Convexity Maven

...it's always about character

A Commentary by Harley Bassman

September 8, 2026

"In FED We Trust"

"Governments which issue and control their own currencies face no financing constraints and no threat of insolvency or default."

L. Randall Wray

"The national debt poses no financial burden whatsoever.
Fiscal deficits increase our wealth and collective savings."

Stephanie Kelton

"Inflation is always and everywhere a monetary phenomenon"

Milton Friedman

"It takes 20 years to build a reputation and five minutes to ruin it.
If you think about that, you'll do things differently."

Warren Buffet

"Pigs can indeed fly if shot out of a large enough cannon;
But eventually they return to Earth as bacon"

Harley Bassman

One of the great advancements in human civilization was the creation of money to replace a "barter economy". This allowed for the specialization of work, to replace each person doing every job. It allowed for the divisibility of large projects into discrete tasks since it was hard for a blacksmith to trade with a baker when one axe might exchange for thirty loaves of bread that quickly stale.

With this came the valuable notion of money as "deferred consumption".

While Gold was first mentioned in Genesis 2:11-12 as an item of value, and again in Exodus 32:2-4 for the construction of the golden calf, it was not until 550 B.C.E. when King Croesus ordered the first minting of Gold coins. (Thus, the expression "rich as Croesus".)

Gold checked all the boxes for use as "money":
1) Its supply is controlled or limited;
2) It is fungible/uniform – this is why diamonds cannot qualify;
3) It is portable – this is why land cannot qualify;
4) It is divisible – thus art cannot be money; and
5) It is liquid – this means people will readily accept it in exchange.

The acceptance of Gold as a universal token of trade furthered humankind as it was now possible to trade with different tribes (nations) in an agreeable manner without first-hand knowledge of the counterparty's character (**Trust**).

The creation of the Federal Reserve Bank in 1913 came with the stipulation that each Note created must be covered by 25% of its face value of Gold held in the vault. Federal Reserve Notes were issued versus Gold at $20.67 per ounce.

Employing what can only be described as force majeure politics, in April 1933 the U.S. Government issued Executive Order 6102, which made it illegal for a citizen to own Gold bullion or coins. Lest they risk a five-year vacation in prison, citizens sold their Gold to the government at the official price of $20.67. This hoard of Gold was then placed in a specially built storage facility – Fort Knox.

Soon after, the official price of Gold was jumped to $35.00 to create inflation to shock a depressed economy. [A careful reader might note this rhymes with the Fed's "Helicopter money" policy of Quantitative Easing (QE).]

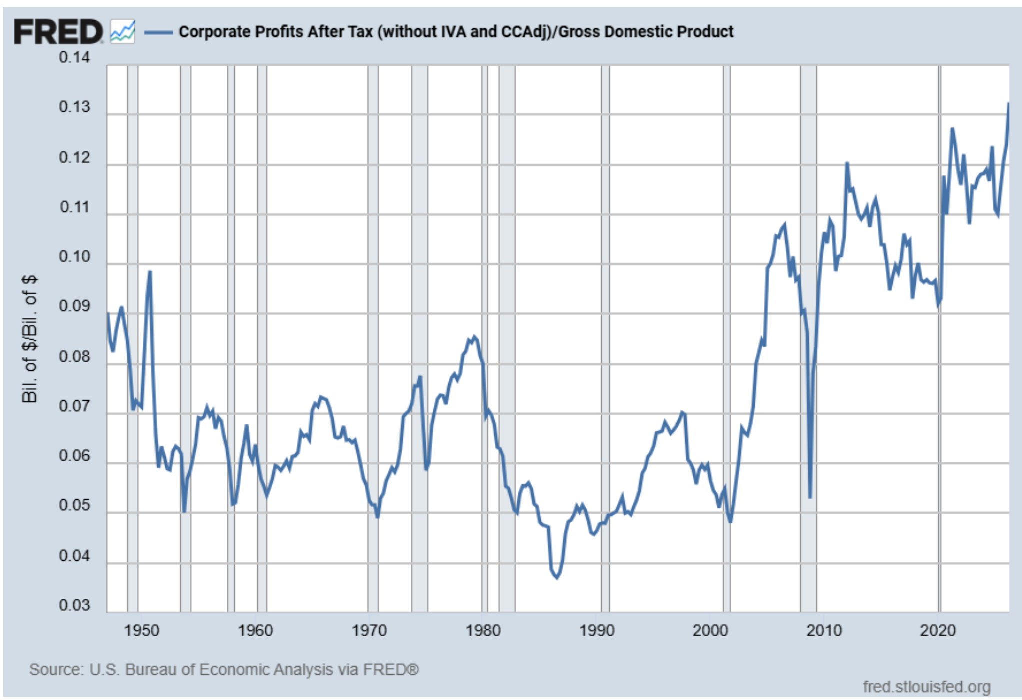
In 1968, as Vietnam War funding converged with the President Johnson's Great Society programs, the 25% Gold coverage was rescinded. In a monetary coup de grace, in 1971 President Nixon abrogated the 1947 Bretton Woods agreement so foreign Central Banks could no longer exchange dollars for Gold.

