

## » *Fisch View*

*October's topic:  
„Power struggle between the Fed and Treasury“*



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## Power struggle between the Fed and Treasury

- The global liquidity cycle is approaching its end but remains in an expansionary phase for now, continuing to buoy equity and credit markets.
- Ample liquidity, coupled with high levels of government spending, is fuelling global economic growth — and with it, inflation. This in turn exerts upward pressure on long-term interest rates.
- In this environment, we remain slightly overweight in terms of risk exposure and neutral to slightly short in duration.

## Overall economic situation

Despite a superficial cooling in the US labour market, there are currently no signs of recession. The GDPNow estimate for the third quarter stands at 3.8%, and the informative Weekly Economic Indicator (WEI) continues to signal stable week-on-week growth. Retail sales and travel activity remain near historical highs. US government spending is surging, and liquidity is rising. Against this backdrop, the Fed's recent rate cut was unnecessary. Europe, too, is seeing a modest acceleration in growth.

## Recent developments: Financial markets ignoring risks

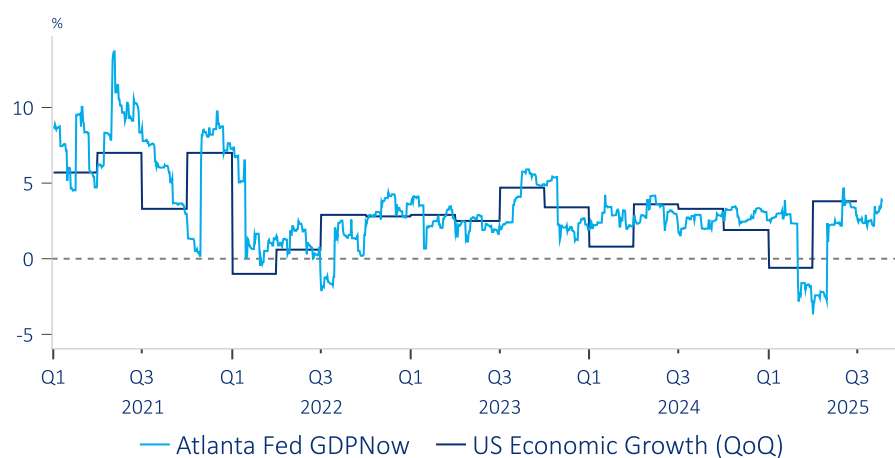
- The global liquidity cycle is now well advanced and nearing its peak. However, liquidity continues to expand — albeit at a slowing pace — providing a tailwind for equity and credit markets.
- As a result, global growth remains supported, though it is driven almost entirely by the aforementioned liquidity expansion and elevated fiscal spending, rendering it unsustainable.
- Meanwhile, a power struggle between the US Treasury and the Federal Reserve is intensifying. The Treasury is increasingly assuming functions traditionally performed by the Fed — including yield curve management through T-bill issuance and purchases of long-dated Treasuries. This interference is unprecedented in modern history and risks undermining confidence in institutional independence.
- For now, however, markets are largely dismissing these risks. The US dollar has yet to weaken meaningfully, and long-term yields have not spiked.

## Overview & outlook: No sell signals yet

» US bank reserves are approaching the danger zone.

- The ongoing tug-of-war between the US Treasury and the Fed remains unresolved and continues to unsettle markets. There is a growing risk that investors lose confidence in the Fed's ability to control interest rates and inflation. In this context, the Fed is actively draining liquidity through the continuation of its Quantitative Tightening (QT) programme and related measures, in an effort to offset the expansionary impact of its recent rate cut and the Treasury's liquidity-boosting T-bill issuance.
- The Fed's liquidity withdrawal directly affects equity and money markets, while the new Treasury-generated liquidity — via T-bill issuance and higher government borrowing — primarily stimulates the real economy. Consequently, the coming months are likely to bring stress in equity and money markets, but continued support for US growth.
- Recent statements by Treasury Secretary Scott Bessent and newly appointed Fed Governor Steven Miran — both advocating a continuation of QT — are noteworthy. This stance is not inconsistent with the Fed's, as both are more concerned with sustaining economic growth than supporting equity markets or fuelling inflationary liquidity. However, stronger growth would tend to push long-term rates and inflation higher — a politically undesirable outcome, particularly for President Trump. Overall, this results in somewhat contradictory signals for stock markets.
- Importantly, global liquidity is still rising, though momentum is fading, and the Fed continues to reduce liquidity (and hence bank reserves) in the US. The situation would only become critical for global markets if US bank reserves — currently at USD 2.96 trillion — were to fall below USD 2.8 trillion. Such a decline would likely trigger a sharp widening of spreads between money-market rates (SOFR) and the Fed funds rate — a strong global warning signal for risk assets.

