APOSTLE

America's debt addiction: the hangover is here

April 2025

Prepared by
Apostle Funds Management

Executive Summary

The U.S. is approaching a fiscal tipping point. The national debt has soared past US$36 trillion, and with interest rates hovering near multi-decade highs, the strain on global markets is intensifying. Borrowing is becoming increasingly expensive, volatility is mounting, and the traditional market playbook is breaking down.

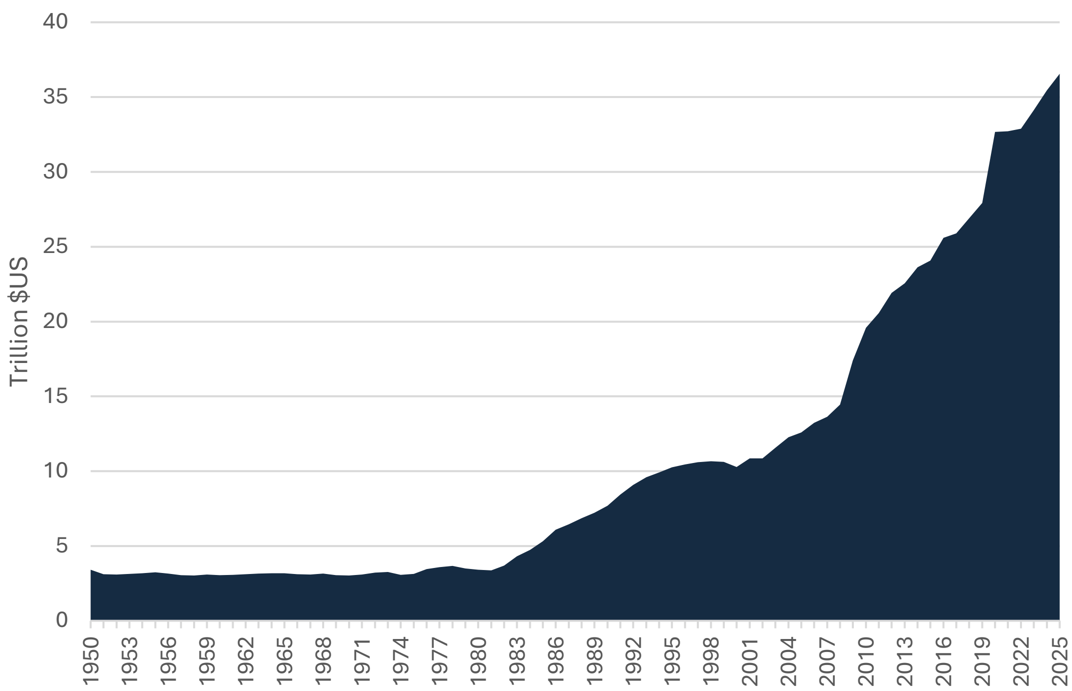
This whitepaper outlines key threats of the U.S. debt spiral and presents defensive strategies to help investors reposition their portfolios for resilience in the face of high rates and high volatility. The era of cheap debt is over - and for markets, the hangover has just begun.

In February 2024, Jerome Powell, Chair of the U.S. Federal Reserve declared: “The federal government is on an unsustainable fiscal path: that means our debt is growing faster than our economy” (CBS News, 2024).

The U.S. Government’s escalating debt burden is pushing the global financial system to its limits. As the U.S. enters a new era of high interest rates, investors must confront the harsh reality of America’s debt addiction - one that threatens to destabilise bond markets, upend traditional diversification and trigger global contagion. For managers seeking to avoid financial rehabilitation, portfolio repositioning has now become a strategic imperative. It is paramount that investors develop a clear understanding of the tactics and mechanisms needed to safeguard their capital in the event of a global debt crisis. This paper explores key risks on the horizon and presents actionable strategies to navigate the volatility ahead.

At the time of Powell’s interview, the national debt figure had recently crossed US$34 trillion, and interest rates were peaking at 5.5% - the highest level seen since 2001 (CBS News, 2024). But just one year later, the Trump Administration has passed its 2025 budget proposal, which will raise the U.S. debt ceiling by at least US$4 trillion. Meanwhile, the national debt figure has surged to US$36.5 trillion and counting (CBO, 2025).

