

Back to Normal

By Bill Koehler, CFA, President and CEO

This past summer, to attend a family gathering, I returned to Normal, Illinois. I had not visited Normal, the home of Illinois State University, since the 1970s. Nearly half a century had passed since my last visit and much had changed. However, the city remains a friendly, vibrant college community. As I have reflected on that trip, it occurred to me I had, quite literally, gone back to Normal.

In the context of my day job, overseeing clients' investment portfolios with our outstanding team, that experience also prompted another reflection on a different topic: the current interest rate environment in the United States. Just as I had literally gone back to Normal, interest rates may be doing much the same thing.

Perspective Matters

Much of today's commentary about interest rates conveys a sense of unease. Mortgage rates above 7%, Treasury yields above 5% and borrowing costs substantially higher than those of recent years are frequently characterized as restrictive, even abnormal. But are they?

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Consider the 10-year U.S. Treasury yield, a fundamental benchmark for pricing capital. From 1970 through 2000, its average annual yield was approximately 8.2%. From 2001 through 2025, that average fell to approximately 3.2%. That difference of five percentage points reflects two distinctly different interest rate environments. However, if we add those two averages up and divide by two, a 56-year average of 5.7% is very close to where we are today at 5.3%. Looking back 50 or 60 years gives us a much clearer perspective than only focusing on the post-9/11 environment.

Mortgage rates offer another illustration. In 1990, the average 30-year fixed mortgage rate was approximately 10.1%. A mortgage rate of 7.4% today, while expensive compared with the extraordinarily low rates of recent years, is considerably lower than what homebuyers faced in 1990. For much of our economic history, Americans built businesses, invested capital and created wealth with interest rates substantially higher than those prevailing today. Economic prosperity did not require zero interest rates then. Why should we assume it does now?

The Great Monetary Experiment

The past quarter century witnessed an extraordinary experiment in monetary policy. Following the 2008 financial crisis, the Federal Reserve reduced short-term interest rates to essentially zero and introduced quantitative easing, purchasing Treasury securities and mortgage-backed securities to suppress longer-term borrowing costs. These policies helped stabilize financial markets and support economic recovery. During the pandemic, monetary intervention became even more expansive.



The consequences extended beyond the bond market. Exceptionally low interest rates encouraged borrowing, elevated asset valuations and reduced returns available to savers. Capital became extraordinarily inexpensive, and investors adjusted their expectations accordingly.

Other forces, including demographics, globalization and worldwide demand for safe assets, also contributed to declining yields. Nevertheless, central bank intervention reinforced an environment in which the price of money was deliberately suppressed. Over time, the

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rates not as a temporary policy condition, but as the natural state of financial markets. Hopefully, we are now moving toward an environment in which interest rates convey meaningful economic information with less dependence upon extraordinary monetary intervention.

Rediscovering the Price of Money

Interest rates are more than economic statistics. They are the price of money over time, communicating essential information about inflation, risk, opportunity, and the competing demands for capital. Like other market prices, interest rates perform an indispensable function: they help allocate scarce resources.

When interest rates are artificially suppressed, those signals become less reliable. Investments that might not be attractive at a market-determined cost of capital can suddenly appear compelling. Asset valuations rise as future cash flows are discounted at unusually low rates. Borrowers assume obligations that may become burdensome

when financing costs increase. The result can be a misallocation of capital, with consequences revealed only when monetary accommodation is withdrawn.

Conversely, a more market-driven interest rate environment restores discipline. Savers receive meaningful compensation for deferring consumption. Borrowers must evaluate investments against a realistic cost of financing. Businesses must demonstrate their returns justify the capital they employ. The price of money matters because the allocation of capital matters.

This does not mean higher interest rates are always better. Excessively high rates can be equally disruptive, and the inflationary experience of the late 1970s and early 1980s was hardly an economic ideal. Rather, the argument is that market prices, including interest rates, convey information that should not be persistently distorted by monetary authorities. This was the premise of last quarter's Perspectives titled "Markets Reflect Truth."

Back to Normal, Again

The transition from artificially low interest rates to more market-driven levels inevitably creates adjustments. Borrowers accustomed to inexpensive financing must adapt. Asset valuations must reflect different discount rates. Economic decisions once justified by nearly free money deserve renewed scrutiny. These adjustments may be uncomfortable, but discomfort does not

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necessarily signal dysfunction. Indeed, a financial system in which capital has a meaningful price may ultimately be healthier, more disciplined, and more sustainable than one dependent upon extraordinary monetary accommodation.



My return to Normal, Illinois, after nearly 50 years reminded me how easily the passage of time can change our frame of reference. Perhaps the same is

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true of interest rates. We may not be entering a strange new world of high interest rates. We may simply be rediscovering the world that

existed before exceptionally low rates became the expectation. Rather than wringing our hands over the disappearance of nearly free money, perhaps we should welcome the restoration of more meaningful market prices.

Interest rates, it seems, may be heading back to *normal*.

CURRENT DISCLOSURES

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To obtain a copy of last month's Perspectives, "Markets Reflect Truth," please speak with your financial advisor.



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