The Damped Spring Report

"Shifts in growth, inflation, risk premium and positioning all lead to opportunities in markets"

11/16/2025

The economy is hot. The expectations priced into markets are for ongoing "run it hot" policy. The only way the economy can be "run hot" is through debt and money creation. The entire economic narrative depends on aggressive debt-financed growth. The credit markets have finally begun to awaken to the approaching debt tsunami.

In this DSR we will:

- **Review the promises made over the past year of massively above-trend spending and investment that are now expected and priced into economic outlooks.**
- **Provide a broad and, in some cases, deep spot assessment of the credit markets to set the groundwork for future reports.**
- **Acknowledge the shift from the past five years of market and economic fluctuations driven by government issuance, spending, and Fed balance sheet policy to one in which private sector credit creation dominates.**
- **Look forward to the trends of what we think will be the dominant factor in US markets, namely, the ability of markets to finance about $10T of private sector debt financed spending while also accommodating $10T of public sector deficit financing over the next five years.**
- **Remind our readers on the plumbing of money and credit and asset markets to aid in understanding our framework.**

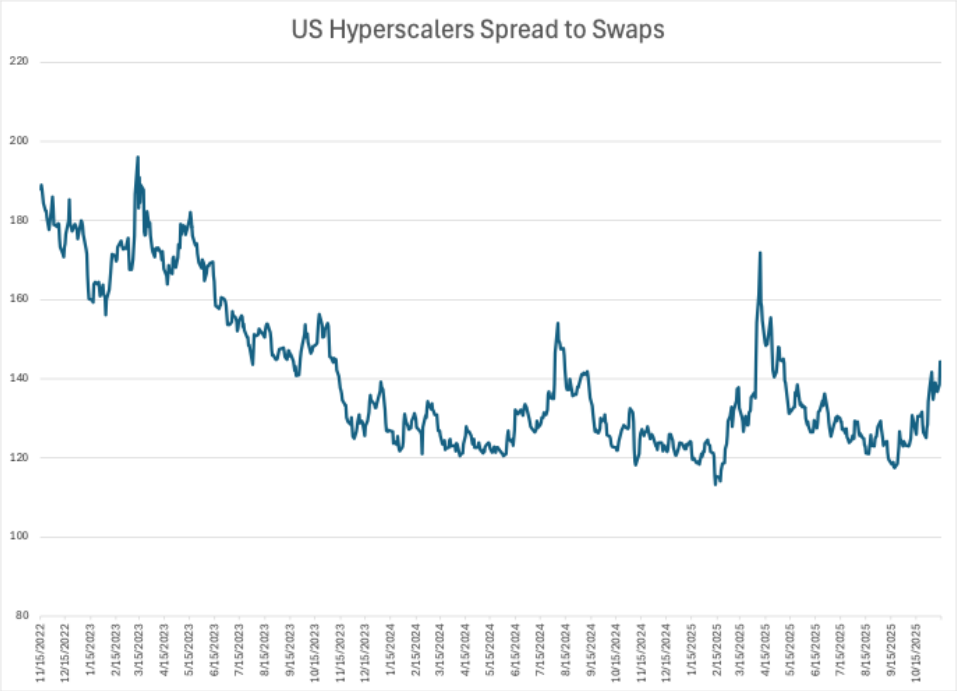
We think the global economy and markets depend on resilient and deep credit markets of all sorts and the willingness of banks and central banks not only to stabilize recent monetary contraction but to embark on a significant credit creation-driven expansion. The depth and resilience of the credit markets will determine how many "hamburgers" we will be able to buy today and how much debt we will promise to repay on "Tuesday."

Hints of stress

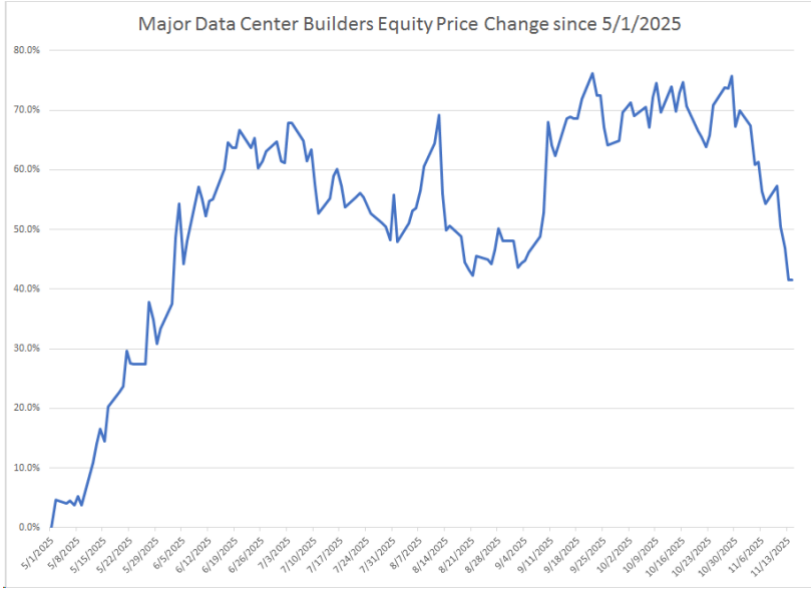
Over the last month, there have been various hints of stress in the credit and money creation channels that, even taken together, do not suggest to us an imminent issue. However, as our focus for this DSR and for the next year at least is these channels and in particular the credit and money creation necessary to fund the rapidly rising promised investment, we are paying attention to the micro stresses while building out our full understanding.

