SMITH AFFILIATED CAPITAL

Research Commentary

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# GENIUS Act: A New Era for Stablecoins — What It Means for Fixed Income Investors

On July 21, 2025, President Trump signed the **GENIUS Act**—short for *Guiding and Establishing National Innovation for U.S. Stablecoins Act*—into law. While headlines largely focused on the impact to the crypto industry, the more lasting and consequential effects may be felt in the U.S. fixed income markets, especially at the front end of the Treasury curve.

The GENIUS Act is the first comprehensive federal legislation to regulate dollar-pegged stablecoins—digital tokens backed 1:1 by U.S. dollars and widely used for payments, remittances, and decentralized finance. With this law, the U.S. government is not only acknowledging stablecoins as legitimate payment instruments but is also placing them under formal regulatory supervision. Stablecoin issuers such as Circle (USDC) and Tether (USDT) must now become registered entities called Permitted Payment Stablecoin Issuers, subject to reserve, audit, and consumer protection standards.

To qualify, issuers must back all circulating stablecoins with high-quality liquid assets, including U.S. Treasury bills, short-dated Treasury Notes, cash deposits in FDIC-insured banks, and Overnight Reverse Repurchase Agreements (ON RRPs) with the Federal Reserve. No leverage, rehypothecation, or riskier instruments like corporate bonds or asset-backed securities are permitted.

The timing of the legislation coincided with a sharp rally in the crypto markets. According to CoinGecko, the global crypto market cap reached $4.01 trillion the day after the Act was signed, reflecting broad optimism around regulatory clarity. But beneath this enthusiasm lies a structural shift that will likely affect how the U.S. government finances its growing debt and how institutional investors—particularly in fixed income—navigate interest rate and liquidity risk.

The most immediate consequence of the GENIUS Act is the emergence of stablecoin issuers as permanent and significant buyers of short-term Treasury instruments. As the market capitalization of stablecoins grows, so too will the demand for reserve assets that meet the Act's strict liquidity requirements. If stablecoin circulation reaches $300 billion in the next few years, and half of those reserves are held in Treasury bills, that represents $150 billion in incremental demand for front-end U.S. government debt. For context, this is a demand pool on par with the largest money market funds in the country.

This additional demand has the potential to compress yields at the short end of the curve, distorting traditional relationships between policy rates and market pricing. Investors may see reduced compensation for interest rate risk in Treasury bills and short notes, and the familiar upward-sloping curve in the 0–2-year space may flatten further. That could diminish roll-down strategies and challenge conventional laddering approaches.

At the same time, this demand provides a new backstop for Treasury issuance. With the national debt surpassing $36 trillion and the Treasury Department relying heavily on bill auctions to manage its financing needs, stablecoin reserves offer a welcome and consistent buyer base. Yet this also creates a quiet dependency: the federal government may increasingly rely on private sector-issued digital dollars to support public debt issuance.

Meanwhile, the Federal Reserve faces a new challenge in managing liquidity and policy transmission. Traditional tools like ON RRPs and interest on reserve balances may become less effective if they are competing with billions of private stablecoin flows influencing the same instruments. The Fed's influence at the front end of the curve may weaken—not due to changes in its policy stance, but because of shifts in market structure driven by regulatory mandates.

For fixed income investors, especially those managing short-duration strategies or targeting low-volatility income, this evolving landscape raises both opportunities and risks. While the added demand for T-bills may provide liquidity and stability, it could also reduce yield potential and alter beta exposure. That's why, in this environment, active management becomes essential.

Passive strategies, which often follow rigid maturity bands or index allocations, may no longer be able to adapt quickly enough to take advantage of dislocations or changing curve dynamics. Active managers can adjust exposures across Treasury maturities, rotate between government and high-grade corporate paper, and manage duration relative to evolving yield relationships. They can also respond more nimbly to changes in the regulatory definition of "liquid assets"—a moving target that could one day include agency debt or restrict ON RRP access. In short, active fixed income management allows investors to stay ahead of structural shifts rather than simply ride them out.

The GENIUS Act may be the most crypto-forward piece of financial legislation to date, but its effects extend far beyond digital wallets. By reshaping how reserve assets are defined, accessed, and absorbed, it has introduced a new player into the Treasury market—and one that is indifferent to interest rate direction, focused solely on liquidity and compliance.

We are monitoring this transformation closely, including two companion bills—the Clarity Act and the Digital Asset Market Structure Act—which are still awaiting Senate approval. These measures will further define how digital assets are issued, regulated, and integrated into broader markets.

In the meantime, we continue to position portfolios to benefit from relative value opportunities along the curve while maintaining flexibility in the face of shifting liquidity trends. As this new era unfolds, our focus remains on preserving capital, managing risk, and seeking income in a market where public policy, private innovation, and macro forces are increasingly intertwined.

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