Hence, the US Dollar would live solely on Trust in the US Government.

This pre-amble is not meant to be a salve for Gold-bugs, but rather to suggest that <u>we do not have a "rate level" problem, per se, but rather a **Trust** problem</u>.

I propose that the winners of the past decade's elections are not the problem, but rather **a symptom of eroding Trust** in our institutions to maintain a level playing field that allows focused effort to offer a path to success.

Perhaps a coincidence, but soon after Citizens United vs. the Federal Election Commission (corporate peoplehood) gained traction in 2007, the -sin line- corporate profits doubled from an historical 6% of GDP to 12% of GDP. This disturbed the balance of income between Capital and Labor.



The source of this distortion and redirection of income is hard to pinpoint since it accelerated under both Republican and Democratic administrations, as well as four Federal Reserve Chairs.

Moreover, it is a classic "frog in the saucepan" situation where the citizenry does not notice an immediate and specific change.

Confounded economic analysts and pundits point to a "Vibes" or a "Vibecession" as the disconnect between seemingly positive economic data, particularly the level of the S&P 500 (SPX), and the sour mood of the general public.

Historically, the -pembe line- Michigan Consumer Sentiment survey coincided with the -porteqali line- SPX. Notice the local peak in January 2020; the COVID drawdown in March; the 2021 rise; the 2022 dip and subsequent 2023 to 2024 rally in both. But recently, they have blown apart like an alligator jaw.

Let me tell you, this is NOT an issue of "Vibes", it just simply Statistics 101.

The most recent Fed data offers that the AVERAGE household income was $121,000 versus the MEDIAN income of $83,700.

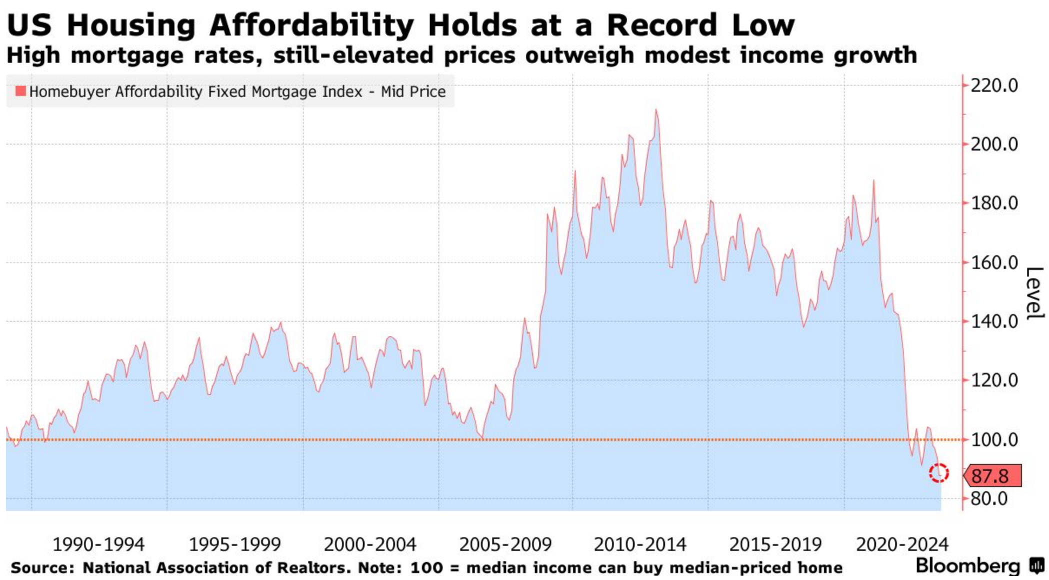
More disconcerting, similar Fed data counted the average household net worth at $1,060,000 versus a median new worth of $197,000.

