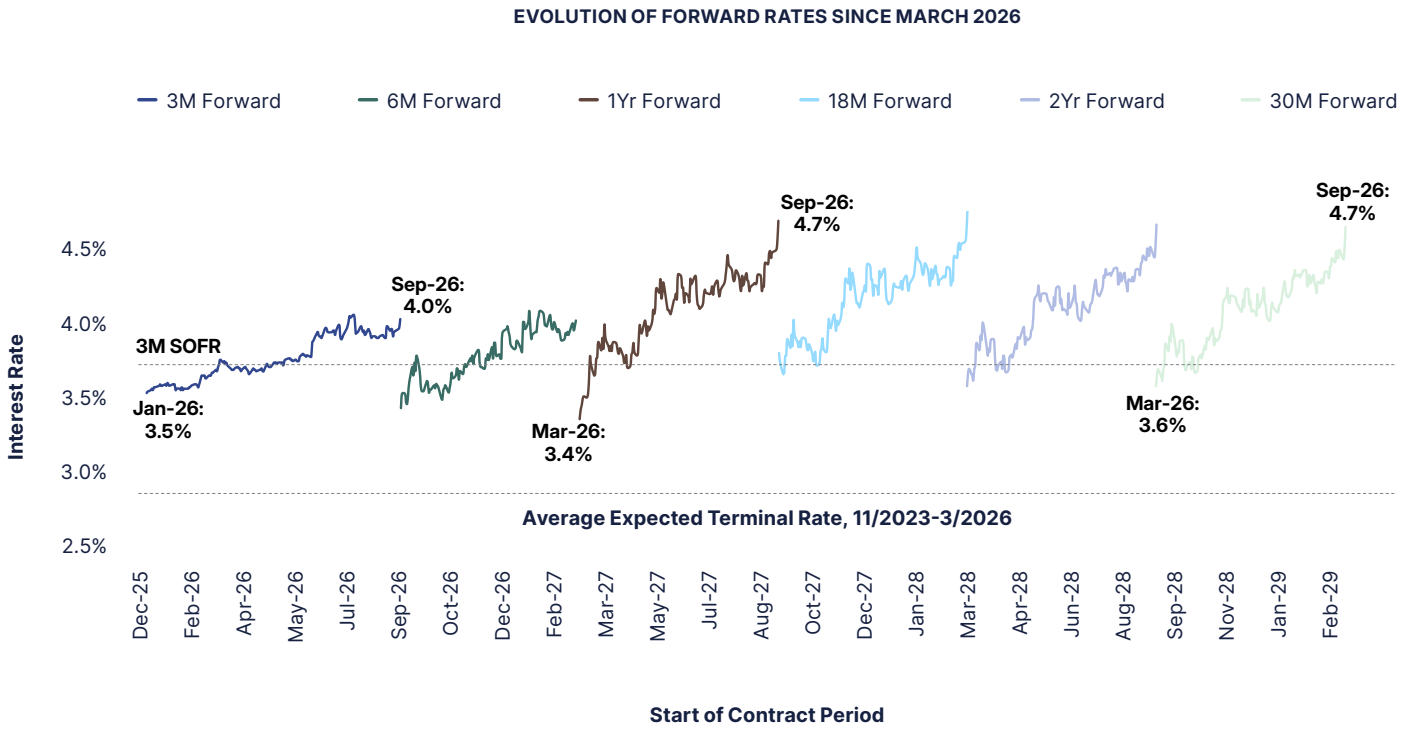
There's been nothing special, or duration-specific, about the rise in Treasury yields. They've simply responded to the rise in forward rates. The spread between the 10 and two-year Treasury yield has declined by 15bps since March, while the spread between the 30 and five-year yield has fallen by 35 basis points.

No doubt the timing of this reassessment is tied to the Hormuz-inflected increase in energy prices, particularly diesel. But the pressure on policymakers to respond to this supply shock wouldn't be so great were it not for the 27% cumulative increase in consumer prices since the start of 2021.[14] And the scale and duration of that inflation overshoot almost certainly stems from complacency borne from the failure to perceive the implications of the dramatic reversal in savings and investment propensities.

Figure 7. Source: Carlyle Analysis; Bloomberg, Federal Reserve Board of Governors, September 2026. There is no guarantee any trends will continue.
14. Source: Carlyle Analysis; Bureau of Labor Statistics, August 2026. There is no guarantee any trends will continue.

