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THE PREHN INSTITUTE | RESEARCH

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The Domino Effect

BOTTOM LINE:

Part I — The First Domino: When Allies Ask for Lifelines The UAE's Dollar Ultimatum Understanding Treasury Bonds The Forced Selling Wave Gold Overtakes Treasuries: A Historic Shift Part II — The Second Domino: Why Interest Rates Keep Rising How Bond Dumping Hits Your Wallet The $1 Trillion Interest Time Bomb Amend, Extend, and Pretend Part III — The Third Domino: The Dollar's Slow-Motion Demotion

FELIX PREHN

Economist and former investment banker
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REPORT SCOPE

Plain-English explanation of the video.

RATING

None

PRICE TARGET

None

About Felix Nikolas Prehn and The Prehn Institute

Felix Nikolas Prehn

Felix Nikolas Prehn is an economist and former investment banker. He writes and lectures on how the financial markets work, with a focus on how ordinary savers can protect what they have built.

The Prehn Institute

Felix Nikolas Prehn is the founder of The Prehn Institute. It publishes research on the financial markets and provides instruction in how they work. It gives no financial advice.

It takes no sponsorships and no endorsements, ever. So its work answers to its readers and to nobody else.

Our work online

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Contents

Part IV — The Domino Framework: Protect & Profit 4

The UAE's Dollar Ultimatum 5

How Bond Dumping Hits Your Wallet 7

Amend, Extend, and Pretend 9

Three Forces Driving the Dollar Down 11

Risk Assessment Matrix 13

Sources & disclosures 14

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THE CREDIT DOWNGRADE NOBODY CAN IGNORE

Part IV — The Domino Framework: Protect & Profit

Step 1: OWN What Benefits From the Chaos

Step 2: AVOID What Gets Crushed

Step 3: FOLLOW the Trend, Not the Headlines

Appendix

Key Data Tables & Risk Matrix

Sources & Citations

May 2026

GLOBAL MACRO · FIXED INCOME · COMMODITIES · GEOPOLITICS

THE DOMINO EFFECT: HOW AMERICA'S

DEBT CRISIS HITS YOUR PORTFOLIO

A chain reaction from the Strait of Hormuz to your mortgage payment — and what to do about it

BOTTOM LINE:

A cascading chain of geopolitical and fiscal events is reshaping the global financial order in ways that directly affect American investors. The closure of the Strait of Hormuz triggered forced Treasury selling by foreign central banks. That selling is pushing interest rates higher — despite the Federal Reserve's best efforts. Higher rates and eroding confidence are weakening the US dollar, while gold has overtaken US Treasuries in global central bank reserves for the first time since the mid-1990s. This is not a banking crisis. It is a TRUST CRISIS — the one type of crisis the US government cannot print its way out of. The US national debt stands at approximately $39 trillion. Annual interest payments now exceed $1 trillion — more than the entire military budget. All three major credit rating agencies have downgraded the United States from its top rating.

We present a three-step framework — OWN, AVOID, FOLLOW — to help investors navigate this environment. Sectors that benefit include energy, financials, gold, and commodities. Sectors at risk include overvalued growth technology, bond proxies, leveraged small-caps, and long-duration bonds. Above all, we emphasize trend-following discipline over headline-driven panic.

Strait of Hormuz

Closure

→

Allies Need Dollar Cash

→

Mass Treasury

Selling

→

Interest Rates

Rise

→

Dollar Weakens

→

Gold &

Commodities Rise

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THE CREDIT DOWNGRADE NOBODY CAN IGNORE

The UAE's Dollar Ultimatum

The Trigger Event. In April, the UAE's Central Bank Governor walked into meetings with US Treasury Secretary Scott Bessent in Washington. The UAE — one of the wealthiest nations on Earth, with approximately $270 billion in foreign exchange reserves and trillions in sovereign wealth funds — had a problem. Since the US-Israeli conflict with Iran escalated in late February, the Strait of Hormuz — the narrow waterway through which roughly 20% of the world's oil transits — had been effectively shut down. The UAE had been struck by over 2,800 missiles and drones. Their oil exports had slowed dramatically.

The Threat. The UAE requested a currency swap line — a dollar lifeline. And then, according to multiple reports, Emirati officials added a statement that sharpened the room: if dollar availability became constrained, they might begin pricing oil sales in Chinese yuan. Treasury Secretary Bessent subsequently confirmed publicly that "many" Gulf and Asian allies have requested swap lines.

