INTEREST RATE UNCERTAINTY · JUNE 2026

A Factor Weight Is Not a Risk Budget.

A formal risk model attributes barely 2% of an illustrative family office portfolio's variance to interest rates. A rate shock takes 14% off it. The gap between those two numbers is where the real exposure lives, and it is cheap to close.

2.2%	−14.3%	20 : 1
of portfolio risk the factor model assigns to interest rates	modelled drawdown in a 2022-style rate shock	resilience gained per unit of return given up

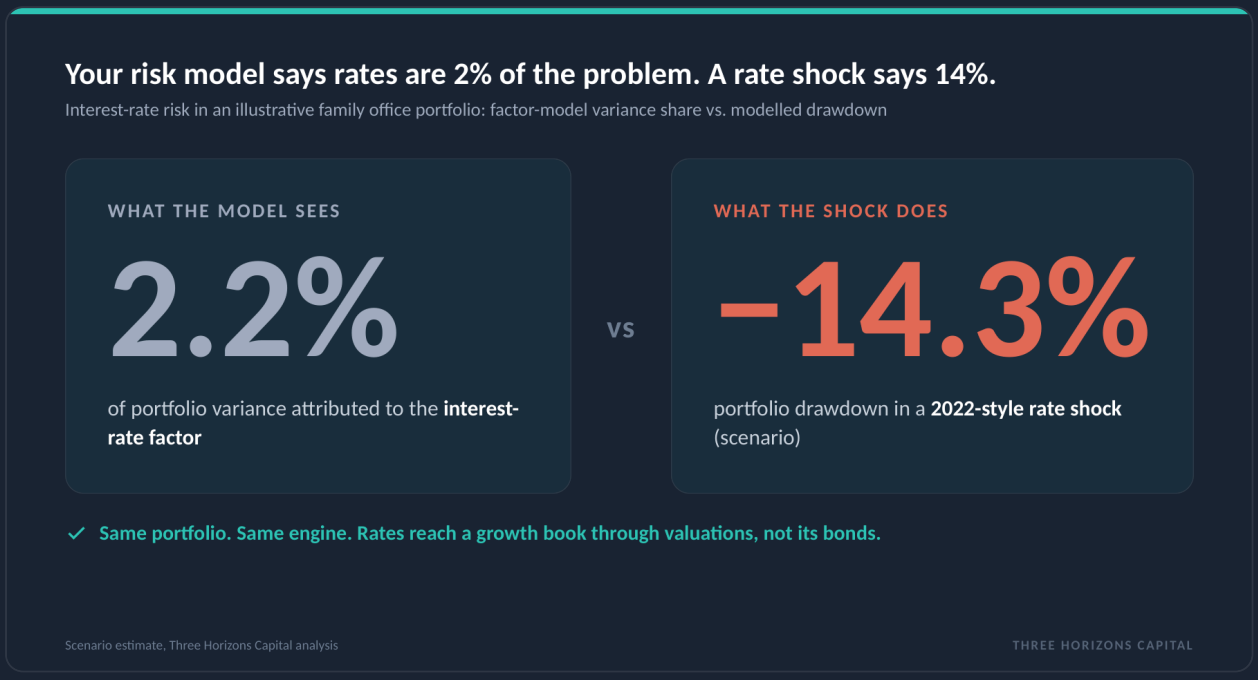
On 17 June 2026, Federal Reserve Chair Kevin Warsh held his first meeting and changed the weather. Rates stayed at 3.50% to 3.75%, but the committee removed its bias toward cuts, the median projection moved toward at least one more hike this year, and easing was pushed out to 2027 and beyond, against a supply-side inflation the Fed cannot fix with rate policy. CPI reached 4.2% in May, the highest since April 2023. For a growth-tilted, illiquid-heavy family office, the standard rates-and-bonds checklist looks in the wrong place. This paper shows where the rate risk actually sits, why the usual hedge is impaired, and a five-step reallocation that buys resilience for eight basis points of return.

> **A word on the data:** portfolio analytics are computed on J.P. Morgan's 2026 Long-Term Capital Market Assumptions. We verified the asset-class baselines this analysis depends on against our own LTCMA data, and they match to the basis point. The factor decomposition, scenario results and rate-sensitivity spectrum are model-derived estimates, labelled as such throughout. The macro backdrop (the June FOMC, May CPI) is corroborated against public reporting. The reference portfolio is analytically constructed and is not based on any client's holdings.

01 · THE REASSURING NUMBER

Two percent of the risk. Fourteen percent of the drawdown.

Run a formal three-factor model over the portfolio and it attributes **2.21% of variance to the interest-rate sub-factor.** On paper, rates are a rounding error. Stress the same portfolio with a rate shock on the scale of 2022 and it returns a **14.3% drawdown**, larger than the loss it projects for a normal recession. Both numbers come out of the same engine.