FIG.08

Forward interest rates rise steadily across every maturity



WHY NOT JUST BORROW FROM FOREIGNERS?

Higher real interest rates would deter private spending and borrowing, at the margin, so as to generate the incremental domestic savings necessary to absorb fiscal deficits and AI-related issuance at price stability. But in an open economy, where capital can flow freely across borders, investment and deficits needn't be financed domestically. Rather than push households, businesses, or the government to spend less of their income, the US could simply draw on foreign savings.

Of course, that's precisely what the US has been doing for decades. Since 2000, cumulative US borrowing from the rest of the world has reached 118% of GDP as domestic savings has consistently fallen short of domestic investment.[15] It's generally not possible to run up external deficits of such size; as with fiscal imbalances, debt service costs eventually consume too large a share of national income. But that hasn't been a problem for the US because the rest of the world has been willing to accept yields far below the returns US investors and businesses earn on their (far smaller) stock of foreign assets. Until recently, effective US net borrowing costs were *less than zero*.[16]

Figure 8. Source: Carlyle Analysis; US Treasury, September 2026. There is no guarantee any trends will continue.
15. This represents the summed total of current account deficits, net of primary income, since 2000. Source: Carlyle Analysis; IMF WEO Database, World Bank WDI Indicators Database, September 2026. There is no guarantee any trends will continue.
16. This situation is analogous to someone lending $50 at a 10% interest rate while borrowing $100 at 3%. This person would generate $2 in net interest income despite running a $50 net deficit.

The size of the implicit US borrowing subsidy rose with global trade volumes (Figure 9). The growth in trade during the period of "globalization" wasn't really about countries selling more finished goods to one another, but the rise of globally-interconnected production networks.[17] Production processes that might have occurred in a single country, or even a single facility, were sliced into stages (product design and development, component manufacturing, final assembly, etc.) and distributed across borders so that each economy specialized in a different part of the process.

As production processes expanded in length, complexity, and cross-border participation, single products sourced components, parts, and other value-added inputs from a dozen or more economies, creating a nightmare for management teams trying to stabilize profit margins in a world of floating (and often volatile) currencies. The solution was obvious: businesses at each stage of the process would both invoice and get invoiced in dollars.[18] This boosted demand for Treasuries to meet dollar payment obligations and backstop foreign banking systems (i.e. reserve accumulation), which placed downward pressure on Treasury yields and cheapened broader dollar funding costs.[19]

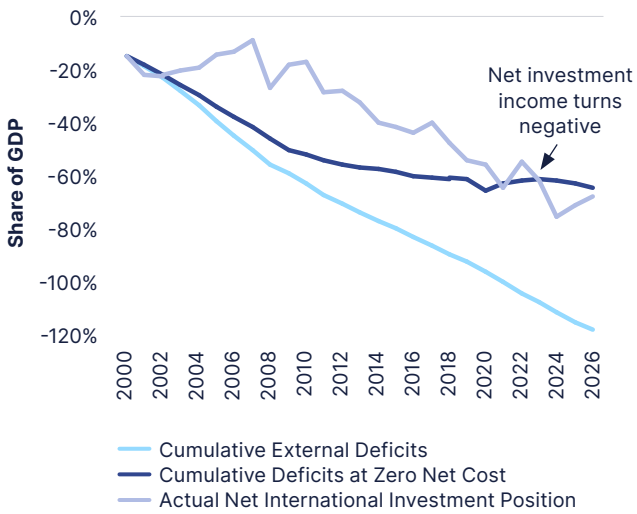
As trade volumes have stagnated and reversed, so too has the US borrowing subsidy (Figure 9). Treasury issuance now outpaces external demand, with foreign allocations to the US increasingly focused on private sector assets that earn returns commensurate to (or more than) those available in their home economies. And as sensible as it may be for the US to scale back external commitments, narrow its goods trade deficit, and restrict foreign adversaries' access to dollar clearing, such policies further reduce the amount of foreign savings available (and willing) to be recycled into low-yielding US assets (Figure 10).

With the funding benefits of "globalization" occluded from public perceptions, it's been easy to recast the whole era as a massive loss for US interests. Should future provocations prompt foreign reserve managers and other liquidity pools to become large net sellers of Treasuries, the spike in mortgage rates may turn today's resentments into tomorrow's fond memories.

