Daily: Treasury pressure: The implications across markets

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From the studio

Video: CIO Monthly | Kiran Ganesh on key market drivers, scenarios, and opportunities (4 mins)Video: Market Playbook | James Cheo on fixed income (5 mins)Video: The AI Show | China tech earnings update and what's next (3 mins)

Thought of the day

The US Treasury's bond market intervention this week has so far had a relatively short-lived effect on long-term borrowing costs. After an initial fall in yields, long-dated government bonds have resumed their sell-off, with yields on the 30-year Treasury climbing back to around 5.25%, about 5 basis points below their intra-week high.

Meanwhile, the DXY dollar index is down almost 1% on the week, and gold prices have risen more than 4.3% to USD 4,560 per ounce.

Investors remain sensitive to the structural forces driving yields higher, including large fiscal deficits, elevated energy prices, and strong AI-related capital demand. The continued upward pressure on yields suggests that these concerns are currently outweighing policymakers' efforts to contain long-term borrowing costs.

At the same time, we would not dismiss the potential impact of further Treasury actions, particularly since policymakers have now signaled a greater willingness to intervene if market conditions deteriorate.

What are some of the implications for investors?

Stay focused on short- and medium-duration bonds. The volatility at the long end of the curve reinforces our preference for short- and intermediate-maturity fixed income. We think that yields in short- and medium-duration fixed income are attractive, while long-end bonds are likely to stay volatile until inflation and growth show clearer signs of moderating, or until fiscal concerns are meaningfully addressed. It remains to be seen what success policymakers will have in capping long-term yields, but we think structural forces are still likely to keep term premia elevated in the near term.

More room to run for gold. Gold prices have extended their monthly advance to 13%, as more investors seek alternatives to both duration risk and dollar exposure. Historically, concerns around debt sustainability and currency weakness have tended to support precious metals. While higher oil prices could keep rate expectations elevated in the near term, we think rising debt burdens and uncertainty over how governments will finance them should be supportive for gold. We expect gold to climb to USD 5,400/oz over the next 12 months.

Dollar weakness could cushion risk assets. The intervention in the Treasury market has contributed to dollar weakness, likely reflecting a combination of fiscal concerns, profit-taking on long-USD positions, and uncertainty over what further Treasury actions could mean for markets. Looking forward, the dollar looks vulnerable to additional weakness, as the window for Federal Reserve hikes appears to be narrowing, and concerns around US debt sustainability tend to be dollar negative. The potential for higher currency volatility means that investors should review strategic currency allocations and ensure they are well-aligned with their personal situations.

Equities remain on an upward trajectory. Higher yields are typically a headwind for equities. However, a softer dollar could offset some of that pressure by easing financial conditions, supporting global liquidity, and boosting overseas earnings for US multinationals. Furthermore, the substantial AI infrastructure buildout may pressure bond markets through higher capital demand, but support equity earnings expectations on the monetization of these data center investments.

So, we don't currently see bond market turbulence as a reason to reduce equity market exposure. It does, however, reinforce the case for diversified equity exposure across sectors and regions, with a balance of cyclical, tech, and defensive stocks.

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