The reason is mechanical. A factor model measures statistical co-movement between holdings and rate-proxy instruments, mostly bonds. It is close to blind to the way rates reach a growth portfolio, which is through valuation. It is blinder still for concentration: this book holds twelve nominal positions but behaves like **4.1 effective positions,** because its assets move together. Risk that looks spread across a dozen line items is, underneath, a few correlated bets, and rates move several at once.

02 · THE TRANSMISSION

Rates do not arrive through the bonds. They arrive through valuations.

Rate risk reaches this portfolio through three valuation channels, none of which runs through the bond allocation the model is watching. Each conceals the loss in a different way.

Private equity, 22% of the book, through the discount rate

The largest single holding. A higher discount rate compresses the value of distant cash flows most; the 2022 analogue implies roughly −15% at the asset level. Marks lag reality by one to three quarters, so the first risk report after a shock looks calm while the loss has already happened.

Core real estate, 9% of the book, through the cap rate

The highest rate sensitivity per dollar of any holding. Rising rates lift cap rates mechanically and compress values; the 2022 analogue implies near −25%. Quarterly appraisal crystallises the loss slowly, so low reported volatility is delayed information, not safety.

Public equities, ~32% of the book, through the multiple

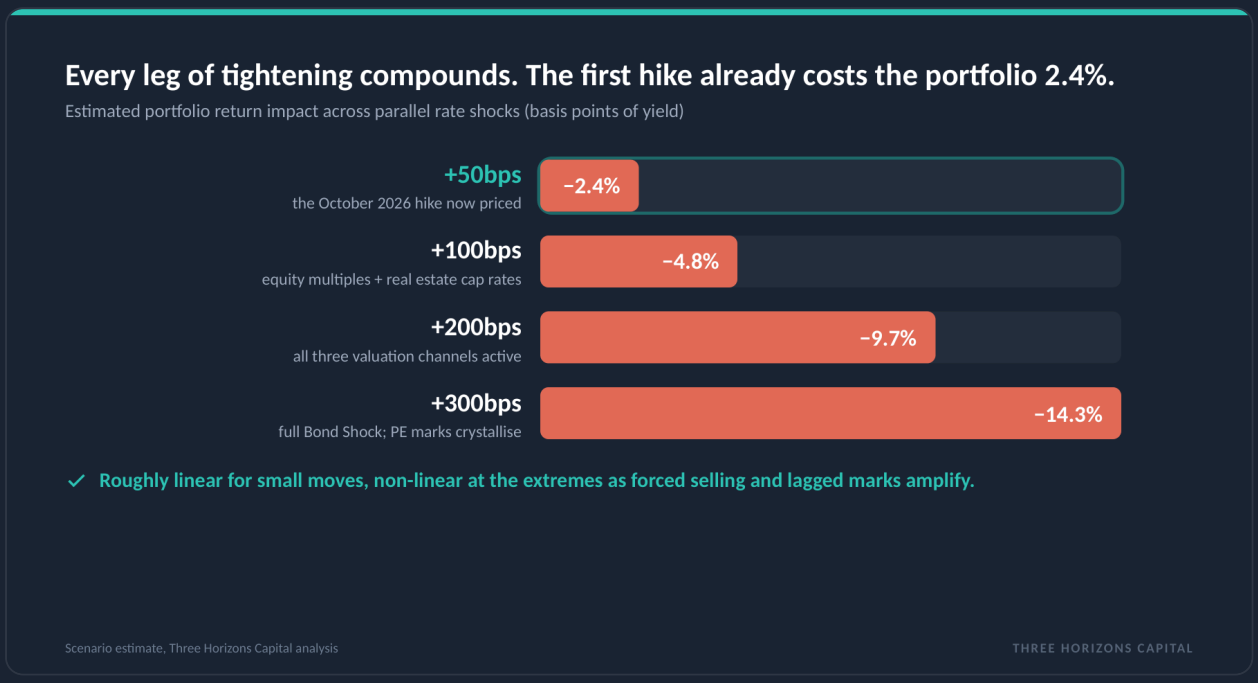
Higher rates raise the discount rate on future earnings and make bond yields compete with the equity risk premium; the 2022 analogue implies −28% to −30%. Today's richer starting valuations amplify the contraction.

Add the channels up and the 14.3% stops looking surprising. The model was not wrong about the bonds. It was silent about everything else.

03 · THE BROKEN HEDGE

A slowdown no longer buys you a rate cut.

For most of the last fifteen years, a slowdown was its own insurance: growth wobbled, the Fed cut, yields fell, and falling yields cushioned the equity loss. Stocks and rates offset each other. The current regime breaks the reflex. When inflation is the binding constraint, a mild slowdown does not automatically buy a rate cut, so the portfolio can face growth risk and rate risk at the same time, with no monetary relief to net them off. That is why the scenario model puts the rate shock, not the recession, at the top of the risk ranking for this environment.



