



Myrmikan Research

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The 3 3 3 Plan

“It’s morning again in America” was the famous opening line of Reagan’s 1984 campaign commercial. Normal Americans felt similarly when Trump regained office. Biden had humiliated the U.S. with the Saigon-like collapse of Kabul, was toothless against Houthi piracy, canceled energy pipeline projects, banned drilling for oil, spent trillions of dollars on the green energy scam, then hundreds of billions on the war in the Ukraine, causing the cost of living to spike, with inflation hitting 1970s levels. He promoted transgender ideology, enforced mass injections of experimental medicines, flooded the country with third-world immigrants, threatened to jail oil executives, criminally persecuted Republicans, even raided Trump’s house. Republicans wanted vengeance. Independents just wanted their country back.

Trump arrived ready to lead, unlike for his first term. He was going to end the war in the Ukraine in the first 24 hours of his presidency. He had first entered into politics in order to condemn the Bush Middle East adventures, guaranteeing that the U.S. would spend its treasure on itself, not on foreign wars. He was going to rebuild American industry, bring back blue collar jobs, chase out third-world labor.

Trump’s economic plan required lower interest rates. Scott Bessent, his Treasury Secretary, told reporters: “The president wants lower rates.” But, “he is not calling for the Fed to lower rates.” Instead: “He and I are focused on the 10-year Treasury and what is the yield of that.”

Bessent understands that the overnight federal funds rate sets the cost of margin loans, of swap agreements, of repo transactions, it is the fuel of Wall Street. The 10-year rate sets the cost of capital for housing, for asset construction, for real economic growth, and for servicing the federal debt.

Bessent had a plan to get long rates lower: a budget deficit of 3 percent of GDP, real GDP growth of 3 percent, and increasing domestic oil production by 3 million barrels per day to bring down all prices. He understood that “President Trump got elected because of [Biden’s] affordability crisis. What is [Trump] going to do? Real wage growth for working Americans is the best way to fix this.”

But the 3 3 3 Plan is not working. The budget deficit is still 5.8% of GDP. The latest real GDP growth figure is 2.1%. Domestic oil production has increased from 13.5 million bbl/day only to 13.8 million. And the 10-year rate is surging higher.

For the deficit, Bessent has begged the market to look past the present numbers: “One of the things that is temporary that is influencing the deficit has been these tariff refunds, and we won’t have to do that again, and [we are] reimplementing the

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same level of tariffs.... The other big item in the budget that we're seeing is the hit that we're taking to revenues from the immediate expensing of factories and equipment and farm structures—that's not government spending, that is an investment in the future, and we're increasing the tax base...."

Trump's One Big Beautiful Bill Act allows businesses to deduct 100% of certain capital equipment, such as microchips, in the year that the investment was made, instead of amortizing the expense over years or decades. And, for a limited time, the full cost of nonresidential real estate construction dedicated toward production is also 100% deductible immediately, instead of over thirty-nine years. The exemption applies only to property for which construction begins by January 1, 2029 and is placed in service before January 1, 2031, which is why the A.I. datacenter buildout is so manic among companies with enormous cash flows, the ones which are the largest tax payers, who save the most through this tax haven.

Presumably, if the market agreed that these investments will produce significant cash flow, the rising deficit figures would not cause the market to demand a higher yield on long-term U.S. debt. But if, as we argued in our August letter, A.I. data centers will not add to productivity over any reasonable timeframe, will not have pricing power, will not produce significant cash flows or tax revenue, then today's missing tax revenue is simply dead weight loss.

In addition to deficits driving up Treasury bond rates, Bessent blames competition from A.I. bonds: "We are also seeing big corporate issuance, and a lot of that corporate issuance is almost yield agnostic because the build-out for A.I., the returns on that, the companies believe they are going to be so high, they don't really care what they are paying."