Corporate Credit Markets

As AI Capex investments to build out data centers and the peripheral assets necessary to support AI revenue generation are extremely large, we are focused on that credit creation channel. Prior to this quarter, free cash flow, and accumulated cash on the balance sheets of the major hyperscalers provided adequate resources for major Capex growth. This quarter, hyperscaler debt issuance climbed, showing a need to also access credit markets. Credit markets have responded rapidly. While credit spreads are still quite tight, the change is notable:

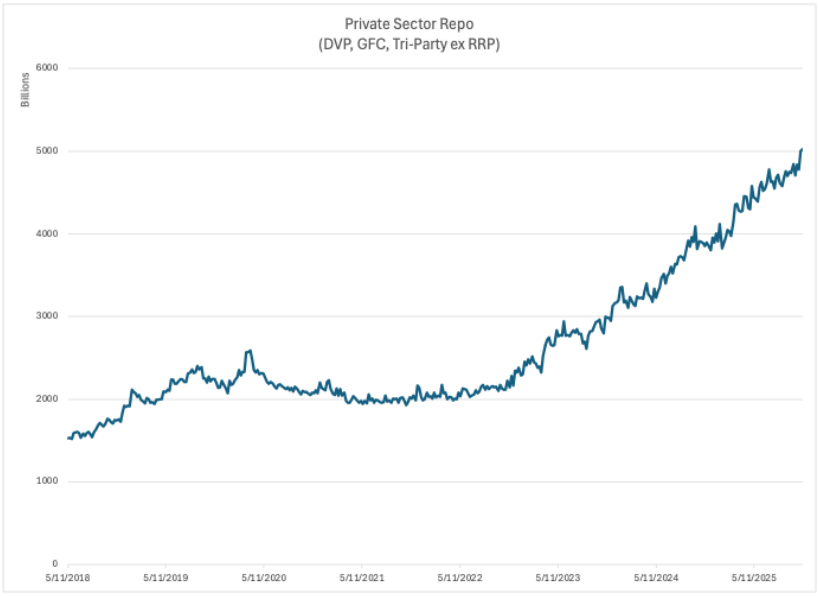


These same companies have been star performers in 2025, but as credit spreads have widened their stock prices have fallen:

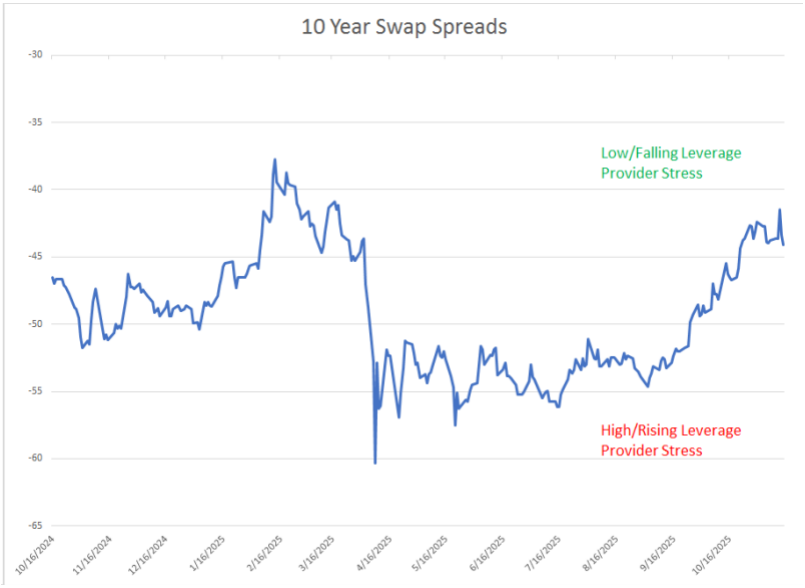


Repo Markets

Repo markets continue to grow as private sector demand for leverage continues to seek leverage in the cheapest place possible. Instead of borrowing via more expensive sources, end investors continue to leverage up by selling their cash Treasuries and buying futures and receiving on swaps. Dealers, banks, and hedge funds facilitate this credit creation in the repo market. As money market funds with sizable AUM see repo rates that are high relative to their alternative of the Fed RRP program, these MMFs are willing and able providers to the various leveraged players to finance the cash portion of the Treasury leg of the basis trade in the repo market:



While the growth may appear like a potential stress, quite the opposite is occurring in the swaps markets. The leverage providers want more of this trade, not less:



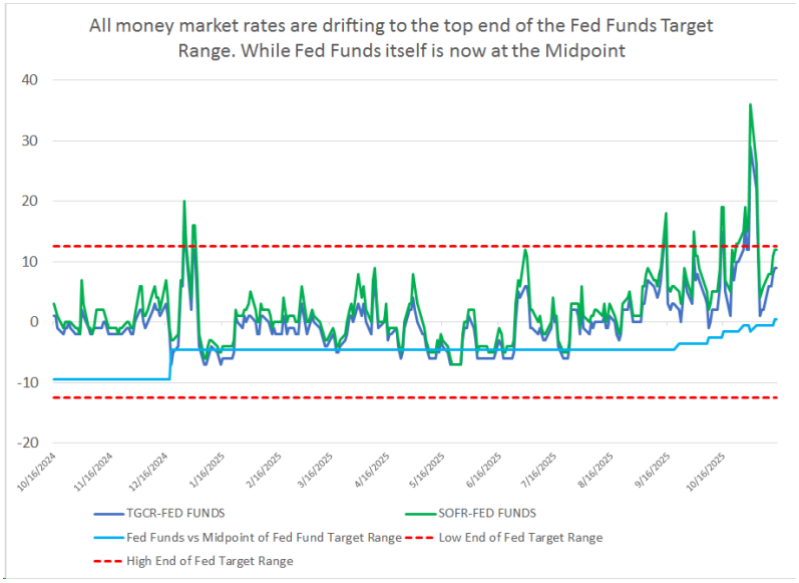
Money market rates and bank reserves

Money market rates depend on the need of borrows to borrow overnight and the supply of "money" to lend to these borrowers. Repo rates are the specific rates at which these overnight transactions occur.

