

A S WE START THE FOURTH CALENDAR QUARTER, we note that inflation (as predicted) is still above the Federal Reserve Bank's arbitrary goal of 2% price stability. The jobs market has softened, but unemployment has remained at a cyclical low. Equity markets that sold off in the Spring have recovered. The economy has slowed but not declined. All in all, the news seems mostly benign, and yet we are wary. Multiple classes of leverage are near historic highs. In this note, we will convey our unease over the long-term increase in leverage that has propped up markets, governments, and personal consumption.

A GLOBAL SNAPSHOT OF DEBT

Sector	1980	2000	2024	Comment
Global debt / GDP	~120 %	~200 %	~349 %	Tripled in 40 years
Advanced-economy public debt	~45 %	~60 %	~110 %	Fiscal activism
Emerging-market debt	~60 %	~100 %	~220 %	Global integration
U.S. household debt / income	~65 %	~95 %	~105 %	Plateau but high
Corporate debt / GDP (U.S.)	~40 %	~65 %	~80 %	Buybacks, cheap credit

Sources: IMF, BIS, World Bank, FRED, S&P Global; figures approximate and represent total debt (public + private) relative to nominal GDP.

Several forces have driven financial leverage higher:

1. Global interest rates declined almost continuously from the early 1980s to 2021. Lower rates inflated housing, commodity, and equity asset values, making borrowing appear painless. Cheap credit became embedded in business models and household behavior.
2. The growth of securitization, derivatives, and shadow banking expanded the capacity of balance sheets to support credit. Leverage migrated from banks to markets, multiplying its reach and opacity.
3. Increased capital mobility allowed debt to flow across borders. Sovereign and corporate debt in emerging markets is now issued in global currencies, linking local cycles to global liquidity.
4. In response to liquidity shocks in 2008 and 2020, central banks and fiscal authorities provided backstops to stabilize markets, adding systemic leverage and encouraging risk-taking and moral hazard.

LOOKING FORWARD

Our concern about leverage is that much of the growth funded consumption rather than investment. Investments that increase output can become self-funding, while consumption-based leverage ultimately results in saturation, overextension, and becomes unsustainable. Over the past four decades, global debt has expanded nearly threefold relative to output, embedding leverage as a structural feature of the modern economy. Governments, corporations, and households depend on continual borrowing to sustain growth, leaving financial systems highly sensitive to rates, liquidity, and confidence shifts.

We continue to balance opportunities for growth and income with conservation and liquidity. Although some stock market segments are mathematically overvalued, our screening process consistently identifies growing and shareholder-friendly businesses. Our philosophy of investing in enduring, cash flow-creating, dividend-paying, and growing businesses and, when appropriate, investment-grade debt hasn't and won't change. We designed our process to produce below-average volatility, above-average income, and competitive long-term returns.

Thank you, Joe, Jim, Ernie, and Rusty

The 21st century has been defined by compounding leverage—rising public, corporate, and household debt.

PUBLIC DEBT

Governments borrowed heavily after the financial crisis and again during the pandemic. Aggregate public debt among advanced economies now exceeds 110 % of GDP, up from roughly 60 % at the turn of the millennium.

CORPORATE DEBT

Nonfinancial corporate borrowing has expanded faster than profits, reaching record levels relative to GDP in many markets. Low interest rates, share buybacks, and private-credit growth all contributed.

HOUSEHOLD DEBT

Mortgages remain the largest category, but consumer credit, auto loans, student debt, and new “buy now, pay later” structures have added additional obligations.

The newest wave of borrowing is more behavioral.

Revolving credit—credit cards, personal lines, and digital wallets—has surpassed \$1.1 trillion in the U.S., an all-time high. Meanwhile, “Buy Now, Pay Later” (BNPL) programs have created short-term, lightly regulated debt that often escapes traditional credit reporting. Surveys suggest roughly one in five adults has used BNPL, and late-payment rates exceed 40 % among frequent users.

Leverage, once institutional, is now personal.

A BRIEF HISTORY OF DEBT

In the early 20th century, debt was episodic—a financing method used for wars, major infrastructure, or industrial expansion. Today, it is structural. Governments, corporations, and households rely on continual borrowing to sustain activity. Governments guarantee financial systems, financial systems fund corporate borrowing, and corporations pay wages that sustain household debt service. This loop creates growth but also tightly couples failure points. By 2024, the world had roughly \$310 trillion of total debt—about 3.5 times global GDP. Debt is no longer the exception; it is the operating medium of the worldwide economy. Crises no longer emerge from isolated speculation; they are endogenous features of debt-based architecture.

THREE CLASSES OF LEVERAGE

Financial leverage works much like the simple machines you learned about in school. Here are three types that shape your investments:



POLICY LEVERAGE

The Teeter-Totter

The Federal Reserve and financial regulators act as the fulcrum on a seesaw, balancing competing priorities like economic growth and inflation control. Their decisions—interest rate changes, banking rules—create the playing field for all other financial activity.



DEBT LEVERAGE

The Wheelbarrow

This is the traditional use of borrowed money to expand capacity and potentially boost returns. Just as a wheelbarrow lets you move more weight than you could carry alone, debt allows businesses and investors to invest in more assets than their cash alone would permit. Capital markets facilitate this type of leverage.



TOOL-BASED LEVERAGE

The Efficiency Multiplier

Modern technology and specialized products—from algorithmic trading to leveraged ETFs—amplify the speed and scale of investment activities. These tools can magnify both opportunities and risks.