



# Crosscurrents buffet U.S. dollar and Treasury market

Atul Bhatia, CFA – Minneapolis

Global and domestic headlines have put the focus squarely on U.S. sovereign assets. We look at what steps investors should take in this time of shifting economic messages.

Treasury bonds used to be boring. Pencil in around two percent inflation, estimate a real growth rate and the result is a decent estimate for a fair yield. If an investor wanted to get fancy, he or she could throw in some term premium and do a little Fed watching.

Those days, it seems, are over. We go from headlines talking about selling pressure in Japanese Government Bonds (JGBs) to fears of overseas investors potentially divesting their U.S. Treasury holdings. In the background, we see gold spiking and the dollar falling. Trying to put all the moving parts together to get a broad perspective on what's happening looks hideously complex.

And, to a certain extent, we believe it is. There are whole textbooks written on these relationships and the feedback loops involved.

But like most things in economics, however, we'd argue there's a core simplicity to what we're seeing. If we strip away the jargon and the rhetoric, certain realities emerge, and what follows is a simplified, but still accurate, view of how we think about the Treasury yield curve in the months and years ahead.

## ABCs of JGBs

The recent rise in Japanese yields took place largely for domestic reasons, but it absolutely, in our view, has a global impact. Investors have a choice of where to lend

### Key points

- Global bond and currency market headlines are causing unease among some Treasury investors.
- Rising Japanese bond yields could make it more expensive for the U.S. to service its debt and is also an important reminder that investor patience with fiscal imprudence is not infinite.
- We see politically driven divestment as a low probability event that would cause short-term disruption, but little longer-term impact.
- Our view is that domestic U.S. factors are the main overhang for Treasury markets and the dollar, and that investors should remain invested in the U.S. but with global diversification.

money and as Japanese yields go up, it puts pressure on other borrowers. Since the U.S. remains by far the world's largest debtor, we think it is inevitably going to be one of the most impacted by this need to pay more to attract and retain capital. This is particularly true for JGB yields, as Japan is the single largest foreign holder of U.S. government debt.

For perspectives on the week from our regional analysts, please see [pages 4–5](#).

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Sure, there are additional complexities. Yields went up in Japan for a reason, so not all the impact is going to translate one-for-one to the U.S. dollar. Hedging costs also play a role in how yields translate between different sovereign issuers. But those are largely quibbles about the magnitude of the impact on the U.S. from the JGB move and not its direction.

The Japanese bond move also has a psychological impact on Treasury investors. Japan has long occupied the role of counter example to folks concerned with the U.S. debt level. The fact that Japan's debt-to-GDP ratio almost doubles that of the U.S. was taken by some to mean that U.S. debt would not impact Treasury yields.

With the recent JGB selloff, it seems that perhaps there is a limit to the debt that markets will overlook. The comparison is particularly troubling for U.S. investors since the proximate drivers for the recent JGB move were, we believe, concerns over large debt loads, expansionary fiscal policy, and underlying inflation pressures. This list has resonance for any U.S. bond observer.

In short, higher Japanese yields set up a competitor for investment capital, making it more expensive for the U.S. to fund its deficit spending. At the same time, it raises so-called "tail risk" concerns, or the idea that we could see a rapid repricing of U.S. debt.

### **The divestment catch-22**

Unlike the situation with Japan, we think the divestment issue is more of a distraction than a real influence on U.S. bond pricing.

To begin with, we think it's highly unlikely to occur on a large scale. Divestment is a good threat to have in the background, but once a country sells its holdings, that's it—the threat is done with and the U.S. would then have a free hand to retaliate. Strategically, it's not necessarily a great move, in our view.

Even if it were to occur, however, we believe it would largely be a reshuffling of assets versus a long-term, fundamental hit to the United States. What we think would happen would be official and quasi-official investment funds selling U.S. assets as private investors and hedge funds bought the securities. The net result, in our view, would be one class of investor going underweight U.S. risk while another type of investor went overweight. This type of investor reprofiling is not a routine occurrence, but it is not unusual. The end result would likely be a moderate increase in yields to a still manageable level.

