BRAY FARM
INCOME ADVISORY

Week of April 8, 2025

There's Something About Treasuries What's going on with Treasuries? Historically, whenever the market gets spooked, it turns toward Treasuries—no matter what. Instead, while the stock market has plummeted, ripped, and re-plummeted in response to trade developments, the entire Treasury curve has shifted up. The equity market's response is rational; it's processing information from binary policy choices that change day-to-day. The Treasury market, however, has been *weird*.

The denomination 'risk-free asset' puts a burden of responsibility on Treasuries to keep the financial plumbing clear. We have assumed for the past 50 years that US federal government debt is the safest investment in the world and have built our financial structure on top of this assumption. So we need to ask: Why are yields moving so strangely? What would it take for the 'risk-free asset' to take on some degree of risk?

First, let's look at what's happened this week. On Monday, the entire Treasury curve shifted up. At the same time, the dollar spot index increased, so we can assume that shift was not a foreign sell off of dollar denominated assets. Some blame the unwinding of the basis trade. Hedge funds have historically used 50 to 100 times leverage to sell Treasury futures and buy the underlying securities. The current net position of this trade is estimated around $1 trillion, making hedge funds some of the largest buyers in the Treasury market. In times of turmoil, funds may need to fire sale their Treasuries to pay back their loans. If too many large holders all try to unload their long positions at once, trading and liquidity can spasm. While some positions were probably sold in a move toward cash, we managed to avoid a self-reinforcing spiral. On Tuesday and Wednesday, yields rose while the dollar fell. There are *rumors* that a foreign creditor government dumped some of their US Treasury Bonds *(ahem China)* to devalue the dollar and worsen the impact of trade wars on US consumers.

This volatility included three auctions this week in the 3-year (April 8), 10-year (April 9), and 30-year (April 10) tenors. In the last few years, the Treasury has had demand issues for the long end of the curve. Sales of $39 billion in 10 years and $22 billion in 30 years could have led asset allocators to dump their positions on Monday. Interestingly, the 3-year auction drew the weakest demand of the bunch. The next auctions had levels of demand consistent with the last few offerings. I don’t know what to make of this yet. But it’s weird.

This degree of volatility begs the question: what would it take for a US Treasury bond to be a risky asset? What changes in our financial system if they’re no longer a risk-free haven? Moving forward, I’ll be looking in depth at the long-term risks to US debt stability and the broader implications for financial market structures.

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