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MACROCOSM

Is There a New US Risk Premium?

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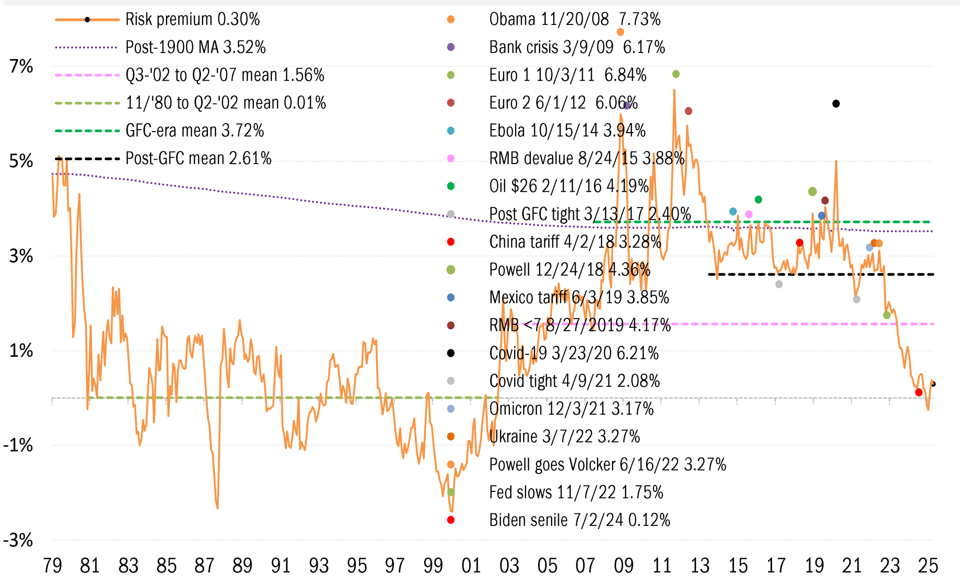
Yields jumped and the dollar fell after Trump's new CEA chief spoke of "burden sharing."

The US equity risk premium has expanded, with stocks falling and long-term yields rising. It's easy to stop there and blame the likely self-destructive tariff war that is unfolding. But it's not that easy. It's worse. Risk premia are rising in every market around the world. *The astonishing thing about it is that risk premia have risen so little given the manifest risks to global trade, and that they are still quite low by the standards of the last two decades* (please see the chart below, and "Data Insights: Global Equity Risk Premia" April 14, 2025).

S&P 500 equity risk premium (365 days-forward earnings yield minus 30-yr Treasury yield)



Source: Various, TrendMacro calculations

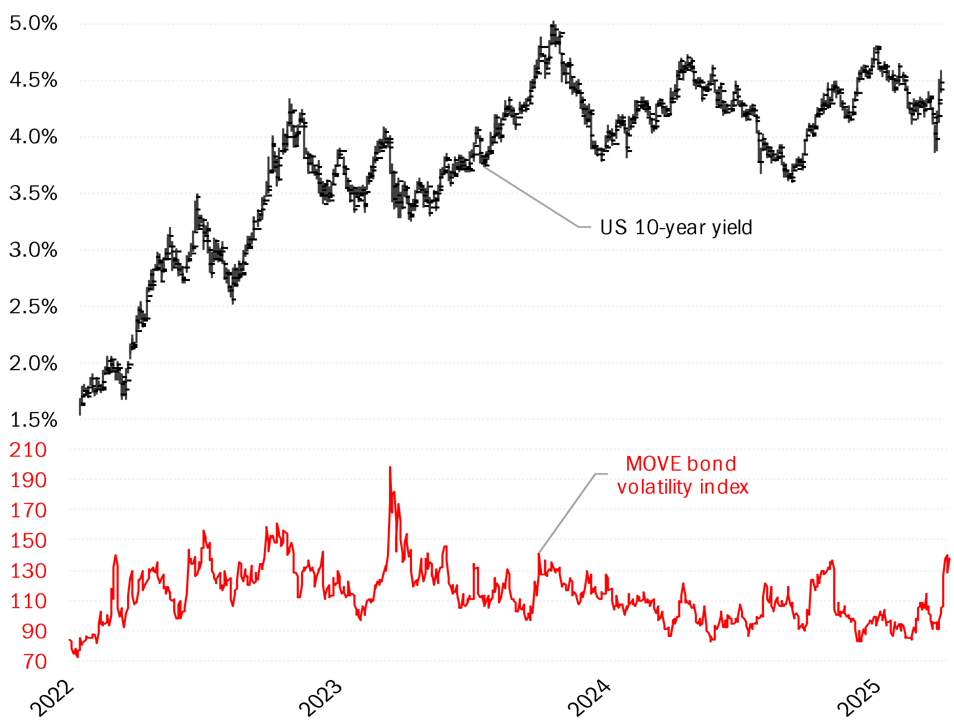
In the US, *bonds and the dollar both fell hard last week*, and that's feeding into the narrative that the US risk premium is uniquely rising and uniquely high. As we will discuss in the moment, these market moves may be important clues about upcoming risks. But the reality, for now, is *that they hardly show up in the charts* (please see the charts on the following pages).