This is not to say that it would be a seamless transition. We believe it would almost certainly be extremely volatile in the short run. But at the end of the day, if people want to own U.S. assets, they will find a way. If official capital divests, private capital will backfill. We've seen that story play out dozens of times. Even heavily sanctioned

countries can find global capital. In the case of the U.S., we think the idea of divestment is much more hype than substance.

### **The call is coming from inside the house**

We think the simple truth is that the biggest threat to Treasuries does not come from abroad but from U.S. fiscal policy. And while we think that threat is manageable for most Treasury bonds, we have concerns about the 30-year maturity.

Even though the U.S. economy is expanding at an above-average pace, the U.S. budget deficit is hovering near six percent of GDP, an amount that historically was associated with recessions. No one, we believe, would argue that this is a sustainable budget, including the politicians that passed it.

It's unclear how, or when, U.S. finances will get back on track, but it seems increasingly likely that it will take an external event to force budgetary sanity on the country. Put simply, if the U.S. government cannot put its fiscal house in order when there is single-party control of government and a strong economic expansion, when will it? These conditions offer a solid backdrop and the lowest friction to pass legislation, and yet no discernible progress has been made on the fiscal front. Tariffs and inbound investments could, in theory, assist at the margin, but nothing in the data or projections suggests they will meaningfully alter the debt trajectory.

This lack of fiscal sanity, we believe, creates multiple headwinds for longer-maturity Treasuries.

One is the issuance of new bonds to fund this spending. Buying a 30-year government bond may not be catching a falling knife, but it's arguably napping under the Sword of Damocles—not a comfortable spot.

Another risk is the potential for growing deficits over time. Taking away benefits is always unpopular, but adding new ones is relatively easy. Future administrations are likely, we believe, to open the spigots further and add to the deficits, creating more supply and higher inflation risk.

Finally, we think there is the question of potential tail risks as we go into longer maturity bonds. If it's true that markets, and not politicians or voters, are going to be the catalyst for change, that catalyst is likely going to come in the form of higher yields and lower bond prices. These impacts—and losses—will likely be felt most severely at the 30-year point. Rational investors, we think, could choose to focus their holdings on shorter-maturity Treasuries.

### **Dollar daze**

Since January 2025, the dollar is down nearly 10 percent against a roughly trade-weighted basket of major currencies. Given the ubiquity of the dollar in global

finance, that simple reality has a way of altering the return perspective on many asset classes. The S&P 500, for instance, turned in a robust 18 percent return in that time; measured in euros, however, it barely cleared a three percent gain. Much of what we think of as rising asset prices is really the impact of using a shorter yardstick to measure the value.

We think the dollar's weakness is related to concerns about the debt but is more generally about the predictability of U.S. policymaking and the apparent absence of any roadmap to fiscal sanity.

In theory, deficits and currency strength are not mutually exclusive. In fact, a small deficit is usually a boon for a country's currency since it contributes to growth and gives room to keep interest rates a touch higher, both of which currency markets tend to like. But deficits and the resulting debt are like adding salt to a dish. A little bit can elevate the taste, but too much and it's unpalatable.

The key line is the real interest rate versus the real growth rate. If the country's economy is growing faster than its cost of funds, the debt is sustainable. If not, the currency will likely face pressure. Unfortunately, there's no way to know the relevant interest and growth rates since we're concerned with future events. We do know, however, that the U.S. long-term real growth rate and the current real interest rate are at about the same level.

Concerns that debt service costs could rise soon are likely playing a role in the dollar's weakness. Even though the Fed has cut short-term interest rates by 1.75 percent since September 2024, the 10-year government bond yield has risen 50 basis points in that time. This leaves the U.S. increasingly forced to choose between stability and price. It can use expensive but predictable 10-year financing, or it can rely on inexpensive short-term money but with the risk of potentially large and rapid swings in debt service costs. So far, the U.S. government has kept to a blended issuance approach, but there is no guarantee that will continue to be its plan.

### Safety of security

More than these theoretical concerns, however, we'd argue that risk management is currently driving the currency bus.

