

The Damped Spring Report

“Shifts in growth, inflation, risk premium and positioning all lead to opportunities in markets”

10/12/2026

At Noon on October 16th the depth of the Bessent Hypocrisy could be revealed. The Dealer Questionnaire ahead of the meeting between the Treasury and the Treasury Borrowing Advisory Committee is likely to be released to the participants and disclosed publicly on the Treasury Website. In that release we will be looking for a “charge” to the committee to comment on the supply and demand for long duration Treasury Bonds, the impact of the recent increase in buybacks in that part of the curve, and perhaps specifically the need for ongoing issuance of 20-year bonds. If the question is asked we expect some reduction in supply of bonds via either ongoing buybacks, reduction in issuance, or both at the November 4th QRA release. If the question is not asked it’s still possible that the Treasury would pursue the same path unilaterally, but it would be a break from tradition of getting feedback from the committee before the formal meeting.

Let’s be clear. The announcement of the increased buybacks (at an annualized pace of 128BN more per year or 29% of existing gross issuance supply) did not include feedback from the TBAC and was done unilaterally by the politically appointed portion of Treasury so they could do this again.

By acting unilaterally and then going on TV and declaring that “I am the house” Treasury Secretary Bessent made clear that he would act to suppress long term interest rates by reducing supply and increasing dependence on short term issuance. This was precisely the thing Bessent and Miran rightly criticized the Yellen Treasury for doing. The question is what is the level of hypocrisy Bessent will pursue to pump the economy and unfortunately support above target inflation?

Ironically maintaining the existing status quo is already expected. It will take a bigger effort to make much of a difference. In this DSR we will provide various scenarios and the impact of those scenarios on duration supply. Those scenarios include

- The “responsible and inevitable choice” consistent with Treasury mission and the last TBAC recommendation
- Maintaining Buybacks at the “new” level
- Replacing “new” marginal buybacks with bond issuance reduction
- Maintaining buybacks at “new” level AND bond issuance reduction

This table reviews all scenarios for the QRA and the likely market reaction. The October 16th "Charge" could increase or decrease the odds of each scenario and markets may front run the actual QRA on November 4th based on the news on Friday.

Damped Spring Assessment of the QRA Decision							
Change	Action	Impact on 20s and 30s \$BN of Annual Supply	Impact on 20s and 30s % of Annual Supply	Implication	Asset Trades	STIR Trades	DS Opinion of Odds
August 19th Bet	Increased buyback	-128	-29%	The increased buyback was a direct attempt to suppress long term interest rates. It largely failed. It is the benchmark for what comes next			
Fold	Cancel new buyback and keep auctions the same	128	29%	Stop intervening and responsibly return to the Treasury mission. Face reality of the inevitable need to finance across the entire yield curve	Aggressive - Sell Equities, Buy USD, Sell Gold, and Buy a large sell off in long end bonds	Aggressive Buy	Low/Zero
Check	Maintain buyback and keep auctions the same	0	0%	Status quo	No Trade	No Trade	Medium
Check Hybrid	Combination of some buybacks maintained and some auctions cut	0	0%	Status quo	No Trade	No Trade	Medium Probably Highest
Check/Raise	Cancel new buyback and eliminate 20 year auction	-40	-9%	Modest raise	Small - Buy Equities, Short USD, Buy Gold	No Trade	Medium
Martingale / Double Down	Maintain buybacks and eliminate 20 Year auction	-168	-38%	Full on attempt to suppress long term interest rates	Aggressive - Buy Equities, Short USD, Buy Gold and short a large rally in long end bonds	Short. If you think FOMC will oppose. That is not clear though.	Medium
Reasonable Maintenance	Eliminate 20 year auctions and fund the 168BN with increased 10s and 30s	0	0%	20 Year bonds are not needed by anyone and are easily replaced in a duration neutral way with 10s and 30s	No Trade	No Trade	Medium

We think there is zero chance the Bessent Treasury will be responsible despite the inevitable path of more issuance of everything. Only the final option would be a new level of hypocrisy and have a marginal market impact, but we don't doubt the level of ego and desire to outsmart the market that Bessent has shown. We hope he acts responsibly and doubt he will.

This Friday we will see a clear tell if the questionnaire speaks of the long end. If it does, we expect a swift up move in gold and stocks and stabilization or an actual 5-10bp rally in the long end. If it doesn't mention the long end, the opposite could happen, but Bessent could still pull a unilateral move at the November 3rd TBAC meeting. Of course, markets are already predicting the former so price action could be surprising. The bigger point is preventing markets to find their levels by intervening is a terrible strategy that rarely works with predictable consequences.

We recognize long term bond yields have gone up. Though we don't see them as a bad deal vs other issuance. We recognize that the administration thinks that inflation will fall and financing long term may be able to be done at more favorable levels. They have said that since taking office as long end yields continue to rise.