FIG.09

Globalization spurred USD demand, lowering US borrowing costs

CUMULATIVE US EXTERNAL BORROWING (% OF GDP)



GLOBAL MERCHANDISE TRADE VOLUMES & CUMULATIVE US BORROWING SUBSIDY

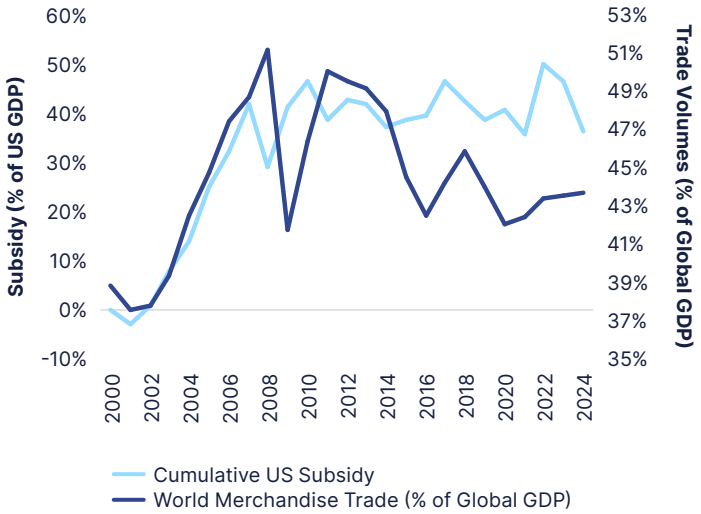


Figure 9. Source: Carlyle Analysis; IMF WEO Database, World Bank WDI Indicators Database, September 2026. There is no guarantee any trends will continue.

17. Timmer, M. et al. (2014), "Slicing Up Global Value Chains," Journal of Economic Perspectives.

18. Gopinath, G. and J. Stein, (2018), "Banking, Trade, and the Making of a Dominant Currency," NBER Working Paper No. 24485.

19. Du, W., J. Im, and J. Schreger (2018), "The US Treasury Premium," Journal of International Economics.

FIG.10

Less demand for Treasuries' safety and liquidity



FIG.11

Government bond yields vary with the share of domestic savings consumed by public debt issuance

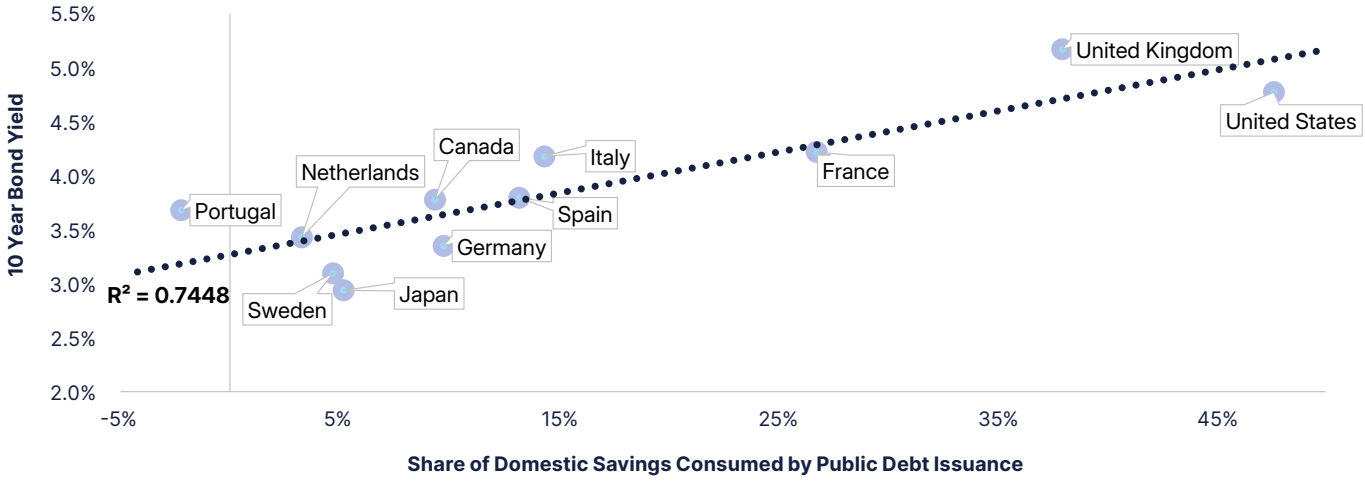


Figure 10. 1. Excludes Caribbean-domiciled hedge funds.
Source: Carlyle Analysis; Bloomberg, BEA IIP, IMF COFER, US Treasury TIC, FEDS Notes 'The Cross-Border Trail of the Treasury Basis Trade' (Barth et al., Oct 2025), SEC Form PF. Shares are approximate. There is no guarantee any trends will continue.
Figure 11. Source: Carlyle Analysis; Bloomberg, IMF WEO Database, September 2026. There is no guarantee any trends will continue.

