# Hamilton-Bates
## Special Update

***December 4, 2025***

# Debt, Inflation, and Their Portfolio Impact

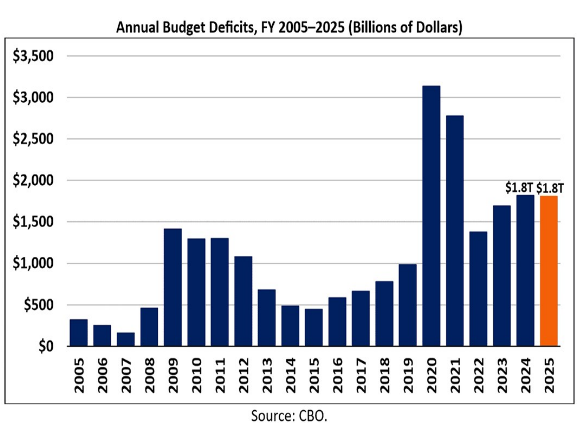
P.O. BOX 98 Mertztown, PA 19539 877.768.4247 www.hbir.com

**Debt, Debt Everywhere**
There is too much debt around, the world is drowning in it. The US Government has too much, US consumers have too much. Everyone has too much.

Some debt is good, like a mortgage for instance. It lets you finance a huge purchase over time, and allowing for better control of your cash flow. Too much debt is not good, and eventually too much debt acts like a loadstone taking a household—or a country, slowly under.

The debt we are talking about in this article is specifically US Government debt. At this point the US Debt stands at $31 Trillion dollars. There are some calculations that there is additional shadow debt and unfunded liabilities that double that number. Even 'just' the $31 Trillion figure is a HUGE number It is so large its tough to even wrap your head around it. Imagine a stack of $100 dollar bills large enough to reach to the moon and back 4 times! Not once, and not $1 bills. A stack of $100 bills over 2 million miles high. That is the government debt.

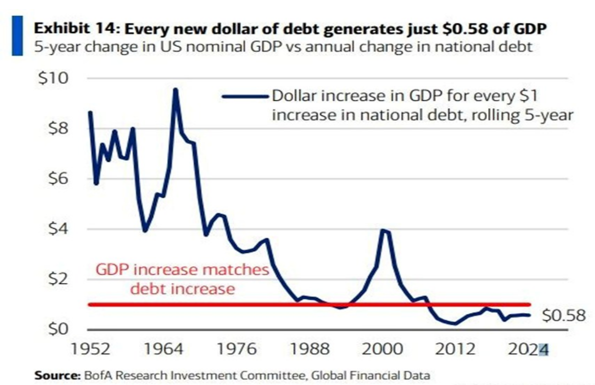
The chart below shows the Deficit on an annual basis, and its clear the Government has a spending problem. The explosion of government spending since 2019 is what triggered the most recent bought of inflation, and pushed total debt to insane levels.




How we got here is immaterial to the article, its enough to say that politicians love to spend money, especially other people's money. Its universal, across all parties and over all time periods.

Small decisions, like raising the retirement age of social security over time, if it was done DECADES ago, would have helped. But why make tough decisions when you can just "kick the can down the road". Politicians love to make it someone else's problem. They look good while a future someone gets the tab. The problem is this cannot be done forever, and eventually you get toward the end of the road.

As government debt grows, its effectiveness in helping the economy diminish. The chart below shows that over time, each new dollar of debt has generated a smaller and smaller amount of growth in the economy. We now get less than a dollar of growth for each dollar of debt. Debt is not really helping anymore. This level where it turns negative, where new debt doesn't help, is not far off. This was studied in a research work by Rienhard and Rogoff that showed levels of debt greater than 90% of GDP were negative. They looked at various high-debt governments across history. We are now at 120% Debt to GDP. The US may be the greatest superpower the world has ever know, but too much debt has negative effects, and we are starting to see unfold right now.




The debt is now so large that it's handling is now front and center. It is not something off to the side like a small credit card balance. Its now so large it demands attention –and the financial markets are now paying attention. Bond investments are now starting to suffer.

That is closer to the point of this article, that the tremendous burden of debt is now manifesting itself very clearly in the financial markets, and this is changing things across the investment and portfolio construction process.

We are oversimplifying some points and concepts, for the sake of space and clarity. The simple basic points are really all that's needed to get to the why's and how's of the story. That brings us to the real 'bad guy' of the story, inflation

**Inflation—the Real Boogeyman**
Inflation is the decrease in purchasing power of your paper money over time, largely due to the overspending of governments. We say paper intentionally, because that is all currency is these days. Pieces of paper backed by government promises. It's a confidence game. When confidence is high, inflation is low. When confidence is low, like with the Weimar Government in Germany in the 1920's, or modern Zimbabwe– inflation is high or even extreme.

In the US we have benefited from the fact that the US Dollar is the 'reserve currency' of the world. The most trusted name in paper currencies. The problem is its still paper, and if the government spends too much for too long, prices rise, and eventually it can get bad.

Inflation laid low for a long-time, but is now reawakening. In the last few years, anyone who remember the 1970's inflation got to watch new generations learn how it feels. It's not fun. It's brutal. I saw a quote somewhere that read "the life you used to afford is now out of stock". Inflation makes everyone feel poorer because they are poorer. Things cost more and you get less.

