Flash Fixed Income

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TwentyFour
a boutique of Vontobel

Treasuries made Trump blink

- **Investors had already lost faith in a "Trump put" for the stock market, but the extreme price action in US Treasuries on April 9 looks to have triggered the 90-day pause on more punitive tariffs.**
- **We think the Trump administration's capricious policy making has raised the risk premium on US assets and created an uncertain business environment that will drag on the US economy.**
- **We reiterate our view that European and UK credit offer better value than their US equivalents, given Europe's advantage in dealing with the impact on growth and inflation.**

After a chaotic week in global markets following the tariffs announced by President Trump on April 2, at time of writing (April 10) investors are left to contemplate 125% tariffs on China, a baseline 10% on the rest of the world, 25% on auto imports and a 90-day pause on more punitive rates.

Since the pause announcement triggered a sharp relief rally in risk assets on April 9, one question we've heard multiple times is how markets might have reacted if they had simply been given this scenario directly on "Liberation Day". It's a great question, but those caught on the wrong side of Trump's destruction of market value will gain little solace in the answer.

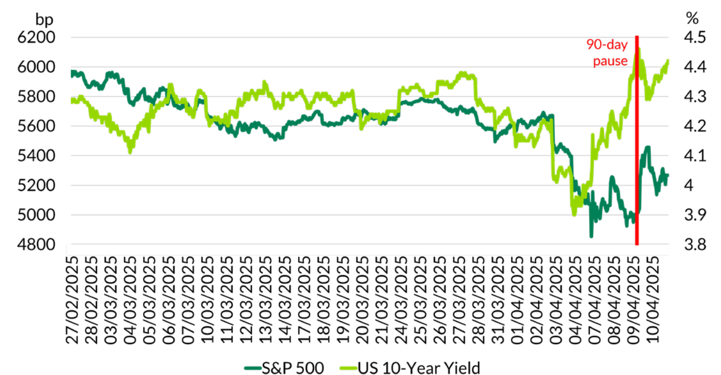
For those looking to navigate what remains an extremely uncertain policy environment, the more important insight going forward is that there appears to be a level of market pain that makes Trump blink.

The "Trump put" exists, just not in stocks

The consensus coming into 2025 was that President Trump would be just as sensitive to the stock market's approval as he appeared to be in his first term, and the assumption was that a "Trump put option" existed with a high strike price. Investors were swiftly disabused of that notion after the plunge in stocks across April 3 and 4 drew no softening of stance from the White House.

It is worth considering exactly which market movement looks to have pushed the administration to act. As bond investors we are no strangers to headlines focused on equity markets, and with the S&P 500 down over 11% from the initial tariff announcement this was an obvious focal point. But as Exhibit 1 shows, while equities were still on a downward trajectory before the 90-day pause announcement, they weren't at their lows. It was US Treasuries (USTs) experiencing maximum pain.

Exhibit 1: 10-year Treasuries were selling off sharply prior to 90-day pause



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Credit market performance

	Total return YTD (%)	Total return last 30 days (%)	Yield (%)	Duration (yrs)
EUR IG	0.06	0.14	3.3	4.4
GBP IG	-0.15	-1.09	5.6	5.7
US IG	-0.03	-2.35	5.5	6.4
EUR HY	-0.71	-1.79	6.3	3.0
GBP HY	1.04	-0.96	8.7	3.0
US HY	-1.64	-3.11	8.6	3.5
EM HY	-0.95	-3.03	8.9	3.8
Euro Senior Banks	0.60	0.37	3.2	3.6
CoCo	-0.89	-2.80	7.2	3.4

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The price action in the UST market over the previous week had begun to create serious consternation among bond traders. USTs had rallied immediately after the sweeping tariff announcement on April 2, providing the downside mitigation investors generally expect from a "safe haven" asset, but the effect was short-lived; yields began climbing in the trading sessions that followed as USTs dropped in value along with equities. There were three main consensus theories about why the typical inverse correlation between rates and risk had broken down.

1. **Volatility begets volatility** – investors move positions around as relative value swings, with some selling government bonds to fund outflows and others to pay margin calls.
2. **Retaliatory selling from China** – owning roughly $800bn of USTs according to the US Treasury Department, Trump's opponent in what is now a full-blown trade war has significant clout.
3. **Investors retreating from US government risk** – foreign and domestic UST investors reappraising the sustainability of the US fiscal position in light of plummeting growth projections, the expected tariff impact on US inflation and general uncertainty around policy.

