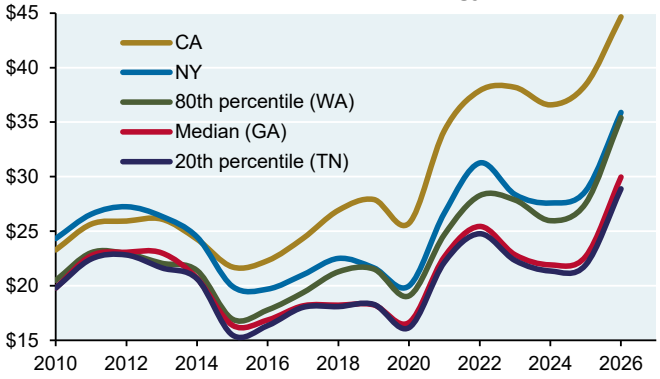
Califoreboding

I was on the West Coast seeing clients last week. California[1] is a strange place; despite energy costs that are 50% higher than the national median and even higher than Alaska (see chart), the highest individual income tax rate and 6th highest corporate income tax rate, the least affordable home ownership market, the largest number of state-level regulatory restrictions, the highest state unemployment rate at 5.1% and the highest rate of unsheltered homeless in the US at 66%, California has experienced the third highest state GDP growth over the last year at 3.6% behind only New York and Idaho, a result largely attributable to AI.

Many client questions I received were laden with a sense of foreboding: third rail questions about the US Federal debt as ten year yields blow through the Bessent Maginot line, the elevated share of market returns and growth attributable to AI, the sustainability of US equity markets close to all-time highs, Anthropic's dire warnings about open weight models and cyber risks, stress in private credit and European deindustrialization. This Eye on the Market walks through my responses to these questions.

What about the 2026 US midterms? There will be time enough to discuss all of that when they're over, although no matter the outcome, I doubt there will be substantial near-term impacts on financial markets. For now, just look at the second chart which I consider to be hilarious.

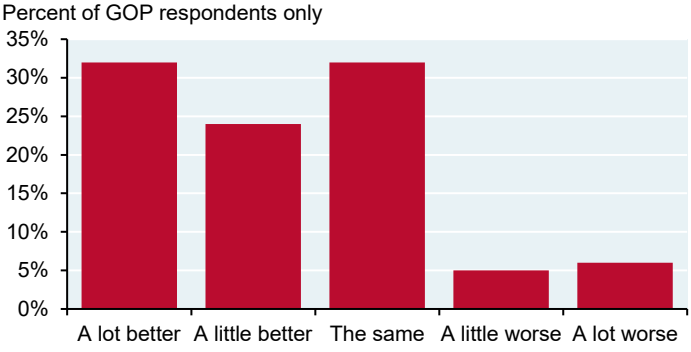
The cost of energy in California…and what that mix would cost elsewhere; $ / mmbtu of final energy consumption



Source: EIA, LLNL, JPMAM, 2026

Do you think the level of corruption under the Trump administration is better or worse than other recent presidential administrations?

Percent of GOP respondents only



Source: Ipsos, August 2026

Michael Cembalest
JP Morgan Asset Management

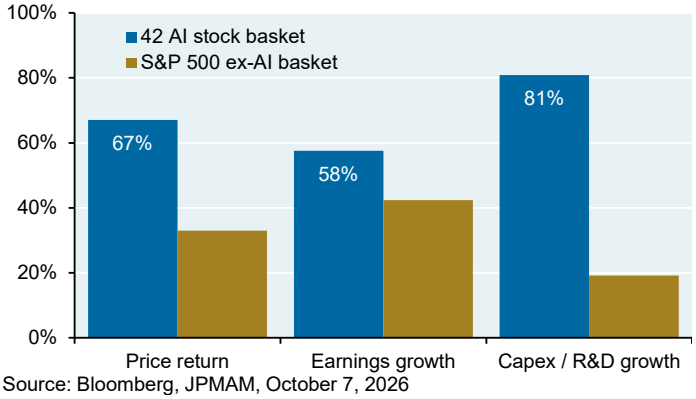
Note: the energy chart above computes the cost of energy per mmbtu for California's actual fuel-sector mix (electricity, natural gas, distillates, renewable fuels, diesel and gasoline as consumed by transport, industrial, commercial and residential sectors). We then take that same fuel-sector mix and compute what it would cost in other states based on their respective energy prices. More to come in the 2027 energy paper.