**Chart: Global liquidity supports markets and the economy – the US as an example**



Sources: Atlanta Fed, BEA, Macrobond, Fisch Asset Management

## Positioning: Tailwinds for corporate bonds

» High refinancing needs across global bond markets.

- Given the ongoing power struggle between the Fed and the US Treasury, monetary policy remains highly uncertain, raising the risk of a loss of control over long-term interest rates and inflation. Yet for now, the Treasury's liquidity creation via T-bill issuance more than offsets the Fed's restrictive stance, implying continued support for the economy, higher inflation, and upward pressure on long-term yields.
- That said, several measures are still in place to dampen long-end yields, so the pressure remains contained. We therefore maintain a neutral to slightly short duration stance. The same applies in Europe, where government bond yields are also rising, albeit amid weaker growth. French OAT yields warrant close monitoring, as they are climbing somewhat faster due to special factors — notably the widening fiscal deficit.
- Corporate bonds — particularly high yield and emerging market issues — continue to benefit from solid global growth and rising market liquidity. However, valuations are now rich and credit spreads tight. Rising rates and substantial refinancing requirements (the so-called debt maturity wall) could create headwinds in the months ahead. Accordingly, we remain neutrally positioned.
- Potential reasons to reduce exposure would include a sharp fall in the US dollar, widening SOFR-Fed funds spreads, rising long-term yields in the US, Germany, France, and Japan, or renewed inflationary pressures. For now, these are cautionary signals rather than outright sell indicators.

<i>Return drivers</i>	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA	Key:
Equities	o	+	o	o	o	o	++ Strong positive market
Gov. Bonds	o	o	-	o	o	o	+ Positive market
Credit IG ( <i>Spreads</i> )	o	o	o	o	o	+	o Neutral
Credit HY ( <i>Spreads</i> )	o	o	o	o	+	o	- Negative market
<i>Total return</i>							-- Strong negative market
Convertibles	o	o	-	+	o	o	
Credit IG	+	+	o	+	+	+	
Credit HY	+	+	o	+	+	+	
	PrecMet	InduMet	Energy				
Commodities	+	o	o				

**Notes regarding the table:** The table summarises the model results for the total return of convertible bonds and credit investment grade and high yield, which are a function of the listed return drivers. Changes from prior month are indicated with ↓ or ↑, i.e. "O ↓" means that the output has weakened from a prior value of + or ++. The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained [here](#). Within government bonds, we take German Bunds into account for Europe.

## Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	Least preferred
<b>Convertible Bonds</b>	<ul style="list-style-type: none"> <li>– Software (Cybersecurity)</li> <li>– Semiconductor (AI-related)</li> <li>– Healthcare</li> <li>– CBs with high convexity</li> <li>– Bond-like CBs with quality credits and attractive yields</li> <li>– Balanced deep investment grade Chinese tech with high convexity</li> </ul>	<ul style="list-style-type: none"> <li>– Consumer discretionary</li> <li>– Unprofitable, early stage, expensively valued IT and biotech</li> <li>– Weak credit quality and/or liquidity</li> <li>– Cryptocurrency-related names</li> </ul>
<b>Global IG Corporates</b>	<ul style="list-style-type: none"> <li>– Financials, healthcare, TMT</li> <li>– EUR-denominated issues</li> <li>– BBB-rated bonds</li> </ul>	<ul style="list-style-type: none"> <li>– US utilities, consumer goods, energy</li> <li>– USD-, GBP- and CAD-denominated issues</li> <li>– A-rated bonds</li> </ul>
<b>Global Corporates</b>	<ul style="list-style-type: none"> <li>– Healthcare, financials, autos</li> <li>– BBB and BB-rated bonds</li> <li>– Developed markets</li> </ul>	<ul style="list-style-type: none"> <li>– US utilities, transportation, consumer goods</li> <li>– AA &amp; B-rated bonds and lower</li> <li>– Emerging markets HY</li> </ul>
<b>Global High Yield</b>	<ul style="list-style-type: none"> <li>– Capital goods</li> <li>– Health care</li> <li>– Telecommunications</li> </ul>	<ul style="list-style-type: none"> <li>– Transportation</li> <li>– Financial services</li> <li>– Insurance</li> </ul>
<b>Emerging Markets - Defensive</b>	<ul style="list-style-type: none"> <li>– LatAm (Mexico, Peru), Eastern Europe</li> <li>– Utilities, supranationals</li> <li>– Maturities 7-10 years</li> </ul>	<ul style="list-style-type: none"> <li>– Asia (India, Hong Kong)</li> <li>– Industrials</li> </ul>
<b>Emerging Markets - Dynamic</b>	<ul style="list-style-type: none"> <li>– LatAm (Mexico, Brazil, Colombia), Eastern Europe</li> <li>– BB-rated bonds</li> <li>– Utilities, metals &amp; mining (esp. precious metals)</li> </ul>	<ul style="list-style-type: none"> <li>– Asia, Middle East IG</li> <li>– Investment grade maturities &lt; 3 years</li> <li>– C-rated bonds</li> </ul>

**Note:** Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

## On the radar: Power struggle between the Fed and Treasury

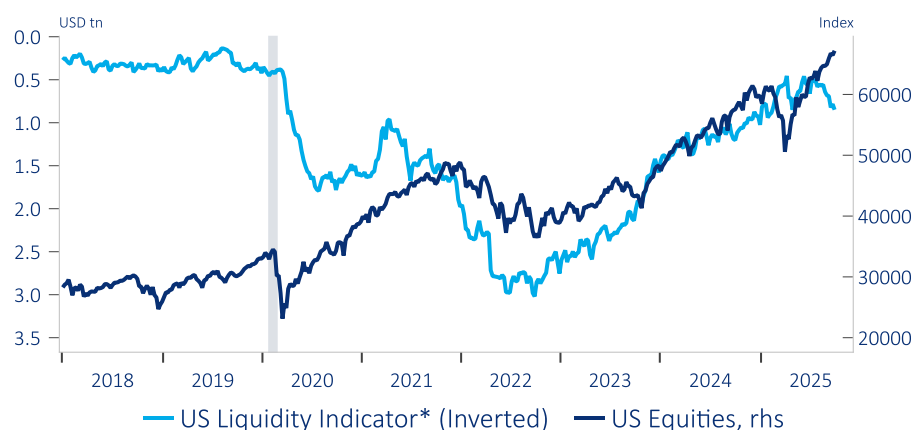
A historically unprecedented contest over US monetary policy is under way. The US Treasury is issuing vast amounts of short-dated T-bills to finance surging public debt while simultaneously seeking to protect the long end of the yield curve. In addition, it is actively purchasing long-dated Treasuries financed with T-bill proceeds — a strategy reminiscent of „Operation Twist“. These actions are highly liquidity-expansive and fall squarely within the Fed’s traditional remit. At the same time, the Fed is pushing back — reducing liquidity via QT and lower US bank reserves. Its recent rate cut is largely irrelevant in this context, as direct liquidity control is far more potent than rate adjustments.

This confrontation is risky: its market implications are difficult to gauge and could erode confidence in public institutions. Nevertheless, some conclusions can be drawn. Treasury-generated liquidity is flowing into the real economy, while Fed liquidity withdrawal is tightening conditions in equity markets. This divergence is risky for equities in the short-term but supportive of US growth. The chart illustrates the divergence between falling Fed liquidity and still-rising equity markets. Meanwhile, the US GDPNow estimate for Q3 has risen to 3.9%, confirming strong cyclical momentum.

» A technical correction in the US equity market is likely.

US equities therefore face the risk of a technical correction amid elevated valuations. However, should volatility rise excessively, the Fed is expected to intervene swiftly — reversing liquidity withdrawal into fresh injections.

**Chart: Fed liquidity is shrinking**



\* Sum of Fed reverse repo facility & US Treasury General Account.  
Sources: Macrobond, Fisch Asset Management

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