

## Liquidity: a subtle support for 2026

December 9, 2025



### TOP THREE TAKEAWAYS

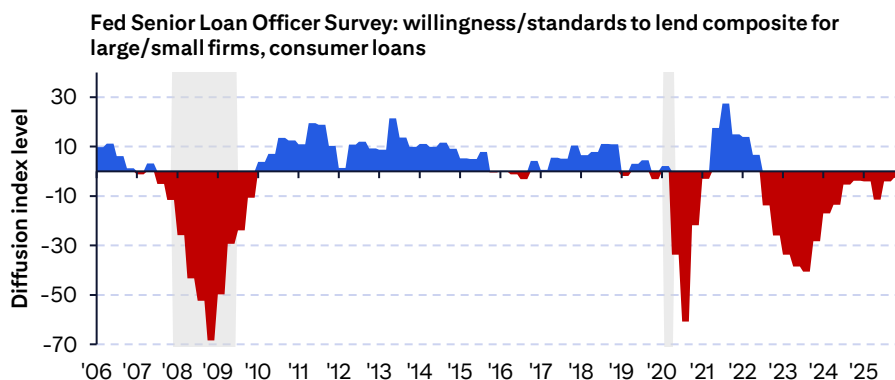
The Fed will likely move toward more accommodative liquidity settings as funding market stress exposes the need for additional cash in the system. Inflation will be a constraining factor on the number of rate cuts in 2026, but lower rates and more liquidity can provide positive inputs for growth.

Global fiscal policy is becoming more supportive. Given this combination of improving liquidity, resilient nominal GDP growth, and strong upstream demand, we see a supportive backdrop for more cyclical financial assets tied to natural resources.

Concerns around private credit have grown, but sector data continues to show healthy asset quality and low leverage across Business Development Company (BDC) structures. We expect well-underwritten private credit strategies to remain attractive for investors able to own less liquid assets, although manager selection is key as dispersion rises.

### THIS WEEK IN CHARTS

**Figure 1:** More liquidity support and less regulation provide a strong starting point for bank lending into 2026.

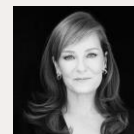


Source: Bloomberg, Federal Reserve Senior Loan Officer Survey as of December 8, 2025. Gray bars are U.S. recessions.



### LOOKING CLOSER

With more liquidity and the prospect of lighter regulation, banks should have higher lending propensity. Banks have slowly loosened lending standards in 2025 – a trend that should continue in 2026, supporting the potential for healthy leverage growth.



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*Liquidity shifts underneath the surface can help drive market directionality, and today's environment marks an inflection point.*

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## The Fed will be shifting its liquidity settings to be more accommodative.

Our investment process is built on marrying macro, fundamental, holistic flow, and valuation dynamics – and U.S. monetary liquidity is a key input into the macro landscape. At inflection points, liquidity – the ease in which corporations and households can access capital – is a powerful driver of market directionality. The relationship between changes in money supply growth combined with Fed balance sheet shifts and S&P 500 returns one year later can be highly significant, particularly around large packages during recessions. However, small adjustments also influence markets, and the Fed is moving towards one of those inflection points.

Recent stress in the funding markets, evidenced through spreads in overnight financing rates, indicates a shortfall of liquidity in the system. As these spreads widened, Fed officials have signaled their awareness that the system needs more cash to function smoothly and will move from Quantitative Tightening (QT) to small purchases. There is debate around the timing and magnitude of this adjustment (Citi Research expects this shift in early 2026), though policy action could begin as soon as this month.

More accommodative liquidity settings coupled with deregulation and strong bank balance sheets create a solid foundation for additional bank lending in a continued stable economic growth environment. Loans and leases relative to deposits are low relative to pre-GFC<sup>1</sup> levels and have room to rise as rates come down and demand for credit increases. Banks are slowly doing less tightening of lending standards for firms and consumers, which we expect to continue into 2026. Overall, the foundations are set for healthy leverage growth in 2026, providing an additional reason for optimism around activity in the new year.

**Bottom line:** An improving liquidity and credit creation environment is further supportive of resilient nominal growth in 2026. While we expect above-target inflation to constrain ongoing rate cuts in 2026, lower policy rates and more accommodative liquidity settings will likely aid cyclical tailwinds.

## Portfolio implications: Stay invested, add diversification, lean into cyclical tailwinds.

The global macro backdrop, industry fundamentals, and asset class flows support natural resource plays into 2026.

An aggressive capital expenditure pipeline and shifting needs for AI infrastructure are set to drive robust, ongoing demand for natural resources, specialized labor, and niche industrial suppliers. Whether viewed via the earnings transcript or corporate survey lens, U.S. capital expenditures (capex) are on track to reach new highs in 2026 when normalized by real GDP. Across the G10, capex is similarly rising as nations invest in AI-related infrastructure. Additionally, global fiscal trends are expanding, not contracting, while monetary policy remains accommodative, another source of nominal growth support in the year ahead.

Given this combination of improving liquidity, resilient nominal GDP growth, and strong upstream demand, we see a supportive backdrop for more cyclical financial assets tied to natural resources. When we overlay our holistic flow analysis, we see opportunities for inflows to return to these asset classes following the outflows seen during the Fed's aggressive 2022 rate-hiking campaign. Earnings revisions are inflecting higher in this corner of the market, reinforcing their complementary role within our asset-allocation framework.

**Bottom line:** Seek to maintain core AI exposure, stay invested through volatility, and consider adding resource-linked cyclicals to capture the next leg of the liquidity-supported growth cycle.