FOREIGN SAVINGS NEEDED AT HOME

The rise in bond yields has hardly been a US-specific phenomenon. The Hormuz shock has contributed to the same front-end repricing as observed in the US and expected debt issuance has been upwardly revised in economies expected to take greater accountability for their own defense. But cross-sectional comparisons reveal the same savings-investment fundamentals at work: across advanced economies, 10-year bond yields are not explained by debt levels or growth rates, but the share of domestic savings absorbed by public debt issuance (Figure 11). Economies with high debt and deficits can enjoy comparably low interest rates – and more fiscal space – when households and businesses consume a smaller share of their income.

With the notable exception of the UK, European economies generally find themselves in a better position to fund increased defense outlays thanks to higher domestic savings rates. While defense spending is often discussed as a "burden," in the case of Europe that's because of the external "leakage" associated with procurement outlays. Europe has not spent to develop its own defense systems and domestic value-added accounts for barely €20 of every €100 of hardware acquired (Figure 12). As the US experience attests,[20] investment in military technology often provides significant commercial spillovers, and that's especially likely today given defense planners' focus on AI, autonomous navigation, propulsion technologies, space, and energy storage.

There's no "peace dividend" readily apparent in the last 20 years of EU growth statistics, but one does see a correlation between the continent's waning global technological relevance and the decline in its defense-industrial base (in contrast to the experience of the US, China, and Israel, for instance). We may find that higher domestic levels of technologically-focused defense output may reveal the 'peace dividend' a perspectival mirage.

FIG.12

Domestic value-added reduces net burden of defense outlays

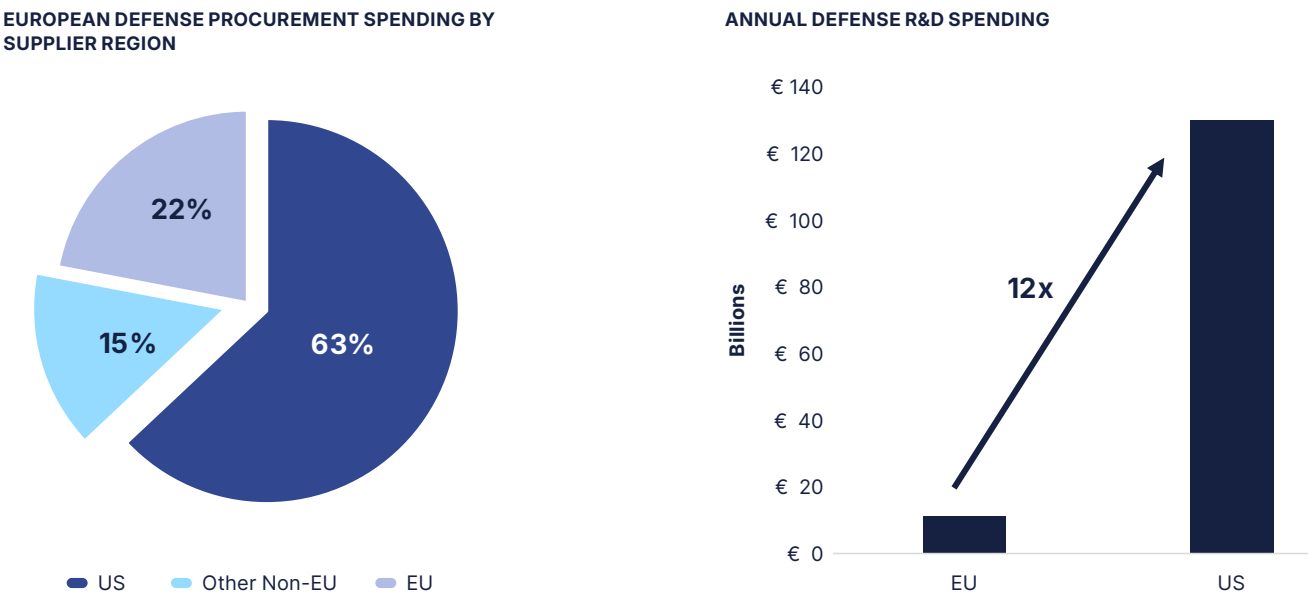


Figure 12. Source: Carlyle Analysis; European Commission, November 2024. There is no guarantee any trends will continue.
20. Pallante, G., E. Russo and A. Roventini (2023), "Does public R&D funding crowd-in private R&D investment? Evidence from military R&D expenditures for US states," Research Policy.