Imagine a small village of ten people; nine of them earn $10,000 and one person makes $410,000. The average is $50,000 while the median is $10,000.

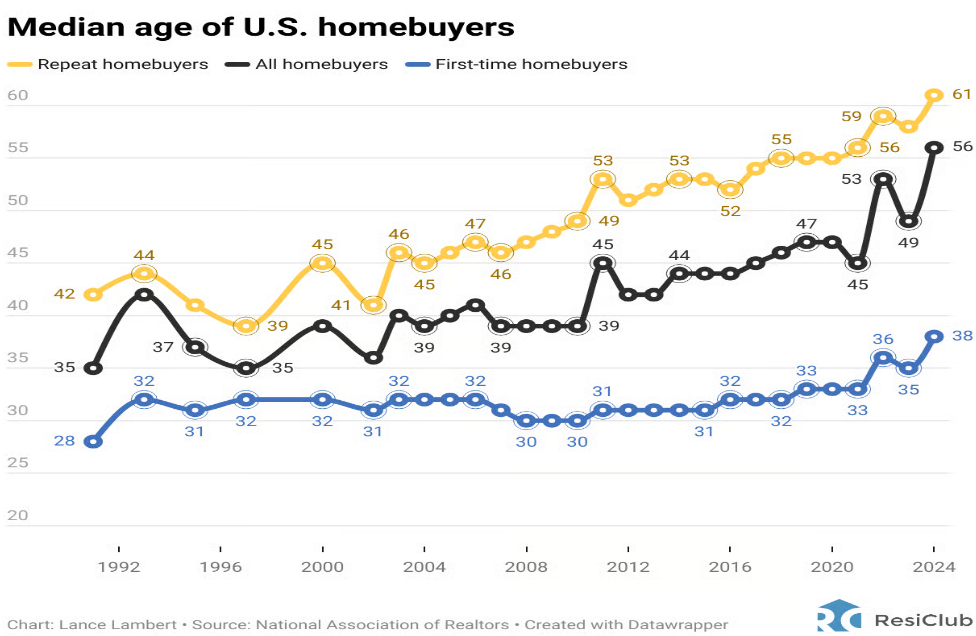
I will give politicians a "pass" on the use of "average" over "median" since it is their raison d'etre to be (re)elected to office; but Wall Street economists and mainstream media reporters should know better.

What is visible is the collapse in -sor line- housing "affordability", as tracked by the National Association of Realtors. Here, the Affordability Index is marked at 100 when the median income can buy the median priced house.

This index recently touched a 35-year low, although it has rebounded a bit as home prices have cooled this past year.



I would suggest that "good public policy" can be measured by Government actions that support a positive outcome. Home ownership (and intact families) is well-correlated with personal success; as such, good public policy should lead to improved affordability and home ownership when families have young children.

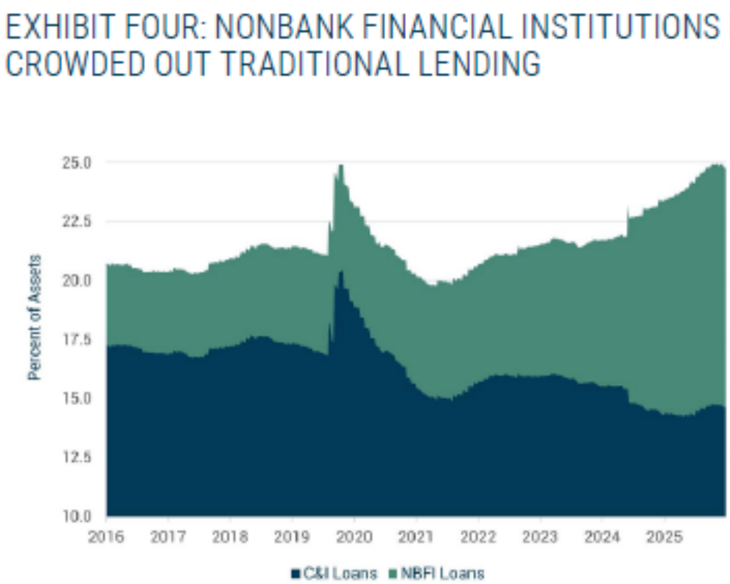


Since I do not believe Millennials work less hard than Boomers, it is fair to point to poor Government (Fiscal and Monetary) policies (not Vibes) that have pushed the -derya line- age of first-time home buyers from 33 to 38 since COVID. Moreover, it is wholly reasonable for people to have less **Trust** in Government.

