Letter from the Editor
Who still wants US Treasuries?

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Letter from the Editor is our weekend read,
which looks at the big picture, one question at a time.

Gone are the days when China was the largest holder of US Treasuries and Washington feared Beijing could weaponize its holdings. In hindsight, China was a far more patient investor than the hedge funds now dominating marginal demand. Recent Treasury market volatility reflects not only rising issuance but also the gradual replacement of strategic holders by price-sensitive traders, a shift tied to the broader trend of de-dollarisation, briefly interrupted by the Iran war. As patient capital retreats, fast money is increasingly setting the price of the world's most important financial asset.

Hello from the Investment Institute

It has been a turbulent month for US Treasuries. Heavy long-duration bond issuance from hyperscalers collided with an already elevated supply of government debt against a backdrop of deteriorating fiscal dynamics and seasonally thin market liquidity. The result was renewed upward pressure on long-end yields and questions about the market's ability to absorb an ever-growing stock of debt.

Interestingly, when asked about the market interventions of the Treasury, US President Trump stated: "We have many types of intervention. That's one. The ultimate intervention is our military. And if we have to use that, we will." What exactly he means with military intervention in the bond market is unclear, but these are bizarre times we are living in.

Much has already been written about the market mechanics behind these moves, with the focus primarily on the supply side of the problem: the federal government and hyperscalers competing for the same pool of capital. But to make sense of the US Treasury Department's actions over the past few weeks – from coordinated FX interventions with the BoJ to the buyback of long-dated bonds – it is equally important to look at the demand side of the market and discuss:

Who is buying US Treasuries?

Over the last few years, the composition of US Treasury buyers has changed significantly, shifting away from patient official capital toward leveraged, shorter-horizon private investors. The most important driver has been the declining appetite of emerging-market central banks, China in particular, and the rising role of hedge funds as marginal buyers. What is emerging is a less-stable equilibrium, with the US Treasury market becoming increasingly sensitive to self-reinforcing bouts of volatility. Small moves in bond yields can trigger margin calls and forced deleveraging, amplifying market stress.

More broadly, these changes reflect the gradual erosion of global trust in the US, a trend that is contributing to the slow but persistent process of de-dollarisation. Paradoxically, although many feared the opposite a decade ago, China's large presence in the US Treasury market was a boon for Washington. The so-called "balance of financial terror" provided more stability than is commonly appreciated. Today, by contrast, the US Treasury market is increasingly dependent on investors that are more valuation-sensitive, more leveraged and quicker to change course. Fast money is no substitute for patient capital.

Before diving into the main text, we would like to hear from our trusted readers. Please share your feedback on this publication, including topics to discuss and things to improve.

China pulls out

Until recently, investors and policymakers worried that China could one day weaponize its US Treasury holdings to pressure Washington. In September 2008, China overtook Japan as the largest foreign holder of US government debt. Back in 2001, when Beijing joined the WTO, it held only around USD 60bn in US Treasuries. Seven years later, that figure had surged to USD 618bn before peaking at roughly USD 1.3tn in late 2013. At the time, China owned nearly 10% of publicly held US debt – the mirror image of its rapidly expanding trade surplus with the US and its efforts to prevent excessive CNY appreciation.

Fears emerged in the Washington establishment that Beijing could leverage its vast US Treasury portfolio to influence US policy decisions. China was often portrayed as having a form of implicit veto power over American monetary, fiscal and financial policy.

The balance of financial terror brought stability

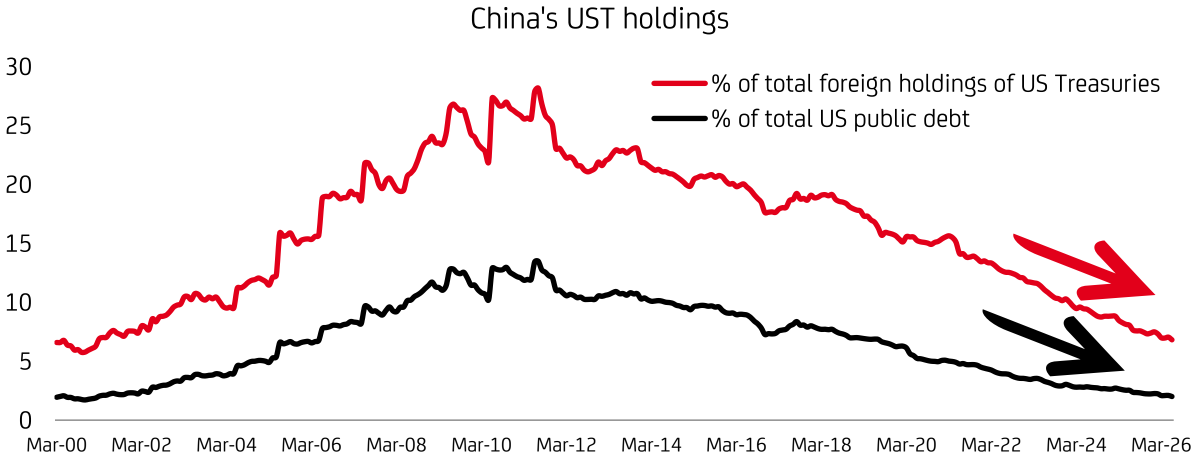
However, this scenario was always far less plausible than many assumed. Liquidating Treasuries to hurt the US would have caused immense financial and economic losses for Beijing, with a potentially paradoxical situation. History suggests that when crises originate in the US and spill over globally, the US dollar and UST market continue to benefit from their safe-haven status.