Figure 1: Inflation-Adjusted U.S. National Debt
(Trillion $US)



Source: Bloomberg data.

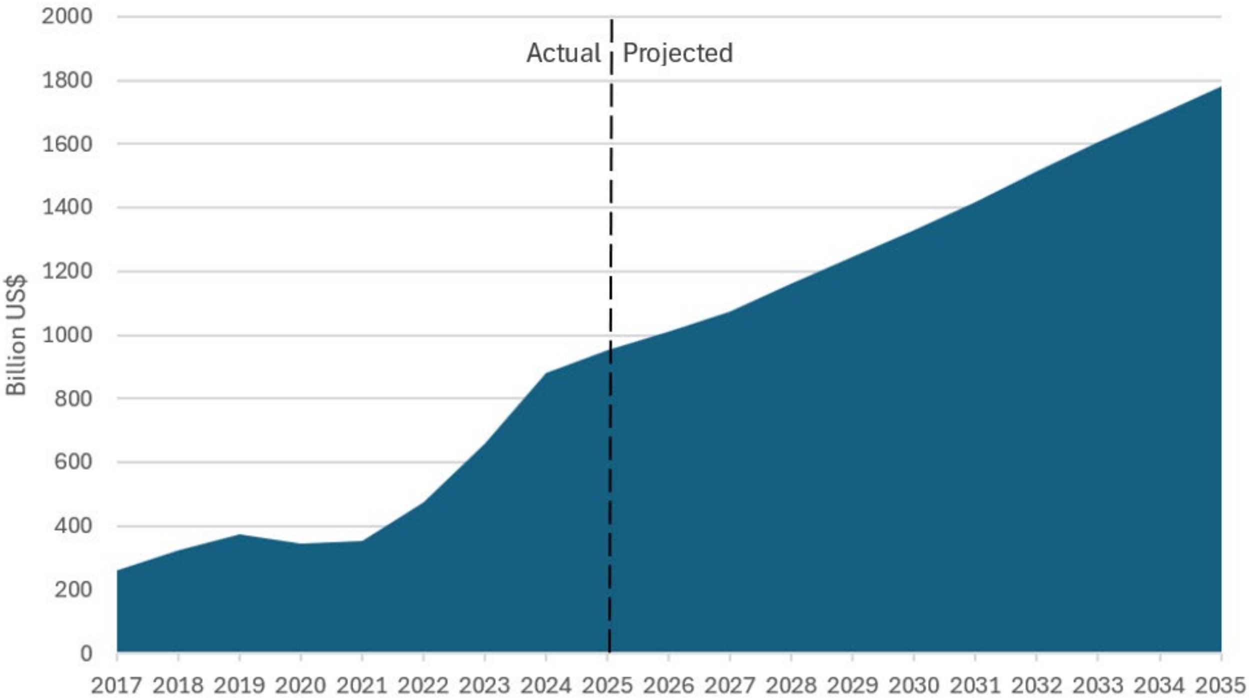
So, how much longer can we ride this unsustainable debt train before it derails?

The tipping point revolves around the rising costs of borrowing, marked by interest rates - the extra cost the government must pay for its debt. When bond vigilantes doubt the Fed's ability to pay for its obligations, or deem debt levels to be untenable, they aggressively sell off bonds to force a change of fiscal strategy. Whilst this is not an immediate pressing risk, it sets the stage for calamity should fiscal deficits remain rampant.

Since the Global Financial Crisis of 2008, the U.S. enjoyed eight years of sub-1% interest rates. These years were the gateway to its spending addiction, where borrowing costs were next-to zero. However, the post-COVID-19 era has shifted the landscape, with rates peaking at 5.5% in 2024. Borrowing now entails a far greater cost and consumes a growing portion of government revenue. The Congressional Budget Office (CBO) projects that net interest payments will rise from an annual cost of US$1.0 trillion in 2026 to US$1.8 trillion in 2035.