The major lender of "money" to the repo borrower comes from MMFs whose specific investment goal is to provide its end investor with a highly liquid place to hold cash at a decent rate of interest. MMFs have historically had two ways to generate interest on cash: buy Treasury bills or provide repo financing. However, during the past three years, they have also been able to lend to the Fed in the Reverse Repo Program. Today, bills and Repo offer better interest rates than RRP, so RRP is hardly used. Over the past few months, demand for overnight borrowing has been brisker than the supply of lending. There are many reasons for this supply-demand imbalance that we have covered in other writings on X and in our Substack and other DSRs, so we will not repeat them here. The big takeaway, however, is that the supply of overnight lending is expanding more slowly than demand for such borrowing is increasing. That also suggests that private sector actors want to lever up their financial and real asset holdings at a brisk pace.

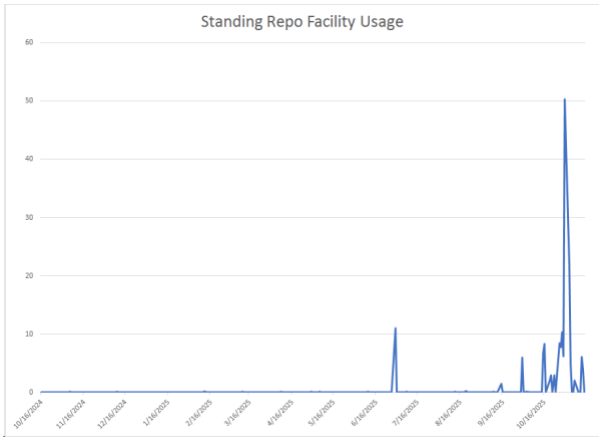
The other major users of the repo market are banks. Sometimes, banks have demand for overnight borrowing when, for example, their clients are making big tax payments or buying a lot of bills. Banks also lend in the repo market when they have excess cash and repo market interest rates are superior to other rates in which they can park cash overnight. Cash in the banking systems is bank Reserves. Lately, some banks have needed to borrow in the repo market while most banks do not but also have no pressing need to lend. That is partly because QT has reduced

Reserves across the entire banking system, but mostly because some banks run a low level of reserves and have felt recent stress:



Rates are clearly rising as this leverage need and low Reserves at certain banks have driven up repo rates. This imbalance has also driven both repo rates and the Fed Funds Rate higher. During the easing cycle, the Fed Funds Rate was able to be kept quite constant at slightly below the middle of the Fed Funds Target range. As QT has driven Reserves from abundant to ample and for now Reserves are unevenly distributed across banks, the Fed Funds Rate has drifted to the middle of the target range. The Fed needs these rates to stay below the high end of their target range to properly transmit its monetary policy. For a much more detailed explanation of this whole dynamic and why it is not likely a big deal (but is worth watching), we strongly suggest you read our recent Substack.

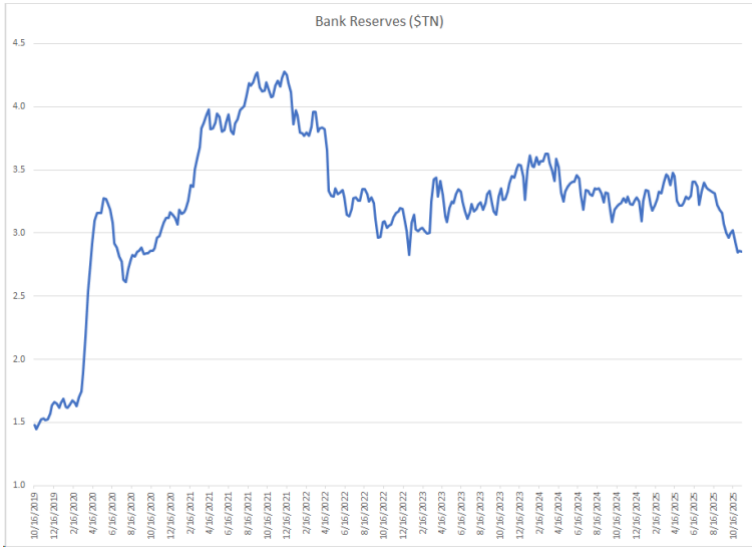
Banks have many options to improve their Reserve position and if systemwide Reserves are in fact ample, we expect no meaningful stress longer term. However, we are certain that in the near term, the recent volatility of money market rates and usage of the Fed's Standing Repo Facility will continue:



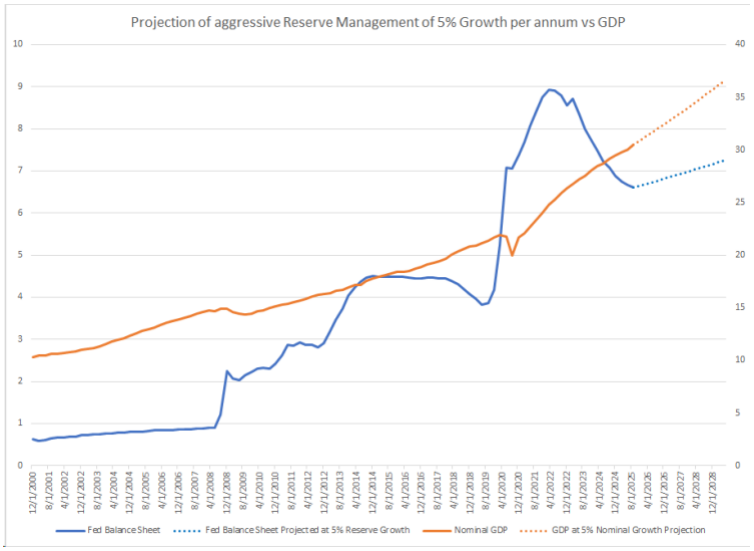
As you can see, some banks have had very spiky and short-term needs to borrow Reserves and have used the repo market for that borrowing, driving up repo rates, while a few have used the Fed's program. Once again, we do not think this is any more than a hint of a stress, but we are keeping an eye out for persistent high SRF usage and TGCR and SOFR rates that are above the Fed's range.

