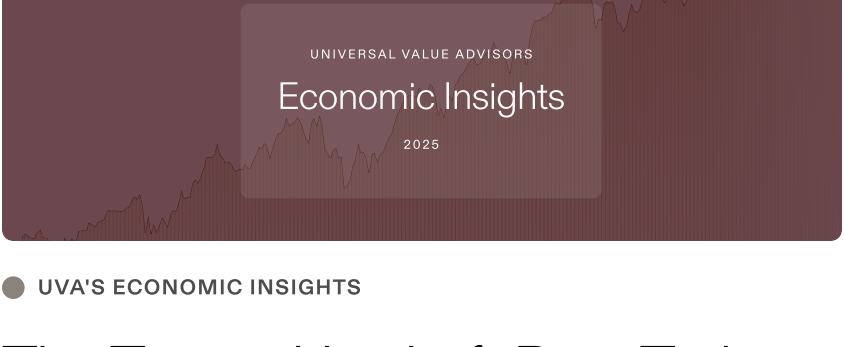




● UVA'S ECONOMIC INSIGHTS

The Titanic Has Left Port: Tight Spreads, Tech Debt, and the Coming Reckoning in Credit

 By Joshua Barone | Nov 10, 2025

When I wrote “*Private Debt: A First-Class Ticket on the Titanic*,” the metaphor wasn’t about catastrophe—it was about complacency. Investors were luxuriating in what felt like unsinkable markets—calm seas mistaken for structural strength.

Now, as 2025 draws to a close, that same complacency has migrated from private credit to the heart of the global financial system. Credit spreads are historically tight, issuance is at record highs, and leverage—both explicit and hidden—has seeped into every layer of the economy.

The ship has left port again, gleaming and confident. But beneath the surface lies a familiar flaw: an over-engineered system sustained by financial illusion.

A Global Flood of Debt

Global bond issuance in 2025 is set to exceed **\$12 trillion**, according to SIFMA and Bloomberg. Every sector is issuing at once—governments rolling over pandemic-era debt, corporates refinancing at thin spreads, and private funds deploying capital into increasingly illiquid structures.

- **U.S. investment-grade issuance:** more than **\$1.3 trillion**, a record pace.
- **Global high-yield:** over **\$250 billion**, the strongest since 2017.
- **Private credit:** approaching **\$500 billion** in new loans.

As *Barron’s* noted on **August 7, 2025**,

“Even the riskiest investment-grade bonds, rated BBB, are averaging yields of 5.13 percent—the lowest since last October.”
(*Financial Times / Barron’s*, Aug 7, 2025)

The result is a paradox: the price of risk has collapsed precisely as the *quantity* of risk has exploded. Late-cycle euphoria always looks calm until the hull buckles.

Big Tech: The New Sovereigns of Credit

Apple, Microsoft, Alphabet, Amazon, Meta, Nvidia, and Tesla—the “Magnificent 7”—now function as quasi-sovereigns in the credit markets. Their paper trades within **100 basis points** of Treasuries, as if these firms were nations rather than companies.

The logic seems flawless: fortress balance sheets, secular growth, and cash to burn. But when perfection is fully priced, there’s no cushion left for error. A slowdown in AI adoption, a regulatory shock, or rising energy costs could send ripples through an over-crowded, duration-heavy bond market.

This is not risk management; it’s risk concentration disguised as prudence.

The Industrialization of AI—and Its Debt Dependency

The modern industrial revolution is being financed with borrowed money. Building AI-ready infrastructure—data centers, fiber, power, and cooling—requires capital intensity unseen since the mid-20th century.

The **Meta-Blue Owl Capital “Hyperion”** project in Louisiana captures the zeitgeist: a **\$27 billion** data-center complex financed through an **80/20** split, with Blue Owl funds holding the bulk of the debt and Meta leasing the facility back.¹ The **private-debt yield** is roughly **6.6 percent**—barely above investment-grade.

On paper, Meta has cleverly minimized on-balance-sheet leverage. In substance, it has **outsourced it**. The risk hasn’t been eliminated; it’s simply been transferred from the issuer to a constellation of private-credit vehicles funded by institutional investors.

This technique is elegant—and eerily familiar. **Enron** pioneered similar off-balance-sheet financing structures in the late 1990s through special-purpose entities (SPEs) designed to obscure leverage and earnings volatility. While Meta’s arrangements are transparent and legitimate, the underlying incentive is identical: **keep capital-intensive assets off the parent’s books to preserve headline ratios**.

As Enron proved, opacity does not eliminate risk; it merely **delays recognition**. If funding costs rise or utilization falters, today’s “innovative structure” becomes tomorrow’s contagion channel.

The Downgrade Wave No One Wants to See

Even as issuance explodes, credit quality is quietly eroding. Through the third quarter, more than **\$40 billion** of bonds have been **downgraded from investment grade to junk**, the largest “fallen-angel” wave in over a decade.²

Yet the **Bloomberg U.S. Investment Grade Index** remains near record highs. Investors are underwriting downgrade risk for free.

VanEck warned in April:

“We expect an uptick in fallen-angel activity in 2025, mainly due to idiosyncratic factors rather than systematic weakness.”
(*VanEck*, Apr 2025)

That same phrase—“idiosyncratic factors”—was used about subprime in 2006. Micro events always aggregate into macro risk; the only question is when the market notices.

