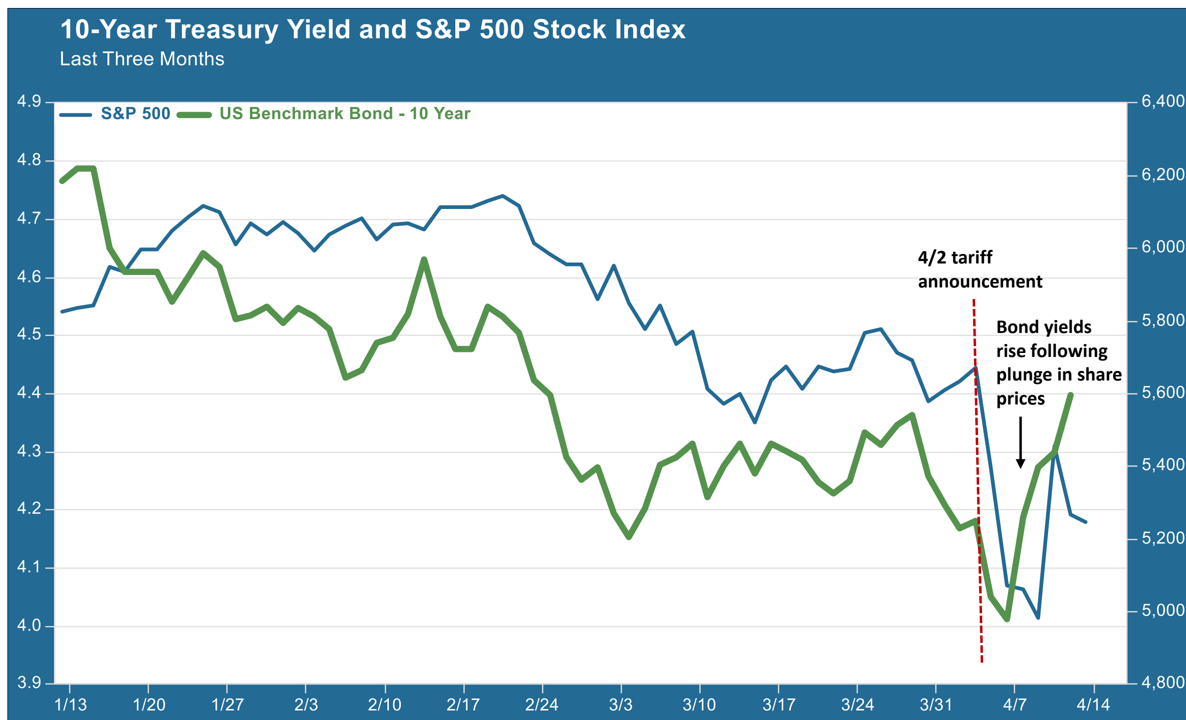
Weekly Market Flash

Don't Mess with the Bond Market

April 11, 2025

The thrills and spills of the new world order (such as it is or may be) continued this week with some of the wildest swings in equity markets since 2008. As much as those gyrations in the Dow and the S&P 500 dominated the financial news shows, though, the real action was taking place in the bond market. It was there, in what is often called the plumbing of the global financial system, that a sudden spike in Treasury yields midweek led to the temporary "pause" on the novel and ill-considered tariff program announced last week.



Source: MVF Research, FactSet

Vigilantes, Of a Sort

A few weeks ago, we made reference in this space to the "bond vigilantes" of a few decades ago – the likes of Salomon Brothers economist Henry Kaufman and his ilk, who bet against bonds (sending yields higher) in reaction to what they considered irresponsible fiscal chicanery coming out of Washington. What we saw this week in the bond market was a bit of vigilante-ism, giving a thumbs-down to the budding trade war, but also something potentially even more concerning.

Because Treasury securities are highly liquid, they are relatively easy to dispose of in the market when you need to raise cash quickly. This week, a number of institutional investors needed to do just that. Plummeting stock prices hastened margin calls, leading financial players highly exposed to short-term market disruptions to unload Treasuries. The spike in yields, shown in the chart above, caused a break in the normally stable fabric between spot yields and Treasury futures for commensurate maturities. Hedge funds are a major player in arcane strategies that aim to profit from the relative value movements

between spot and futures prices. When those movements go wonky, as they did earlier this week, bad things happen. The mechanics are complex, but the net outcome is that more Treasuries get sold, and then yields keep going up, and then more needs to get sold in what can turn into a very nasty doom loop.

Shades of 2020

The last time things got this bad in the Treasury market was in March 2020, at the height of the Covid panic. The S&P 500 had fallen by 34 percent from its recent high on March 23 of that year, when the Fed stepped in with a fire hose of liquidity to stabilize markets. But the Fed wasn't there because of the equity market plunge. It was there because the Treasury market was about to blow up, and the consequences of that would be far, far worse than any damage stock prices could cause. It worked – both stocks and bonds stabilized after the Fed's intervention, and the "everything rally" in risk assets began.

This time around, though, the root cause of the market disruption was not an exogenous event like a health pandemic. It was a policy decision that had the potential to severely damage the global trading system – a decision of human construction that could be reversed as easily as it was put in place. The "pause" announced Wednesday wasn't great – it did not include China (and the problem with that is a story in and of itself), it is only for 90 days, and it still leaves us with a much higher average rate of tariffs than we had at the beginning of the year. But it was enough, for the moment at least, to reduce tension in the bond market to a manageable level.

A Lesson About Short-Term Market Moves

You have heard us say over and over again that short-term movements in the market are unknowable. In times of unusually high volatility, like now, the big intraday swings can be either up or down. When the S&P 500 racked up more than twelve percent in losses in the four trading days after the April 2 tariff announcement, the limbic brain was urging sell, sell, sell! But then came the backtrack on April 9, and whoosh – up goes the index by 9.5 percent in less than four hours of trading. The point is – things are going to happen, and we aren't going to know what those things are until they happen, and they are going to move prices both up and down, often instantaneously. Trying to outguess any of this is a futile exercise. Stay disciplined. As for us we will, to paraphrase Metallica, sleep with one eye open…on the bond market.

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