However, we are certain that the Treasury and Secretary Bessent are price takers and not price makers despite the ego of the latter. We advocate tapping liquidity

wherever it's found and not market time when you are the largest bond seller on the planet. We see you coming a mile away.

The Treasury Secretary could absolutely go big enough to prevent long term yields from rising. If he does the only things to own are gold and stocks and be short the dollar. Going big will also be massively inflationary which will then challenge the independence of the Fed. We have no confidence that Chairman Warsh will counteract Bessent. Scroll down to the Synthesis section to get our expectation of what will happen but recognize this administration remains unpredictable.

August QRA – A foreshadowing

In order to understand where the committee stood prior to Bessent intervening we can observe their statement regarding the path of future issuance from the August 5th meeting. The inevitable path of issuance is to issue more of everything. Prior to the intervention market participants and the TBAC had penciled in increased issuance in 2027

On issuance, the Committee recommended keeping nominal coupon, FRN, and TIPS auction sizes unchanged. The Committee continues to believe that current projections could warrant increases in coupon issuance in FY27. Given the projected funding gaps in FY27 and FY28, members recommended that Treasury consider updating its forward-guidance language to preserve flexibility heading into FY27. As always, the Committee emphasized that clear communication and a regular, predictable operating framework would help market participants adjust to any future changes.

The career Treasury Staff however hinted at something else.

NOMINAL COUPON AND FRN FINANCING

Treasury believes its current auction sizes leave it well positioned to address potential changes to the fiscal outlook and to the size and composition of the SOMA portfolio. Based on current projected borrowing needs, Treasury anticipates maintaining nominal coupon and FRN auction sizes for at least the next several quarters. Treasury is monitoring SOMA purchases of Treasury bills and growing demand for Treasury bills from the private sector. Looking ahead, Treasury continues to evaluate potential future **changes** to nominal coupon and FRN auction sizes, with a focus on trends in structural demand and potential costs and risks of various issuance profiles.

In their official statement they changed a word (in the red box) from “increases” to “changes” which opened the door to reducing a specific maturity or a set of maturities while increasing others. This was a foreshadowing of a potential Treasury Shift.

What is common in both the Treasury and TBAC statements is maintaining auction sizes for at least the next quarter if not more was mutually agreed by both parties. Nonetheless here we are going into this QRA with expectations of a shift in coupon issuance. Why?

“The House” – Shift

On August 19th the Treasury announced an increase in its long-term bond buyback program of at least 2BN per operations (which has since averaged 3.5BN per

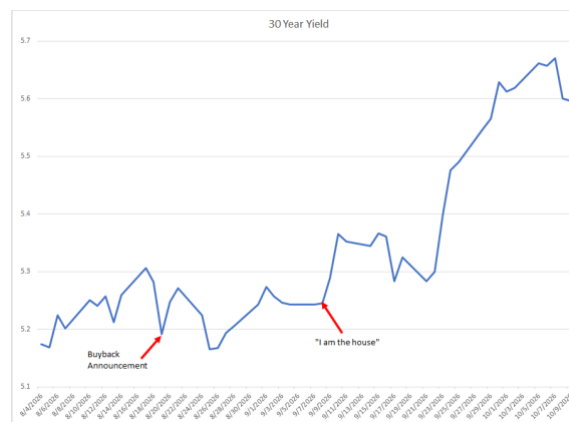
operation). Though those operations were only authorized through the QRA on November 4th the pace of increase was a roughly 128BN annualized. Not nothing as it offsets 27% of total issuance of long-term bonds. Given the timing of the announcement it was done at the direction of Bessent or his political appointees as the TBAC and career Treasury officials said nothing of the need for such an action just two weeks prior. Secretary Bessent claimed later that day that "This is a routine liquidity measure, not an attempt to suppress yields." That was obviously either not true, or extreme micromanaging.

A week later Stanley Druckenmiller, Bessent's mentor, harshly criticized the move. Claiming it was "price management" and "Governments defending prices against fundamentals always lose." He also stated the obvious "A credible fiscal package would do more for the long end of the curve than a buyback program 1,000 times this size."

Bessent then doubled down on the "wisdom" of his actions making it quite clear what his intent was. In public comments in early September, he said "Stan's a great investor. He changes his mind a lot, and he doesn't like losing money. I think he lost money the day he sent in the editorial" and "My job is to make sure that the market is looking at fundamentals and that the market does not dictate policy. Hedge fund managers like to speed things up; mine is to slow things down."

Bessent's intent to suppress interest rates couldn't be clearer. But he proceeded to Martingale even further. On September 8th his ego got the best of him he said, "I am the house now." / "Anyone betting against the Treasury is playing a losing hand."

Markets have since tested his ego.