The Fed itself is acting to make sure this Reserve stress can be temporarily mitigated by meeting with primary dealers and banks to try to destigmatize SRF usage and by acting to stop QT run off and cause reserves to stop declining.

The level of reserves in the system will bottom and stabilize on December 1.



Lastly, the Fed has begun discussing how Reserves levels will be managed going forward to assure markets that ample reserve policy will be maintained and any short-term Reserve tightness will be temporary. Our expectations for Reserves will result in modest balance sheet expansion over the years to come in line with the long-term trend and nominal GDP:



Promises

While certain modest stresses are occurring in the credit markets, the big deal is still the demand for credit to fund promises. A growing economy always has secular and cyclical demands for credit, and borrowers explicitly make promises when they borrow. The promise is to pay it back, but the creditor has an interest in how the borrowing is going to be spent and how that will result in the borrower being able to repay them. Today, the desired spending of borrowers is anything but normal secular or cyclical desires. Two major promises are being made in the U.S economy and, to some extent, globally.

- Promises to invest in reshoring US production.
- Promises to build compute capacity and all its peripheral support infrastructure to deliver AI productivity enhancements.

These promises are huge. On top of that, global and US fiscal debts are large and, in some cases, rising at rapid rates (though less so lately), which, alongside secular and cyclical debt growth, will need funding. We are focused on the burst of new promises while of course always being aware of the trend and wiggles of normal credit creation of a normal economy. Given the size of the new promises and the risk of whether those new promises will result in long-term productivity improvement, we think the new promises are the dominant force on the economy and markets over the next several years.

Boring framework section

One goal of this DSR is to outline the challenges of funding the promises made by various actors for substantial spending and investment. However, our higher-level goal is to explain our framework for understanding the mechanics of the money and credit creation machine to better understand the various cogs in the machine and to track all the forces on each part of the machine. Yes, we once worked at Bridgewater, so we often drone on about framework, but we think it is crucial to understand this dynamic over the next few years.

Credit Creation Channel

We start with Credit creation. The important thing is someone wants to spend. First, let us break down this question into Private Sector-related spending,

Government Deficit spending, and Government private sector investment. In this section we will ignore banks and central banks. In the Money Creation Channel, we will add those actors to the stage.

Private sector spending.

For a private sector actor to spend, they must:

1. Spend physical currency like paper bills and coinage;
2. Spend a deposit;
3. Sell an asset for a deposit and spend the deposit; or
4. Borrow to get a deposit and the spend the deposit.

For simplicity, we are going to shelve discussion about physical currency and just talk about bank deposits.

Spending a deposit reduces that actor's ability to spend in the future. Selling an asset requires some other actor to buy that asset and that dynamic circles around until somebody buys the asset being sold with a deposit or physical currency. Borrowing from another non-bank private sector actor (like by issuing a corporate bond) also requires one private sector actor to surrender their deposit.

So spending is a tightening of conditions for those who fund the spending by using a deposit. However, spending is an easing for the recipient of the spending. It becomes income that can be spent or saved. Ultimately, all spending gets saved. We will discuss the impact of the timing of these flows later in the report. However, when a private sector actor borrows from another private sector non-bank actor, credit is created. Before the transaction occurred, there was nothing owed. After the transaction, money was owed to one actor by another. The borrower has cash and can use it to spend but must have a source to repay their loan or they may become insolvent, exposing the lender to the risk it may not be repaid. Credit creation within the private sector increase risk in the economy while not changing deposit levels in the economy. Most importantly, as private sector non-bank credit creation hands a deposit that was otherwise doing little to an actor who will put the money to work via consumption and investment, credit creation is short term expansionary to the economy and long term contractionary when the debt comes due.

Government deficit spending

Many mistakenly believe that deficit spending is money creation. When a government spends more than it collects in taxes, it does not increase bank deposits. The government spending does increase bank deposits, but its debt issuance to fund the spending reduces deposits of existing savers who buy the bonds. However, similarly to private sector credit creation, the flows of the spending allow for short term consumption and investment, which affects the economy just as credit creation does. Government deficit spending activates bank deposits which are otherwise "dead."

Government private sector investment

The US has signaled its desire to make investments in the private sector. Unfortunately for the US, the flows of such investment are identical to deficit-funded flows. Many of the "promises" the Trump administration has secured from our trading counterparts are with countries with sizable trade surpluses with the US. These promises can get funded in ways that are more like private sector choices and flow through the system in the same way. Perhaps the largest method of funding the promises made by foreign governments will be made by selling existing US assets to spend on new factories, data centers, and chip fabrication plants. This is like item 3 in the private sector flows listed above. However, it is possible that these countries may borrow as well, which would create new credit.

You may notice that we have only focused on deposits being spent. We will expand our framework and describe the role of other important actors later, but, as an example, MMFs may appear to be a source of deposits but really are not. MMFs happen to own assets with the money they hold, assets like bills and Repo lending. For MMFs to provide deposits which a borrower can spend, they must sell bills or unwind repo agreements. In so doing they are just part of the hot potato game. In the end, for credit to be created between non-banks, a deposit must be transferred from the saver to the spender and money becomes owed.

