INSTANT INSIGHTS

April 14, 2025

What's Happening to US Treasuries

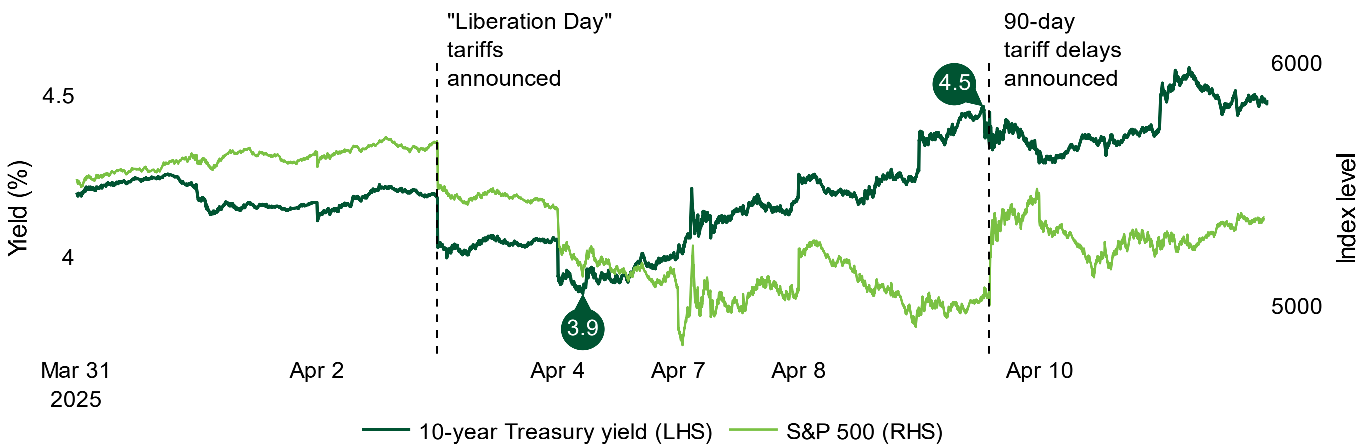
The recent Treasury sell-off displays signs of reduced liquidity and shows signs of some market dysfunction. However, we believe fixed income remains attractive, although investors may need to embrace uncertainty.

A "QUEASY" RUN FOR LONG-DATED TREASURIES

Amid volatility surrounding President Trump's "Liberation Day" tariff announcements, the US Treasury market suffered disruption.

Treasuries initially played their "safe-haven" role after the President's address but sharply reversed course. Yields rose as much as 60 basis points (bp) despite continued equity market turmoil (Figure 1).

FIGURE 1: SHARP RISE IN TREASURY YIELDS PROMPTS TARIFF DELAY[1]



Charts are provided for illustrative purposes only.

The move appeared to be a major factor in the administration's decision to pause most tariffs for 90 days , with the President noting "queasy" bond markets. However, after initial relief, Treasury market volatility continued. We see three reasons for the sell-off:

1) A dash for cash

Memories of recent Treasury liquidity squeezes appeared to spur demand for cash and cash-like assets. This may have included some selling of longer-dated Treasuries.

2) Anticipation of lower foreign demand

Fewer imports imply fewer US dollars circulating in foreign economies, where they might be invested in US Treasuries.

Foreign investors currently account for ~30% of all US Treasury holders, albeit their holdings are mostly concentrated at maturities below five-years. Speculation of retaliatory "dumping" seems unlikely to us, but expectations of lower foreign Treasury demand probably contributed to the sell-off, whether it involved significant foreign sales or not.