Does he override his own career staff and attempt to cajole/convince the TBAC in order to martingale his multiple terrible calls over the past few months? Not sure what Druck thinks of Martingale, but this guy seems like he may double down again and again. He actually is "the house". He can use his tools to suppress long term interest rates but there will be serious consequences on inflation and asset prices and ultimately failure.

Current status of issuance and buybacks

The current status of issuance and buybacks is the benchmark for the future. That benchmark includes an increase in buybacks since the August QRA of 128BN on an annual pace and 444BN of current annual issuance of 20- and 30-year nominal bonds. Net of buybacks the supply is running at 316BN per year. While the buyback increase was not announced as being an ongoing constant feature and perhaps reverting to the old plan is partly priced, we are assuming that 316BN per year net of new buybacks issuance is the benchmark status quo flow.

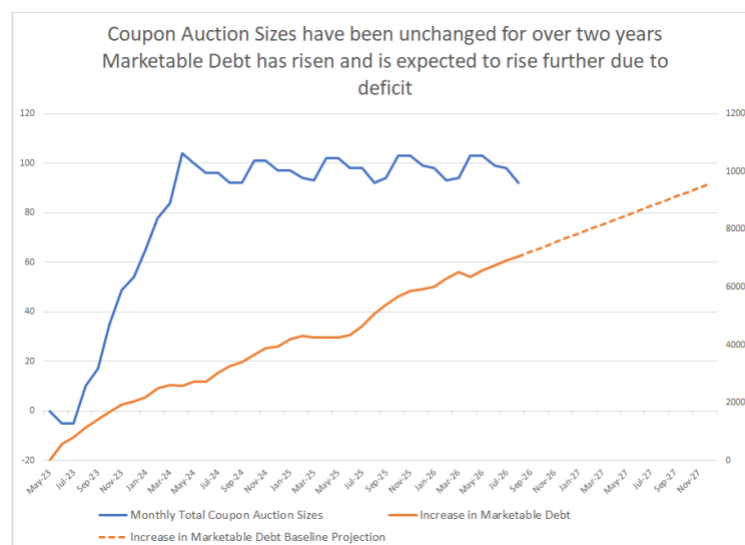
The inevitable path

Given the ongoing and growing deficit which seems stuck at 6% of GDP the inevitable path of issuance is to sell more of everything. We have estimated that in order to maintain bills ratio at roughly current levels coupon auction sizes across the entire set of maturities needs to be increased by 10-15% in 2027. This estimate assumes the "Temporary" increase of 128BN of additional annualized buybacks would end and revert to the pre-August 19th level of 2BN per auction.

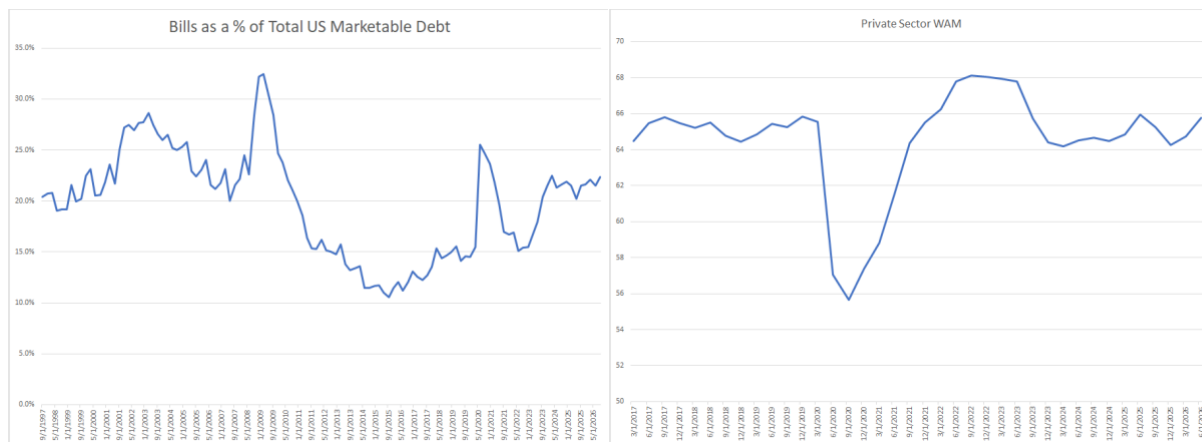
If the 128BN of buybacks is maintained in order for the buyback to be duration neutral as the Treasury claims (which has been a gaslighting since it started) the increase of 128BN of buybacks would need to be funded with 128BN or 29% MORE On the Run 20- and 30-year Bond auctions. Making the total increase in long term treasury issuance to keep the Bills ratio fixed and WAM not shortening would require 37-42% **Increase** in long term issuance.

In our view the responsible path is to return to 2BN per buyback operation and increase coupon auctions in Q1 2027 by 10-15% across the board. We think there is zero chance Bessent does the responsible thing.