The inflation *era* of the 1970's started in the 1960s and extended into the early 1980s. It waxed and waned within those years but gradually worsened until interest rates where jacked sky high and it crushed the economy and inflation. That solution was quite painful. Two recessions and high unemployment. That option isn't available now because our debt is so high that jacking up rates will make the debt situation virtually untenable—it would literally bankrupt the government.

Now we're roughly four years into a period of post-COVID inflationary pressure, largely the result too much spending since 2020, along with a Federal Reserve being too timid to slowly raise rates as inflation went over 4% then to 6 then to 8%. Inflation peaked in 2022 but remains stuck above the pre-pandemic rate. We hope it falls further, but it may end up being stubbornly stuck.

**The thing about inflation is that it is a rate, not a level.** If you have a year of, say 4% inflation followed by a year of 1% inflation then yes, the inflation rate is lower. But prices are still 5% higher than they were two years earlier. They have slowed their rate of ascent but have not descended. Absent outright deflation, which has its own different but painful problems, inflation is a permanent increase in the price level. This is the rub—inflation once out of the bottle is virtually impossible to put back in. Things now cost 20-30-40% more than they did 4-5 years ago. Unless your income grew as much, you are feeling the pinch. And nearly everyone but the ultra-rich is feeling it.

The financial markets adjust to conditions, and we are seeing inflation's impact unfold across markets, impacting portfolios and portfolio construction. **The debt burden and inflation are likely to be key issues affecting portfolios and the financial markets for decades to come.**

As happened in the previous inflation era, several forces are combining to keep inflation alive. One is the fact that the Government simply can't cut spending. Even when it wants to, like with the attempt at Doge—it is nearly impossible to actually cut the budget. Cut defense? No way we have to deal with China! Cut Medicare, Medicaid, or Social Security? Yeah – no way. Anyone talking about this will not get elected. Government may be inefficient, but even cutting ALL the graft and waste wouldn't get it done. The US government could simply default on its debt but that's not likely. It would create a worldwide depression, and after 2008 the Central Banks fear an economic slowdown above all.

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What is likely is that the US Government will try to grow its way out of the debt by keeping economic growth strong and trying to limit inflation where it can, but likely suffering through periods of higher inflation. Over time this would gradually bring the debt burden down. Why will it likely be this path? Because for politicians it will be the only one palatable to the people.

**Portfolio Impact and Portfolio Construction**
Now we are getting to where the rubber meets the road—how these things affect portfolios and investments.

In the not so recent past, a simple portfolio of 60% Stocks and 40% Bonds did really well. For decades stocks grew during booms, while bonds rose and protected the portfolio during recessions. That worked for long time, right up until too much debt combined with reckless spending to trigger the inflation monster that has reared its ugly head in the past few years.

What has happened is that bonds haven't offered the downside protection during periods of recession or stock market weakness. With debt so high, when the economy slows and there is belief that the government will collect less taxes and spend more fiscally to support the economy—the bond market goes DOWN when in the past it went up.

**The bond shock absorber is no longer absorbing shock during downturns but rather makes the portfolio worse off**.

We don't like Government bonds, and we have avoided this sector of the bond market for a few years now. We have limited exposure to fixed income, cutting maturities to short-term bonds in the corporate area. We also use a bit more cash—with cash still yielding rates comparable to or better than short-intermediate government debt. As a result, during the last few market drawdowns we did not have the additional lodestone of bonds dragging portfolios, reducing drawdowns dramatically. Additionally, having that bit more cash gave us flexibility to buy when opportunity presented itself. In the government bond area, I-Bonds and Inflation Protected Securities still offer some attraction.

As far as inflation goes, stocks should do well in an environment where the plan is to 'run things hot' to manage the debt burden. Earnings growth and share buybacks should help offset inflation as dividends and stock prices rise. Stocks have been a solid inflation hedge over time. Its one of the few investments that have helped mitigate inflation. But you can't be 100% in stocks—that won't work for most investors and it creates incredible volatility and drawdown.

A sensible portfolio includes stocks but also some bonds as well, with the tweaks noted previously. Higher yielding corporate bonds in shorter maturities have greater appeal. A relatively new twist, but something we have been doing for a few years now is that we have also been incorporating inflation hedges more and more. These have begun to pay off. This includes ETF's and mutual funds that hold assets that mitigate inflation—such as non-dollar assets (like the Swiss Franc), commodities like agriculture and base metals, as well as with precious metals. Gold and silver have done extremely well lately, and some think they have hit a top. But the rise of the metals may be just beginning. More on that in the next special Update covering just *The Rise of the Metals*.

We study the financial markets, and we can see the changes unfolding over time. That is the benefit of having a portfolio manager with 30 years of experience that does this day after day. This is not our first rodeo. The financial markets change, and we do as well. Our managed portfolios are flexible and will adjust with conditions and come to reflect the new investment realities. This isn't about chasing fads or hot stocks. We invest in solid companies, and most funds and ETF's we own pay solid dividends. We create balanced portfolios that mitigate risks—including bonds, cash and alternative investments like inflation hedges noted above.

Over the next decade protecting the purchasing power of your assets could be just as important as protecting your assets themselves. We see the key do achieving both is flexibility, along with the methodology and willingness to adjust portfolios over time to reflect changing markets. Flexibility is a good thing, just ask anyone getting older about the importance and benefits of flexibility.