Yardeni Research

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Morning Briefing

On US Treasuries, The Big Beauty & S&P 500 Earnings

Check out the accompanying chart collection.

Executive Summary: The headlines were wrong: Global investors in US Treasury bonds didn't beat a hasty retreat when Moody's downgraded the US's debt rating. A "Liz Truss Moment" it wasn't. Asian investors and policymakers already knew what Moody's had to say, William reports. So global demand for US dollars remains intact, though the dollar does face risks. … Also: Melissa shares her analysis of Trump's tax-cut bill, which carries a hefty price tag. … And: Joe recaps data on which way the winds of industry analysts' net estimate revisions have been blowing (hint: It's not north).

US Bonds: Why 'Selling America' Trade Flopped. It's never good when "#LizTrussMoment" is trending on social media. It's even worse when the subject of debt-crisis chatter is the world's biggest economy. Unsurprisingly, last week's decision by Moody's to yank away the US's long-standing AAA rating has Asian policymakers and investors in a whirl.

Asia is home to many of the top central bank holders of US Treasury securities—including Japan and China—with *$2.5 trillion-plus* of exposure. It's also as dollarized a region as you'll find anywhere, highly reliant on exports to the US for growth.

Yet what's most remarkable about Moody's May 16 downgrade to Aa1 status is that it didn't trigger global investors to "sell America," as the Liz Truss hashtag suggests. The rise in 30-year yields *toward 5.00%* aside, there's no sign of turmoil remotely like that of the short-lived 2022 Truss premiership in the UK, when *unfunded tax cuts* cratered the gilt market.

Let's explore why no one is asking whether a *head of lettuce* might outlast US Treasury bonds:

(1) *The Moody's call is backwards-looking*. In Asia, the US carrying a $36 trillion debt burden is news to exactly no one. Neither is the fact that, as Moody's stressed, interest-

payment ratios are at “levels that are significantly higher than similarly rated sovereigns.”

In a LinkedIn post, Morningstar’s Dave Sekera calls the downgrade “*largely symbolic*.” Bond market signals, he adds, “appear to be more indicative of market movement looking for a headline than a headline moving the market.”

Also, the feel-good effect over President Donald Trump’s U-turn on tariffs appeared to drown out concerns about Washington’s fiscal trajectory. Asian officials, meanwhile, notice that Trump is suddenly going after *Bruce Springsteen* and *Beyoncé* a lot harder than he is Federal Reserve Chair Jerome Powell.

(2) *Strong US job market*. For all the handwringing about the US economy’s *shrinking 0.3%* y/y during Q1, employment remains strong. And with Trump throttling back his trade war, Asian investors aren’t fleeing US assets as feared. Case in point: The US dollar is *down all of 0.8%* since Friday.

Also, global currency alternatives are in short supply. Sure, cases can be made that the euro, yen, pound, and Chinese yuan might grab market share. But from the most liquid of these (the euro and yen) to the least (the yuan), none has the deep capital markets or investor trust to dethrone the greenback.

(3) *Not out of the woods yet?* As Ray Dalio of Bridgewater Associates warns via *social media platform X*, the risk to Treasuries may be greater than Moody’s thinks. US credit ratings “don’t include the greater risk that the countries in debt will print money to pay their debts.”

In Asia, there are indeed rumblings of potential sales to come. *Bloomberg reports* that Hong Kong pension managers might be obliged to sell now that Treasuries are sub-AAA. This raises questions about how the city’s $166 billion Mandatory Provident Fund system proceeds from here.

For now, though, most in the region featuring many of the biggest holders of Treasuries are saying “no” to the “sell America” trade. And saying “hold the lettuce” analogies.

US Dollar: Risks Still Abound. Notwithstanding the dollar’s resilience in recent days, it does face risks. Let’s look at the most immediate:

(1) *Trump going tariff wild again*. Odds aren’t great that Chinese leader Xi Jinping is in a

giving mood on concessions. No doubt, Trump is annoyed by the popular narrative that he caved. Might he fight back with even higher import taxes, provoking the Bond Vigilantes (as well as the Stock Vigilantes and Dollar Vigilantes) anew?

There's the risk of a Truss-style tax-cut blunder. Over the weekend, Treasury Secretary Scott Bessent doubled down on the very policies that worry Moody's. This includes a *tax cut* expected to add *$4 trillion*—roughly the equivalent of Japan's annual GDP—to the federal primary debt over the next decade. Some, but not all, of the debt hit will be offset by spending cuts, as discussed below.