We consider the outlook for Treasury issuance to be inevitable and require notes and bonds issuance growth. The Blue line can simply not stay as is in a large deficit and rising debt fiscal situation.



If it stays the same the bills ratio would accelerate. Creating meaningful capacity constraint in the event of another economic slowdown or crisis. The Private sector WAM would fall. Maintaining the bills ratio and current WAM requires increasing coupon auctions across the maturity spectrum AND cancelling the new buybacks or financing the buybacks with much larger 20- and 30-year bond issuance.



Two status quo options and a hybrid

From a flow of supply standpoint, the Treasury could maintain the status quo since August 19th in two ways.

Maintain new buybacks.

The current buyback program was announced with a fixed end date. That end date was November 4th which was not chosen randomly. It was chosen because it corresponds with the Quarterly Refunding Meeting and Announcement. As a reminder the August 19th announcement and subsequent actual operations increased the buyback by roughly 4BN per operation and there are 32 operations per year in the 20-30 Year Maturity bucket resulting in a 128BN annual increase in buybacks and a 29% decrease in supply of bonds.

A status quo action would be to maintain the buyback at current levels and maintain the current issuance amounts across the maturity spectrum. **We see this as a bad plan as we don't see any stress whatsoever in the off the run market, but it is in the realm of possible decisions.** Again, it is status quo and terms in the debt a bit, putting upward pressure on the bills ratio and downward pressure on private sector WAM. It is unclear that the market will react to such a status quo decision.

Bond Auction size decrease to replace buybacks.

Given the lack of stress in the off the run market if the Treasury wants to pursue their desire to suppress long term interest rates in a way that is essentially status quo, they can return the buyback program to 2BN per operation while reducing the size of bond auctions. In order to "replace" the cancelled buyback the Treasury

could reduce 20 and 30 year on the run auction sizes by 128BN annually to maintain the reduction in supply of 29% in the long end that the new buybacks caused. That reduction could be done pro rata reducing both 20-year and 30-year auction sizes but it's more likely that the Treasury eliminates the 20-Year.

The current 20-year bond is the "black sheep" of the Treasury market. No one really needs this bond in their portfolio, and it has been part of the Treasury Auction quiver sporadically. During the early 80's it was introduced for a few years and then was eliminated for three decades. Only during Covid when the Treasury had massive debt to fund was it reintroduced. It's expensive as well given the lack of demand. Even though 30-year debt is arguably riskier and would require a higher yield the 20-year point has regularly and consistently been more expensive than the 30-year. When considering the "average" yield of 10s and 30s compared to the 20-year yield the 20-year yield is simply a bad deal for the Treasury.

The annual pace of 20-year issuance is 168BN so completely canceling that auction would more than fully replace the 128BN "new" buybacks, but the idea has merit. What we mean by merit is if you intend to attempt to suppress long term interest rates canceling new issuance of 20-year debt makes plenty of sense to us. Of course, we think suppressing interest rates is a massive mistake, but our view is not particularly relevant in determining what Bessent wants to do.



A status quo option of ending the "new" buybacks and cancelling new issuance of 20 Year bonds is what we think the "Activist Treasury" should do if they want to keep the status quo and manage it more sensibly. This idea would almost certainly be surfaced on October 16th in the charge. We are keeping a close eye on that for a clear signal. However, notice the cancellation of the 20 Year would be a further reduction in supply as 168BN would be a larger supply reduction than the 128bn of cancelled "new" buybacks.

Hybrid

Notice all the moving parts. We imagine a hybrid status quo option as well. Instead of reverting to pre-August 19th buyback sizes, they could target 2BN more buybacks instead of 4BN per operation. They could cancel the 20 year AND increase 10- and 30-year issuance. They could maintain the 20-year auction but

reduce its size and the size of the 30-year. All are moving parts. We are focused on comparing the current flow with the current “new” buyback amounts vs the post QRA flow. **Anything that roughly withdraws 128BN of bond supply is Status Quo to us.**

Full Hypocrisy option

Will Bessent’s damaged ego cause him to martingale his awful decision to suppress interest rates? Will he double down again? Let’s be clear he has the lever to make himself right for the next two years. He absolutely can suppress long term interest rates by pulling his levers. The pros for him may outweigh the cons. The pros are stronger growth driven by low-cost financing for investment, support of asset markets, and low-cost borrowing for wealthy households. The cons are inflation and a weak dollar. Here’s how he martingales and makes sure “The House” wins.