Money Creation Channel

Commercial banks

Of course, while lots of credit is created by non-banks lending and borrowing from each other, banks play a key role in credit creation. A significant part of the credit creation process begins with a bank loan. Typically, a borrower goes to their bank, signs some papers, and then out of thin air the bank creates a deposit in the borrower's name, which can then be spent. On the other side of the bank's balance sheet, the signed papers represent a loan in which the borrower agrees to pay back the deposit. In this particular transaction not only is credit created in that one party now owes money to another, but spendable money has been created. Economy wide deposits have grown out of thin air.

As a separate matter, commercial banks may package and sell its loans to the private sector. When this occurs, the deposit disappears and a credit creation has occurred between two non-bank private sectors actors (a transaction of the kind covered above), and the commercial bank is just a temporary principal in what ultimately was a facilitation function.

The Fed

Just like commercial banks, the Fed can create money and credit. By purchasing financial assets (MBS or Treasuries) from the Private sector, the Fed can create spendable deposits. While the Fed rarely creates private sector credit (e.g., it has occasionally bought corporate bonds), it mostly creates money and public credit, by buying government bonds.

Money and credit circulation

So private sector non-banks can create credit and commercial banks, and central banks can create money and credit. What is important is to understand the flows of money and credit and the portfolio risk changes that occur when credit and money are created or destroyed. Theses flows are mostly fairly circular, but they are not simultaneous.

Circularity

When private sector credit is created, someone has demanded a loan. The impact of that price taking is to push up interest rates and widen credit spreads. There are plenty of examples when credit creation is "pushed" by central banks and even some examples where credit is pushed on private sector borrowers by the aggressive demands of lenders. In most cases, however, the flow is where the borrower is the inelastic flow. Once borrowed, the money is spent on stuff, which is new demand which pushes up prices and increases real economic activity. The spending becomes someone else's income, which in turn becomes someone's eventual savings which can then be used to buy assets, thereby pushing down interest rates and narrowing credit spreads. As the borrowing comes due, the opposite flows occur, and economic activity slows and prices of real things are pressed lower.

When the government spends borrowed money, the borrowing flow happens first and has the same impact as the credit creation above, as well as its circular nature.

"Spirality" – credit and money creation

When money creation is also occurring, the initial increase in interest rates and credit spreads can be mitigated as the money creation can support demand for that loan supply. Credit creation accompanied by money creation can be stimulative without impacting asset prices. Anyone paying attention over the past five years knows that Fed money creation paired with sizable government credit creation kept economic activity quite vigorous and allowed both inflation and asset prices to stay high. Even the slight destruction in money caused by quantitative tightening has had negligible impact on the economy and borrowing rates. Over the past five years, the Damped Spring Report has focused on this central bank money creation and destruction and how it has occurred. Going forward, central bank money creation will largely be a non-factor. What matters going forward is credit creation and private sector bank money creation.

Timing

While all this credit and money creation and credit payback and money destruction circularity is always happening, the timing of each flow and the speed at which money and credit circles through the economy have profound impact on medium term asset prices and economic outcomes. However, because the underlying flows that enable the economy to take on more debt and leverage up are not

synchronized, the potential for a forced deleveraging of some actor or actors increases.

Repo and temporary leverage providers

Demand for credit can be sizable and fast moving while the spending is always slower and more protracted. Not only is the spending slower and more protracted, but the process of spending becoming income becoming savings can slow things down even more. Given the issuance is fast moving and the ultimate end buyer savings accumulation is slow-moving, temporary buyers of all these borrowings need to step in and facilitate the process. The temporary liquidity providers are willing to leverage up their balance sheet, borrowing in the repo market and hedging in the futures market. They are in it for small fees and are willing to leverage significantly to earn adequate returns on equity. Banks, and other leveraged investors, including hedge funds and non-depository financial institutions (not banks), step in to provide that temporary liquidity knowing that deposits will flow to savers who will ultimately and eventually buy the risky assets they are temporarily buying as the circle plays out. The Repo market provides the leverage, as do banks if necessary.

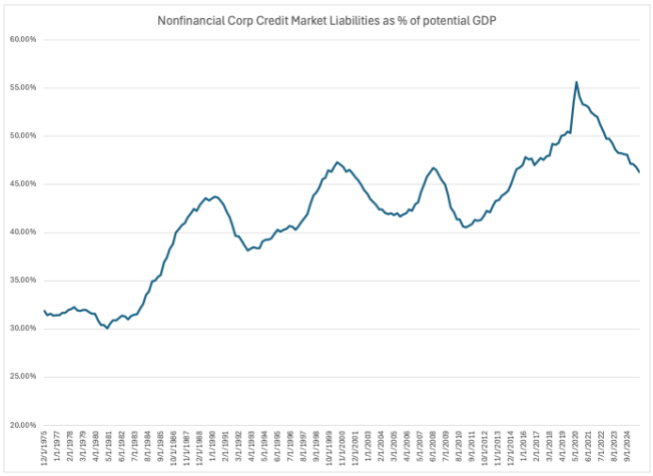
What is

We have outlined how credit and money are created and by whom. We have outlined who borrows to spend and invest. We have described how credit creation is at some level a circle that results in expansion followed by contraction, and how various portfolio rebalances occur during that process. As we have seen since as far back as 2008, money creation and destruction by policymakers can have a major impact on the money and credit creation process. Lastly, we reminded you that in most every credit cycle before 2008, private sector money and credit cycles depended on banks and the demand for credit by the private sector.