[1] Sources include the 2024 Mercatus StateReg Data Project, US Department of Housing and Urban Development, Public Policy Institute of California, EIA, Lawrence Livermore National Labs, Tax Foundation, HUD Office of Policy Development and Research

One trick pony: the concentrated contributions of AI to US markets and growth

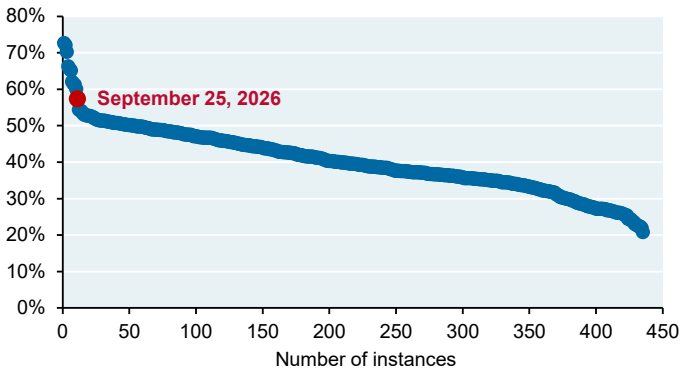
Anyone concerned about US reliance on AI, look no further. The charts below show that (i) a basket of 42 AI stocks accounts for 60%-80% of all S&P earnings growth, price returns and capital spending since Jan 2024; (ii) at the same time, 60% of S&P 500 stocks are down 20% or more from their all-time highs despite the market being close to all-time highs…

S&P 500 share of returns, earnings growth and capex growth from AI stocks since January 2024



Source: Bloomberg, JPMAM, October 7, 2026

% of stocks more than 20% below all-time highs when the S&P 500 was within 1% of its all-time high, 1990-2026



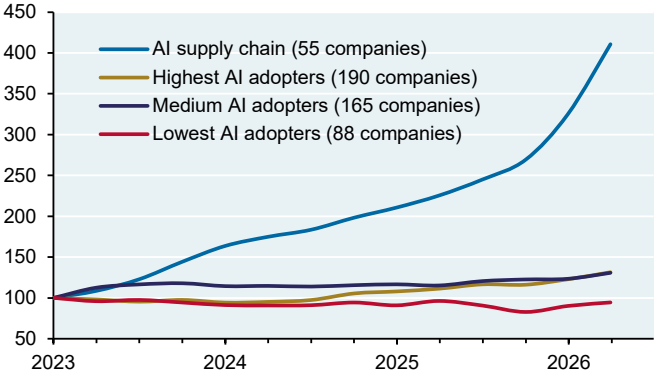
Source: FactSet, JPMAM, October 1, 2026

…(iii) only 30% of stocks are outperforming the S&P 500, one of the lowest figures since 1991; (iv) AI is primarily benefitting AI supply chain companies rather than the companies adopting it…

Share of S&P 500 companies outperforming the index on a 3 year trailing basis, Percent

Source: Bloomberg, JPMAM, September 30, 2026

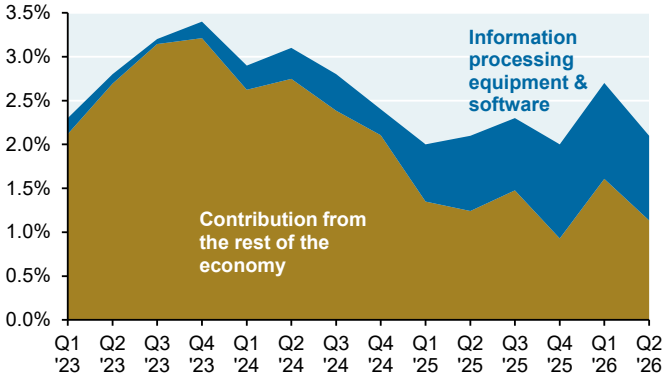
S&P 500 AI supply chain, AI adopters and non-AI adopters
Trailing 12-month earnings, index (100 = March 2023)



