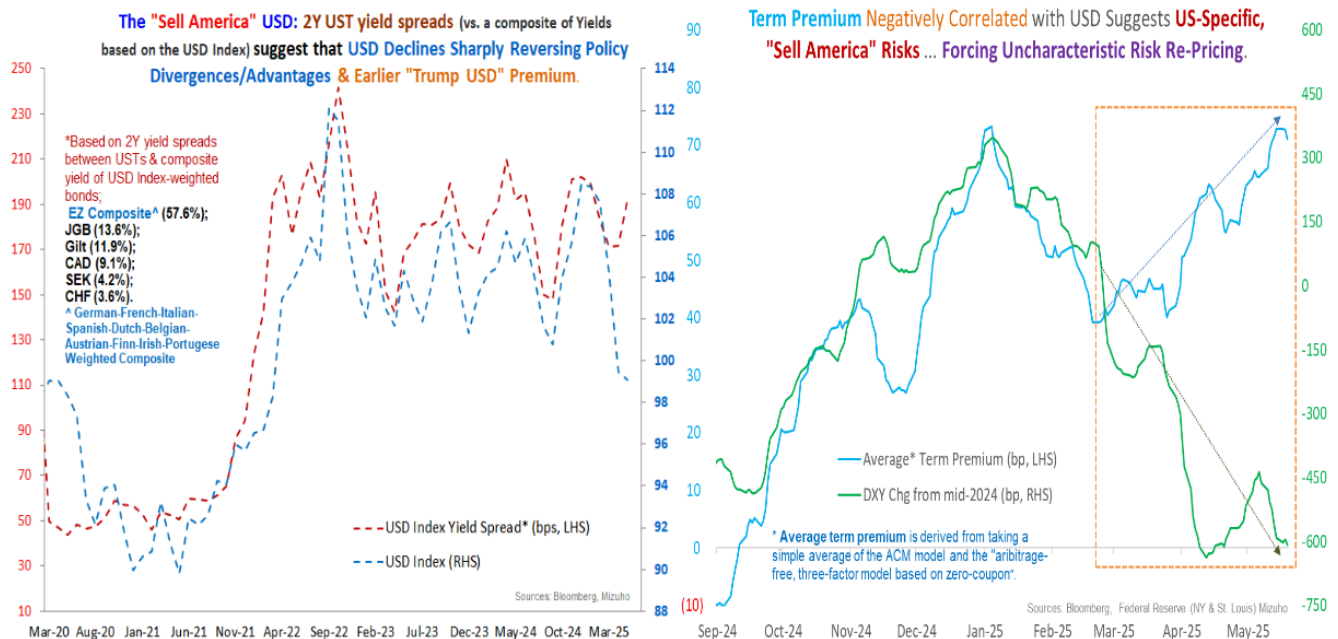


“Sell America” & Re-pricing Term Premium



“It is a capital mistake to theorize before one has data. Insensibly one begins to twist facts to suit theories, instead of theories to suit facts.” – Sherlock Holmes

In a Nutshell:

- **Exceptional de-coupling is USD-UST yield/spread framed as “Sell America”** may suggest entrenched de-dollarization underway.
- But the aggressive iteration of “Sell America”/De-dollarization narrative pointing to a collapse in USD/USTs is arguably misguided.
- Instead, the evidence suggests **term premium being re-priced considerably higher** to account for US *fiscal, trade, credit, and geoeconomic risks* alongside some hedge against USD debasement.
- The implications are:
 - i) **Bets on entrenched USD bearishness may be overdone.**
 - ii) **USD is likely set to resume positive response to UST yields/spreads on sufficient risk-pricing.**
 - iii) **Interim pent-up volatility and potential USD-led inflections in FX markets are par for the course**
 - iv) **Higher UST term premium could spill-over to later compromise higher-yielding AXJ with fiscal/trade vulnerabilities.**

- **Unravelling USD-UST yield (positive) correlation**, as previously discussed*, is a **profound disruption**, but arguably *not a permanent dislocation*.
- In other words, this may be **unfamiliar risk re-pricing to recalibrate USD and UST yields**, *not necessarily an all-out de-dollarization revolution* in FX-bond markets.
- To be fair, the **“Sell America”** narrative, with a *simultaneous drop in USD* and *rise in UST yields/spreads*, has **wrong-footed some** and **confounded many**.
- Most obviously as **established (positive) USD correlation with UST yields/spreads appear to be upended** by this **exceptional departure** (in USD and UST yield/spreads).
- In the wake of which, USD is now uncharacteristically uninspired by, if not overtly defiant of, yield/spread cues.
- Trouble is, this **unfamiliar USD dynamics** that has resulted **challenge the ability to reliably anticipate USD moves/risks**.
- What’s more, *beyond de-coupling*, the **innate instability** in recent **USD-UST yield/spread correlations shifts further obscure clarity on FX dynamics**.
- The upshot is that it is **premature, if not misguided, to assume** that the **breakdown in USD-UST yield/spread correlation is a permanent feature**.
- Instead, the **negative flip in USD-UST yield correlation** arguably **reflects a temporary recalibration process of risk re-pricing, even if it is abrupt and non-linear**.
- This is more revealing in the **USD-term premium divergence**, against a sharply softer USD for corresponding term premium.
- The **softer USD defying higher yields/term premium suggests the allure of “all-in carry” of USTs has been compromised by the demand for risk premium** to hold USTs.
- Specifically, to account for **a conspiracy of fiscal, credit, trade, geo-economic risks in the wake of** brutal Trump 2.0 tariff and wider geo-economic assault that has inflicted untold **US self-harm**.
- The **evidence** squares with *sharp US fiscal/credit deterioration alongside USD debasement risks (from trade and geo-economic threats)* increasingly **priced into the term premium**.
- And this implies several implications for the FX landscape:
 1. It is **too hasty to conclude an entrenched bearish USD through “risk off”**, and *despite higher yields*.
 2. Instead, **positive USD-UST yield/spread correlations to be re-established once sufficient term premium** and corresponding **USD moderation** are realized.
 3. *But* assessing **“sufficient” risk re-pricing** will be a **dynamic process**. So abrupt USD-led inflection and pent-up volatility are par for the course as headline risks roll on.
 4. **USD-UST risk re-pricing** could have a **wider spill-over to the detriment of higher-yielding AXJ** (now in the cover of a softer USD) with some focus on fiscal and trade vulnerabilities.

*Please see recently published note: Macro Brief - Exceptional Correlation Departures Mask FX Risks, 21st May 2025

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