Investors like to have assets that they perceive as a safe haven. It's great to have at least one position in a portfolio that is expected to do well when things turn scary in the world. For a long time, the dollar and the Treasury bond played that role. The best part was that they tended to generate a reasonable amount of income as well—essentially it acted like an insurance policy that simultaneously protected and paid the investor. Nice deal if you can get it.

We believe there is reasonable evidence that global investors may feel less secure in being plugged in to the dollar ecosystem. While it still offers exposure to one of the world's largest and most vibrant economies, the exposure carries with it a potential pain point that can be exploited. To the extent that global investors have reduced appetite to hold dollars as a safety asset, their reallocation of those funds is likely to create ongoing headwinds for the greenback. One reason to believe that the search for safety is a key component of the recent dollar weakness is the concurrent very strong performance of precious metals and currencies such as the Swiss franc.

It's important to distinguish this type of reprofiling from divestment. The former is likely to be a gradual process driven primarily by traditional risk-return calculations while the latter is done as a means of applying pressure to a government even if it is not economically advisable.

### What does this mean for investors?

We think investors should consider taking modest steps in response to the evolving landscape. These include:

- **Remain invested in the United States:** It's a huge, productive economy and needs to be in investor portfolios, in our view.
- **Diversify globally:** Non-U.S. equities can offer currency exposure and diversification benefits.
- **Shorten up maturities:** We are generally cautious on the longest maturity bonds in many jurisdictions. We see benefits to keeping maturities or high probability call dates within 10 years.

### Simple question, difficult answer

At the end of the day, we think the biggest overhang for longer-term Treasuries and to a lesser extent the dollar is the lack of a clear, simple story on why an investor should own them. Not too long ago, that question would have been considered non-sensical by most investors; Treasuries and dollars were seen as the key to safety.

Now, however, we see U.S. debt dynamics and an apparent lack of interest in returning to a sustainable fiscal path as major overhangs for longer-term Treasuries. The dollar is still the default trade currency and continues to benefit from a lack of obvious replacements, but its utility now comes at a higher apparent cost in the form of a potentially exploitable exposure.

Global bond markets, precious metals, and currencies are sending us a signal on sustainability. We think investors should listen.

## UNITED STATES

Phil d’Entremont, CFA – Minneapolis

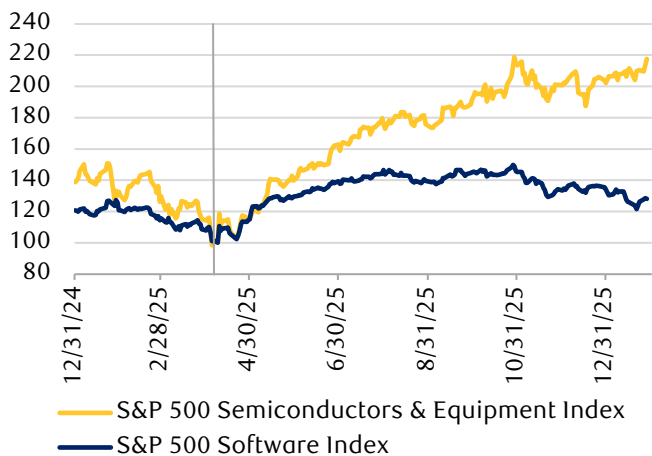
■ **The S&P 500 hit an all-time high, briefly crossing above 7,000 for the first time on Wednesday morning.** This feat was far from an obvious outcome for U.S. equity investors almost 10 months ago when the index closed at 4,982.77 on April 8. At that time, “Liberation Day” and ultra-high tariff levels were the topic du jour. While tariff rates were lowered and new trade deals have come together since then, their importance has recently faded to an extent, with the S&P 500 now up about 40% from the April 2025 lows and new trade deal headlines now relegated to below the fold at most news outlets.