He is half right—it is true that investors do not care what they are paying, but that is because the marginal buyers are PE-captured life insurance companies (as also discussed in our August letter). Life insurance companies are uniquely positioned to purchase long-term Treasuries because they do not care about real returns, they just need a nominal return high enough to fulfill the insurance contract obligation. But now their PE overlords are forcing them to disgorge Treasuries in order to buy the A.I. debt that the PE firms are issuing.

The figures are staggering. The amount of debt tied to artificial intelligence has ballooned past \$1.2 trillion, or 15% of the investment-grade market. Goldman Sachs estimates that just the five hyperscalers will issue another \$420 billion of debt in 2027. According to estimates by Michael Burry, the hyperscalers are also now carrying more than \$3 trillion of off-balance sheet liabilities.

This wall of financial capital, much of which needs to be spent completely before 2031 to claim the depreciation tax benefit, also affects Bessent's second target, GDP growth, which illustrates the problem with GDP—it is a measure of activity, not wealth creation. If we are correct that Solow's paradox will push real productivity gains of A.I. into the distant future, much of this debt will default: the financial capital will not flood back into Treasury bonds to lower yields, it will simply cease to exist, along with the value of the data centers it financed. If the real *GDP* growth figure is 2.1% with the A.I. buildout, it means the figure that represents real *productivity* growth—or, perhaps more simply, taxable growth—is even further away from Bessent's 3% target.

Finally, over the first half of Trump's term, domestic oil production has increased only by 10% of Bessent's target. And now war is the only story that is relevant to

energy prices. Oil prices have increased 56%, from \$57/bbl at the beginning of the year to \$89/bbl; gasoline prices have jumped 89% because of underinvestment in refineries in the U.S., the shuttering of capacity in Europe from climate paranoia, and the destruction of capacity in Russia by Ukrainian drones. The price increase of gas is so damaging politically that Trump briefly threatened to ban diesel exports in an attempt to lower domestic prices.

Trump hopes voters will forgive the shock to their wallets: “For you to pay a tiny little bit more for your gasoline, just remember, you’re doing it so that a very evil country cannot have—a country, really, it’s the number one state-sponsor of terror in the world—we don’t want to have them have a nuclear weapon.” Biden said just about the same thing during his Ukraine war: “We’re banning all imports of Russian oil and gas and energy.... Americans have rallied to support the Ukrainian people and made it clear we will not be part of subsidizing Putin’s war.... I said I would level with the American people from the beginning. And when I first spoke to this, I said defending freedom is going to cost—it’s going to cost us as well, in the United States.”

It also cost Kamala Harris the presidency, as Trump’s war will cost him control of Congress and get him, his family, his supporters investigated, impeached, perhaps imprisoned. One thing higher energy prices and higher war spending are not going to do is bring down interest rates.

With the 3 3 3 Plan in shambles, Bessent tried direct action against the bond market. In August, under the cover of summer illiquidity, he used funds in the Treasury General Account to buy back long-term bonds to club yields lower. The action makes a kind of sense: some of these thirty-year bonds were issued with yields as low as 1%; now that the 30-year yield has increased to 5.7%, the nominal prices of these bonds have collapsed by upwards of 50%.¹ In other words, Bessent can spend \$1 billion to buy back bonds that have a face value of \$2 billion and thereby shrink the national debt by \$1 billion.

Note, however, that whereas the Treasury was paying a 1% coupon on the \$2 billion, it now must pay 4–5% on the \$1 billion of newly issued debt (depending on the term of new issuance), meaning the deficit increases by 2–3% on the \$1 billion. And the average maturity of U.S. debt decreases as 30-year bonds are replaced by short-term bills, making federal government funding more sensitive to short rates.

It was Yellen who figured out that over issuing bills would juice the markets because bills function as reserves in the banking system. Plus, more bills meant fewer long-term bonds, and fewer supply increased their prices to lower their yields. As a private citizen, Bessent had criticized this practice, dubbed Activist Treasury Issuance by Nouriel Roubini, as a kind of Treasury-sponsored QE. But then Bessent as government official has not only continued Yellen’s strategy, he is now actively intervening to twist the Treasury curve further.