As observed by political scientist Daniel Drezner in the aftermath of the 2008 financial crisis: “When the United States owes China tens of billions of dollars, that is America’s problem. When it owes trillions, that is China’s problem.” A little bit like the US and the Soviet Union during the Cold War were stuck in an equilibrium guaranteed by "mutual assured destruction" of nuclear deterrence, China and the US were stuck in an equilibrium defined by a “balance of financial terror”.

It is therefore unsurprising that over time China has gradually reduced, rather than expanded (see chart below), its financial exposure to the US government debt market. Today, its US Treasury holdings stand at roughly USD 600bn, broadly like the levels seen in 2008. The difference, however, is that US public debt has expanded dramatically over the same period, rising from about USD 5tn to about USD 33tn. As a result, China’s share of outstanding federal debt has fallen from around 10% to just 2% (a share that could be higher if one accounted for Chinese custodian accounts outside the US) – a precautionary move given intensifying tensions with the US.

More importantly, China is not an isolated case. Central banks, particularly in emerging markets, have been steadily reducing the relative role of the US dollar in their reserve portfolios. As recently as 2011, official institutions accounted for roughly three quarters of UST held by foreigners; today, that share has fallen to around 40%. While there are many factors behind this trend, geopolitical fragmentation, rising concerns about the weaponisation of the US dollar and America's declining appeal as a trusted economic partner have accelerated reserve diversification.

CHINA HAS REDUCED ITS EXPOSURE TO THE US



Source: US Treasury, The Investment Institute by UniCredit

The arrival of levered investors

The flipside of the decline in foreign official ownership of Treasuries, along with a shrinking Fed balance sheet, is the growing importance of private investors, both domestic and foreign, which now hold roughly 75% of the Treasury market, up from about 50% a decade ago.

Within this group, the most notable development has been the rapid rise of hedge funds. Their share is above 8% of total US debt (about USD 2.6tn as of September 2025, which goes up to USD 4tn if one includes short positions), having doubled in just a few years. US Treasury holdings of hedge funds now exceed those of mutual funds and US chartered depository institutions, and are larger than the combined holdings of Japan, the UK, China, Belgium and Canada. Their footprint in the Treasury market is now roughly comparable to China's at the peak of its holdings (see chart).

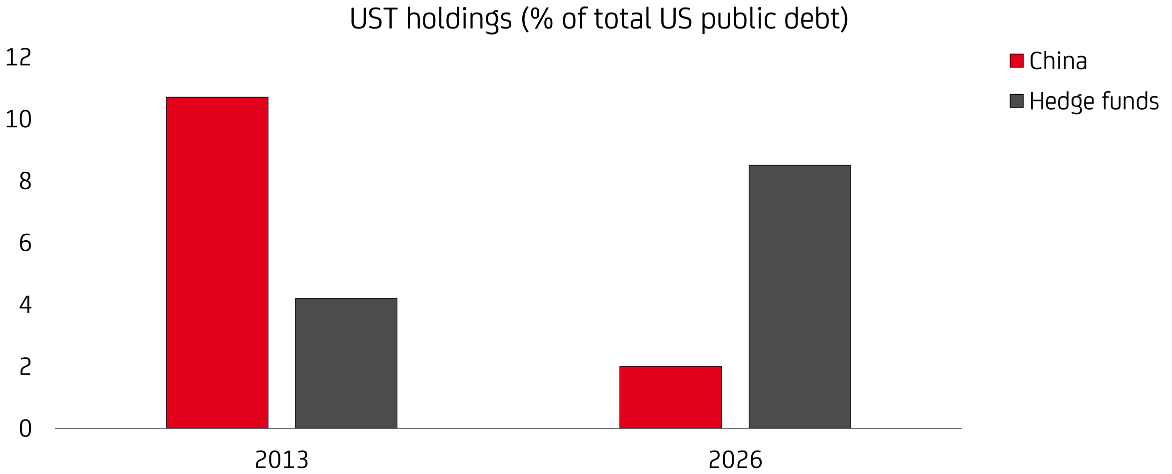
Reliance on hedge funds introduces new vulnerabilities. Unlike official investors, hedge funds are typically highly leveraged and finance a significant share of their Treasury positions through short-term repo borrowing. A large part of their activity is linked to the so-called basis trade, a relative-value strategy that seeks to profit from small price differences between Treasury securities and Treasury futures contracts. While the arbitrage spread is tiny, returns are amplified through leverage, creating very large gross exposures that depend on stable funding conditions.