■ **Semiconductor stocks are continuing to outperform software stocks.** Over this same time horizon, investors have preferred semiconductors over software names within the Technology sector. From April 8, 2025 to Jan. 28, 2026, the S&P 500 Semiconductors & Semiconductor Equipment industry has risen approximately 120% compared to the 30% advance for the S&P 500 Software industry as **investors perceive AI driving increased demand for semiconductor products while eroding the economic moats of software companies.** This new narrative has flipped the script of the past decade-plus; software was once seen as wide-moat companies with sticky revenue streams trading at premium valuations but is now experiencing valuation pressures as barriers to entry collapse. Meanwhile, semiconductor stocks, which typically saw earnings growth come in cycles, are now seeing structural tailwinds potentially increasing visibility into future earnings growth, driving semi stocks higher. Value and growth investors, take note.

■ **AI funding is alive and well.** As AI newsflow grows, some market participants are asking how these investments will be funded; will AI chatbots be profitable? How will companies recoup their AI investments? Tech

### Semiconductors pull away from software

S&P 500 sector performance indexed to 100 on 4/8/25



Source - RBC Wealth Management, FactSet, Standard & Poor’s

giants such as Amazon.com, Microsoft, Meta, and Alphabet have mature business lines to produce cash flows that subsidize emerging ventures. Yesterday alone, **Microsoft and Meta both reported Q4 earnings which show capital expenditure (capex) remaining strong. What about AI startups? This week, reports from Bloomberg and others circulated about OpenAI’s efforts to raise \$100 billion and competitor Anthropic’s efforts to raise \$20 billion** in current fundraising rounds. So long as free cash flow supports tech giant capex and investors are eager to fund AI startups, we expect chip demand to grow.

## CANADA

Nguyen Dang, CFA – Toronto

■ **The Bank of Canada (BoC) on Wednesday held its benchmark policy rate steady at 2.25%, in line with market expectations, signalling continued caution amid a complex economic backdrop.** BoC Governor Tiff Macklem emphasized elevated uncertainty, particularly from trade tensions with the U.S. and political pressures affecting U.S. monetary policy, as key reasons why forecasting the next policy move remains challenging. Meanwhile, the BoC maintained its forecast for modest economic growth—around 1.1% in 2026 and 1.5% in 2027—contingent on a stable trade environment. The BoC expects inflation to hover near its 2% target, reflecting confidence that price pressures remain broadly contained. While the Canadian economy has shown resilience, including a projected 1.7% expansion in 2025, trade risks and slower hiring intentions continue to weigh on the outlook. RBC Economics believes the BoC will likely keep overnight rates steady through the end of 2026—indicating limited impetus for further easing but also a reluctance to tighten without clear evidence of renewed inflationary pressures—which reinforces the message that future policy decisions will be influenced by incoming growth, inflation, labour market, and trade developments.

■ **Canadian retail sales rose 1.3% m/m to CA\$70.4 billion in November, rebounding after October’s weakness was linked to a labour dispute at British Columbia’s liquor distribution branch.** Sales increased across eight of nine subsectors, led by a 3.0% gain at food and beverage retailers. Within that category, beer, wine, and liquor store sales surged 14.3%, reversing a sizable decline in October as distribution disruptions eased. Excluding gasoline stations and motor vehicle dealers, core retail sales rose by 1.6%, rebounding after two straight months of declines. Still, we believe November’s strength in retail sales likely, in part, reflects normalization following temporary supply disruptions rather than a durable shift in underlying demand, particularly as the BoC’s latest consumer survey showed households are feeling less optimistic about their finances. Overall, the November data was mixed—pointing

to pockets of resilience but also highlighting uneven momentum and continued caution among households. Looking ahead, Statistics Canada's advanced estimate points to a 0.5% decline in retail sales in December.

## EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The euro has strengthened as much as 3.5% against the U.S. dollar since mid-January**, raising questions regarding the potential impact on both European corporate earnings and the European Central Bank's (ECB's) monetary policy. We estimate that a 10% increase in the euro relative to the U.S. dollar can shave some 2% to 3% off of European equities earnings—a mild headwind.
- With respect to the impact on ECB policy, **we think concentrating on the euro relative to a basket of trading partners' currencies is more relevant**. Given that the euro has weakened relative to the Norwegian, Swedish, and even British currencies year to date, we estimate that the euro strengthened versus the basket of all its trading partners' currencies only marginally. According to ECB studies, such a marginal strengthening is not sufficient to dampen inflation. Therefore, we maintain our view that the ECB will remain on pause this year.
- **ASML reported record order intake of €13.2 billion in Q4 2025**, almost double the €6.8 billion consensus estimate. The semiconductor equipment company's CEO stated that in recent months, many of its customers "have shared a notably more positive assessment of the medium-term market situation, primarily based on more robust expectations of the sustainability of AI-related demand." This has translated into a "marked step-up in their medium-term capacity plans," supporting wafer fab equipment (WFE) spending trends, including a significant increase in demand for ASML's Extreme Ultraviolet Lithography (EUV) equipment that supports AI chip manufacturing with higher productivity. ASML's share price is up 34% year to date and has almost doubled over the past six months. The stock now represents over 5% of the MSCI Europe ex UK Index with a market cap of €480 billion (US\$575 billion).
- **Global luxury leader LVMH delivered organic revenue growth of 1% in Q4**, in line with Q3. After rallying in H2 2025 on improving trends and signs that cyclical headwinds might be bottoming, LVMH's shares (alongside those of luxury goods peers) have retraced some of those gains early in 2026. LVMH's CEO, on the results call, said: "short term, it's very difficult to provide a serious forecast," reflecting current geopolitical and economic uncertainty. As we move deeper into 2026, we

think the luxury goods sector's recovery will be shaped by companies starting to lap lower year-over-year comparatives from 2025, as well as new collections from various new creative directors starting to arrive in stores.

## ASIA-PACIFIC

Nicholas Gwee, CFA – Singapore

- **Japan has seen sharp moves across a variety of asset classes recently as the country gears up for a snap election** for the lower house of Parliament on Feb. 8. Prime Minister Sanae Takaichi's expansionary fiscal policies and questions surrounding how to fund her programs have significantly rattled Japanese markets in recent days.
- **The yen appreciated sharply against the U.S. dollar after signs last Friday that the U.S. could take the rare step of joining Japan in defending its currency**, strengthening to approximately 153 as of the time of this writing from 159.23 last Friday. The move came after Reuters and other outlets that day reported that the Federal Reserve Bank of New York had contacted financial institutions to conduct rate checks on the dollar/yen currency pair, and that top finance authorities of the two countries have been in close communication. U.S. Treasury Secretary Scott Bessent later clarified that the U.S. has not intervened in the dollar/yen market. RBC thinks that rate checks are usually a precursor to an intervention. Adding to the prospects of intervention, **Takaichi said on Sunday that the government is prepared to prevent any "highly abnormal" market moves**.
- Coordinated intervention to prop up the yen is rare. The U.S. has intervened in currency markets on only three occasions since 1996, most recently selling the yen alongside other G7 nations to help stabilize trading after the 2011 earthquake in Japan. The last time the Japanese government intervened in the currency market was in 2024; Bloomberg reported that **Tokyo spent almost US\$100 billion on yen-buying to prop up the currency over four occasions that year. On each of those occasions, the yen's exchange rate was around 160 per dollar**.
- **A weaker yen has a positive effect of boosting short-term corporate earnings** (especially for exporters), but it also has the negative effect of reducing the value of unhedged investments.
- Our local research correspondents noted that corporate Japan currently assumes an average of 145 yen to the dollar. History suggests the government may step in when the yen exceeds 160. **Our local research correspondents also anticipate negative implications for Japanese equities if the yen exceeds 165**.