Figure 2:

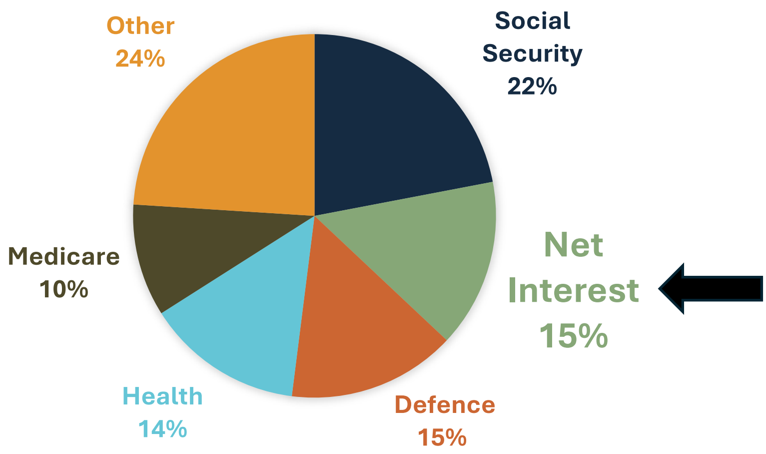
Annual Net Interest Payments



Source: Congressional Budget Office.

The consequences of aggressive quantitative tightening during the pandemic recovery are catching up with the Fed. Despite temporary quantitative easing this year, continuing inflation concerns signal that higher rates will become the new normal in years ahead. Interest payments are the fastest growing portion of the federal budget, and in FY25, 15 cents of every tax-payer's dollar will be paid solely to service previous debt issuances. For the first time in FY24, the U.S spent more on interest alone than it did on its own military (CBO, 2025).

Figure 3: Federal outlays FY25



Source: Congressional Budget Office.

To pay for these growing obligations, the Treasury must issue more bonds, at higher yields - exacerbating the ongoing debt spiral. Consequently, the national debt is due to increase 52% in just nine years - to US$55 trillion in 2034 (CBO, 2025). Looking at national debt as a percentage of GDP, we can gauge the real value of these nominal figures. In 2024 the debt held by the public was 98% of GDP, however by 2029, the CBO forecasts this will rise above the nation's all-time high of 106% - reached in 1946 following WWII.

Figure 4:

U.S. National Debt as % of GDP

Source: Congressional Budget Office.

As interest payments continue to consume an increasing portion of tax revenue, policymakers face a difficult dilemma to achieve balance: raise taxes or cut spending. Both options have economic and political consequences.

Detailed below are three key risks on the horizon, and strategies investors can employ to navigate them:

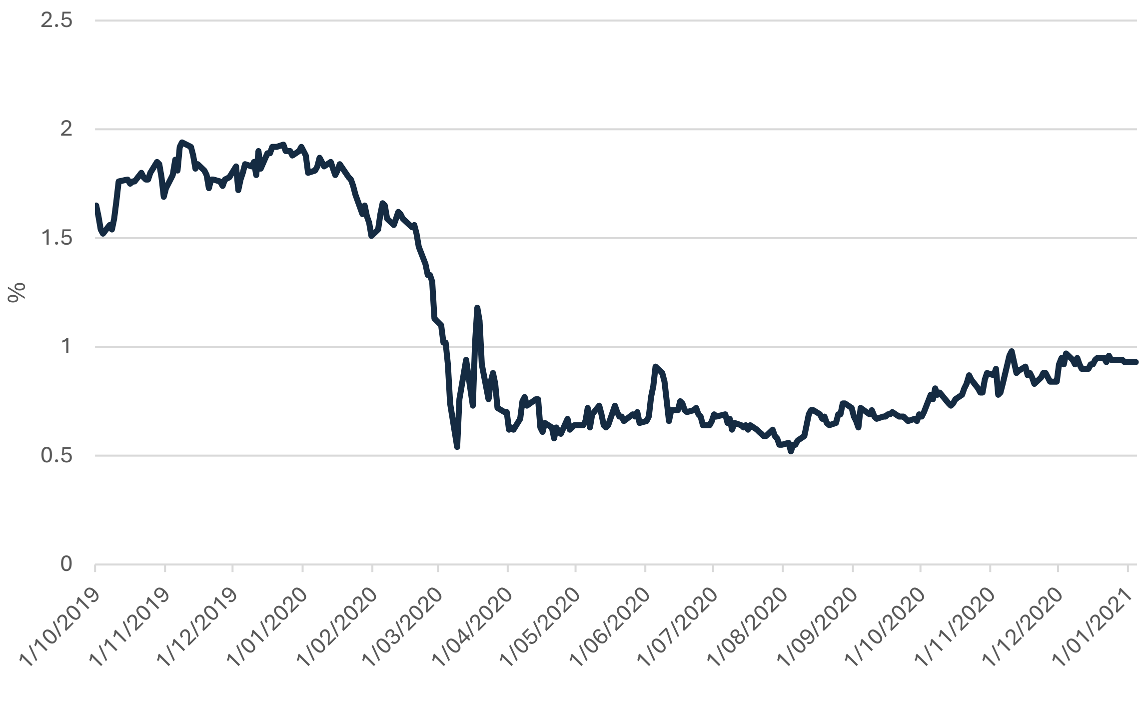
1. Bond market instability poses a fundamental risk to fixed income security.
2. Fiscal strains are upending traditional market correlations and reshaping diversification.
3. When the U.S. sneezes: how rising yields send shockwaves through global markets.

