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Axonic Insights: Don't Fight the TED

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Key takeaways

- Treasury is supplanting the Fed as the bond market's current active interventionist.
- Treasury appears unwilling to allow yields to fully reflect fundamental inflation or growth inputs (i.e. - note and bond yields would be higher).
- We believe the Treasury will communicate aggressive increases to its 'notes-for-bills' twist should the 10-year yield exceed 5.0%.
- We maintain our view that 4.75% to 5.0% on 10-year yields is a prudent place to add duration.
- A September FOMC rate hike has, perhaps counterintuitively, lowered the risk of runaway 10-year yields.¹
- The Treasury and Fed – whether intentionally or not – may have crossed the Rubicon towards a consolidated balance sheet.
- Don't fight the TED (Fed + Treasury).

Overview

During a Bloomberg roundtable in June 2024, then-citizen Scott Bessent accused then-Treasury Secretary Janet Yellen of having “taken control of monetary policy” through Treasury bill issuance and said the change in issuance composition had “eased financial conditions substantially.” Yellen rejected the accusation that Treasury was managing its borrowing strategy to support the economy ahead of the election. Bessent now appears to be employing a similar strategy.

The difficult thing about analyzing complex multivariate economic systems is isolating variables. Isolating the effect of Bessent's announcement of the soon-to-be twist on the yield curve is difficult given the offsetting move higher in oil that occurred at the same time. The correct question? Where would yields be without his communication? If we think about this, it is not only a powerful tool signaling the presence of a Treasury 'put', but it is also a stealthy form of Fed-backed QE. Why? The Treasury issues bills to buy

¹The September 2026 FOMC rate hike was essential to preserving Fed credibility. On its own, the 25bps hike may not have been enough to curtail inflation fears, but a hawkish move in the 2026 dots for another hike this year - coupled with eight members looking for another hike next year - reinforced this new Fed's commitment to fighting inflation in a 'timelier' fashion. This should help control an inflation-driven move in the long end.

notes and bonds. The Fed will then buy those bills as part of its reserve management program (“RMP”). While one step removed, the Fed is creating reserves that serve as the ultimate source of funds for the long end purchase.

Treasury’s Recent Actions and Signaling

In recent months, there have been a number of policy signals and actions designed with the implicit or explicit intent to control the long end of the US treasury curve.

- **Action.** Treasury’s unusual intervention in Japanese currency markets was aimed at preventing Japan from selling US Treasuries to fund Yen purchases in defense of the currency. Our largest treasury buyer owns \$1.1T of US debt, and its sale of US Treasuries would be significant enough to move long yields higher.
- **Signal.** The treasury has announced an upside to its yield curve ‘twist’ program. While the Treasury Buyback program is almost entirely signal at this point, it is a powerful one... but it may have limitations.
 - o **Limitation.** Bill issuance drains reserve balances because banks move out of reserves held at the Fed and into higher-yielding bills. There are no longer any reserves available in the ON RRP program to absorb outflows from bill issuance, so bill issuance to fund buybacks drains aggregate reserves. In turn, this requires the Fed to continue RMP.
 - o **Limitation.** The underlying cause for higher note and bond yields is fundamental: strong growth, higher-than-target inflation, large AI CapEx demand creation, and flagrant government deficit spending. This combination of fundamental factors makes treasury’s attempts at yield curve control (YCC) difficult.
- **Signal.** Recent talk of a full SLR exemption of US Treasuries indicates such action is still possible. It would be another meaningful tool to help manage yields. Banks would be more willing to keep Treasuries on balance sheet with an exemption in place.

Last month on August 19th, the US Treasury doubled the size of its long-end buyback operations, from \$2B to \$4B each effective September 9th. There are 4 operations per quarter, so this totals \$64B in buybacks per year. In the context of the size of the long-end (10-30s) market’s ~\$800B in issuance annually, it is small, but it serves as a powerful signal. Moreover, the marginal buyer sets price. Its direct intervention in the Yen market and its announced intervention directly in the US market appear to signal that Treasury has crossed the Rubicon and will take all measures in its power to contain long-end sovereign yields.

To be clear, the Treasury's buyback program is a 'sterilized' intervention. Unlike the Fed, Treasury cannot create reserves (a special form of money that only depository institutions can hold) to pay for what it buys. Rather, it must fund every dollar of bond purchases by first selling a dollar of bills to the same private sector that just sold it the bonds. That is a type of Operation Twist run by the fiscal agent (Treasury) rather than the monetary one (the Fed), at a fraction of Twist's size. For context, the 2011 Fed Twist was \$400B, extended in 2012 by an additional \$270B.

A subsequent follow-up announcement on August 24th, indicating that the Treasury may use the Treasury General Account ("TGA") to fund buybacks, had some impact with 10-year yields, moving from 4.73% to 4.70% on the news. This indicates that the Treasury may be willing to spend down a portion of its TGA to fund upsized buybacks, which simply means this iteration of buybacks would not require bill issuance, but only because Treasury believes it had some excess cash/cushion in its savings account. The TGA is the Treasury's main fed checking account by which it makes payments to the private sector and saves money collected via taxes.

(Please see the Appendix for a timeline of recent interventions and additional discussion.)

A Dangerous Precedent

The Treasury and Fed are supposed to remain independent, but what's happening now may risk that separation and look more like consolidated balance sheet quantitative easing ("QE"). Only under exigent circumstances has Section 13(3) of the FRA been invoked to break down that barrier. Here's what's happening now.