The problem is not the Fed Funds rate….

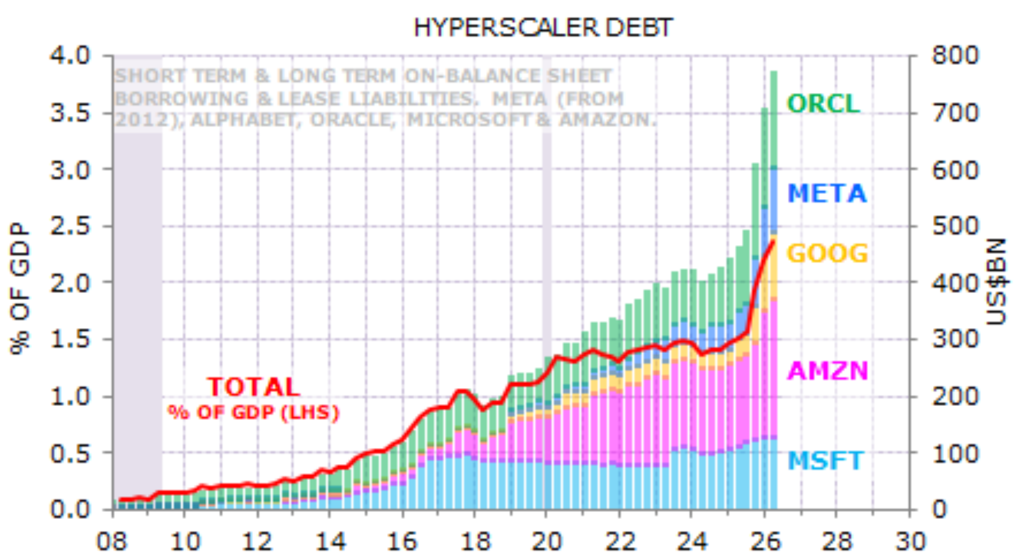
Once upon a time, the Fed Funds rate was a primary driver of Monetary Policy. This rate was a direct drive to the banking system, and the cost of money.

But the Fed has less influence over the -kesk shading- non-bank financial institutions (NBFI) who are disintermediating the banking system.



Source: GMO and Bloomberg

Perhaps more important, the so-called Hyperscalers are projected to issue over $750bn of debt…<u>at any interest rate</u>. Theirs is an existential race that cannot be lost; as such, there is no difference between a coupon of 6% or 9%.