Status quo won’t get the job done. Reducing long term supply of bonds by 29% on an annualized flow basis hasn’t helped. Perhaps he always intended this buyback fiasco to be temporary. Perhaps the market assumes he will follow the inevitable and responsible path mentioned above. Nah! No way markets expect him to allow rates to rise. So, he has to double down. In order to go big enough to matter he needs to both maintain buybacks (possibly even increase them) and reduce auction sizes materially. **We estimate that a reduction in long term bond supply of greater than 50% to less than 200BN of new bonds per year would get that done. Cancelling the 20-year auction, \$168BN annually, and maintaining the new buybacks at 6BN per operation would reduce supply of bonds from \$444BN to 148BN annually.** When we say “get that done” we mean long term bond yields would be suppressed vs conditions over the next two years by 25-35bp. Much of that rally would happen fairly rapidly upon announcement. Whether that suppression would be maintained is another matter as the suppression would be stimulative and drive up both inflation and real growth. **Buying bonds based on suppression of this sort is NOT the trade. Buying stocks and gold and shorting the dollar is the trade if Bessent doubles down over the next three weeks.**

Framework Section

In the prior section we outlined the various possibilities of Treasuries issuance and buyback strategy. In this section we will describe our framework of why issuance and buybacks impact markets and the economy and assess whether there are valid reasons for the Treasury to radically change its actions and increase its intervention in markets. Feel free to drop down to the Synthesis section if these concepts are well known to you already.

Are long term bonds a bad deal for the government to issue?

The simple answer is long term bonds are a fine source of financing for the Treasury. While investors who are able to time markets may be able to generate excess returns by buying and selling rich or cheap Treasury bonds and notes, the US Treasury can’t possibly extract that alpha from markets. They announce their

intent to issue or buyback Treasuries months in advance and run high profile auctions at specific times in order to optimize the price they receive. They are too large, announce their intent ahead of the trade, and frankly are not attempting to make money in markets as their mission is to optimize the long-term cost of financing of the government debt. In addition, market timing Treasury bonds is really hard to do and the most sophisticated investors on the planet who can operate stealthily often fail to generate excess returns. The good folks at the Treasury simply are not equipped or trained to beat markets and may struggle even if they were stealthy and small.

The Treasury auctions 4TN of coupon bonds per year and has 7.5TN of bills outstanding which roll at least once per year and as many as 52 times. Because of this massive ongoing financing need the US government must tap all possible sources of liquidity whether they like the price short term or not. The US government needs roughly 1.7TN of new financing every year and that number is growing along with the nominal economy. Making a few bp on a couple hundred billion of UST simply doesn't matter to the Treasury or the American Taxpayer. They don't usually try and they wouldn't be good at it if they could.

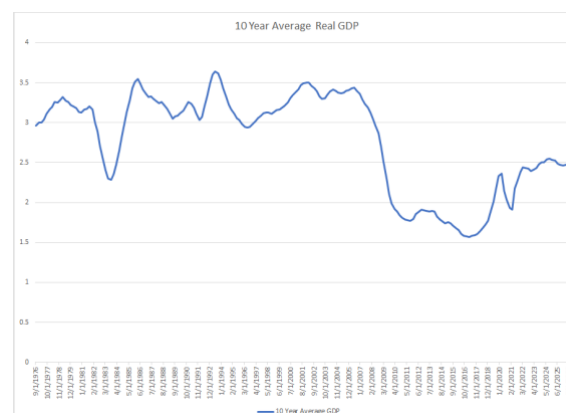
That said it is still worth thinking about whether long term bonds are a good deal for the Treasury to sell. If they are cheap, we still don't think the Treasury can extract that cheapness by cancelling auctions and selling something else or buying back cheap bonds. But let's start with whether bonds are cheap or not?

What makes long term bonds cheap and thus not as good to issue and worth buying back.

- Long term growth expectations are too high.
- Long term inflation expectations are too high.
- Risk premiums are too high.
- Financing markets are under stress suggesting too much supply.

Long term Growth Expectations are too high?

Measuring long term real growth expectations is tricky. Perhaps the simplest thing to consider is what has been the historic long term real growth rate of the US economy. It's ranged around current levels.



Prior to the GFC it was roughly 3% reflecting a fairly large population growth phase in US history. The GFC caused a period of sustained poor growth as the economy delevered. Since then, Growth has recovered despite the substantial impact of the COVID shutdown. Today GDP is running at roughly 2.5% YoY, and hopes are quite elevated that AI will create substantial growth due to productivity gains despite a flat lining of worker population. The question is what growth should bond investors consider as future long-term expectations. 2.5-3% seems about right we would think? What would you choose? What would Treasury think?

Market pricing of real interest rates is linked to real growth but lots of factors impact pricing. Clearly real interest rates have risen a lot recently and at 3.32% represent a fair premium to real growth history and any real growth that extrapolates history into expectations.