Source: Bloomberg, MIT FutureTech, JPMAM, Q2 2026

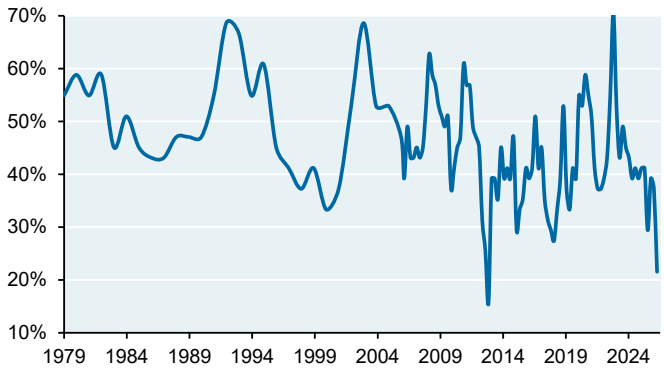
…(v) the technology share of GDP growth has risen from almost zero to 2022 to ~33%; (vi) only 20% of US states are growing faster than the national average, almost the lowest figure since 1979…

Contribution to real GDP growth
Percent, YoY



Source: Bloomberg, BEA, JPMAM, Q2 2026

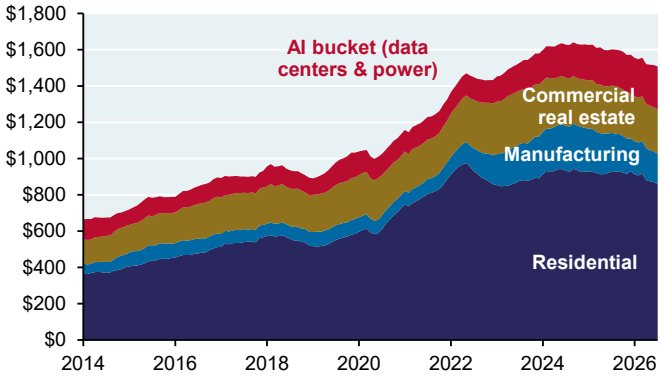
Share of states with GDP growth greater than national avg
Percent



Source: BEA, JPMAM, Q2 2026

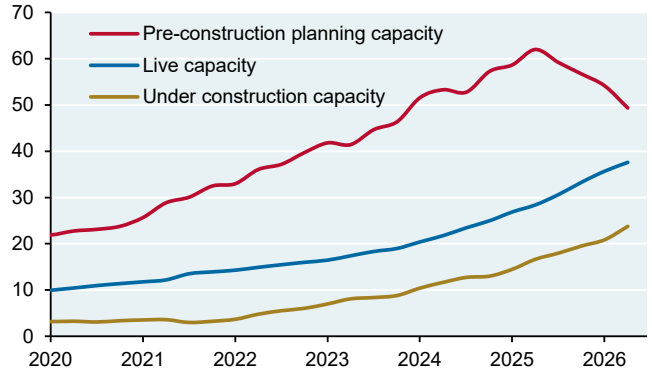
…and (vii) AI accounts for the only positive trend in US construction spending, having risen by 38% since January 2024. Unfortunately the other three main categories are down since then (manufacturing -28%, commercial real estate -13% and residential -6%). That's why the decline in planned data center projects is something to watch.