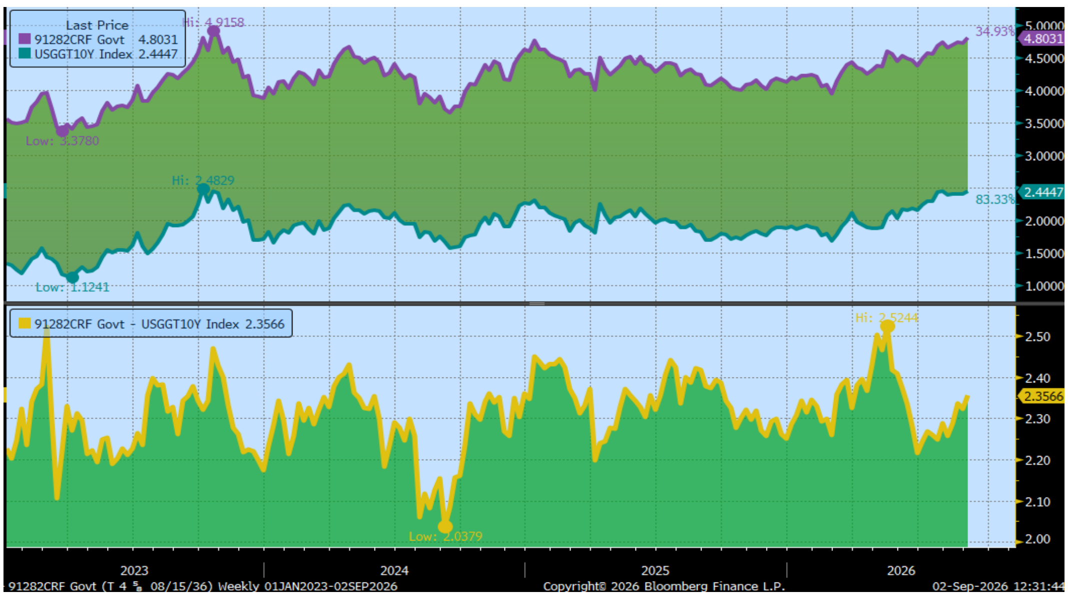


Source – Gerard Minack

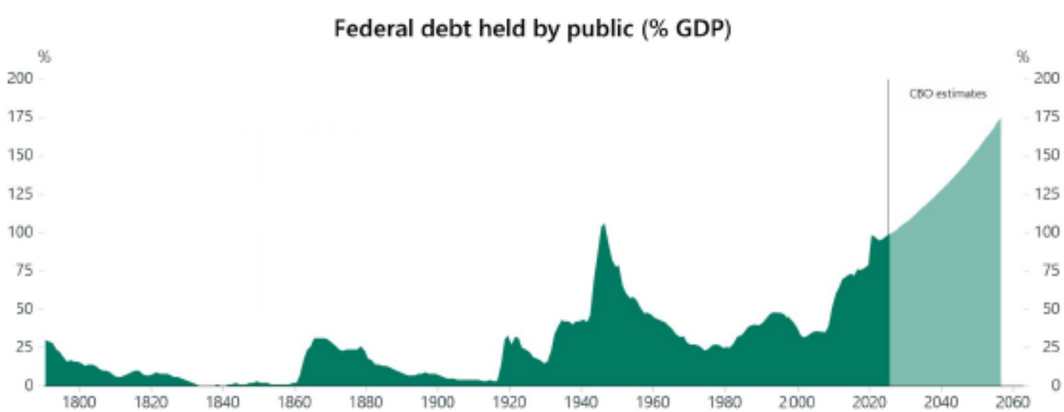
The problem is not a fear of Inflation….

Since the Fed Funds rate peaked at 5.08% in early 2023, the -serab line- UST 10yr has slowly depreciated from 3.25% to its current 4.75%. Over this same period, the -firuzi line- 10yr TIPs (Treasury Inflation Protected Securities) real rate has similarly deprecated from 1.00% to 2.40%.

Notwithstanding my view of "higher for longer", the -miz line- implied breakeven inflation rate has consistently hovered near 2.35%, close to the Fed's targeted rate of 2.0%. <u>UST rates have increased for reasons other than fear of inflation</u>.

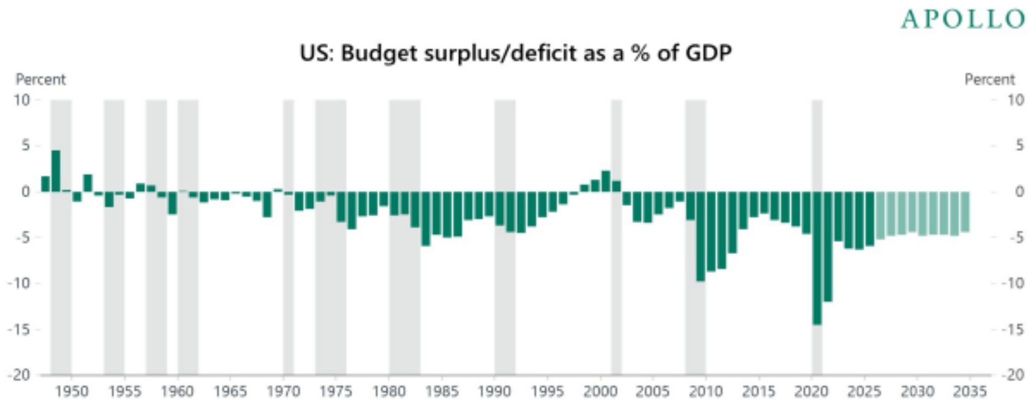


I would propose that UST rates are touching twenty-year highs because the **market does not trust the US Government** to manage its Fiscal matrix (Revenues vs Expenses) to control its -zeytun shading- debt issuance. I will not call this a default premium, but note the UST 10yr yields 75bps above Greece.