1: Bond market instability poses a fundamental risk to fixed income security.

To compete for capital in private markets, bonds must be issued at higher yields to attract investors. This has a cascading effect on borrowing costs across the economy as U.S. Treasuries provide a foundation for market liquidity and serve as the benchmark for fixed income markets. A sudden spike in yields may trigger a fire sale as long-term bond holders realise losses and institutions search to offload assets. The result is a liquidity crunch.

Investors might doubt this could happen to the 'world's safest asset class', but look no further than the 2020 'global dash for cash'. The pandemic-induced economic shutdown ignited an immediate need for liquidity to protect portfolios from market turmoil. This shock saw the 10-year Treasury yield rise from 1.5% to 3.2% in just one week - the largest increase since 1987 (Bloomberg, 2025). Consequently, fixed income markets saw historic outflows, with liquidity evaporating in investment-grade bonds whilst high-yield bonds faced mass redemptions.

Figure 5: U.S. 10-year Treasury Yield
(2019-2021)



Source: Bloomberg Data.

Evidently, a sudden shock to the debt market erodes fixed income stability and in turn, undermines economic momentum. To navigate these challenges, investors should prioritise assets with strong cash flows, resilient balance sheets and low debt exposure. Further, shifting towards inflation-protected securities can provide a hedge against rising borrowing costs and market volatility.

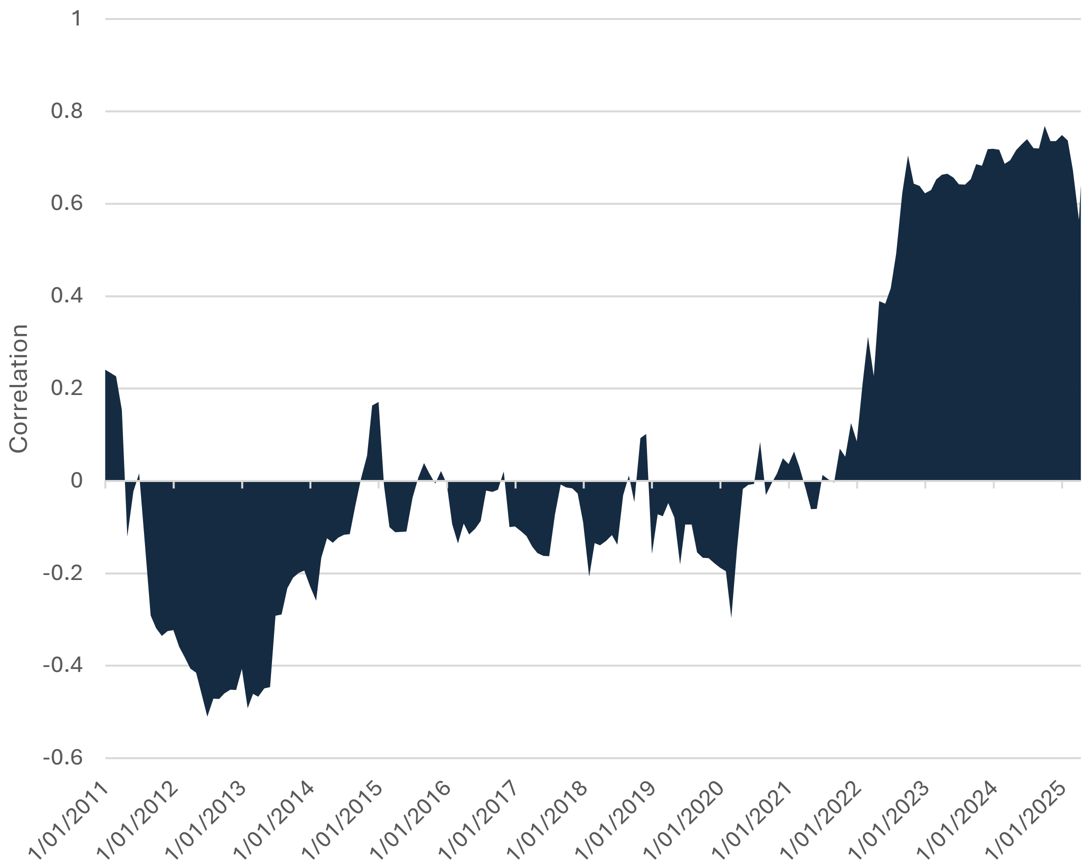
2: Fiscal strains are upending traditional market correlations and reshaping diversification.