When an investor considers whether to buy bonds or the Treasury considers buying back bonds or curtailing issuance of long-term bonds, they must consider their own expectations of future real growth and what's priced into bonds themselves. Obviously, this very rough metric of bond "value" is simplistic and actual value is far more complex but put simply it's unlikely that investors think growth is going to be weaker than average going forward but real interest rates reflect fairly high growth expectations. If we were in the Treasury seat AND we thought we could time markets we would be uncertain regarding bonds being cheap due to real interest rates as we would expect growth to be good but pricing to reflect that growth. We wouldn't have confidence to act given our footprint in markets.

Long term Inflation Expectations are too high?

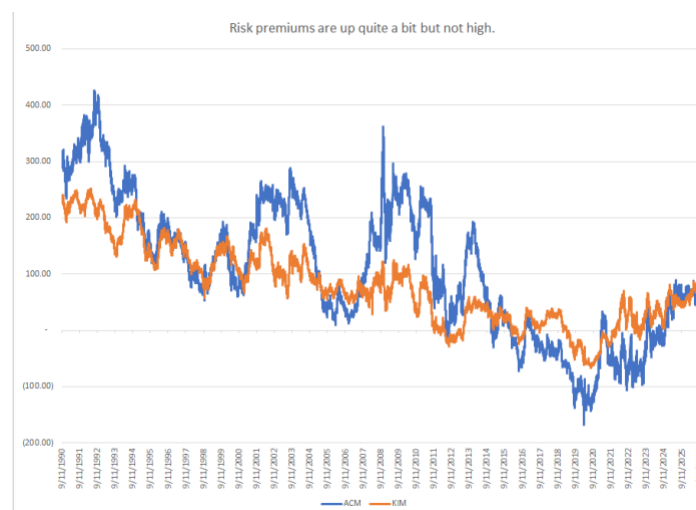
Inflation has been above target for many years. However long-term bond inflation expectations are pretty close to target. What is particularly noticeable is the anchored level over the last 5 years despite the Fed failing to achieve its mandate



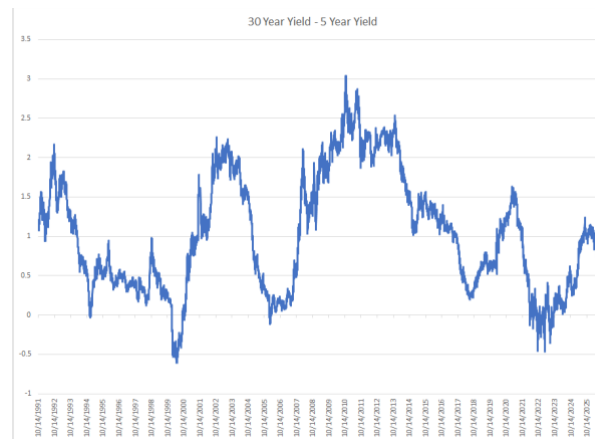
As an investor buying bonds it's very clear that betting on inflation expectations being too high makes little or no sense. On the other hand, the administration is quite confident that inflation will return to target. Nominal bonds are not a bargain based on inflation expectations which would suggest not cutting supply but perhaps the administration is willing to roll the dice on inflation falling. Once again, we remind readers that the Treasury and Administration is unlikely to have any edge betting on inflation and is too large to make a bet anyway. Nonetheless we think pricing is not favorable for betting long bonds based on an inflation view.

Risk Premiums are too high?

Risk premiums have climbed quite a bit from the QE lows in which bond yields fell below 1% and owning bonds had a negative excess return expectation vs cash. However, at 90bp of excess return at current risk premium levels the Sharpe ratio of owning bonds is poor at .15. Selling bonds isn't as fantastic a bargain as it once was (when Yellen and then Bessent refused to term out the debt) but it's still a great deal for the government to issue. We see the recent term premium increase as a normalization with more to go, NOT a peak which if one could market time would suggest buying bonds and curtailing issuance. Term Premium levels are not a good reason to curtail supply.

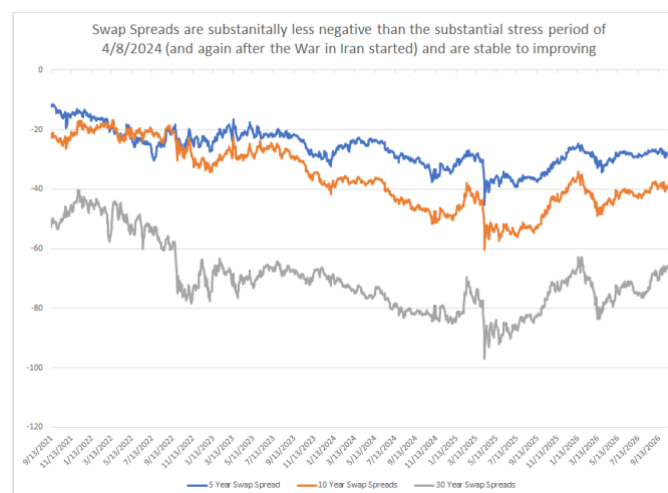


Term premiums are theoretical and model dependent. They are clearly higher but not high enough to act upon. Simpler measures such as the steepness of the curve from 5s to 30's suggest long term bonds are a pretty great deal for the US government to issue.