US construction spending
US$, billions, seasonally adjusted annual rate



Source: Census Bureau, JPMAM, July 2026

Data center IT capacity by stage
GW



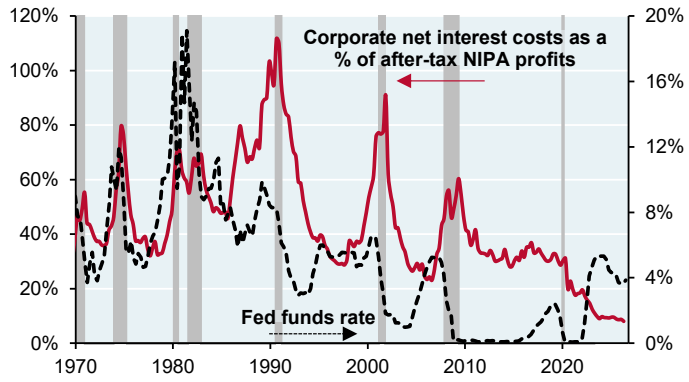
Source: BNEF, JPMAM, Q2 2026

What about the rise in short term interest rates as a threat to corporate profits? I built the next chart a couple of years ago when financial markets were preoccupied with an inverted yield curve and the inevitable recession that never happened. When short term rates go up, there is usually a spike in interest costs as a share of profits. But this time around, we did not see that spike and this continues to be the case; net interest costs are still at an all-time low share of corporate profits. I could theorize as to why but the bottom line is that the US corporate sector seems more immune to rising short term rates than in the past, at least so far.

What about valuations and investor exuberance on AI? I would not say tech multiples are cheap, but since January 2024 when the AI boom began to take off, technology stocks around the world have mostly been driven by earnings growth rather than by P/E multiple expansion; that's the chart on the right. Markets driven by earnings growth are in my experience less susceptible to rapid declines than those driven mostly by multiples.

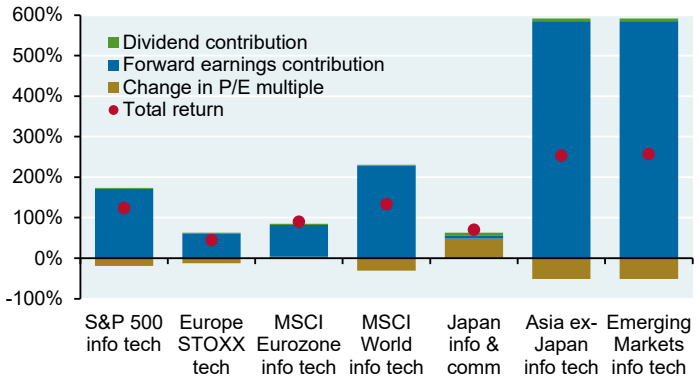
I had a sense of foreboding on the SpaceX IPO given the track record of other large IPOs since 2010 as lockup expirations approached, but as shown in the table, SpaceX is holding up better than most after 116 days. Maybe it's too early to judge since only ~20% of SpaceX shares have been released into the free float.

US nonfin. corporate net interest costs vs Fed funds rate
Percent Percent



Source: Bloomberg, JPMAM, Q3 2026

Technology index return decompositions
Total return contribution from Jan 1, 2024 to Oct 2, 2026



Source: Bloomberg, JPMAM, October 2, 2026

Performance of major tech IPOs by Day 116

	Palantir	Airbnb	Snowflake	Doordash	SpaceX	Coinbase	Snap	Lyft	Uber	Rivian	Meta
Since IPO price	349%	175%	150%	31%	28%	3%	2%	-10%	-32%	-39%	-49%
	Palantir	Airbnb	Snowflake	SpaceX	Lyft	Coinbase	Uber	Snap	Doordash	Meta	Rivian
Since first close	243%	29%	18%	8%	-17%	-21%	-26%	-29%	-30%	-49%	-53%