In response to a debt-heavy fiscal framework, monetary authorities may deviate from the natural forces of supply and demand in money markets, artificially raising interest rates to manage rising debt levels. This approach distorts well-established market mechanisms and undermines investor confidence. As a result, both bond and equity markets experience a selloff, disrupting the traditional negative correlation between these asset classes.

In this scenario, economic conditions deteriorate as corporate earnings weaken, increasing the risk of defaults among low-rated issuers. The result would entail a widening of credit spreads as investors demand higher yields to compensate for the rising probability of default. Simultaneously, equity markets tumble as risk appetite evaporates and earnings expectations are revised downwards. The concurrent decline in both asset classes reduces the traditional diversification benefits and leaves investors with fewer safe havens.

This trend has been evident since the pandemic recovery, where the higher-for-longer interest rate environment has led to a persistent positive correlation between stocks and bonds - marking a structural shift from the traditional negative relationship. This elevated correlation - at levels unseen in 75 years - signals the reshaping of market behaviour, where even the slightest economic tremor can trigger dramatic swings across asset classes. Against this backdrop, the argument for alternative investments as a source of diversification appears particularly compelling. Investors have acted to reduce their concentration in high-growth sectors and reallocated toward sectors that are less sensitive to interest rate fluctuations, including healthcare, utilities and consumer staples.

Figure 6: Stock-Bond Market: 30-Day Rolling Correlation



Source: Bloomberg Data.

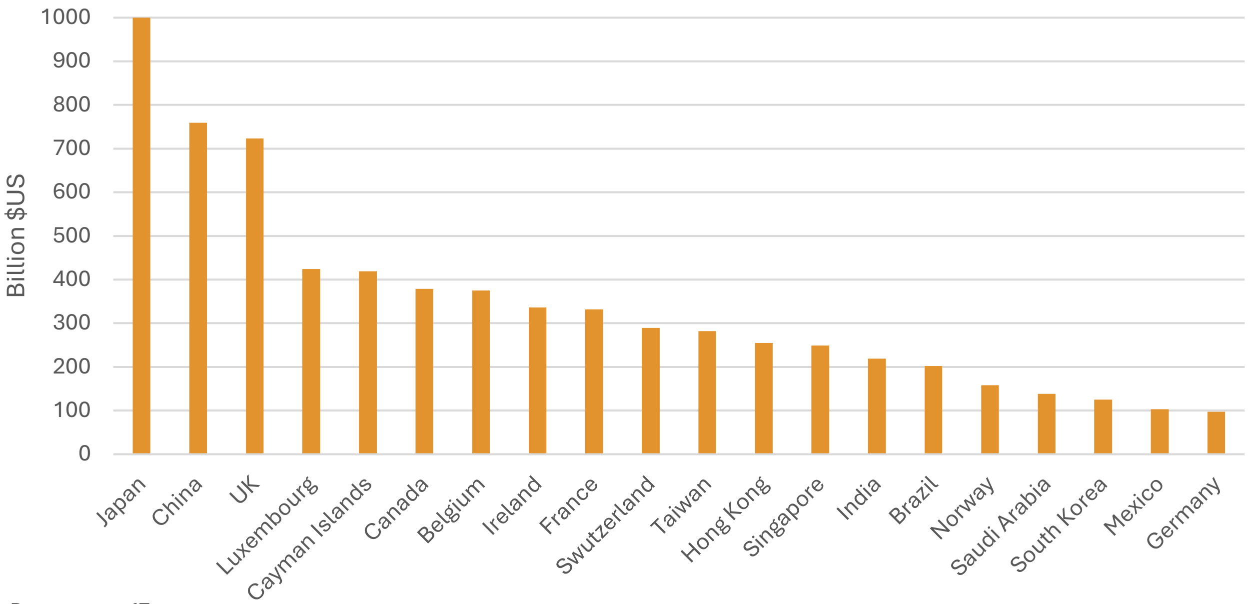
3: When the U.S. sneezes: how rising yields send shockwaves through global markets.

