

Higher Growth Driving Higher Yields

Top of mind for investors heading into the end of the year is the rapid rise in US Treasury yields and global yields overall. Case in point, the 10-year US Treasury yield, which is viewed by investors as the most important indicator of global financing costs, broke through the 5% barrier in September. Yields had already increased significantly following the Federal Reserve's last rate hiking cycle in 2022-23, one of the steepest in history as they raised the Fed Funds rate 525 bps in 17 months. Now, markets are pricing in an additional 75 to 100 bps increase in rates by the Federal Reserve over the next 12 months, following a 25 bps hike at its September meeting.¹ This recent spike in yields has left investors grappling with the underlying cause(s) as well as its sustainability.

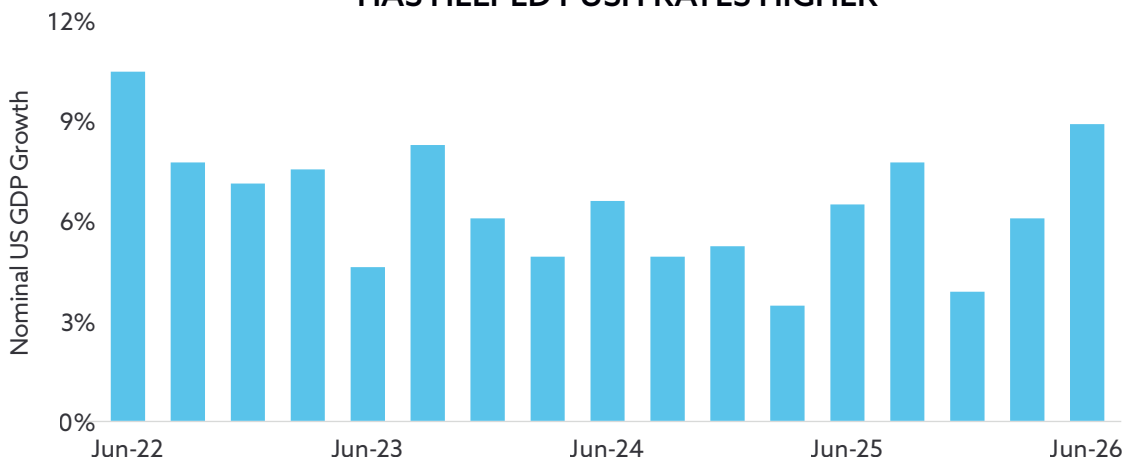
Market observers have pointed to a handful of reasons: inflation brought on by elevated energy prices across the globe as a result of the ongoing conflict in the Middle East; concerns about US fiscal health as the deficit sits at nearly 6% of GDP; questions about the credibility of the Fed, now under a new chairman who has minimized forward guidance; and higher-than-anticipated economic growth fueled, in part, by massive capex spending on the AI infrastructure buildout.²

We posit that the first three factors above are not particularly new areas of concern and are, therefore, unlikely to be the principal drivers of the rapid increase in Treasury rates. For example, inflation has been above the 2% target for years, and breakeven pricing does not indicate that market participants particularly believe that inflation outcomes will be persistently higher in the long term. Fiscal health apprehension is not a new development since the US government has run at a deficit for decades, and the Congressional Budget Office has been predicting higher deficits through 2036 (6.7% of GDP estimated) for a while.² In fact, higher nominal growth may be slightly slowing the rate of increase in the US debt to GDP ratio. On the issue of Fed credibility, while every change in leadership has often led to some uncertainty about the communication style and reaction function, they have rarely led to the magnitude of increase in rates experienced in the past few months.



OGECHI NWACHUKWU
Chief Investment Officer

ROBUST ECONOMIC ACTIVITY HAS HELPED PUSH RATES HIGHER³



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In our view, what has changed is the relatively recent recalibration of US economic strength with Q2 2026 nominal GDP growth coming in at 8.5% - the highest percentage growth since Q2 2022.³ For market participants, the flash PMI report late in September that indicated a much faster growth rate in US business activity crystallized the realization that Treasury rates may be too low, given the underlying rate of economic expansion.⁴ In our opinion, this report provided the immediate catalyst that drove yields to their recent highs.

The chart below shows a decomposition of the increase in Treasury rates and demonstrates that real yields, which are usually related to a reassessment of growth expectations, have been the driver of the increase in rates. This is contrary to the widely held view that higher rates have been driven by higher inflation expectations. In fact, the breakeven rate, which represents the market's inflation expectations, has been relatively unchanged over the last few months.