<sup>1</sup> Global Financial Crisis (GFC) refers to the worldwide economic downturn that occurred from 2007-2009.

The Fed's shift toward more accommodative liquidity, combined with the potential for better credit creation and resilient nominal growth, sets a constructive tone for 2026. This environment supports staying invested in core AI leadership while adding diversification through natural-resource cyclicals and remaining selective in private credit opportunities.

## Private credit: Not seeing broad-based deterioration, but manager selection is critical.

There has been a growing chorus of concerns around private credit lately with the rapid pace of growth of the asset class in the past few years, increased prevalence of payment-in-kind optionality for borrowers, and several recent high-profile bankruptcies all contributing to the noise. While we acknowledge the validity of these datapoints as potential warning signs and key areas to monitor going forward, we think the negative narrative has become somewhat overblown.

We track a variety of metrics across the BDC sector to gauge the health of private credit given BDC assets have grown to represent roughly 30% of the market<sup>2</sup>. Overall, we find that asset quality metrics across this space remain healthy. Importantly, the fact that BDC structures themselves are typically low levered (despite lending primarily to highly levered, private companies) provides significant cushion to absorb a material potential increase in credit stress.

Further, as we highlighted in last week's bulletin, credit trends across the banking system have been stable to improving in recent quarters and the sector remains well capitalized, helping to alleviate fears of possible contagion risk stemming from private credit.

**Bottom line:** Despite some indications of increasing credit stress in pockets of the private credit market, we have seen limited evidence of broad-based deterioration. We continue to believe that an allocation for suitable and qualified investors to private credit makes sense for portfolios with flexibility to own illiquid assets but emphasize the importance of focusing on managers with differentiated origination, underwriting, and workout capabilities given our expectation for growing dispersion in performance across the asset class.

<sup>2</sup> U.S. Securities and Exchange Commission's Division of Economic and Risk Analysis (DERA), June 2025

## WHAT HAPPENED

## WHAT'S AHEAD

<b>U.S.</b> <ul style="list-style-type: none"> <li>November Institute for Supply Management (ISM) Manufacturing Index missed on weaker employment and new orders, while ISM Services was the highest in nine months.</li> <li>Automatic Data Processing (ADP) payrolls ended well below consensus, but jobless claims and layoffs remain subdued.</li> <li>Black Friday spending outpaced last year by 9.1%.</li> </ul>	<b>ECONOMIC DATA</b>	<b>U.S.</b> <ul style="list-style-type: none"> <li>October Job Openings and Labor Turnover Survey (JOLTS) report</li> <li>November Producer Price Index (PPI)</li> <li>Q3 employment cost index</li> <li>National Federation of Independent Business (NFIB) small business optimism</li> </ul>
<b>GLOBAL</b> <ul style="list-style-type: none"> <li>Eurozone core inflation in line, headline a bit warmer.</li> <li>Japan household spending falls by most since Jan 2024.</li> </ul>		<b>GLOBAL</b> <ul style="list-style-type: none"> <li>China imports/exports, CPI/PPI for November</li> </ul>

<b>U.S.</b> <ul style="list-style-type: none"> <li>Trump referred to Kevin Hassett when discussing Chair Powell's replacement at his 12/2 cabinet meeting.</li> <li>Little hope of bipartisan breakthrough for Affordable Care Act (ACA) subsidy extension.</li> </ul>	<b>POLICY</b>	<b>U.S.</b> <ul style="list-style-type: none"> <li>Federal Open Market Committee (FOMC) expected to cut next week.</li> <li>Republican victory in Tennessee came at a much smaller margin than 2024, reinforcing political shift into midterm year.</li> </ul>
<b>GLOBAL</b> <ul style="list-style-type: none"> <li>No developments in Ukraine-Russia peace talks.</li> <li>Japanese bond worries eased with strong demand for 10-year auction</li> </ul>		<b>GLOBAL</b> <ul style="list-style-type: none"> <li>Bank of Japan (BoJ) set to hike this month.</li> <li>Germany and France narrowly pass budget bills, both governments still face fiscal challenges.</li> </ul>

<b>U.S.</b> <ul style="list-style-type: none"> <li>Equities higher globally with growth outperforming value, yields higher behind lower layoffs.</li> <li>American Association of Individual Investors (AAII) bullishness showed biggest jump since January, snapping three-weeks of negative readings.</li> </ul>	<b>MARKETS</b>	<b>U.S.</b> <ul style="list-style-type: none"> <li>Notable tech and retail earnings set to report this week.</li> </ul>
<b>GLOBAL</b> <ul style="list-style-type: none"> <li>Japan long-end bond yields hit 18-year high on inflation expectations.</li> </ul>		<b>GLOBAL</b> <ul style="list-style-type: none"> <li>Volatility approaching relative lows as we head into lower liquidity days.</li> </ul>

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Bond credit quality ratings		Rating agencies	
Credit risk	Moody's <sup>1</sup>	Standard and Poor's <sup>2</sup>	Fitch Rating <sup>2</sup>
Investment Grade			
Highest quality	Aaa	AAA	AAA
High quality (very strong)	Aa	AA	AA
Upper medium grade (Strong)	A	A	A
Medium grade	Baa	BBB	BBB
Not Investment Grade			
Lower medium grade (somewhat speculative)	Ba	BB	BB
Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

1 The ratings from Aa to Ca by Moody's may be modified by the addition of a 1, 2, or 3, to show relative standing within the category.

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- less regulation and higher fees than mutual funds; and
- manager risk.

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