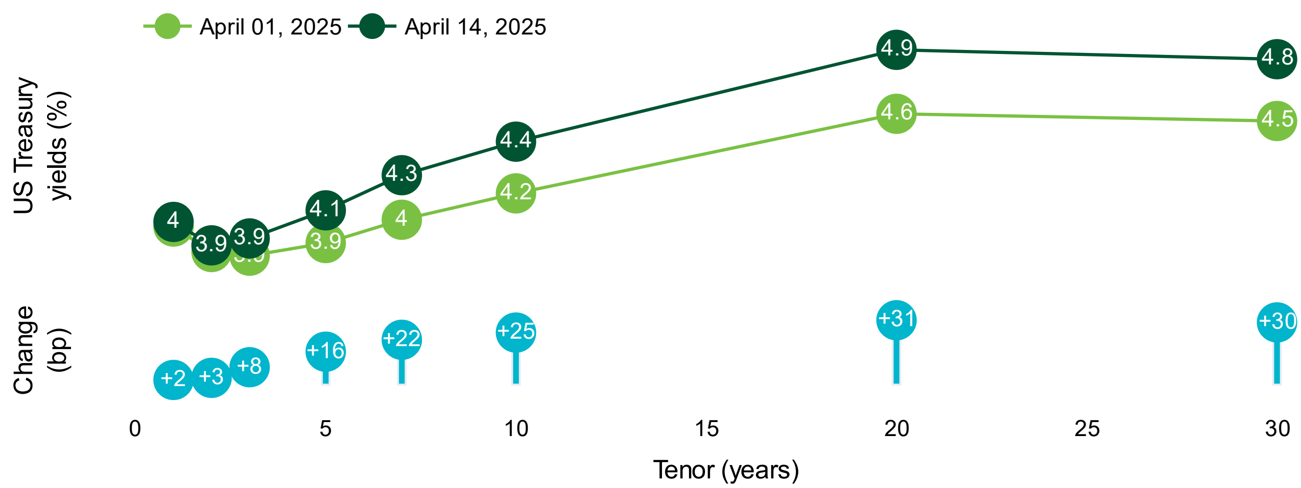
1. Bloomberg, Insight, April 2025
2. New York Times, "From 'Be Cool!' to 'Getting Yippy': Inside Trump's Reversal on Tariffs"
3. BNP, Bloomberg, April, 2025

"Liberation day" refers to the day that the president announced import taxes, including "reciprocal" tariffs that would match the rates charged by other countries and account for other subsidies.

3) Rising inflation and term risk premia

The sell-off at longer maturities (Figure 2) may reflect greater inflation and growth (i.e., stagflation) concerns. It may also reflect potential repricing of the fiscal policy outlook. Proposed congressional budget resolutions may have raised doubts about the administration's ability to reign in the deficit, despite expected tariff revenues and its efficiency drive.

FIGURE 2: INVESTORS MAY BE PRICING IN HIGHER INFLATION AND TERM PREMIA[4]



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MARKET LIQUIDITY HAS TAKEN A HIT

We have observed Treasury and corporate bid-ask spreads widening two-to-three-fold. According to JP Morgan's market depth indicator, Treasury market liquidity is the thinnest since the regional banking crisis in 2023 and the height of the pandemic.

On April 11, the CME Group increased its margin requirements for secured overnight financing rate (SOFR) and Fed funds futures, reflecting higher volatility. However, it has not yet done so for Treasury futures or cleared interest rate swaps.

There have been concerns about hedge funds becoming forced sellers of Treasuries to meet margin calls on their highly levered Treasury futures basis trades, similar to what happened in 2020. We have seen little evidence of it happening yet, its memory is fresh in investors' minds and may be contributing to sentiment.

THE ENVIRONMENT MAY SUIT FIXED INCOME – BUT IT'S TIME TO EMBRACE UNCERTAINTY

This episode has raised further questions about the US' status as the ultimate safe haven. However, we see no immediate alternative to the US as the world's global reserve currency. At some point, we believe there will be a limit to how far long-dated Treasuries sell off. Hypothetical levels in the 5% to 6% range would, we suspect, be attractive to many global investors. The Federal Reserve would also, in our view, stand ready to intervene if needed. In our view, it may be a matter of time before investors warm to duration exposure.

For now, we believe fixed income assets, particularly short-dated high quality sovereign curves, look attractive. Staying close to home but remaining nimble and employing the optionality of tactical liquidity may best position investors to take advantage of compelling entry points. Some may already be available in credit, with investment grade yields at ~5.5%, high yield over 8.5% and nominal agency Mortgage-backed securities (MBS) spreads at ~70bp. We also see global fixed income as attractive, given its wide diversification and ability to target alpha opportunities among tariff winners and losers.

Investors nonetheless face substantial uncertainty. We believe this elevates the importance of seeking a well-resourced manager to mitigate market risk and liquidity. We further find it important to stay allocated to high quality fixed income through a well-diversified portfolio focusing on contractual sources of return through strong credit selection and a bias toward more liquid, cash instruments.

4 Bloomberg, Insight, April 2025   5 JP Morgan, April 2025   6 CME Group April 2025 7 Bloomberg, Insight, April 2025
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