1. Treasury buys long bonds funded by its own bill issuance. Privately held duration falls (i.e. – 10-year notes are replaced by bills).
 - a. When Treasury issues a bill, the buyer's payment settles into the TGA at the Fed. (The TGA is not a reserve balance at the Fed.) A dollar sitting in TGA is a dollar not available to the banking system. Therefore, bill issuance drains system reserves.
2. The Fed creates new reserves to buy bills under RMP. Since December the FOMC has directed the Desk to buy bills to keep reserves ample. While not technically QE, when paired with Treasury's bill issuance and note buybacks it results in duration transformation that is QE.
3. Outcome: The private sector has now swapped a 10 or 30-year bond for an overnight reserve balance, and the government has retired long-duration debt and replaced it with overnight money. That is QE, split across two agencies, each of which can truthfully deny doing it. While neither leg is QE, the composite result is.

Bill supply drains reserves, drained reserves trigger RMPs, and RMPs create new reserves. Will the Fed increase the size of the RMP as it plays with twist? We believe it will. We note that the Fed made no mention of ending the program during its most recent meeting.

Conclusion

While none of Treasury's actions appear extraordinary, we may be witnessing the slide down a proverbial slippery slope towards a consolidated balance sheet. As investors, we must look past our visceral reaction and recognize that there will be a bid for duration that may not be fundamental but that is just as powerful. Ultimately, will Stan Druckenmiller be right? Will the experiment fail? Perhaps, but for now we are not prepared to fight the TED (Fed + Treasury) and will look to extend duration given what we perceive to be asymmetry to long yields in a sad world where fundamentals won't matter – until they do. We will admit that the size of the RMP and Treasury twist is not yet large enough to correct for disaster were it to occur, but the direction of travel is clear. Treasury (with the Fed in waiting) is ready to act.

APPENDIX – Timeline and Discussion

7/31/2026: FX Intervention. On July 31st the US joined Japan in buying Yen, the first joint operation since 1998. The Treasury (not the Fed) sold Euros out of its reserve account to buy Yen (the amount Treasury bought remains undisclosed, but estimates based on a picture of his notepad suggest \$5-10B while Japan bought over \$50B). Context is what makes it striking: Treasury's own semi-annual currency report, published only weeks earlier, kept Japan on its monitoring list of countries that may be weakening their currency for competitive advantage. Bessent has also repeatedly called on the BOJ to raise rates to correct for an undervaluation in the Yen: this intervention occurred after the BOJ's meeting where they did not raise rates. Treasury told the ECB only after the trade had cleared, and Lagarde and Bessent spoke the following day. That broke a postwar convention of advance consultation among G7 authorities.

8/02/2026: Pressure to expand Fed FIMA program. Bessent then publicly pressed the Fed to expand its Foreign and International Monetary Authorities Repo Facility ("FIMA") so Japan could raise dollars against its roughly \$1.1T of Treasury holdings rather than selling them outright. That facility carries a \$60B per-counterparty daily cap and has gone essentially unused since it became standing in 2021 (was created in March of 2020), against estimates of \$60B to \$80B for the size of Japan's recent intervention.

8/05/2026: The Refunding Language. The August 5th QRA statement made two changes to the coupon paragraph. The first is a new sentence: "Treasury is monitoring SOMA purchases of Treasury bills and growing demand for Treasury bills from the private sector." This is suggesting greater demand for short-term paper but also acknowledging the Fed's presence in the bill market as it relates to its Reserve Management Purchase program (Fed is buying bills to inject reserves into the banking system). The second language tweak feeds into the first, as the Treasury changed its guidance on future composition from "continues to evaluate potential future increases to nominal coupon and FRN auction sizes" to "potential future changes." Given only larger than expected issuance needs, either bills or coupons will have to increase.

In May, the Treasury Borrowing Advisory Committee ("TBAC") stated that current projections could warrant increases in coupons in FY2027 and recommended Treasury update its guidance to preserve flexibility. Treasury is already running at +22% bills as a % of total outstanding US debt, above the 15-20% guidance from TBAC. The highest period in recent history was in the thick of the COVID crisis, when it rose to 24%. Prior to that, it was during the GFC when it rose to 35%. We are discussing major tail-crisis funding paradigms during one of the strongest and most robust US growth periods in recent memory.

8/19/2026: Buyback Program Upsize. On August 19 Treasury doubled long-end liquidity-support operations from \$2B to \$4B each, effective September 9th, and Bessent then hinted at more. Treasury announced it off-cycle, two weeks after the refunding. That departure from "regular and predictable" marks it as a reaction function rather than debt management. Long-end yields gave back the initial rally almost immediately. There is roughly \$32T of US debt held by the private sector, and the buyback increase amounts to \$64B additional per year. TTM, there has been close to \$800B in gross issuance in 10, 20, 30-year maturities.

8/24/2026: Buybacks using TGA. On August 24th, sources suggested that the Treasury was considering using its TGA at the Fed to fund buybacks. This would avoid the need to raise new capital via bill issuance for now, but the optics may be negative and it's a band aid solution. Bessent refrained from confirming that speculation later in the day. Treasury has been discussing ways to improve its return on excess cash, such as running a repo program. Spending down the TGA to fund buybacks would have limited size based on refunding surveys of primary dealers, and moreover, last September, Treasury officials indicated that they had no plans to move away from the 5-7d precautionary cash buffer.

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