Financing markets are under stress suggesting too much supply?

Policymakers have a financial stability mandate. While this has historically been the Fed's job but the Treasury Department definitely has an active role. In addition, a healthy repo and financing market is critically important for both financial stability and the ability for the Treasury to deliver on its mission of optimizing the long-term cost of borrowing of the government. Adjusting supply of Treasuries by buying back off the run treasuries or shifting composition based on financing stress is a sensible response. However, no such stress exists. Financing conditions have improved markedly over the past few months.

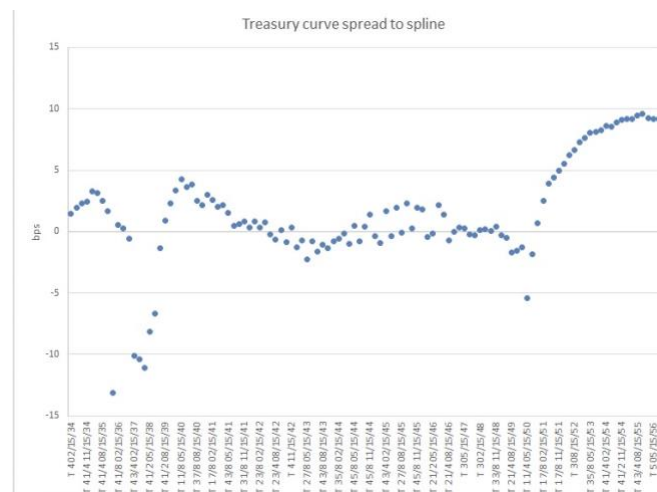


There is simply no justification for reducing Treasury supply due to financing stress today.

The increase in the buyback program for liquidity support of off the run treasury bonds was pitched as a necessity due to stress in the banking system due to off the

runs held by banks constraining their ability to provide financing to the economy. By relieving the stress created from the off the run holdings the economy would operate more efficiently. While we agree a duration neutral liquidity backstop is a smart action by the Treasury particularly if they passively buy cheap off the runs and issue relatively rich on the runs, the buyback has not been financed duration neutral as auctions of on the runs have been literally unchanged since the original buyback plan and of course remain unchanged with the big buyback announced in August. In order to buyback more bonds the Treasury had to pay up. That is exactly the opposite of passively providing a buyer at a price for those who need stress relief. But perhaps more importantly the off the run market is NOT under stress.

One way to look at the individual Treasury bonds richness or cheapness is to compare individual bonds to a spline build of the yield curve. Notice that the long end is cheap. All of the cheap bonds were issued as 30-year bonds in the last five years. Notice the bonds maturing from 10 years to 25 Years from now are not particularly cheap at all. But perhaps the most notable thing is the on the run 30 year which is the farthest dot to the right is near the cheapest on this curve. Older 30's are less cheap and hence the idea that the off the run market is under stress and needs intervention is simply not true.

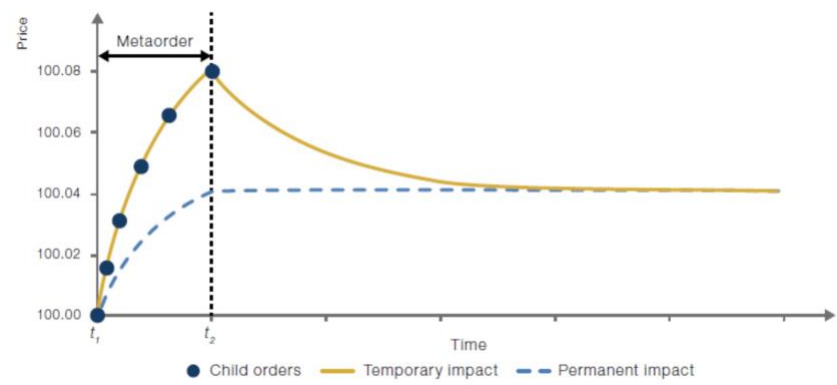


Sum it all up

There is no financing or off the run stress of note. Inflation expectations are low, growth expectations are high and priced high, risk premiums are elevated and have risen lately but are not high, and the curve is pretty flat. We see no good reason for the US Treasury to curtail supply at all. Given this opinion we see the buybacks and possible auction cancelations as a simple effort to suppress long term interest rates to stimulate growth in the economy and cause inflation to remain above target. Treasury is using activist treasury issuance (ATI) policy to stimulate the economy for purely political reasons. Just as Yellen did Bessent is pumping to please his boss despite causing further inflation and wealth disparity.