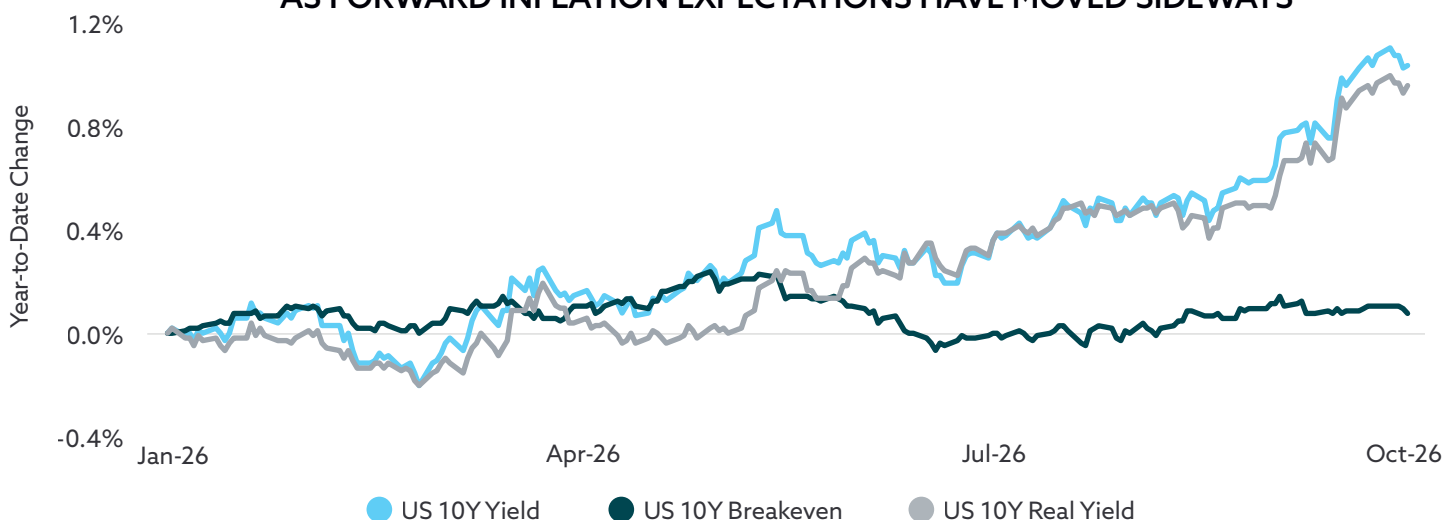
Although US economic growth is firm, our suspicion is that it may not be as strong as the second quarter nominal growth rate indicates. While the pockets of the economy benefiting from the AI infrastructure build-out are powering full steam ahead, other sectors are struggling. Sales of existing homes are down as potential buyers struggle with higher mortgage rates.⁵ Similarly, the pace of durable goods purchases has slowed from previous years as the cost of financing increases.⁶ The labor market has created an average of just under 65,000 jobs over the last 12 months, hardly the sign of an overheating economy, especially when compared to the nearly 210,000 created

per month in 2023.⁷ We believe that a market recalibration of the underlying growth rate could eventually provide the impetus for rates to fall.

When that happens is difficult to say. In the meantime, we are constantly assessing various areas of the markets that may come under pressure. One of the sectors we are concerned about are French banks, which are largely linked to the French sovereign credit. Much like the US, France has experienced a run-up in rates with the 10-year OAT bond yield recently touching a high not seen since 2002.⁸ The 10-year OAT-Bund spread (Germany's interest rate benchmark is the Bund) currently sits at 170 bps, a difference not seen since the 2011 Eurozone crisis.⁸ France is more vulnerable than the US to higher interest rates – French growth is lower, and the country lacks the monetary sovereignty of the US, being part of the Eurozone. This puts France in a more precarious position with a less clear path out of emerging sovereign debt concerns. Tremors from a potential French debt crisis could also spill over into other vulnerable EU countries, notably Italy and, by derivation, the Italian banking sector.

Returning to US markets, rising interest rates may put certain segments of the market under stress. Given their floating rate structures, persistently higher rates would challenge economically stretched names in the private credit and broader leveraged loan markets. Additionally, higher rates may also expose cracks in certain parts of the structured credit markets, particularly for deals sponsored by highly levered data center providers who finance themselves in the high yield markets.

REAL RATES HAVE DRIVEN THE MOVE AS FORWARD INFLATION EXPECTATIONS HAVE MOVED SIDEWAYS⁹



(4) S&P Global. "S&P Global US Flash PMI." 23 September 2026. (5) National Association of Realtors. 13 October 2026. (6) United States Census Bureau. 25 September 2026. (7) Bureau of Labor Statistics. US nonfarm payrolls month-over-month. 13 October 2026. (8) FactSet. 22 October 2026. (9) FactSet. Daily data through 9 October 2026.

Given the concerns outlined above, PPM is being cautious in deploying new capital. Being a bottom-up, fundamentals-based asset manager, we rely on our experienced credit research team to find relative value opportunities across all areas of the market. Positioning portfolios based on interest rate forecasts is not and has never been a strategy for us. As a result, the increase in Treasury yields over the past two months has not been a large contributor to relative performance across our portfolios.

That being said, we have been re-underwriting all sectors affected by higher rates to evaluate the robustness of their business models. With the nascent concerns about risks associated with the AI build-out, this includes a rigorous analysis of our Technology sector exposure within bank loans as well as other AI-related debt. To summarize our approach to markets at this point in time, we are being highly selective in making investment decisions for our clients, especially given the higher financing burden for businesses. Having said that, we are not overtly bearish because we believe these higher rates are, for the most part, justified by higher economic growth.

(10) AUM includes committed but unfunded capital for PPM's private equity and commercial real estate businesses. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed.

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