> "If we can't get dollars easily... we may have to sell oil in Chinese yuan."

- ✓ UAE officials to US Treasury, April 2026 (Fortune, Middle East Eye)

Why It Matters. Since 1974, when Saudi Arabia agreed to price oil exclusively in US dollars, the dollar has served as the world's oil currency. Every barrel sold anywhere on the planet is priced in dollars. This arrangement — the "petrodollar system" — is foundational to the dollar's status as the global reserve currency. When an ally, not an adversary, openly discusses alternatives, it signals structural stress in a system that has held for over 50 years.

Understanding Treasury Bonds

What Is a Treasury Bond? Think of it simply: when you lend a friend $1,000 and he writes you an IOU promising to pay you back in 10 years, plus $50 each year as a thank-you — that piece of paper is essentially a Treasury bond. It is a promise by the United States government to repay borrowed money with interest.

The Scale. The US government has done this with everyone

- ✓ domestic investors, foreign governments, central banks. The total: approximately $39 trillion in outstanding debt. Foreign countries — Japan, China, the United Kingdom, the Gulf states — hold roughly $9 trillion of these IOUs. For 80 years, these were considered the safest investment on Earth.

The Question. What happens when the people who lent you the money suddenly need their cash back — all at the same time?

The Forced Selling Wave

Not Choice, But Necessity. Central banks are not selling Treasury bonds because they want to. They are selling because they have to. The chain is direct: the Strait of Hormuz closure created the largest oil supply disruption in the history of the world oil market. Kuwait — a major oil exporter — exported zero barrels of crude oil in April, declaring force majeure for the first time since the Gulf War in 1991.

The Dollar Scramble. Oil-importing nations — Japan, South Korea, India, Thailand, Turkey — desperately need oil. Oil is priced in dollars. So they need dollars. The fastest way for a central bank to obtain dollars is to sell its most liquid dollar-denominated asset: US Treasury bonds.

Indicator	Value	Significance
NY Fed Custody Holdings	Lowest since 2012	Foreign central banks rapidly withdrawing
China		

Treasury

Holdings

$652 billion

18-year low (lowest since Sept. 2008)

Japan Treasury Sales (single month)

~$47 billion

Quarterly outflow of $30B — largest since 2022

Total Foreign Holdings (March)

$9.49T → $9.25T

$240 billion sold in 30 days

Net Buyer

United Kingdom (+$30B)

Essentially the only major buyer

Gold Overtakes Treasuries: A Historic Shift

A Once-in-a-Generation Data Point. Gold now constitutes 24% of global central bank reserves. US Treasuries sit at 21%. This is the first time gold has overtaken American government bonds since the mid-1990s.

244 TONNES

GOLD PURCHASED BY CENTRAL BANKS IN Q1 —

WORTH $37 BILLION — THE HIGHEST SINGLE-

QUARTER VALUE EVER RECORDED

Who Is Buying. Poland is the largest buyer, on a multi-year plan to stockpile 700 tonnes. China, Uzbekistan, Kazakhstan, and the Czech Republic are all adding aggressively. The people whose literal job is to protect their nation's wealth are choosing a physical metal over American government promises.

Wall Street Gold Forecasts	Target (per ounce)
J.P. Morgan	$6,300
Wells Fargo	$6,100 – $6,300
Goldman Sachs	$5,400

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How Bond Dumping Hits Your Wallet

The Bond Math. When countries sell bonds en masse, it is analogous to every homeowner on a street putting their house up for sale simultaneously — prices collapse. In bond markets, when prices fall, yields (interest rates) rise. They move in opposite directions. Always. Mass selling of Treasury bonds pushes interest rates higher across the entire economy.

Interest Rate Benchmark	Current Level	Context
10-Year Treasury Yield	4.7%	~55 basis points above CBO projections
30-Year Treasury Yield	5.2%	Highest since 2007
30-Year		

Mortgage

Rate

~6.3%

Spread above Treasuries wider than normal

Credit Card APR >20%

Tracking well above historical averages

Fund Managers Expecting 30Y to Hit 6%

62%

Bank of America global survey

Personal Impact: A 55 basis point increase in mortgage rates on a $500,000 30-year mortgage adds approximately $200 per month — or $64,000 over the life of the loan. When interest rates rise, companies borrow at higher rates too, and those costs flow through to consumers via higher prices for groceries, insurance, and subscriptions.