Does supply and demand matter

We have a fairly classic view of how supply and demand impacts markets. This chart was prepared by Man Group and is based on academic work done by Almgren-Chriss, but it is also the framework of most institutional investors and is ours as well.



It describes the shorter-term price impact of a new inelastic buyer of an asset. It also describes the longer-term impact of this buying on the equilibrium price. Much has been written on flow vs stock of market participant actions. This framework handles both. Firstly, inelastic buying flow drives the price up as the order is executed and filled. After its completed the impact decays. Secondly, the stock impact of a buyer who intends to hold much longer than the prior holders creates a permanently higher price.

We see large central bank and Treasury issuance composition changes to flows and the stock of debt held by CB's and issued by Treasury to have similar impact. Obviously, the flows are inelastic as the policymaker pays whatever price is offered. Furthermore, the size of the flow is large relative to volumes and notional and the stock impact may be large as well particularly if no reversal of these flows is expected.

In the case of Treasury buybacks and compositions change we expect a meaningful impact both temporary and permanent. If Bessent wants to suppress interest rates for the balance of his term by 25-50bp he can.

Is reducing long end supply QE?

Ah the evergreen question. Is the Treasury pursuing QE. The answer is yes and no. We aren't particularly into labels, but we label QE as both the purchase of long-term assets AND an injection of reserves into the private sector banking system. Using this label Treasury buybacks and composition changes are not classically defined QE. They aren't because no reserves are created. The Treasury buys long term bonds and/or issues less long-term bonds and funds the government with bills or short-term treasuries. Reserves are not impacted. However, like QE it does impact the yields on the treasuries they buy and sell. In particular as bills have deep demand and are not price sensitive, unlike the long end, a dollar funded by

bills to buy long term treasuries does put downward pressure on bond term premium. Acts a bit like QE but isn't QE.

How does suppressed bond yields impact the economy.

The point of yield suppression is to change the rate of borrowing and lending in the economy to a rate that is artificially accommodative. We have understood the Fed and its use of the short-term interest rate level for decades. When the Fed wants to slow the economy, it raises rates above the neutral rate. When it wants to stimulate the economy, it cuts rates below the neutral rate. The neutral rate is the rate that, but for the Fed, would be set by market forces and make desire to lend and borrow balanced. By setting rates artificially different from that market rate the Fed restricts or accommodates the economy. This logic is simply extended across the entire yield curve. Particularly the part of the yield curve where most borrowing occurs. The long-term rate impacts all fixed rate financings and is the discount rate for asset markets. If it is artificially high less financing is done and the economy slows. If the Treasury is able to suppress long term interest rates, they are stimulating the economy and doing the monetary policymaker's job. The monetary policymakers have a stable prices mandate. The Treasury has no such mandate.

What's the consequences of suppressing long term bond yields

The primary method that Treasury can use to suppress interest rates is issuing more money like T-Bills and less long-term risky treasury notes and bonds. They suppress term premiums and stimulate dissaving, borrowing, and corporate issuance. That is bullish growth and inflationary as it increases demand. More subtly the use of T-Bills to fund the deficit puts more money like treasury obligations in the market which, as they offer better collateral terms than long term treasuries, allow for greater private sector money creation. That money like nature is bearish USD. We describe this whole dynamic in the DSR ["Future Money or Spot Money Tough Choices"](#). Suppressing long term bond yields is great for gold, and stocks (particularly foreign), only modestly good for bonds, and bad for the dollar and inflationary.

The Fed has a lever – what can they do?

The Fed task force on the balance sheet is yet to provide its report. We have done a deep dive on the use of the balance sheet and conclude the Fed can do little to impact monetary policy with their balance sheet unless they sell assets directly to the private sector or the Treasury cooperates. Given the Treasury may be actively offsetting monetary restriction by its buybacks and potential issuance shifts it seems unlikely the Fed can do much at all with their balance sheet unless they make bold moves. That leaves the less effective short term rate lever. At this stage the Fed seems entirely complacent, but we will see what the task force concludes and how the Fed responds to an even more "ATI" Treasury particularly if the Treasury doubles down on suppressing bond yields.

Synthesis

On October 16th we may get news of the Treasury doubling down to suppress long term bond yields. The fact that bond yields are perfectly fine at current levels and there is no financial stability stress means to us that the Treasury would be attempting to manage monetary policy and pump the economy. We will be aggressively trading in both beta and alpha portfolios if the Treasury doubles down. We will buy gold and short the USD and favor equities over bonds. If no news comes on October 16th the odds decrease that the Treasury will double down but waiting until the actual QRA is likely to be the move. We believe any ATI is inflationary and not needed. We hope the TBAC and Treasury Staff push back on the politicians and prepare to do the responsible and inevitable thing of increasing all issuance and staying out of the manipulation games.