WHAT'S AN ASSET ALLOCATOR TO DO?

When market volatility stems from changes in analytical frameworks, risk becomes unbounded by fundamentals. The volatility in software stocks is an example of this phenomenon. Advancements in AI capabilities led to a 40% crash in software-as-a-service (SaaS) stocks between February and April 2026 that's been followed by a 60% rebound on virtually no new information. While traders must always concern themselves with such ephemeralities, asset allocators today must be equally conscious of the risk of discrete shifts in perceptions.

With that in mind, we offer our perspective on how to approach this unusually uncertain moment:

1. **You probably have enough *direct* AI exposure.** With AI-exposed stocks accounting for over two-fifths of US market capitalization,[21] it seems unlikely that "diversified" portfolios lack sufficient AI exposure, especially when accounting for public companies' investments in AI labs and the guarantees they've extended to data center projects. There's a region of the distribution where monetization fails to catch up with capital outlays and it looks underpriced, if not "functionally invisible." Incremental direct AI exposures should offer upside convex enough to offset repricing risk.
2. **The returns from technological revolutions tend to be more derivative and diffuse than initially perceived.** The economic value added from railroads, electrification, and the internet accrued mainly to the users of the technology rather than firms that build the infrastructure.[22] Who in the late-1990s would have expected Walmart to derive greater long-term benefits from IT investment than Lucent? AI has and will open doors to similar downstream value creation and efficiency gains. In ten years, investors may be surprised to learn where AI-related gains accrued in their portfolios.
3. **Fiscal troubles are likely to manifest as higher inflation.** Don't view Treasury debt through a credit lens; there is no borrower more creditworthy, in USD terms, than the US Treasury. The government borrows in a unit it can manufacture; a situation analogous to Microsoft issuing bonds with coupons and principal payable in Microsoft stock. What the Treasury cannot guarantee is the real value of the dollars it repays. If you doubt that the Fed will deliver the real rates necessary for price stability or suspect that such rates will threaten US fiscal stability, the answer is not diversifying into "higher quality" issuers.
4. **Better to take credit than duration risk.** Increasing fixed income returns beyond the cash yields (currently 3.65% in USD) requires the assumption of duration or credit risk. If inflation arrives, it will do what it always does: erode the real value of principal balances. That's bad news for a fixed obligation due in 2056, but bullish for speculative grade credit as issuers' revenue and EBITDA rise mechanically relative to their debt burdens.
5. **Defense and energy are the "deglobalization" plays.** Cut through the noise: to function, economies must be able to power and defend themselves. If reliance on external actors becomes untenable, they'll have to make the necessary domestic arrangements. Cross-border frictions to trade and capital flows can be resolved through price adjustments. While their potential magnitude shouldn't be trivialized, their practical consequences pale in comparison to those of fuel, electron, and defense hardware shortages.

21. BIS Bulletin no. 122.
22. Bubbles as a Feature Not a Bug, January 2026.

Jason Thomas

HEAD OF GLOBAL RESEARCH & INVESTMENT STRATEGY

Jason Thomas is Head of Global Research & Investment Strategy at Carlyle. Mr. Thomas helps to formulate firmwide investment strategies and serves as the Chief Investment Officer for managed accounts and the economic adviser to the firm's Global Private Equity and Credit Investment Committees.

Prior to joining Carlyle, Mr. Thomas served on the White House staff as Special Assistant to the President and Director for Policy Development at the National Economic Council. In this capacity, Mr. Thomas acted as the primary adviser to the President for public finance.

Mr. Thomas received a BA from Claremont McKenna College and an MS and PhD in finance from George Washington University, where he studied as a Bank of America Foundation, Leo and Lillian Goodwin Foundation, and School of Business Fellow.

Mr. Thomas has earned the chartered financial analyst designation and is a Financial Risk Manager certified by the Global Association of Risk Professionals.

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