Source: Bloomberg, JPMAM, October 6, 2026

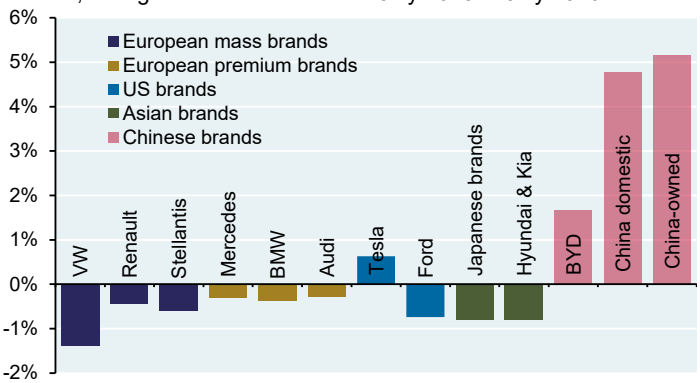
What about the sick man of Europe? Over time, there has been competition in terms of which country this term applies to (UK, France, Germany, Italy and the Ottoman Empire originally). You can be forgiven for having a sense of foreboding about Germany given what's happening to European car markets. Using VW's auto plants as a proxy, labor costs, labor productivity, sick leave rates, unit costs and electricity costs in its China plants are a **fraction** of what they are in Europe, so no one should be surprised at the market share shifts on the right. Even the imposition of 17%-35% tariffs has done little to slow European imports of Chinese EVs.

Volkswagen manufacturing economics by plant

	Emden, Germany	Palmela, Portugal	Tianjin, China
Manufacturing labor cost per hour	€ 74	€ 37	€ 12
Annual effective working hours	1,282	1,419	2,065
Sick leave rate	10.5%	4.1%	1.0%
Annual vehicle output per employee	29	39.9	51.3
Factory cost per vehicle	€ 4,850	€ 2,385	€ 1,078
Electricity cost per kWh	0.15-0.23 €/kWh	0.10-0.16 €/kWh	0.06-0.10 €/kWh

Source: BILD, Deutsche Welle, September 3, 2026

Chinese auto brands are gaining market share in Europe
Percent, change in market share from July 2025 to July 2026



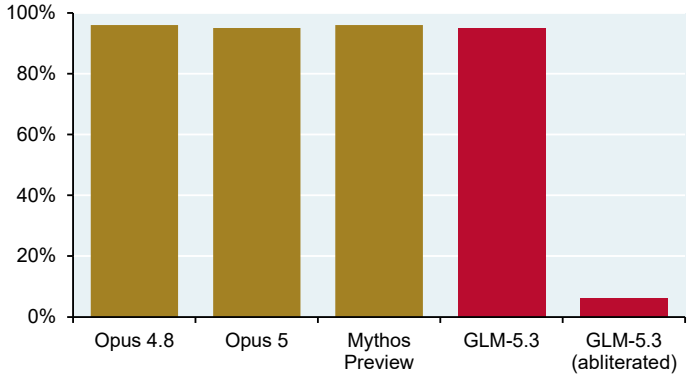
Source: Goldman Sachs, August 10, 2026

Europe is reportedly prepared to act against China with their own version of US Section 301 tariffs if China does not meet EU demands for voluntary export restrictions, more predictable rare earth export licenses, reduced industrial overcapacity and better market access to European companies. But China may have the upper hand: it exports even more rare earths and permanent magnets to Germany alone than to the US[2], and has begun to open anti-dumping investigations into European exports as trade tensions escalate.

More foreboding from Anthropic on cyber risks from open weight models, and a new AI word to learn