Whether the burden falls on the American public, foreign corporations or government reserves, the cost of the Fed's monstrous debt must be paid - making its spillover into global markets unavoidable. A higher U.S. Treasury yield lures capital away from overseas funds, heightening risks for emerging markets and commodity-driven economies like Australia. The result would effectively export the U.S. deficit to countries heavily exposed to U.S. dollar denominated debt, such as Japan, China and the UK, making it increasingly difficult for them to meet their obligations. In response, central banks in these nations would be forced to aggressively hike interest rates, triggering a domestic slowdown.

To mitigate these risks, investors can allocate capital to defensive sectors and assets that have historically benefitted from high-interest climates. These might include energy and infrastructure industries, or multinational corporations with significant revenue in USD. Furthermore, sectors like U.S. financials and defence, which are less sensitive to currency fluctuations will provide stability.

When the U.S. sneezes, the world catches a cold. The Australian economy - particularly the banking sector - could be hit hard with financial fever. As U.S. yields rise, Australian bond markets could face upward pressure on rates, reducing demand for longer-duration debt and increasing refinancing risks across the economy. As corporates seek financing outside traditional banks, investors should turn to alternative lenders and private credit markets, which may benefit from tighter bank lending conditions. Global Credit Funds are a prime example of downside-protected, secure investments to safeguard capital in times of financial turmoil.

Figure 7: Countries Holding the Most U.S. Debt in FY24



Source: U.S. Department of Treasury.

In summary, the U.S. debt trajectory is certainly on an unsustainable path, and the implications will be felt across global financial markets and asset classes. Fixed income and equity markets face fundamental vulnerabilities, whilst emerging markets and commodity-driven economies face fiscal instability and currency depreciation and in growth.

As the debt addiction swells, credit costs will rise, monetary flexibility will shrink, and market volatility will intensify. Policymakers and investors must forgo their expectations of low interest levels and prepare for a higher-for-longer environment in the coming decade. The U.S. fiscal structure is evidently overloaded - how the world adapts remains the pressing question.

References

Adrian, Tobias, et al. (2024), "The Fiscal and Financial Risks of a High-Debt, Slow-Growth World", IMF, 28 March, www.imf.org/en/Blogs/Articles/2024/03/28/the-fiscal-and-financial-risks-of-a-high-debt-slow-growth-world.

Congressional Budget Office (2025), "Budget and Economic Data | Congressional Budget Office", *Budget Economic Data*, 31 January, www.cbo.gov/data/budget-economic-data#3.

Gokhale J (2025), "Penn Wharton Budget Model", *Penn Wharton Budget Model*, 27 January, budgetmodel.wharton.upenn.edu/issues/2025/1/27/complete-measures-of-us-national-debt.

Harris, Ben, et al., (2025) "Assessing the Risks and Costs of the Rising US Federal Debt", *Brookings*, 12 February, www.brookings.edu/articles/assessing-the-risks-and-costs-of-the-rising-us-federal-debt/

International Monetary Fund (2022), "Central Government Debt", imf.org, www.imf.org/external/datamapper/CG_DEBT_GDP@GDD/CHN/FRA/DEU/ITA/JPN/GBR/USA.

Peterson Foundation (2024), "The Current Federal Deficit and Debt", *Peterson Foundation,* 22 August, www.pgpf.org/programs-and-projects/fiscal-policy/monthly-interest-tracker-national-debt/.

60 Minutes (2024), "Jerome Powell: The 2024 60 Minutes Interview", *CBS News*, 4 February, https://www.cbsnews.com/news/full-transcript-fed-chair-jerome-powell-60-minutes-interview-economy/

Disclaimer