

The Yen Carry Trade Unwind

A Hidden Risk For Global Markets?

🕒 By Nico Tschanz, Head of Wealth Management at Dexbridge Capital

What Is the Carry Trade and Its Unwinding?

The Japanese yen carry trade is a long-standing strategy where investors borrow yen at ultra-low interest rates—often near 0% due to Japan's prolonged zero-rate policy—and invest in higher-yielding assets like U.S. Treasuries, tech stocks, or emerging market bonds. Profits come from the interest rate differential and a weakening yen, which makes loan repayments cheaper in foreign currency terms. In 2025, this trade is unraveling due to the Bank of Japan's (BoJ) unexpected rate hikes, triggering a broad market reaction. As the yen strengthens and investors sell off U.S. assets, currency, bond, and stock markets are feeling the pressure. With equities at record highs, a correction may follow—making diversification and vigilance essential.

What Does “Unwinding” Mean?

Unwinding occurs when the carry trade becomes unprofitable or risky, prompting investors to exit their positions. This typically happens when the BoJ raises interest rates, increasing borrowing costs, or when the yen appreciates, making loan repayments more expensive in foreign currency terms. Investors respond by selling their foreign assets—such as U.S. bonds or stocks—to buy yen and repay their loans. This process can trigger an Unwind Chain Reaction, where initial asset sales depress prices, prompting further sales to cover losses and amplifying market volatility. For example, selling U.S. Treasuries raises yields, which can pressure stock valuations, and eventually leading to broader market sell-offs.

A Real Example: The 2025 BoJ Rate Hike

On January 23, 2025, the BoJ raised its benchmark interest rate from 0.25% to 0.5%, the highest level since the 2008 global financial crisis, in response to rising inflation pressures. This marked a significant turning point in Japan's long-standing ultra-loose monetary policy and surprised global markets. More recently, in May, Japan's 40-year government bonds yields hit an all-time high of 3.68% — almost 70 basis points higher so far this year. Yields on 30-year government debt are up more than 60 basis points this year, also not too far from all-time highs, while for 20-year debt they are up over 50 basis points.

How Does the Unwinding Affect Global Markets?

USD/Yen Exchange Rate

The unwind drives demand for yen as investors sell foreign assets to repay loans, strengthening the yen and weakening the U.S. dollar. In 2025, the yen's rise increased the cost of repaying, squeezing carry trade profits. Speculators placed record bets on further yen appreciation, with net long positions in yen futures reaching 96,000 contracts (\$8 billion) in February 2025, reflecting expectations of additional BoJ rate hikes. This volatility in the USD/Yen rate disrupts currency markets, impacting investors with unhedged foreign currency exposures.

Bond Markets

The unwind significantly affects bond markets, particularly U.S. Treasuries. Japanese investors, holding over \$1.3 trillion in U.S. debt—much of it funded by carry trade loans—sold approximately \$100 billion in Treasuries in Q1 2025, reducing demand and driving the 10-year Treasury yield up. Japanese bond yields also climbed, with 10-year JGBs reaching 1.51%, drawing capital back home and further unsettling global bond markets.

Equity Markets

The unwind pressures equity markets, especially U.S. tech stocks, which have driven the 2025 rally. With the S&P 500 trading at 28x earnings (at the time of writing) and the Nasdaq at all-time highs, selling to cover yen loans could trigger a correction. A similar event in August 2024 saw the S&P Global Broad Market Index drop 3.3% in a single day due to an earlier unwind, with the yen appreciating 10% against the dollar. In 2025, the unwind's impact is amplified by high valuations and narrow market leadership, with the top seven S&P 500 stocks accounting for 60% of gains, making markets vulnerable to a broader sell-off.

Risks and Impacts for Investors and Portfolios

Global markets remain fragile in June 2025, with stretched equity valuations and concentrated gains in a handful of tech giants. A rapid unwind of the yen carry trade—driven by rising Japanese rates and a stronger yen—could trigger sharp volatility. Hedge funds and leveraged investors may face forced liquidations, as seen during the August 2024 sell-off when the VIX spiked dramatically. Portfolios heavily exposed to U.S. growth stocks or emerging markets are especially vulnerable. Yen strength erodes dollar-based returns, and rising Treasury yields can pressure stock prices, potentially leading to a 5–10% equity correction and testing portfolio resilience

What Investors Can Do To Navigate This Risk:

Spread Out: Shift capital to less volatile assets like commodities (e.g., Gold/XAU up 27% YTD) or **Structured Products** with guaranteed coupons, which are less exposed to carry trade flows and generate steady income. **Hedge:** Use currency hedges (e.g., yen futures) or options to protect against yen appreciation or equity declines. **Stay Alert:** Monitor BoJ policy announcements and USD/Yen movements, as these are early indicators of further unwinding.

Why This Matters Today

The yen carry trade unwind, ignited by the BoJ's January 2025 rate hike, is a hidden threat lurking behind the market's optimistic facade in June 2025. With the yen strengthening and investors selling \$100 billion in U.S. assets, the Unwind Chain Reaction is already disrupting bonds and stocks. As equity markets sit at all-time highs with lofty valuations, this could be the spark that triggers a broader correction. Investors must act now to ensure their portfolios are resilient against this unfolding risk.

Wishing you a refreshing and relaxing start to summer.

Warm Regards,

Nico