Private Credit: The Hidden Ballast Below Deck

Private credit has become the ballast of the financial system—and ballast turns deadly when the ship tilts.

Now a **\$1.5 trillion** market on its way to \$2.6 trillion, private debt promises “high yield with low volatility.” But its stability is a mirage built on:

- **Covenant-lite structures** that suppress distress signals,
- **Leverage-on-leverage** within business-development companies, and
- **Mark-to-model pricing** that hides volatility.

Private-loan spreads have compressed to within **150–200 basis points** of public high yield—a wafer-thin premium for opacity and illiquidity. Investors have replaced yield discipline with yield illusion.

As I wrote previously:

“Private credit is marketed as a high-yield, low-volatility solution—like passengers aboard the Titanic enjoying the first-class experience, unaware of the design flaws below deck.”

Those design flaws have only multiplied.

Funding Markets Flashing Yellow

Even as long-term credit looks tranquil, the *short-term funding markets*—the plumbing of the financial system—are showing signs of strain.

The spread between **SOFR (Secured Overnight Financing Rate)** and the **effective Fed Funds rate**, typically a quiet gauge of liquidity, has widened from **2 basis points** in January to nearly **10 basis points** by late October—the largest gap since the 2020 pandemic.

Bloomberg reported on **November 4, 2025**:

“The SOFR rate fixed at 4.13 percent as of Nov. 3. The effective fed-funds rate fixed at 3.87 percent.”
(*Bloomberg*, Nov. 4, 2025)

Investing.com added:

“Repo has tightened, the effective funds rate has risen, and the Fed has reacted with a promise to buy T-bills... The spread from the funds rate to SOFR will remain elevated.”
(*Investing.com*, Nov. 2025)

At first glance, a few basis points seem trivial. But in funding markets, direction and persistence matter more than magnitude. This divergence indicates rising frictions between policy rates and the real cost of secured financing—a micro-signal of macro stress.

What’s Driving It

Three forces explain the widening:

1. **Excess Treasury issuance:** The U.S. government has flooded the market with short-term paper, absorbing dealer balance-sheet capacity.
2. **Reverse-repo flows:** Money-market funds have pulled liquidity out of the system, parking trillions at the Fed’s overnight RRP facility rather than supplying repo markets.
3. **Dealer constraints:** Regulatory capital rules still limit large banks’ ability to expand repo books, even as collateral volumes soar.

In essence, the system is **awash in collateral but starved for balance sheet**—a problem eerily similar to the 2019 repo spike, when overnight rates briefly surged to 10 percent and forced the Fed to intervene.

Back then, the Fed’s response was immediate and massive: a return to balance-sheet expansion. Today, it remains in **quantitative tightening (QT)** mode—removing liquidity from the same channels showing stress. The consequence is an unstable equilibrium where *headline liquidity appears abundant*, but *market liquidity is tightening beneath the surface*.

Why It Matters

Historically, small anomalies in short-term funding spreads have preceded major turning points in credit markets. In 2007, the TED spread quietly widened months before the subprime crisis erupted. In late 2018, a similar drift signaled the liquidity stress that forced the Fed’s early pivot.

The current SOFR–Fed Funds divergence is that same canary in the coal mine—a sign that balance sheets are maxed out, issuance is overwhelming capacity, and the marginal cost of leverage is rising faster than official policy rates suggest.

The Fed, as usual, is **behind the curve**, dismissing the signals as “technical.” But in a world this leveraged, the technical always becomes the fundamental.

Fiscal Flood Meets Monetary Lag

The U.S. Treasury must refinance nearly **\$8 trillion** of maturing debt over the next year while running deficits exceeding **6 percent of GDP**. With the Fed still shrinking its balance sheet, the public and private sectors are competing for the same pool of capital.

This is **fiscal dominance** in action: policy constrained not by inflation targets but by the government’s own refinancing schedule. Rates will eventually fall—not because inflation is tamed, but because the system can’t fund itself otherwise.

The Fed, predictably, remains **behind the curve**—tightening too long, then easing too late.

The Psychology of Perfection

Every cycle has its rationalization. In 2006, it was “subprime is contained.” In 2021, “inflation is transitory.” In 2025, it’s “AI will outgrow the debt.”

Markets have succumbed to **recency bias**—the assumption that calm equals resilience. Spreads tighten, volatility declines, and analysts infer that risk has been “structurally reduced.” In reality, all that’s changed is the willingness to ignore fragility.

The Repricing Ahead

When spreads widen—and they will—the process will be mechanical:

1. **Investment grade** reprices first as Treasury supply overwhelms buyers.
2. **High yield** follows as refinancing windows close.
3. **Private credit**, buffered by mark-to-model pricing, unravels last—and hardest.

Liquidity doesn’t erode gradually; it disappears all at once.

As Robert Barone often writes:

“Liquidity is not capital—it’s confidence. And confidence is the first casualty when spreads normalize.”

Navigating the Iceberg Field

The Titanic analogy endures because the psychology never changes. Investors see calm waters and assume the hull is sound. Policymakers see tight spreads and declare “financial stability.” Private-credit managers see smooth returns and call them “alpha.”

But the ship is overleveraged, overconfident, and over-issued. When spreads widen and funding cracks appear, the illusion of unsinkability will vanish—as it always does.

The question isn’t *if* the market will hit the iceberg.

It’s *who will still be on board when it does*.

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