As a result, the US Treasury market has become more sensitive to funding stress and volatility. In a risk-off environment, margin calls or tighter repo financing can force hedge funds to rapidly unwind positions, amplifying market moves and creating self-reinforcing feedback loops. A clear example was the March 2020 "dash for cash". As investors scrambled for liquidity at the onset of the pandemic, even US Treasuries were sold aggressively. At the same time, leveraged investors were forced to reduce positions as funding conditions deteriorated and margin calls rose, contributing to severe dysfunction in the world's deepest government bond market. The Fed ultimately had to intervene on a massive scale to restore market functioning.

This backdrop might help to explain some of the US Treasury Department's recent actions. Faced with a rise in long-term US Treasury yields, Treasury Secretary Scott Bessent announced a modest expansion of buyback operations for longer-dated securities. Officially, the measure was aimed at improving liquidity in less-traded off-the-run bonds during a seasonally thin market. More broadly, however, it can also be viewed as a response to a UST market that is increasingly dependent on leveraged private investors rather than stable official buyers.

With basis-trade positions alone estimated at around USD 830bn, and overall hedge-fund US Treasury exposures far larger via leveraged arbitrage strategies, sharp increases in yields can trigger margin calls, funding pressures and forced selling. By supporting liquidity in the cash market, buybacks reduce the risk that a rise in yields becomes self-reinforcing. The same logic may also help to explain the coordinated US-Japan intervention in the yen market a few weeks earlier. As the largest foreign holder of US Treasuries, Japan could have been forced to liquidate dollar assets, including US Treasuries, to support its currency. By coordinating the intervention, US authorities reduced the risk of official Japanese selling adding further pressure to an already fragile Treasury market.

FROM PATIENT CAPITAL TO FAST MONEY



Source: US Treasury and Fed, The Investment Institute by UniCredit
Note: 2013 is the first year for which we have data on hedge funds' UST holdings. Latest available data are September 2025.

Investment implications

With the Fed under the leadership of Chair Kevin Warsh aiming to shrink its balance sheet, the increasing presence of fast money is a source of potential stress and volatility, especially in the context of ballooning US public debt. While interventions by the US Treasury may help smooth abrupt market dislocations, their effectiveness is inherently limited. Unlike the Federal Reserve, the US Treasury cannot create money and therefore cannot serve as an unlimited backstop. The combination of an active Treasury and a passive Fed is bad news for markets.

Moreover, recent interventions may create their own risks. By demonstrating a willingness to manage market outcomes, Bessent could inadvertently encourage investors to test the government's resolve to defend critical yield levels. Should such episodes become recurrent, markets may increasingly demand proof that policymakers are both willing and able to intervene on a meaningful scale. This all argues in favour of the debasement trade, as visible with the recent gold rally.

Over the medium term, lasting stability will likely require either a credible fiscal adjustment that slows the growth of public debt (virtuous solution) or a renewed willingness by the Fed to act more directly as a buyer of government securities (less virtuous option). Or the Trump administration could force foreign governments to buy USTs in exchange for security guarantees – albeit at the cost of accepting a stronger USD.

If today's dynamics already argue for greater caution toward the US Treasury market, the changing composition of US Treasury buyers may also reflect a broader shift in America's global standing. The willingness of foreign investors to hold US government debt has long been a pillar of America's financial and geopolitical influence. A buyer base increasingly dominated by opportunistic rather than strategic investors is therefore not just a market phenomenon, but a signal of broader erosion in the foundations of US power.

This trend is occurring at a symbolic moment. US interest payments have surpassed USD 1tn annually and now exceed defence spending. Historically, such a transition has often coincided with periods of relative hegemonic decline, a relationship captured by the so-called "Ferguson's Law", which suggests that great powers begin to weaken when debt-servicing costs overtake military expenditure. Recent efforts by Washington to shift a greater share of security costs onto allies are themselves an acknowledgment that sustaining the international order is too expensive.

To be sure, investors continue to hold US dollars and Treasuries because no alternative market can match their scale, liquidity and institutional depth (another reason for Europe to accelerate its integration process). Yet the evolution of Treasury ownership is telling. The marginal buyer is increasingly motivated by yield and trading opportunities rather than a long-term commitment to the stability and leadership of the US. Bretton Woods II (i.e. Beijing recycling huge trade surpluses into USTs) was often criticised as giving China too much financial influence over the US. Yet from today's perspective, the old system provided Washington with an exceptionally accommodating creditor.

China had a strategic reason to keep buying USTs, hedge funds do not. This may not matter in normal times, but it could prove consequential when the next period of market stress arrives.

Enjoy your weekend!

Edo

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