(2) *Getting Fed up*. Arguably, nothing would trigger the "avalanche" of dollar selling of which economist Stephen Jen, founder of Eurizon SLJ Capital, *warns* faster than Trump diluting the Fed's independence. In Asia, investors and policymakers often care more about Fed rate decisions than they do about what their own monetary authorities are up to.

US Fiscal Policy I: The 'One Big Beautiful Bill' Totes a Big Ugly Tab. Moody's downgrade of US government debt after the markets closed on Friday has been rattling the bond markets (*Fig. 1*). This week, Trump's "big, beautiful" tax bill (his words) added another thorn in bond investors' sides.

Republicans are teeing up a fresh round of tax and spending cuts under a bill that's making its way to President Trump's desk, likely before the fireworks begin on July 4. *According* to the *WSJ*, the House is expected to pass the bill this week with its narrow majority, just ahead of the Memorial Day break.

Frankly, we're underwhelmed. This looks more like an obligatory extension of the 2017 Tax Cuts and Jobs Act (TCJA) than a bold new reform, as we've *discussed* before. Investors presume that the 2017 tax cuts won't expire, so much of this bill's revenue impact is baked into market expectations already. If it fails, the financial markets won't be happy. But if it passes—well, that might be just as problematic.

Why? Because budget deficits matter. That's especially so when they lead to higher interest rates, higher bond yields, and potentially higher inflation. We suspect the Bond Vigilantes already anticipate this, as Dr Ed *observed* on Monday.

The legislation proposes cuts to Medicaid as a partial offset for the revenue losses—a politically controversial idea. While we don't view the proposed changes as structurally transformative, the Medicaid work requirements could be a speed bump on the bill's road to passage.

Here's where the bill currently stands:

(1) *Deficit math*. According to the Tax Foundation, the House bill would reduce federal tax revenues by $4.1 trillion from 2025 to 2034—before accounting for macroeconomic effects. After factoring in growth, the hit drops to $3.3 trillion. These numbers are derived from the bill *text* and Joint Committee on Taxation estimates reviewed by the House Ways and Means Committee on May 12, right before markup and passage on May 13.

The bill fits within the House budget resolution, which allows for up to $4.5 trillion in deficit increases over a decade, provided that $1.7 trillion in spending cuts are enacted. That's the reconciliation trade-off.

(2) *Medicaid work rules.* Republicans are *proposing* national work requirements for Medicaid eligibility. Adults aged 19–55 would need to work, volunteer, or be in school to maintain coverage—unless disabled. Realistically, this would trim the number of Medicaid recipients.

While Republicans argue that the requirements promote self-sufficiency, Democrats view them as punitive and risky. Even within the GOP, some lawmakers are concerned that the reforms don't go far enough in overhauling Medicaid's structure.

(3) *Debt reckoning.* Federal debt held by the public relative to GDP is nearing 100%. If current laws remain unchanged, we're looking at pushing the debt-to-GDP ratio to a record 117% by 2035, according to Congressional Budget Office data (*Fig. 2*).

That's before layering on the tax bill's impact. Even with the Tax Foundation's growth-adjusted $3.3 trillion estimate and the offsetting spending cuts, the bill still adds fuel to the fiscal fire. And should lawmakers later extend provisions for individuals currently set to expire in 2028—like the expanded child tax credit and higher standard deduction—another *$1.6 trillion* could be tacked onto the debt, per the Committee for a Responsible Federal Budget.

US Fiscal Policy II: The Big Bill's Big Five. Trump 2.0's tax and spending bill—now moving swiftly through Congress—packs a fiscal punch. The *Tax Foundation* estimates a revenue loss (before accounting for growth or spending cuts) of $4.1 trillion over the next decade (2025–34), with just a handful of tax provisions responsible for most of that hit

(*Table 1*).

Lower-income families get some lift from deductions and credits but lose out on exemptions. Middle-class households are the primary beneficiaries thanks to rate cuts and the bigger standard deduction. High earners see a mix of gains and offsets. In addition to the immediate revenue impact of the tax changes, all household budgets will be affected if the tax bill results in fiscal stress and higher interest rates.

Here are the bill's five key changes, three cuts and two offsets; each exceeds $500 billion and reshape the burden across income groups:

(1) The three big giveaways:

- *Lower tax rates & expanded brackets* (-$2.75 trillion): This is the bill's biggest cut, locking in the 2017 TCJA's lower rates and wider brackets. It primarily benefits middle-income taxpayers, who face the steepest marginal rates.
- *Standard deduction expansion* (-$1.23 trillion): The larger standard deduction simplifies filing and lowers taxes for the roughly 90% of filers who don't itemize, a boon for middle-income households.
- *AMT exemption hike* (-$1.13 trillion): This disproportionately helps high-income households in high-tax states. The Alternative Minimum Tax hits wealthier taxpayers, and lifting its threshold offers them a meaningful break.