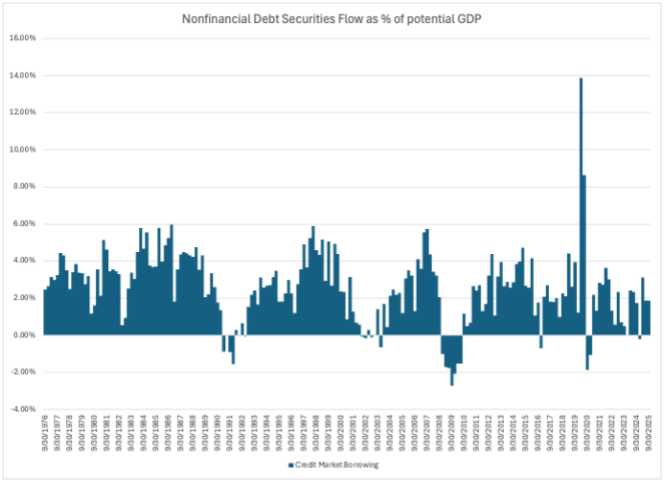
Without a true economic crisis, we expect that the next several years will be dominated not by policymakers but by the private sector money and credit creation cycle and the economic wisdom of those borrowing today. We also see that the promises of future spending are enormous and excessive versus normal economic growth, and that the demands on the money and credit creation system are equally enormous. Expect much more work from Damped Spring as we dig into these observations with practical data of what is going on in this process. It will be the primary focus of Damped Spring Reports until further notice. That said we want to share our assessment of "what is" today to help us navigate markets shorter term.

Corporate Debt and Public Markets

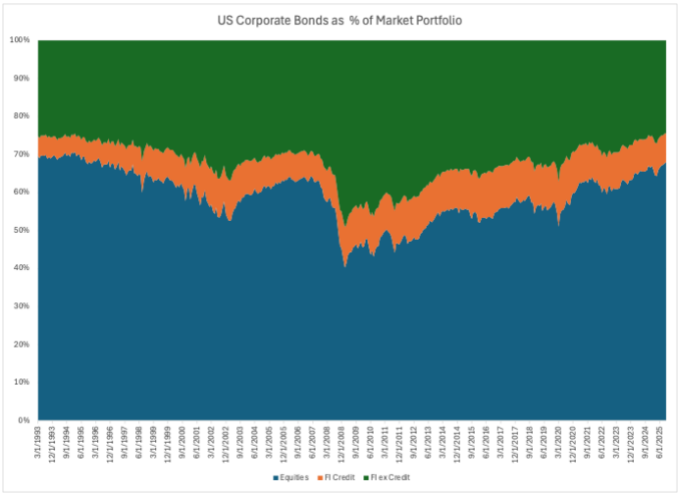
We have described a tsunami of incoming corporate debt, and we have shown how recent AI spend has begun to use debt for funding and how both the credit spreads and the stock prices of these borrowers have suffered recently. However, under no circumstances can one suggest that corporations are over leveraged:



Debt issuance flow has also been relatively light:

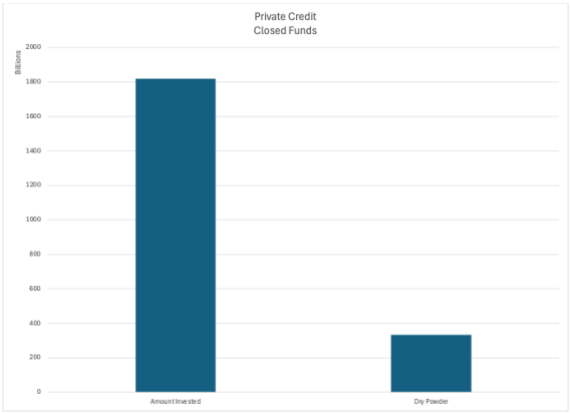


Investors also have a low allocation to public corporate bonds, which means they may have the ability to absorb corporates but that will require selling (or buying fewer) stocks.

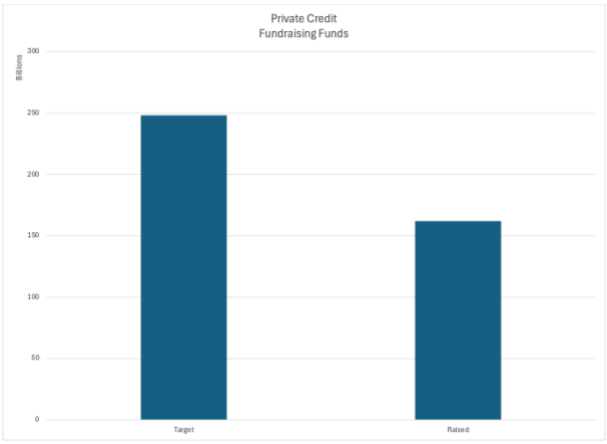


Private Credit

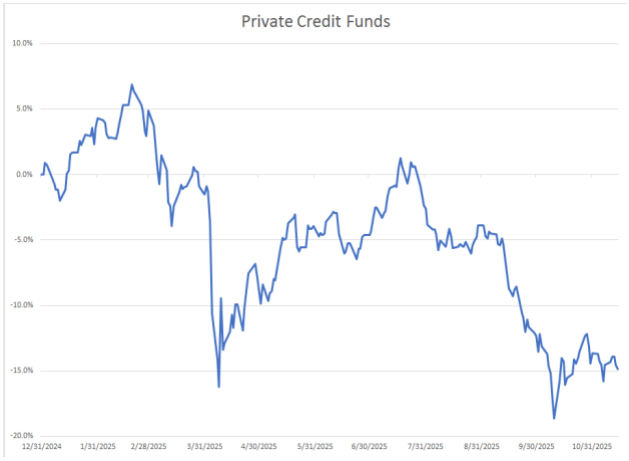
Private credit market dynamics look less healthy. Dry powder of existing private credit providers is low:



New funds are raising money but not in huge size:

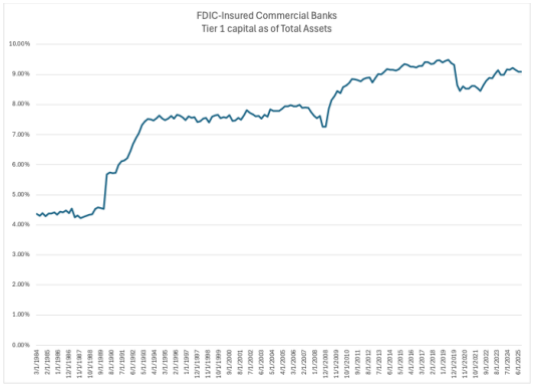


Private credit funds are also performing poorly recently and for the year:



Banks

Banks play a key role in creating both credit and money. They are still in good shape, but do not seem particularly willing to leverage up:

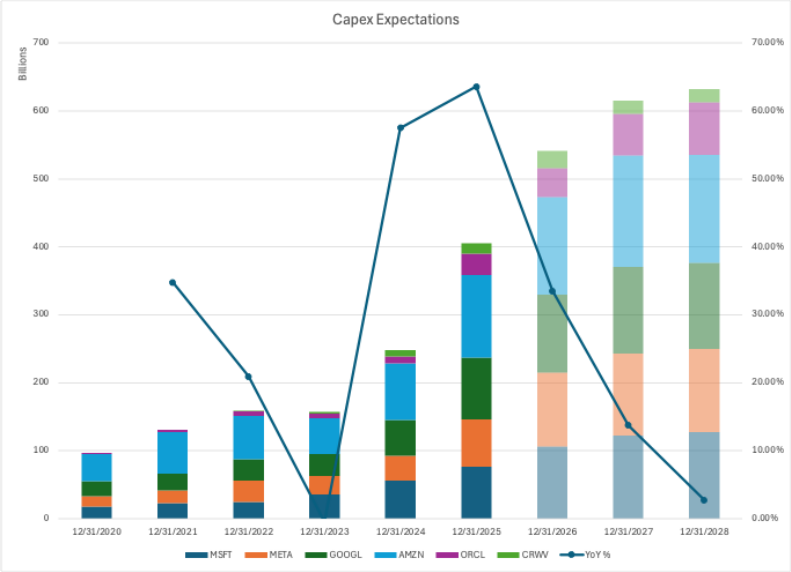


Banks may be unwilling to drop leverage ratios much below 8.5% tier one capital to assets, but with $25T of assets they do have the ability to create about $1.5T of money and credit without raising capital by leveraging up. They are able, but it is unclear whether they are willing at today's prices. As you can see above, the banks have been unwilling despite being able for many years, and prices are now poorer.

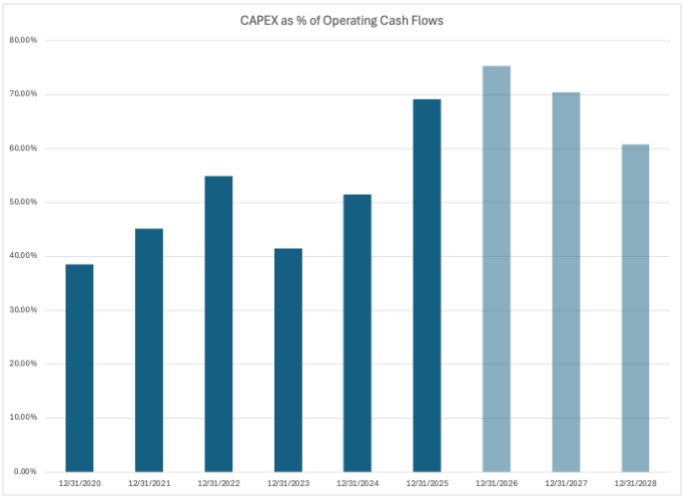
AI Promises

By far the biggest promises are the Capex plans to build the necessary components of the AI compute infrastructure. To date, only the hyperscalers have already made huge Capex investments and have ambitious plans for more spending. We expect they will spend the money; the question is what it will cost.

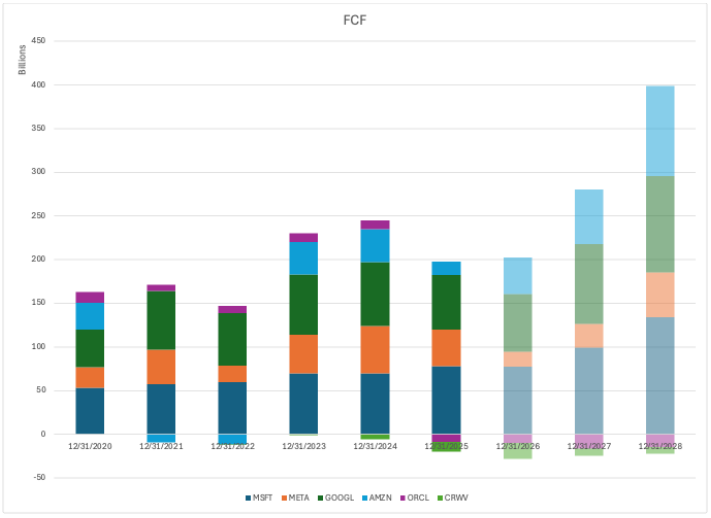
The largest Capex spenders have likely reached peak growth of Capex but will still be spending and financing that spending at an elevated level for years.