Each day that passed with stocks falling and yields rising reduced our belief that the more benign theory (number 1) could explain these movements, and ultimately we believe the most plausible explanation is theory number 3.

Threat to "safe haven" status of USTs

The hint of a buyers' strike on USTs has a number of unsettling consequences.

First, if investors reduce or have less confidence in the "risk-off" allocation of their portfolios it makes it harder for them to allocate to risk, with obvious negative implications for credit spreads.

Second, pushing up the funding costs of the US government severely curtails its ability to offer a fiscal response to a potential tariff-driven recession.

Third, it brings to a head doubts about the sustainability of the federal deficit, with the corresponding danger of a negative spiral; investors sell USTs because they fear higher federal debt service costs, further exacerbating those costs and thus their own fears. The short-lived UK prime minister, Liz Truss, quickly learned the political cost of losing fiscal credibility after bond vigilantes scorned the unfunded spending plans of her "mini-Budget" in late 2022 and sent UK Gilt yields soaring.

It is easy to imagine Trump's Treasury Secretary, Scott Bessent, seeing the potential cliff edge UST price action was approaching and convincing the president action needed to be taken.

Tariffs slap risk premium on US assets

Where does this leave us? As investors, is the administration's signaled awareness of the existence and power of bond vigilantes enough to assure market stability from here? In a word, no.

The volatility of the last week will have inflicted considerable losses on a variety of portfolios and left a bad impression on long-term investors. The Trump administration's apparent tolerance for the carnage has demonstrably raised the risk premium on US assets in our view. The appeal of global diversification appears stronger than ever. From a business investment point of view, material uncertainty remains. Psychologists may be more use than economists in predicting the length and success of negotiations to end the trade war with China.

Even the rolled-back baseline 10% tariff for the rest of the world remains substantially higher than the US historical weighted average tariff level of 2.5%. Perhaps more importantly, from the 1970s to 2025 that average never moved more than 1% in a year; the stability of the regime allowed businesses requiring imports to plan and invest. The shattering of US policy certainty raises the return on investment required for any endeavour involving significant import costs. Many otherwise growth-expanding projects will almost certainly not go ahead as a result – factories unbuilt, business expansion curtailed, new business creation cancelled. This added inactivity and the ripples it causes across the rest of the economy are expected to create a downward shift in US growth, one that the market still has to calculate and digest.

Flexibility in portfolios is essential

From a fixed income point of view, we are faced with a number of unknowns. On credit spreads, how big will the hit to growth be and how much of a difference will it make to companies' ability to service their debts? On USTs, does the inflationary impact of the China trade war and the tariffs that are being implemented outweigh the unemployment implications the Federal Reserve also considers? Despite the Trump administration's tacit acknowledgement that UST yields do matter, what additional term premium should USTs trade with given its capricious policy making?

Rates dashboard

		Current (%)	Change (bp) 1w	1m	YTD
US Treasury	2yr	3.86	18	-12	-38
	10yr	4.42	40	11	-11
	30yr	4.87	40	24	12
UK Gilt	2yr	3.90	-11	-32	-55
	10yr	4.64	12	-8	3
	30yr	5.43	24	10	26
German Bund	2yr	1.79	-16	-44	-30
	10yr	2.58	-7	-30	21
	30yr	2.96	-8	-21	36

	Market projection	Current (%)	Change (bp) 1w	1m	YTD
Base rate 4.50%	end-2025	3.49	14	-20	-45
	end-2026	3.29	22	-28	-66
Base rate 4.50%	end-2025	3.61	-8	-32	-52
	end-2026	3.51	-1	-42	-47
Base rate 2.50%	end-2025	1.80	2	-32	-11
	end-2026	1.92	3	-39	-14

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High conviction on market direction will be hard to find. For some time we have favoured improving the resilience of portfolios via higher credit quality holdings. Higher liquidity allowing flexibility in portfolios can also help; the spread widening has undoubtedly created opportunities in regions and sectors that are less exposed both to baseline tariffs and the lingering threat of higher ones.

As global investors, we also have the benefit of being able to spread our positions across a variety of government bond yield curves. The instability of the business environment in the US strengthens the case for higher allocations to European and UK credit in our view. Developed market rates and credit have both been historically strongly correlated to their US equivalents, but diversification can still help and as divergence in policy widens we expect outcomes to increasingly differ.

Credibility and stability in policy has two complementary benefits. One, it makes it easier for asset owners to invest, which supports asset valuations. Two, it supports the macroeconomic environment within which the businesses underlying those assets operate, which further supports asset valuations. Our own asset allocations reflect our view that Europe now has a clear advantage over the US in this respect.

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