

Views from the Floor Is the Bond Market Calling Washington's Bluff?

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Sticky inflation and high debt loads are turning sovereign paper into a source of portfolio risk.

With 10-year US Treasury yields piercing 5%, the definition of "risk-free" is starting to come apart.

For decades, that label was synonymous with US Treasuries. Yes, traders will spend Wednesday obsessing over whether Federal Reserve (Fed) Chair Kevin Warsh raises rates to counter 3.4% inflation and \$100+ oil. But that focuses on the wrong end of the yield curve. The Fed can only really tweak the dials on the front end, but as yesterday showed, the real story is at the long end, where US Treasuries are losing their status as an unassailable haven.

Last week's US bond market drama was topped yesterday when the 10-year US Treasury yield, which also acts as the benchmark for trillions of dollars in global assets, climbed to the psychological mark of 5%. At this point, the rise in US rates feels more like credit spread widening than a change representing the ebb and flow of economic cycles. The trouble is that those looking to reallocate to other markets or geographies are quickly faced with the same problem as the US, such as high debt loads as a function of GDP and interest bills that are rising at a critical period of ongoing geopolitical strife, sticky inflation and squeezed consumers.

Figure 1. Long-term Treasury yields are now behaving like a credit spread

Source: : Bloomberg as of 14 September 2026. Note: The overnight rate (SOFR) is the rate at which institutions borrow overnight against Treasury collateral, which moves with the Fed's policy target.

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Flight from quality?

In an odd twist, investors seem to have been forced into a flight from quality, with money moving out of US debt and, dare we say, chasing the runaway upside of AI stocks instead. Last weekend's plea from AI leaders for a slowdown in frontier model developments makes this an even more complicated decision.

There is a subtle yet critical difference between the drivers of "return on capital" and "return of capital". This is where the concept of flight to quality really comes from.

If you buy a 10-year Treasury and yields drift up from 4.5% to 5.5%, you lose roughly 7% of your money, as the rise in yield eats up the price of your bond. If this is the path that you think we are going, it might be a fast way to lose a lot of money on an asset that had traditionally been labelled "risk-free". In theory and historically, the label simply meant the US government was unlikely to default on its nominal dollars. In practice, investors typically treated it as a guarantee against losing money. But when inflation is sticky and yields are climbing, guaranteed return of capital offers very little comfort if the purchasing power of that capital is being steadily eroded.

With bonds, your return is capped at par plus accrued interest. With a basket of AI and data centre equities, you might own the next Nvidia (recently nick-named the AI central bank). It looks to us like investors are getting out of the way of what they believe to be an imminent repricing of the US yield curve. We think this is being driven by lack of faith in current fiscal policy, high levels of debt and debt service costs, and very questionable actions that could make the problem worse, not better.

Warsh's reality and the house doesn't always win

The macro picture makes this increasingly complicated. Tomorrow, the Fed's Kevin Warsh is faced with a reality that, in our view, almost certainly warrant a raise in the front-end. Additionally, the messaging from AI leadership around "slowing down" is being viewed as a multi-faceted problem as it relates to US-based growth and competition on the global stage.

Washington's attempts to manage the curve last week appear to have done little to help, judging by the reaction to Treasury Secretary Scott Bessent's intervention in the Japanese currency market and bond buying.

Japan is a major US creditor, and when the yen slides, Tokyo tends to sell US paper to fund its currency defence, pushing American yields higher. Bessent stepped in to prop up the currency, proclaiming that "he is the house" and implying he owns the casino everyone else is playing in. He then kicked off a new version of Operation Twist, offering to spend up to \$6 billion (up from \$2 billion) to buy back 10- to 20-year paper while issuing short-term debt. The theory is that it would bring down long-term rates.

In practice, the market heard him and bonds sold off anyway, sending yields up five basis points within moments of the buyback announcement. The market sees the US Treasury trying to talk its way into lower rates when all signs are pointing the other direction. Central banks may set the overnight rate, but they cannot control long-term borrowing costs when investors refuse to absorb trillions in new debt.

Wall Street's fear gauge nudging up

And yet, the S&P 500 remains not too far from its all-time highs and the market's fear gauge, the VIX, still sits at a yawn-inducing 17 (although in fairness, it has nudged up in recent days, and with the prospect of a bumpy rest of the year, the direction of travel is probably very much up).

That disconnect between the stock and bond market looks ripe for a reckoning, but history warns against calling time on momentum.

Alan Greenspan gave his "irrational exuberance" speech on 5 December 1996. The peak of the dot-com boom happened on 10 March 2000, three years and three months later. Being early is the same as being wrong, so I'd be careful not to declare the game over too soon.

Going forward, we believe we all need to be on our toes and not lean on static assumptions. When the bedrock of the global financial system begins to wobble, assuming sovereign bonds will offer shelter looks increasingly fragile. You may get your money back, but it may not be a straight line.

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For further clarification on the terms which appear here, please visit our Glossary page.