These Capex plans are at an elevated level of FCF:



The drop in future spending as a percentage of operating cash flow depends on the spend having relatively high payoff in the near-term:



The future of AI is unclear. These projections are estimates and guidance from analysts and the companies themselves. We will not know for years how these investments will pay off. However, markets are likely currently priced based on this consensus. What is not known and what we will track is how all this spend will be funded.

Promises from foreign countries and deficits.

We will not have details on this particular set of promises. The SCOTUS ruling on the legality of current tariffs, the steps taken by the Trump administration regardless of the ruling, and the volatile nature of the administration's own tariff policy is particularly unpredictable over the next few months. What is relevant is that the promises made by foreign governments to invest in the US, if honored, requires financing and if tariffs drop significantly perhaps these promises are empty

ones. On the other hand, if the tariff revenues drop, the deficit in the US will rise, resulting in another financing need. As the SCOTUS ruling and the administration's response becomes known, we will adjust estimates consistent with our framework

"What is" synthesis

We see:

- The promises made and the uncertainty about their wisdom.
- Healthy banks able, if not clearly willing, to create money and credit.
- Corporations with large capacity to add debt.
- Public asset markets that are undersupplied, which can rebalance out of equities to absorb credit.
- Private credit markets are sluggish and on their back foot and may not be able to provide substantial amounts of credit.
- Tariffs, and reshoring promises to remain uncertain.

Synthesis

The next year and perhaps the years to come are being shaped with promises and financed with massive debt. Public sector debt growth is plateauing and slowing but the full range of large promises will require significant private sector credit growth while public sector credit growth remains high. Over the last year, as the promises have accumulated, equity investors have benefited from the short-term increases in earnings, increases in earnings expectations and increase in multiples. Over the next year, the financing of these promises will challenge the private sector, requiring a leveraging up of the financial system, and potentially significant rebalances in asset markets. While some forms of credit creation are showing some fatigue due to the relatively low credit creation of the past year others, particularly the broad banking system, have substantial capacity to play a role in leveraging up. The promises made are of two general classes. The first is reshoring productive capacity to the US. The second is building out compute to deliver capacity for AI productivity enhancements. Like all debt financed economic activity, these promises must deliver real productive growth to service and repay debt and deliver adequate equity returns. For now, markets simply do not know whether the investments will pay off or not. In the case of reshoring, we are highly skeptical that reshoring is productivity enhancing while we are certain it is a form of insurance for national security purposes. While insurance may be worth buying, it is not productive. AI productivity enhancements are likely years off and to truly benefit from their productivity (if it delivers as or more than promised) also requires a painful rebalance in human jobs, which must end up being as productive as before AI or else a drag on demand will need to be addressed.

We do not know if current investments will pay off. We also expect sentiment for these payoffs to fluctuate wildly on the way to the eventual

payoff moment. In a world where debt creation must be large to fund investment, the potential for a weakening in sentiment to drive a credit event which extends the time horizon for the Investment payoff seems more likely to us.

As of today, our job is to ride these waves while looking out at the upcoming waves on the visible horizon. We have built a framework and are refining tools to assess the seas ahead and at this stage we expect a short-term debt issuance tsunami that will stress credit markets and place intense light on the economic case for promises made.

Current Portfolio and Performance

	Assumed Portfolio size	$ 100,000,000			
	LTD P/L	$ 75,675,809			
	Total Return	75.68%	YTD Return in excess of cash		5.62%
	Today's Date	11/16/2025	Portfolio Created		4/15/2019

Date	Position	Entry Price	Amount	Worst case loss	MTM	P/L	Open/Closed
9/18/2025	SPX 12/31/2025 6650/6850 Call Spread (paired with SFRM6)	114.05	-116	$ 1,000,000	123.75	$ (112,856)	Open
9/30/2025	SPX 12/31/2025 6500/6300/6100 Put Butterfly Spread	10.77	1856	$ 1,998,912	11.50	$ 135,488	Open
10/16/2025	NDX 1/16/2026 21000 Put	227.27	88	$ 2,000,000	131.85	$ (839,720)	Open
7/3/2025	SFRM6	96.62	2400	$ 2,000,000	96.64	$ 330,000	Open
9/18/2025	SFRM6 (paired with SPX Call spread)	96.79	1600		96.64	$ (580,000)	Open
9/23/2025	GCZ 11/24/2025 3750/3850 Call Spread	47.20	-189	$ 1,000,000	91.00	$ (829,545)	Open
10/28/2025	GCZ 11/24/2025 3850 Put	51.50	62	$ 319,300	12.00	$ (244,900)	Open
Debasement Cove Tail 1% of AUM							
10/21/2025	QQQ 3/20/2026 700 Calls	5.17	966	500,000	4.91	$ (25,512)	Open
10/21/2025	GLD 3/20/2026 450 Calls	6.79	737	500,000	3.58	$ (236,183)	Open
RIH Point Tail 1% of AUM							
10/21/2025	**QQQ 3/20/2026 700 Calls**	**5.17**	**966**	**500,000**	**4.91**	**$ (25,512)**	**Open**
10/21/2025	**TLT 3/20/2026 84 Puts**	**0.63**	**7,949**	**500,000**	**0.88**	**$ 199,523**	**Open**
Recession Island Tail 2% of AUM							
10/21/2025	**SPY 3/20/2026 600 Puts**	**9.91**	**672**	**666,667**	**8.90**	**$ (68,186)**	**Open**
10/21/2025	**TLT 3/20/2026 100 Calls**	**0.89**	**7499**	**666,667**	**0.32**	**$ (426,697)**	**Open**
10/21/2025	**GLD 3/20/2026 350 Puts**	**6.71**	**994**	**666,667**	**6.45**	**$ (25,354)**	**Open**
			Tails not included	8.0%		6.10%	