The problem is that it isn’t working. Bessent kept promising greater and greater scales of intervention in an effort to entice traders to front run him and do his work for him—to make the point clear, he boasted: “I am the house now,”—but long-term Treasury prices have continued their decline, with yields reaching the highest in decades.

And then in mid-September, the Fed raised the overnight fed funds rate. Warsh was supposed to lower rates. Trump had told supporters: “I think we’re going to do something that’s really spectacular.... You know, every [percentage] point is six

¹ See, for example: <https://www.bondsupermart.com/bsm/bond-factsheet/US912810SN90>

hundred billion dollars; all he has to do—if we went down two points, we don't have a deficit any more. And that's without cutting, and it's just a paper charge." And Warsh had applied for the job by writing: "AI will be a significant disinflationary force," justifying interest rate cuts.

But CPI is increasing again as energy costs begin to affect—with varying lags—the price of every good and service in the economy. Trump's main economic advisor, Peter Navarro, argues that the Fed is not supposed to hike rates into a supply shock: The point of rate hikes is to take cash out of the system to prevent prices from increasing. The increase in oil prices is already serving that function, so to raise rates is to hit the economy twice. Navarro's narrow point may not be wrong, but financial conditions must still be far too loose if stocks are able to continue hitting all-time highs and Wall Street is able to market A.I. debt as investment grade.

The real issue the Fed faced in its September meeting was something else: reasonable minds differ on whether the Fed sets rates or follows them. On one hand, the 2-year rate, for example, is nothing more than the average-expected overnight rate over the ensuing two years (otherwise there would be an arbitrage). The Fed sets the overnight rate and, by extension, controls the 2-year and, in turn, the longer-term rates.

On the other hand, the Fed does not set rates with speeches, it does so with market actions or threats of actions. Before the September Fed meeting, the market had already priced in a quarter point hike. If the Fed had held rates steady, would fear of holding positions contrary to Fed policy have prompted traders to buy bonds on their own to put the fed funds rate back to unchanged? Or would the Fed have had to wade into the market and jam bond prices sufficiently higher to bring the yield down to target? How many bonds would the Fed have had to buy? The governors probably did not want to risk finding out the answer to these questions.

Another strong possibility is that FOMC members just hate Trump and want him to fail in the midterms. Let us remember the words of former president of the Federal Reserve Bank of New York William Dudley, words that were not overheard in some dark hallway, words he actually published in *Bloomberg*: "I understand and support Fed officials' desire to remain apolitical. But Trump's ongoing attacks on Powell and on the institution have made that untenable.... There's even an argument that the election itself falls within the Fed's purview. After all, Trump's reelection arguably presents a threat to the U.S. and global economy, to the Fed's independence and its ability to achieve its employment and inflation objectives." These words likely explain why Powell inexplicitly dropped interest rate by 50 basis points right before the 2024 election and they may help explain the current tightening.

Powell is no longer chairman, yet he remains on the committee until January 2028. Warsh may now be the face of the Fed, but Powell surely has more influence with his FOMC colleagues. And since Warsh does not control his committee, he is forced to vote with them—it would have been absurd for Warsh to have dissented from his own committee on his first vote as chairman. Trump admitted as much: "I'm relying on Kevin. But he has a very tough board.... I said 'You might as well vote with the board because it's not going to matter.'" So now the short-end of the yield curve is rising, the long-end is also rising, interest costs are going to continue to climb, worsening the deficit further.

Gold has been surprisingly sluggish in the face of the meltdown of the largest bond market the world has ever known. Even more perplexing is that the S&P 500 continues to make all-time highs. As the risk-free rate of return on USD increases, especially as dramatically as now, *ceteris paribus*, investors ought to take the marginal dollar out of equity markets and put it into debt markets—unless, of course, the market is anticipating an approaching inflationary inferno, but in that case gold would be multiples higher.