(2) The two big takebacks:

- *Repeal of personal exemptions* (+$1.98 trillion): Scrapping personal exemptions hits large households the hardest.
- *SALT deduction cap* (+$603 billion): The $30,000 cap on state and local tax deductions stays in place, phasing down for higher earners. This is a targeted hike on wealthy itemizers in high-tax states.

Strategy: Analysts' Faith in Company Prospects Still Waning. This week, LSEG released its May snapshot of the monthly consensus net earnings estimate revision (NERI) activity over the past month. The revenues and earnings forecasts are captured in our *S&P 500 NRRI & NERI* report, where we index the analysts' estimate revisions activity by the number of upward revisions less the number of downward ones, expressed as a percentage of total estimates. Our past-three-months lens allows us to see an entire quarterly reporting cycle, so it's moot that analysts' tendency to revise their estimates differs at different points in the cycle.

“Yikes!” was Joe’s reaction to the May data: It was worst NERI activity in more than two years. Here are his takeaways:

(1) *Tariff uncertainty takes S&P 500 NERI down to a 28-month low.* The S&P 500’s NERI index was negative in May for an eighth straight month (*Fig. 3*). That’s the longest negative NERI streak since May 2023, when it was negative for 10 months on the heels of the Magnificent-7’s year of cost-cutting. NERI fell to a 28-month low of -7.8% in May from -5.7% in April. (A zero reading indicates that an equal number of estimates were raised as were lowered over the past three months.)

Also underscoring the breadth of downward revisions, May’s -7.8% ranks in the bottom-fifth of its readings since March 1985, when the data were first calculated, and is well below the average reading of -1.9% seen since.

(2) *Positive NERI club nearly empty.* Just one S&P 500 sector had a positive NERI reading in May, the lowest count in 15 months. NERI was barely positive for the Utilities sector, and Financials’ turned negative m/m for the first time in 15 months (*Fig. 4* and *Fig. 5*).

Financials’ latest reading was still third best in class among the S&P 500’s 11 sectors but is down from a three-year high of 8.0% in February. Utilities’ was positive for a 12th straight month in May, but barely so at 0.01%, and is now down from a two-year high of 2.6% in November.

Among the poorer performing sectors, Consumer Staples’ NERI dropped to a 16-year low in May, followed by Industrials’ at a 58-month low (*Fig. 6* and *Fig. 7*).

In fact, eight of the 11 sectors’ NERIs were at their lowest levels in many months during May: Utilities (0.0%, 12-month low), Communication Services (-1.6, 16-month low), Financials (-3.6, 16-month low), Information Technology (-5.0, 27-month low), Real Estate (-7.8, 28-month low), S&P 500 (-7.8, 28-month low), Consumer Discretionary (-11.0, 30-month low), Industrials (-12.3, 58-month low), and Consumer Staples (-14.5, 16-year low).

(3) *Forward earnings not as bad as NERI suggests.* The downward estimate revisions, while widespread, are relatively minor. Estimates are only being nickeled and dimed lower, not slashed deeply. Indeed, forward earnings remains close to record highs for the S&P 500 and nine of its 11 sectors (*Fig. 8*). The S&P 500’s forward EPS is down just 1.1% from its

record high. Among the 11 sectors, only two deep cyclicals are lagging considerably: Energy and Materials.

Calendars

US: Wed: MBA Mortgage Applications. **Thurs:** Initial Claims 227k; M-PMI & NM-PMI Flash Estimates 49.9 & 50.7; Existing Home Sales 4.15mu; Kansas City Fed Manufacturing Index; Chicago Fed National Activity Index; Williams. (FXStreet estimates)

Global: Wed: UK Headline & Core CPI 3.3% & 3.6%y/y; Japan Core Machinery Orders -1.6%m/m, -2.2%y/y; ECB Financial Stability Review; Lane; Balz. **Thurs:** Germany Ifo Business Climate Index, Headline, Current Situation & Expectations 87.5, 87.7, 88.3; Eurozone PMI & NM-PMI Flash Estimates 49.3 & 50.6; UK M-PMI & NM-PMI Flash Estimates 46.2 & 50.0; UK Gfk Consumer Confidence -22; UK CBI Industrial Trend Orders -25; ECB Publishes Account of Monetary Policy Meeting; De Guindos; Elderson; Nagel; Pill; Breeden; Dhringa. (FXStreet estimates)

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