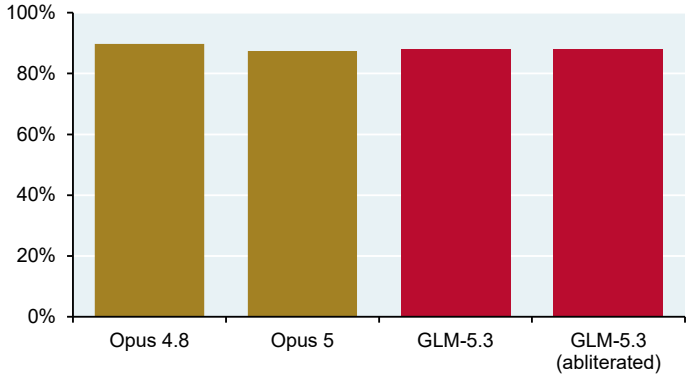
Anthropic authored a hit piece last week on open weight models, this time on Z.AI's GLM 5.3[3], an open weight model that can generate similar performance at ~25% of the cost per task of frontier models[4]. For less than $5,000, Anthropic engineers were able to "**abliterate**" Z.AI's GLM 5.3 model which is AI jargon for manipulating open model weights to remove restrictions on safety controls. As shown below, once abliteration took place, GLM's bad action refusal rate plummeted to almost 0% (left chart) while suffering no degradation in performance (right chart). This is yet another pre-IPO signal flare from Anthropic urgently arguing for regulation of competitor open weight models; no clear sign yet on if/how the Administration plans to act on this issue.

Mean refusal rate on harmful request benchmarks
Percent of requests refused



Source: Anthropic, September 29, 2026

Performance on difficult reasoning benchmark
Score on GPQA-Diamond benchmark



Source: Anthropic, OpenRouter, September 29, 2026

[2] Gavekal Research Geoeconomic Monitor, October 2, 2026

[3] "*GLM-5.3 and the spread of advanced cyber capabilities*", Anthropic, Sep 29, 2026

[4] Artificial Intelligence estimates of cost per task: GLM 5.3 at $2.00 vs Claude Fable 5.1 at $7.63

US Federal debt: are rising yields a foreboding of future budget restructuring options?

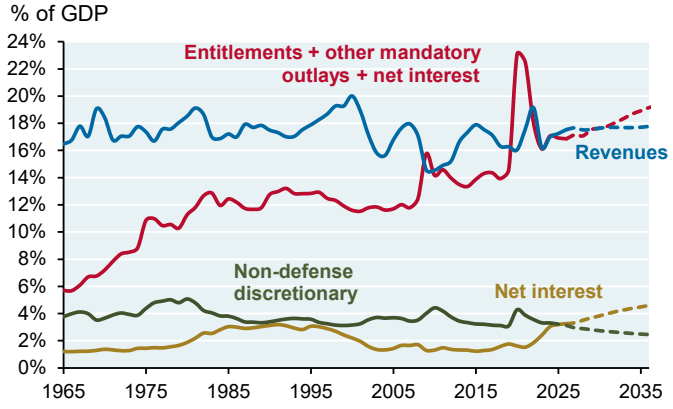
Now that the ten year US Treasury yield has blown through Bessent's Maginot Line from the August Twist operation, I'm getting more questions about the Federal debt. I don't think the "Final Act" is underway now; the current rise in yields appears to be a function of sticky inflation, hyperscaler debt issuance and US GDP growth above expectations. But if the fuse *were* lit under this Administration, I guess it would not surprise me: for the first time since 1970, the US budget deficit is worse than 5% of GDP and deteriorating during a period of economic expansion (defined as manufacturing PMI > 50 and unemployment rate less than NAIRU).

By 2030-2031, 100% of Federal tax revenues are projected by the CBO to be needed just to pay entitlements and interest on the Federal debt. Something may have to give by then, possibly after a riot in the bond market combined with a rating agency downgrade and signs of reduced Treasury demand from foreign official buyers.