We avoid opining on short term market fluctuations, which are, in general, predictable accurately only to traders at money-center banks who see real-time liquidity flows. We would observe, however, that the stock market made an all-time high on October 9, 2007, even though the fed funds rate had moved from 1% in June of 2004 to 5.3% in July of 2007, undeterred by Bernanke's explicit warning that mortgage delinquency rates had risen sharply, despite the collapse of two internal Bear Stearns real estate funds, notwithstanding a run on Europe's second-largest bank's real estate funds. Stocks would crash by more than half over the ensuing eighteen months.

Trump is aware of the danger and is trying to shift the blame to Democrats. Three weeks before he assumed office, Trump tweeted: "I call it '1929' because the Democrats don't care what our Country may be forced into. In fact, they would prefer 'Depression' as long as it hurt the Republican Party." He hoped to play Roosevelt to Biden's Hoover: a sudden crisis would have allowed him to remake the political and financial foundations of the United States. But the bubble was too strong and kept inflating. Last Saturday, Trump again told reporters: "If the Democrats win, you will have an economic depression much like 1929." But no one will hold Congressional democrats responsible for a crash—the president's party always takes the blame.

In 2008 it was Republicans under Bush, ushering in a closet Marxist regime. In 1980 it was the Democrats who owned the collapse of the dollar, heralding the Reagan revolution. Before that Hoover to Roosevelt. The Republicans were routed after the Panic of 1873. The Panic of 1857 drove the Democrats from power in favor of the newly constituted Republican Party. The double panics of 1837 and 1839 ended Democrat Party dominance in favor of the Whig Party. Expecting voters to exonerate the party in power through a considered examination of the origins of the credit cycle is an overly optimistic view of human nature.

For all of Trump's flaws, we think history will be kinder to him than midterm voters will be. Trump was correct to encourage domestic capital investment, and distant reflection may concede that he did not design the financial system that allows PE bosses to pilfer capital from the prudent and earn fees deploying it into malinvestments.

Nor is the Iran war, in fact, a repeat of the Bush nation-building lunacy. The war can be interpreted as vassalage to Israel, as implementing the neocon policy of global dominance, as prophylactic against nuclear war, as revenge for the 1970s hostage humiliation, as a reestablishment of the imperial preference system, as hybrid warfare against China, in terms of the age-old conflict between civilization and piracy, even as an attempt to restore the Persian rule of Iran as a kind of modern crusade to roll back the Arab conquest. Trump himself has articulated clearly only the nuclear deterrent objective, leaving his constituents to argue over what other strategic imperatives, if any, are at work. The latter two are arguably causes worth fighting for, and history may judge the military and economic outcome as commentary on Western virility rather than imperialist folly.

Finally, Trump's heroic charge against the bureaucracy with DOGE was commendable—bureaucracy kills empires. But his failures threaten to return the uniparty to power, and the only difference between Democrats and mainstream Republicans is how fast they wish to submit America to the pathologies promoted by the Biden cultural arsonists.

Between stocks being supported by passive flows, a third of the S&P 500 being priced off A.I. malinvestment (the S&P 500 is up 13% year-to-date, while the median component is up only 3%), the soaring yield of A.I. debt along with Treasuries, the fact that (as UBS reports) investment outside technology has effectively been in recession for at least two years, a "1929" moment is coming. Will gold plunge with the market, as it did from March to November of 2008? Or as it did during COVID? On a closing basis, gold traded from \$1,687/oz on March 3, 2020 to \$1,480 on March 19, as the panic took hold. But investors had seen the movie before—they knew the Fed was going to print, and print big. Gold was above \$1,700 by mid-April.

It would make sense that sharply higher rates in the global reserve currency should pressure asset prices. But wherever short term liquidity pushes gold, in the long term gold measures solvency. And the U.S. government is insolvent. The higher yields rise, the more insolvent it becomes, and the more insolvency concerns should push yields higher. And the Fed will have to intervene when the debt markets start to collapse. And imagine how much worse it will be if the Democrats do wrest back power.



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