## MARKET Scorecard

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	6,978.03	1.9%	1.9%	15.0%	42.7%
Dow Industrials (DJIA)	49,015.60	2.0%	2.0%	9.3%	28.6%
Nasdaq	23,857.45	2.6%	2.6%	20.9%	54.4%
Russell 2000	2,653.55	6.9%	6.9%	15.9%	34.1%
S&P/TSX Comp	33,176.07	4.6%	4.6%	30.5%	57.0%
FTSE All-Share	5,482.42	2.5%	2.5%	18.3%	31.3%
STOXX Europe 600	608.51	2.8%	2.8%	14.5%	25.8%
EURO STOXX 50	5,933.20	2.4%	2.4%	14.2%	28.0%
Hang Seng	27,826.91	8.6%	8.6%	37.6%	74.4%
Shanghai Comp	4,151.24	4.6%	4.6%	27.7%	42.6%
Nikkei 225	53,358.71	6.0%	6.0%	36.8%	49.3%
India Sensex	82,344.68	-3.4%	-3.4%	8.5%	16.5%
Singapore Straits Times	4,909.34	5.7%	5.7%	29.2%	55.4%
Brazil Ibovespa	184,691.05	14.6%	14.6%	48.9%	43.2%
Mexican Bolsa IPC	69,960.09	8.8%	8.8%	35.8%	23.0%
Gov't bonds (bps change)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Treasury	4.241%	7.4	7.4	-29.1	10.4
Canada 10-Yr	3.426%	-0.7	-0.7	22.3	-9.7
UK 10-Yr	4.544%	6.5	6.5	-7.0	58.0
Germany 10-Yr	2.857%	0.2	0.2	29.2	55.8
Fixed income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	4.36%	0.2%	0.2%	6.8%	10.2%
U.S. Investment-Grade Corp	4.85%	0.3%	0.3%	7.3%	11.6%
U.S. High-Yield Corp	6.53%	0.7%	0.7%	8.0%	18.4%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	5,383.66	24.6%	24.6%	94.8%	166.7%
Silver (spot \$/oz)	116.26	62.2%	62.2%	282.2%	409.8%
Copper (\$/metric ton)	12,912.70	3.7%	3.7%	45.7%	52.8%
Oil (WTI spot \$/bbl)	63.51	10.6%	10.6%	-13.9%	-18.6%
Oil (Brent spot \$/bbl)	68.67	12.9%	12.9%	-11.4%	-17.8%
Natural Gas (\$/mmBtu)	7.46	102.4%	102.4%	114.9%	175.1%
Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	96.4050	-1.9%	-1.9%	-10.6%	-6.8%
CAD/USD	0.7376	1.2%	1.2%	6.2%	-0.8%
USD/CAD	1.3558	-1.2%	-1.2%	-5.8%	0.8%
EUR/USD	1.1948	1.7%	1.7%	14.6%	10.1%
GBP/USD	1.3805	2.4%	2.4%	10.9%	8.7%
AUD/USD	0.7037	5.5%	5.5%	12.5%	7.0%
USD/JPY	153.3900	-2.1%	-2.1%	-1.4%	3.5%
EUR/JPY	183.2700	-0.4%	-0.4%	13.0%	14.0%
EUR/GBP	0.8655	-0.7%	-0.7%	3.2%	1.3%
EUR/CHF	0.9186	-1.3%	-1.3%	-2.6%	-2.1%
USD/SGD	1.2626	-1.8%	-1.8%	-6.5%	-5.9%
USD/CNY	6.9484	-0.6%	-0.6%	-4.1%	-3.2%
USD/MXN	17.1875	-4.6%	-4.6%	-16.4%	0.2%
USD/BRL	5.1974	-5.1%	-5.1%	-11.4%	5.8%

Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Tuesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing.

Examples of how to interpret currency data: CAD/USD 0.73 means 1 Canadian dollar will buy 0.73 U.S. dollar. CAD/USD 1.2% return means the Canadian dollar has risen 1.2% vs. the U.S. dollar year to date. USD/JPY 153.39 means 1 U.S. dollar will buy 153.39 yen. USD/JPY -2.1% return means the U.S. dollar has fallen 2.1% vs. the yen year to date.

Source - Bloomberg; data as of 1/28/26

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As of December 31, 2025

Rating	Count	Percent	Investment Banking Services Provided During Past 12 Months	
			Count	Percent
Buy [Outperform]	884	58.31	282	31.90
Hold [Sector Perform]	586	38.65	160	27.30
Sell [Underperform]	46	3.03	3	6.52

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