10-year US Treasury yield

Source: Bloomberg, JPMAM, October 6, 2026

Federal revenues and major spending components

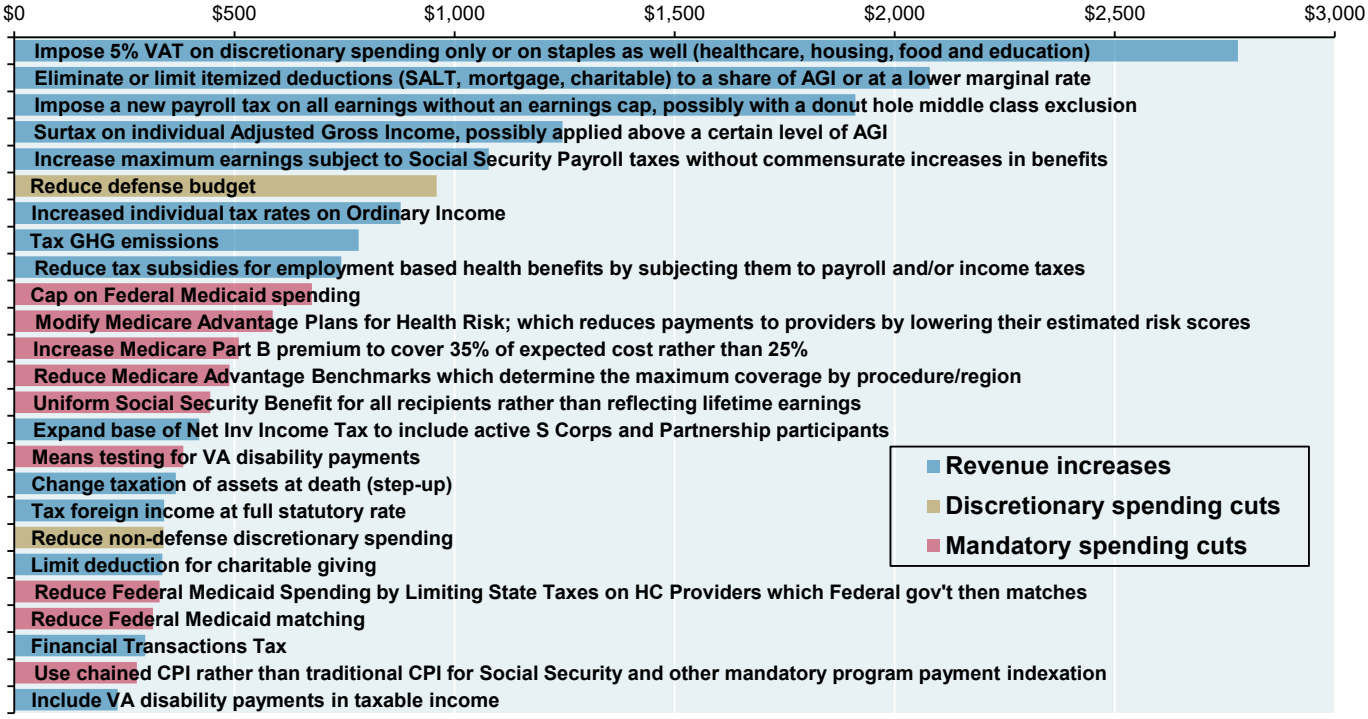


Source: CBO, JPMAM, 2026. Dots are CBO projections

So, here's a look at deficit reduction options. There's almost no discretionary spending left to cut; it's almost all tax increases and cuts to mandatory spending, many involving means-testing. The items below represent 80% of all budget action values in the most recent CBO report (click here for the full list). We will update this again in December since a new post-OBBBA version is expected. The important point: I consider an eventual budget restructuring more likely than outright Fed debt monetization, which would be positive in the long run.

Budget options to reduce the Federal Debt

Midpoint deficit impact over ten year budget window, US$, billions



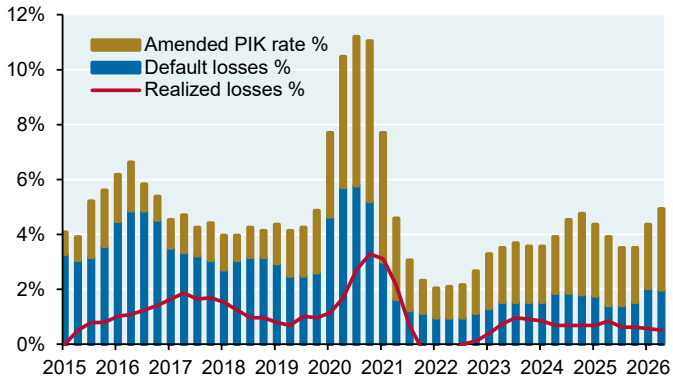
Source: CBO, JPMAM, December 2024

Foreboding in private credit: measuring stress is a combination of art and science