To take what may turn out to be an unrealistically optimistic view (we'll discuss the alternative in a moment), maybe a method to the trade

Update to strategic view

US MACRO, US STOCKS, US BONDS, FX: The US equity risk premium has expanded somewhat as stocks have fallen and long-term bond yields have risen. But it is still very narrow, and ERPs have risen everywhere else in the world, too. Last week's rise in bond yields and fall in the US dollar began with Miran's first public speech since Senate approval as White House CEA chair. He tried to walk back the specifics of his radical November manifesto, but the speech still echoes its major theme: burden sharing by other nations, to compensate the US for providing the world's reserve currency and defense umbrella. Trump said Friday he is going to fold defense spending into trade negotiations. One particularly alarming part of the speech hints at taxation of foreign holdings of Treasury securities to incentive their sale, and the subsequent purchase of US goods and services. This could trigger the demise of the US dollar as world's reserve currency, which is Miran's ultimate objective. For all these risks, we don't have the evidence to make a recession call at this time. We are on high alert.

US Treasury yield and volatility (daily, from 2002)



Source: Bloomberg, TrendMacro calculations

madness is emerging. Indeed it's likely the one we pointed to almost a month ago (see [“Uncertainty Has Become a Cliché”] March 17, 2025). _*The idea is to use tariff threats to browbeat American allies to join the US in decoupling from China*_. We like [commentator Michael McNair's] name for it: the “coalition of the compelled.” _*[It's been working with Canada and Mexico]*_, which is why they were largely exempt from new tariffs on “liberation day.” _*Now on to Europe, Japan, S. Korea and all the rest*_. Yes, a big shock to decouple from China. But _*there's an offset if we can force the rest of the world into something like an America-led free-trade zone*_.

Now let's turn to the dark side, even though, for all the volatility, in the grand scheme of things – and considering the seeming risks – markets are not there, at least not yet.

*Last week's sell-off in bonds and the US dollar began precisely when Stephen Miran, the newly Senate confirmed chair of the White House Council of Economic Advisors, gave [his first public speech]*.

- We've been telling you about Miran – and his [radical November manifesto] – all year (see, first, [“Predictions for 2025: Tariffs”] January 3, 2025). He advocates US dollar devaluation and various steps that would abdicate its role as the world's reserve currency. He believes reserve currency status is not an [“exorbitant privilege,”] as French Finance Minister Valéry Giscard d'Estaing famously said in the 1960s – but rather an [“exorbitant burden,”] as our friend economist Michael Pettis has argued for almost fifteen years, in