Source – Torsten Slok, CBO, Macrobond

In what can only be called **gross fiscal mismanagement**, since 2001, under equally divided Governments, we have reversed a -tiri shading- budget surplus to a relentless 6% deficit while debt has accumulated from $5.8Tn to over $40Tn.



Source – Torsten Slok, CBO, Macrobond

Modesty (almost) hinders me from taking a victory lap about the absurdity of Modern Monetary Theory, which proposed the Government can borrow with no limits, with the stipulation that it would cut spending or raise taxes at the point of inflection. That's fine in theory, but not as each election cycle nears.

Time for a Fed intervention….

Prior to the last Fed meeting I issued the Commentary "The FED should hike by 50bps" (July 28, 2026), and I stand by that. I will offer no economic support for a 50bps hike, rather I am looking solely at market psychology and politics.

As I detailed in my Commentary - "Moral Hazard" (May 23, 2023), **I believe Forward Guidance contributed greatly to the GFC, and the DOTs have only made it worse.** Investors have used such to increase both risk and leverage. The FED's March 2021 Forward Guidance that rates would remain near zero until 2023 contributed to why SVB did not hedge.

Presently, the market does not trust the US Government, despite Treasury Secretary Bessent's best effort to be the "adult in the room".

Perhaps not quite a redux of Jack Nicholson standing on the wall in "A Few Good Men", Chair Warsh needs to shock the market and make investors believe he will do "whatever it takes" to maintain US Dollar's reserve currency status.

Maybe economically unwarranted, a 50bps hike shows there is a new Sheriff who is not beholden to the President. An independent Fed is the cornerstone of the Global financial system, smartly confirmed by the recent **Supreme Court** decision that exempted the Fed from Executive Branch (Presidential) control.

The December 2026 Fed Funds futures contract is priced at 3.94% with the UST 2yr at 4.37%, so the notion of a "market Armageddon" is silly. The market already has the rate right, just not the timing.

The market has almost fully priced in 50bp by year end, so why drag its feet; rip the band aid so it can be "one and done" and move on. Likely a back-end rally follows which leads to lowers MBS rates - a public policy win.

It's never different this time….

Notwithstanding curriculum changes in some venues that have deemphasized the stodgy study of Western Civilization, the Greek Tragedies (penned by Aeschylus, Sophocles and Euripides circa 520 BCE) and Shakespeare (circa 1600 AD) both highlight the downfall of man is almost always sourced from Hubris.

Hubris, defined as extreme and unreasonable pride and arrogance, is a mark against one's character, and a person's "good character" is linked to **Trust**.

I do not think I need to connect the dots between hubris and a myriad of Government policies over the past decade, but a trusted Fed working with a rational Treasury may calm the markets with a possible "Fed::Treasury Accord" redux on the horizon.

A current "true real rate" of +50bps (4.12% Funds rate minus 3.62% inflation) for the safe holding of an infinite size of US Dollars sounds right to me.

Remember: For most investments, sizing is more important than entry level.

Harley S. Bassman
September 8, 2026

Follow me on Twitter: **@ConvexityMaven**
Your comments are always welcome at: harley@bassman.net

If you would like to be added to my distribution, just ping me.

To become better educated on macro-economic fundamentals and policy, I urge you to connect with my good friend, Michael Green, aka, @profplum99.

For reference literature on the financial markets - particularly about options and derivatives - I will immodestly direct you to my educational archive at:

https://www.convexitymaven.com/classroom/

If you still have kids in the house, please take a vacation that is more interesting than the Four Seasons, Costa Rica – life is not a dress rehearsal. Turn off the Crackberry (did I just date myself ?) and explore with the family. You don't need to break the bank, rent an RV and see the U.S. We traveled with our four kids on five incredible RV trips.

http://bassman.net

Special credit to Gerard Minack, the best macro analyst on the planet.