Stress in private credit is a precursor to realized defaults, which is why people track stress in the first place. But the level of stress in private credit is in the eye of the beholder. Some sources cite very low private credit default rates, on the order of 1%-3%. Examples include KBRA, Lincoln International, S&P, Houlihan Lokey and Proskauer Rose. The definitions of stress from each provider are different; some include covenant defaults and certain distressed restructurings while others do not.

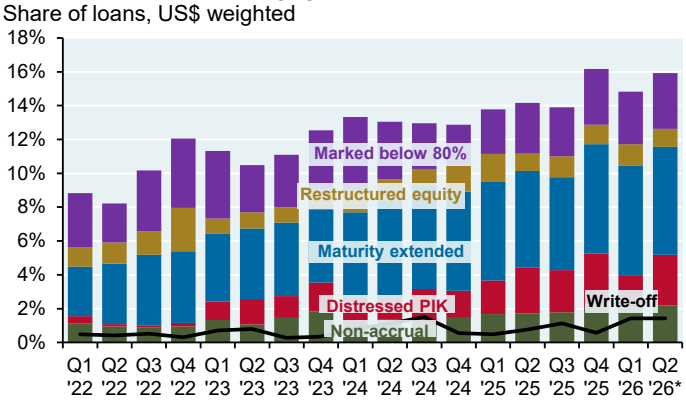
At a minimum, stress should include loans that have been deemed impaired by the lender (i.e., non-accrual), and loans whose distress resulted in the exercise of a PIK (pay-in-kind) option that capitalizes part of the interest. The first chart from Cliffwater does exactly that: stress is defined as the dollar value of non-accruals plus PIK-exercised loans for which fair value is 96 or below[5], divided by total loan balances. PIK loans are important to measure; according to Cliffwater's data, 70% of amended PIK loans never fully return to cash pay two years later. Using Cliffwater's definition, private credit stress is running at ~5%. Cliffwater compares this measure to actual realized losses which continue to be very low (below 1%) as the can is kicked the road.

Stress level on private credit loans
Percent, trailing 4 quarter



Source: Cliffwater Research, September 22, 2026

BDC shadow defaults by type
Share of loans, US$ weighted



Source: PitchBook, JPMAM, Q2 2026 (final quarter is an estimate)

I asked our Asset Management Private Credit and Risk teams to derive their own measure of stress in private credit. Using Pitchbook data on BDC loans with consistent reporting of debt identifiers (around half of the BDC loan universe), excluding syndicated loans and non-senior tranches, the team tracked five categories of stress:

- Loans deemed non-accrual by the lenders
- Distressed PIK: loans with at least one year of seasoning with any PIK usage valued below 90% of par
- Maturity extensions of more than 2 years marked below 95% of par
- Loans that have been foreclosed upon and converted from debt into equity
- Loans valued below 80% of par for reasons other than those captured above

The results were then divided by the total loans in the analyzed BDC universe. The chart on the right looks quite different: stress in this BDC universe is closer to 15%. The black line shows the share of loans disappearing from BDC balance sheets entirely in each period, which we consider to be a proxy for total write-off with no recovery. As with Cliffwater realized loss data, the JP Morgan Asset Management actual write-off rate is a very low 1%-2%.

The bottom line: measuring private credit stress is both art and science; stress measures should include non-accruals, PIK conversions, maturity extensions and debt-to-equity conversions; and the eventual investor return won't be known until more stressed positions are subject to greater price discovery. In other words, this is consistent with the findings on Private Equity and Venture Capital in our "Deep End" Alts piece from last December which cited the highest level of unmonetized investments in the history of both asset classes.

[5] "*Decoding defaults in private credit*", Cliffwater Research, September 22, 2026

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