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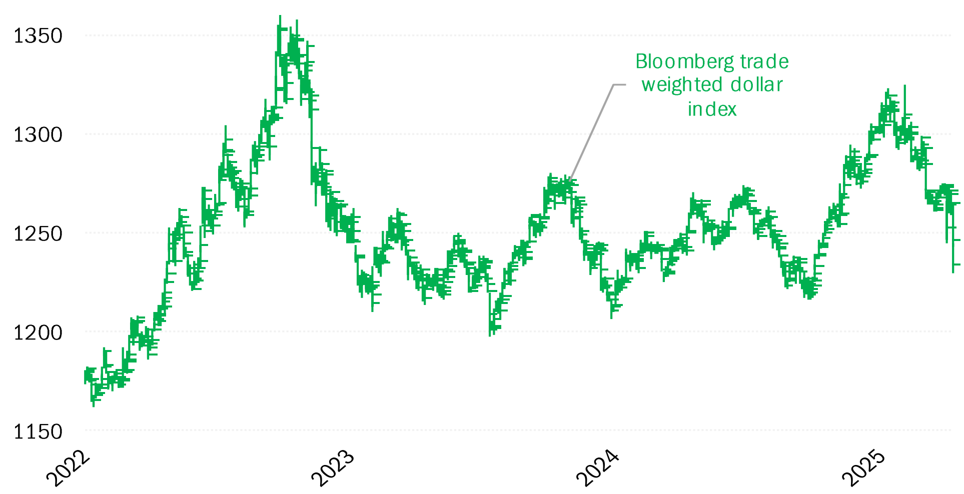
Trade-weighted US dollar (daily, from 2002)



Source: Bloomberg, TrendMacro calculations

terms much more serious and persuasive than Miran's (see ["Video: TrendMacro conversation with Michael Pettis on the risk to the US dollar losing reserve currency status"]() August 27, 2024).

- We've criticized Miran and his manifesto, for such extremist suggestions as selling all the gold in Fort Knox in order to devalue the dollar, or a "Mar-a-Lago Accord" that would forcibly exchange foreign-owned Treasury coupon bonds for 100-year zeroes (see ["How Much Do Tariffs Matter?"]() January 28, 2025).
- In the Q-and-A following the speech, Miran did try to distance himself from the manifesto. He said, in part:

> "It's not important. … It doesn't reflect administration policy. Uh, lots of people have speculated that we're secretly following, um, you know, sort of some, some policy path laid out in that, in that document. Nothing could be further from the truth… that piece really aims to provide a recipe book, right? …Uh, I'm not the chef. There's one chef and that's the president, and he decides what he's gonna make."

- Nevertheless, the speech was very much on-theme with the essence of the manifesto – that the US dollar's role as the world's reserve currency – and the US's provision of a global security umbrella – are "public goods" that are a "burden" for us to "provide." *His speech is a call for burden-sharing*.
- There is much that is serious and worthy about his point of view. Yet *he taints his argument with deceptive and manipulative use of key terms*.
- *The US dollar is the world's reserve currency, but the US does not "provide" it*. We sell it to other nations for valuable consideration, receiving in exchange their goods and services. The "burden" is that other nations don't spend the dollars they receive on US goods and services. Or do they? Is not maintenance of a currency so

reliable that other nations want to hold it rather than spend it, itself a good or service that we provide? *Why is it a "public good"? It is simply an article of trade.*

- In some important sense, we wish other nations would buy other goods and services from us, which would arguably lead to higher employment, especially manufacturing employment. But we are already at full employment in the US economy. In the meantime, the fact that other nations don't spend those dollars, but rather saves them, means that the US is awash in foreign capital which we can use to make productive investments. If we fail to use that capital wisely, that's on us.
- As to the security umbrella element, we think Miran isn't wrong when he calls that a "public good" or cites the US "burden" to "provide" it. At the same time, it's far from clear what optimal burden-sharing would look like (and far from clear, despite the US's evident disproportionate defense spending, that we aren't there right now).
- From Miran's speech, here are what he considers to be the five key elements of burden sharing – while noting "There are many options."

> "First, other countries can accept tariffs on their exports to the United States without retaliation, providing revenue to the U.S. Treasury to finance public goods provision. Critically, retaliation will exacerbate rather than improve the distribution of burdens and make it even more difficult for us to finance global public goods."

- Tariffs are not taxes on "their exports." They are taxes on our imports from them. To be sure, ultimately other nations may effectively pay the tariffs, at least in part, through currency depreciation or price concessions (in the 2018-2019 tariff episode, China did (see "Will the Trump Tariffs Be Inflationary?" April 9, 2025). But Miran is sloppy to the point of deception by glossing over the point, getting you to "think past the sale" by focusing on the end, not the means, "to finance public goods." And again, we hardly see it as a "public good" to be "financed" to accept goods and services in exchange for financial claims. Indeed, it is our counterparty nations that are doing all the financing.