The Fed's Diminishing Influence. The Federal Reserve is supposed to control interest rates. But when the world dumps $240 billion in Treasuries in a single month, the market sets the rate — not the Fed. The tail is wagging the dog.

The $1 Trillion Interest Time Bomb

$1 TRILLION

ANNUAL US GOVERNMENT INTEREST PAYMENTS —

MORE THAN THE ENTIRE MILITARY BUDGET ($947B)

By the Numbers. The US government now pays over $1 trillion per year in interest on its own debt. This consumes 19 cents of every dollar the government collects in taxes. By 2036, that figure rises to 26 cents. At approximately $3 billion per day, interest on the national debt is the fastest-growing line item in the federal budget — projected to increase 106% over the next decade, outpacing Medicare (85%), Social Security (65%), and defense spending.

Federal Budget Category	Projected 10-Year Growth
Interest on Debt	+106%
Medicare	+85%
Social Security	+65%
Defense	Lower
The Compounding Problem. The Congressional Budget	
Office has calculated that if Treasury yields remain 55 basis	
points above projections for a decade, it would add another	
$2 trillion in interest costs on top of what is already projected.	
The government cannot grow its way out at current GDP	
growth rates. It cannot cut its way out — there is no political	
will from either party. It is left with two options: inflate the debt	
away (quietly destroying savings and purchasing power) or	
borrow more (making the problem larger). There is no door	
number three.	

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Amend, Extend, and Pretend

The Template. The UAE swap line is not an isolated incident. It is a template for how the entire financial system is currently operating. Wall Street calls it "Amend, Extend, and Pretend"

- ✓ change the terms, push out the deadline, pretend everything is fine.

How Swap Lines Work. Imagine your neighbor's house is flooding. He is about to dump all his furniture (Treasury bonds) onto the street at fire-sale prices, crashing property values in your neighborhood. Instead, you loan him a pump (dollars). He gives you his car keys as collateral (his local currency). He fixes the flood, returns the pump, you return the keys. Crisis averted. Temporarily. The Fed already has permanent swap lines with five major central banks and is now proposing to extend them further.

Maturity Wall	Amount	Timeline
US Treasury Debt Maturing	~$10 trillion (one- third of total)	2026
Commercial		Real
Estate Debt		
		$1.26 trillion
		Through
		2027
Office		Loan
Delinquency Rate		
		83.7% Current
Leveraged Corporate		
Debt		
		$140 billion Due 2027
Our Assessment. Amend-extend-pretend works for a while.		
It is rational in the short term. But every time this strategy has		
been deployed in financial history, it has eventually stopped		
working. The question is not if, but when — and whether		
investors are positioned appropriately when it does.		

PART III: THE THIRD DOMINO — THE DOLLAR'S SLOW-MOTION DEMOTION

The Dollar Index Decline

Measurable Weakness. The Dollar Index (DXY), which measures the dollar against a basket of six major currencies, has dropped from approximately 107 in late 2025 to around 99 — a meaningful decline for a global reserve currency. Goldman Sachs, JPMorgan, and ING all forecast the DXY falling into the low-90s by year-end, which would represent the weakest dollar in years.

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THE CREDIT DOWNGRADE NOBODY CAN IGNORE

Three Forces Driving the Dollar Down

Force 1: A Fractured Federal Reserve. The April FOMC meeting produced an 8-to-4 vote — the largest committee split since October 1992. The incoming Fed Chair, Kevin Warsh, has signaled openness to cutting rates earlier than expected. A divided, unpredictable Fed translates to an unpredictable dollar, and currency markets penalize unpredictability.

Force 2: Accelerating De-dollarization. The dollar's share of global central bank reserves has fallen to 58.2% — the lowest since 1995. BRICS nations are actively building alternative payment systems. Countries are signing bilateral trade agreements in their own currencies, cutting the dollar out entirely.

Force 3: Safe-Haven Premium Unwinding. During the worst of the Iran crisis, money flooded into dollars as a safety trade. As signs of de-escalation emerge — ceasefire talks, oil easing off peaks — that fear-driven demand for dollars is reversing.