Even the single hike the market is now weighing produces an estimated **−2.4%** at the portfolio level. The relationship is roughly linear for small moves and turns non-linear at the extremes, as forced selling and lagged marks amplify the theoretical transmission.

04 · THE FIX

Buy resilience, do not sell growth.

The fix is not a defensive crouch. The portfolio's **7.07% expected return** comes from its growth and illiquidity, and none of that need be surrendered. The problem is narrower: the natural hedge budget, at 12% of assets, is too small for the rate environment. Five targeted adjustments close most of the gap, each funded from within the book.

ADJUSTMENT	MOVE	WHY IT WORKS
Add TIPS	0 → 4%	The only structurally positive real-rate sleeve; funded from nominal aggregate bonds.
Expand direct lending	5 → 8%	The only floating-rate instrument; spread income rises with base rates, principal at par.
Initiate macro hedge funds	0 → 3%	Low correlation (0.14); lengthens in sustained rate shocks. Funded from cash.
Trim core real estate	9 → 5%	Removes the most concentrated valuation-channel exposure, via normal redemptions.
Double gold	2 → 4%	An underused diversifier with a strong case in a year of geopolitical and real-rate risk.

The funding chain above is shown illustratively. The modelled rate-resilient portfolio is normalised to 100% of assets, with the gold increase funded partly from the real estate trim and partly from a small trim elsewhere; the portfolio metrics below are computed on the normalised weights.

What it buys: the Bond Shock drawdown improves from **−14.3% to −12.7%, a gain of 160 basis points,** while expected return falls by **8 basis points** and volatility falls by 42. The natural hedge budget rises from 12% to 21% of assets, and effective positions improve from 4.1 to 4.8. A Sharpe ratio that moves by 0.007 is inside the model's own noise. That is roughly twenty to one, on the risk most relevant to the current policy environment.

05 · THE RISK YOU CANNOT MODEL

The honesty is the point, not the footnote.

Two risks sit outside any scenario table, and pretending otherwise is its own error. The first is the governance gap inside private equity: because marks lag, reported volatility in the first quarter of a rate shock can **understate the true drawdown by an estimated 300 to 600 basis points.** Risk reports written in that window are not a safe basis for positioning; capital-call planning must assume the full economic hit before the marks show it; and any apparent private-market outperformance during the shock is an accounting artefact, not skill.

The second is the redesign of Fed communication itself. The Chair has signalled a review of how the committee guides markets, including the dot plot that has anchored forward rate pricing since 2012. If that anchor is widened into ranges, published less often, or retired, the credible interval around every rate forecast widens with it. This is uncertainty about uncertainty, and it has no point estimate. It is the strongest case for holding instruments, inflation protection and macro among them, that do better precisely when the rate outlook becomes harder to read.

> **The honest part:** every scenario number in this report is a point estimate inside a range that could widen. The verified layer is the J.P. Morgan baseline assumptions; the factor decomposition, the drawdowns and the spectrum are model estimates. We would rather show the range and the assumptions than a single confident figure that the next Fed press conference could undo. The discipline is not predicting the rate path. It is making sure a portfolio is not relying on a number that says rates are 2% of its risk, when the drawdown says 14%.

The reference portfolio carries no special mandate, which is the point: the single low rate-factor weight and the thin hedge budget are the **default state** of a great many growth portfolios that have never been put through a factor and scenario lens.

01 Decompose the true factor exposure
Any portfolio, broken into the factors and channels that actually drive its variance, so a hidden rate exposure shows up before the market finds it.

02 Ground it in reconciled assumptions
Computed on capital-market assumptions with the baselines verified against source data, then stress-tested across the standard scenario matrix, including the ones the statistical model underweights.

03 Size a cheap resilience overlay
A small, targeted reallocation with the cost disclosed in full, so the recommendation reads as analysis, not a sales pitch.

One honest note: every factor, scenario and rate-sensitivity figure in this report is a model estimate, not a forecast. The reallocation's resilience holds on standard scenario grounds; the figures would shift under a different rate path. The J.P. Morgan baseline assumptions are verified against our own data; the model outputs are estimates.

Sources: J.P. Morgan 2026 Long-Term Capital Market Assumptions (10-year, USD), verified against Three Horizons Capital's analytics estate; Three Horizons Capital portfolio analytics, three-factor model and scenario engine; macro backdrop (June 2026 FOMC; May 2026 CPI) corroborated against public reporting as of 25 June 2026. For research and platform-demonstration purposes; not investment advice.

Want this run against your own book?

We can take any portfolio, decompose its true rate exposure, ground it in reconciled capital-market assumptions, and show, with the cost disclosed, the cheapest way to make it more resilient to a rate shock.

READ THE FULL PIECE ONLINE

www.threehorizonscapital.com/insights/interest-rate-uncertainty