> "Second, they can stop unfair and harmful trading practices by opening their markets and buying more from America;"

- It would be a better world for all if they did. But we fail to see how doing so is a "burden" for them which they would contribute toward "burden sharing."

> "Third, they can boost defense spending and procurement from the U.S., buying more U.S.-made goods, and taking strain off our servicemembers and creating jobs here;"

- Fair enough. But again, we don't know (and Miran doesn't know) what the optimal sharing rule is.

"Fourth, they can invest in and install factories in America. They won't face tariffs if they make their stuff in this country;"

- But they are already investing in America by holding our currency and our bonds. We are perfectly free to use that capital to build factories ourselves.

Fifth, they could simply write checks to Treasury that help us finance global public goods.

- Ah, this is the scary one.
- He does not return to this in the speech and explain what he means by it. It can't mean indirectly paying US tariffs – that's his Number One idea. It isn't spending more on defense by buying US-made goods – that's Number Three.
- *We think it speaks to an intention to tax income from foreign holdings of Treasuries and perhaps other securities at the statutory limit of 30%*. Or at the least, Chinese holdings. This has already been hinted at in the America First Investment Policy published by the White House in late February, saying "we will review whether to suspend or terminate the 1984 United States-The People's Republic of China Income Tax Convention."
- Such a move would make Treasuries less attractive for foreign investors to hold, requiring a higher yield to make them indifferent. Foreign investors are only about 28% of the market – leaving 72% not requiring a higher yield. So it seems unlikely that yields could rise sufficiently to assure that foreign holders would not – gradually or suddenly – decide simply to get out.
- *Ideally for Miran, we think, this would spell the end of the dollar as the world's reserve currency by making it too expensive to hold*
- For decades an exodus by foreign Treasury holders has been a staple "black swan" worry in markets, driving yields higher and pitching the US into a debt/deficit/debt-service death spiral. But for Miran this is a feature, not a bug. In his conceptual universe, *China, say, would be left with nothing to do with dollars it no longer wishes to hold than to use them to buy US goods and services*. That would close our trade gap with China, and the repatriated dollars would enable US citizens to buy any Treasury bonds the Chinese no longer hold.

So where is Trump – Miran's "chef" – on all this? We know that Trump is barely acquainted with Miran and had not met him at the time he nominated him. Miran was picked by Treasury Secretary Scott Bessent, whom markets think of, perhaps overoptimistically, as the voice of reason in the White House economic team.

- *On Friday, Trump said he'd fold talks about potential US troop reduction in Europe and Asia into trade negotiations*. As a

> technique, this is classic Trump – getting as many elements as possible into a negotiation in order to expand the solution space. *But what he is calling a "package deal" speaks to a broader theme: Miran's core idea of integrating trade and security in the context of "burden sharing."*

For all the tumult and the potential tumult, we remain somewhat awestruck by how mild the reaction in markets has been, and how little objective macroeconomic evidence there is for impending recession. We do note that, over the last week as earnings season has just barely begun, our favorite business cycle indicator – 365 days-ahead S&P 500 forward earnings – has ever-so-slightly fallen, having recovered from a small swoon that began in late January (see "The Other Trump Effect: Uncertainty" February 25, 2025). We haven't pulled the trigger on a recession call (see "Video: What you're not hearing about how tariffs are taxes -- and big new tariffs are big tax hikes" April 8, 2025). We remain on high alert.

Bottom line

The US equity risk premium has expanded somewhat as stocks have fallen and long-term bond yields have risen. But it is still very narrow, and ERPs have risen everywhere else in the world, too. Last week's rise in bond yields and fall in the US dollar began with Miran's first public speech since Senate approval as White House CEA chair. He tried to walk back the specifics of his radical November manifesto, but the speech still echoes its major theme: burden sharing by other nations, to compensate the US for providing the world's reserve currency and defense umbrella. Trump said Friday he is going to fold defense spending into trade negotiations. One particularly alarming part of the speech hints at taxation of foreign holdings of Treasury securities to incentive their sale, and the subsequent purchase of US goods and services. This could trigger the demise of the US dollar as world's reserve currency, which is Miran's ultimate objective. For all these risks, we don't have the evidence to make a recession call at this time. We are on high alert.