The Credit Downgrade Nobody Can Ignore

All Three Agencies Agree. In May 2025, Moody's downgraded the United States from its pristine Aaa credit rating to Aa1. They were the last major agency to act — S&P downgraded in 2011, Fitch in 2023. Moody's cited "a decade of fiscal decline, rising debt burden, soaring interest costs, and political gridlock." All three major credit rating agencies now say the same thing: America is no longer AAA.

Rating Agency	Downgrade Year	Current US Rating
S&P Global	2011	AA+
Fitch Ratings	2023	AA+
Moody's	2025	Aa1

> "Don't listen to what institutions say. Watch what they do."

✓ Felix Prehn

The smartest, most well-resourced money on the planet — central banks and ratings agencies — is saying, through their actions and their ratings, that the risk of holding American government debt has increased. They are not panicking. They are not running for the exits. But they are quietly, methodically shifting their bets.

PART IV: THE DOMINO FRAMEWORK — PROTECT & PROFIT

We present a three-step framework for positioning portfolios in this environment. This is not a prediction of collapse — it is a structured approach to navigating a shifting landscape.

STEP 1: OWN WHAT BENEFITS FROM THE CHAOS

Energy. The sector directly benefits from the Strait of Hormuz trigger event. Historically, energy stocks are the single best inflation hedge in equities — beating inflation 74% of the time with average real returns of 12.9%. No other sector comes close.

Banks & Insurance. Banks borrow short-term and lend long-term. When interest rates rise and the yield curve steepens, the spread between borrowing and lending costs widens — meaning fatter profits. Insurance companies similarly benefit from higher yields on their premium investment portfolios.

Gold & Gold Miners. Central banks are buying gold at record pace, the dollar is weakening, and Treasuries are losing reserve status. Gold miners offer leveraged exposure: when gold rises 20%, miners can rise 50–70% because costs are relatively fixed while revenue moves with the gold price.

Commodities Broadly. Oil, copper, agriculture, timber — real, physical assets that cannot be printed, cannot be inflated away, and tend to rise when currencies weaken.

STEP 2: AVOID WHAT GETS CRUSHED

Overvalued Growth Technology. When the 10-year Treasury yields 4.7%, future cash flows are discounted much harder. The present value of profits expected 5–10 years from now shrinks dramatically. The 2022 tech crash was a preview of this dynamic.

REITs & Utilities ("Bond Proxies"). When Treasuries yield 4.7% essentially risk-free, the appeal of REITs yielding 4% with attached real estate risk diminishes significantly. Money flows out of these sectors and into safer Treasuries.

Highly Leveraged Small-Cap Companies. Companies with floating-rate debt are watching interest expenses spike in real-time. Many took out loans at near-zero rates and cannot afford to refinance at current levels.

Long-Duration Bonds. Lending to a government that owes $39 trillion, pays $1 trillion per year in interest, and has been downgraded by all three major agencies presents unfavorable risk-reward unless rates have clearly peaked.

The single biggest mistake investors make during a crisis is not being in the wrong stocks — it is timing. They panic-sell quality at the bottom, then fear-of-missing-out-buy junk at the top. Instead of reacting to headlines, use a systematic framework: if a stock's 50-day moving average is rising and price is above the 200-day moving average, the uptrend is intact. If the 50-day rolls over and price breaks below support, the trend has broken down. This framework works in every environment because it follows what the market is actually doing — not what someone on television is predicting.

Fix Your Timing Once and For All

If buying at the top and selling at the bottom has been costing you returns, this is for you. Felix is teaching a free live workshop: "How to Fix Bad Timing Once and For All"

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Risk Assessment Matrix

Risk Factor	Current Status	Investor Impact	Probability
Strait of Hormuz remains closed	Ongoing — 20% of world oil affected	Continued forced Treasury selling, elevated oil	High

KEY DATA SUMMARY

US Fiscal Position	
National Debt	~$39 trillion

Foreign Holdings & Reserves	
Total Foreign Treasury Holdings	~$9.25 trillion (March)
China Holdings	$652B (18-year low)
Gold % of Central Bank Reserves	24%
Treasury % of Central Bank	
Reserves	
	21%
Q1 Central Bank Gold Purchases	244 tonnes ($37B)
Dollar Share of Global Reserves	
	58.2% (low since
	1995)

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