

Fixed Income

VIGILANTES STAY HOME: THE CASE FOR FIXED INCOME

We believe volatility in the bond market will remain elevated because of the uncertainty in fiscal, trade and monetary policy. We've already seen a few early warning signs that volatility will be a theme in 2025. The 10-year Treasury term premium, which compensates investors for bearing the risk of future interest rate fluctuations, has been climbing. In our view, the 10-year Treasury yield outlook can be considered a function of several dynamics:

- Long-term inflation expectations are and should remain anchored.
- The expected path of the real federal funds rate looks to be lower, but inflationary pressures stabilizing at levels higher than the Federal Reserve's (the Fed) target could lead to slower or fewer cuts than the market expects.
- Potential increases in the term premium would raise the 10-year Treasury yield, slowing the economy. This would require less restrictive monetary policy to achieve the central bank's dual mandate, adding uncertainty to the path of real short-term interest rates and volatility to interest rates overall.
- The demand for borrowing is currently high, given the need to finance federal deficits. This will likely keep longer term rates higher, similar to those seen prior to the Covid-19 pandemic.

Compelling case for fixed income at home and abroad

With yields near three-year highs and the Fed in easing mode, there is a compelling case for fixed income investing in 2025.

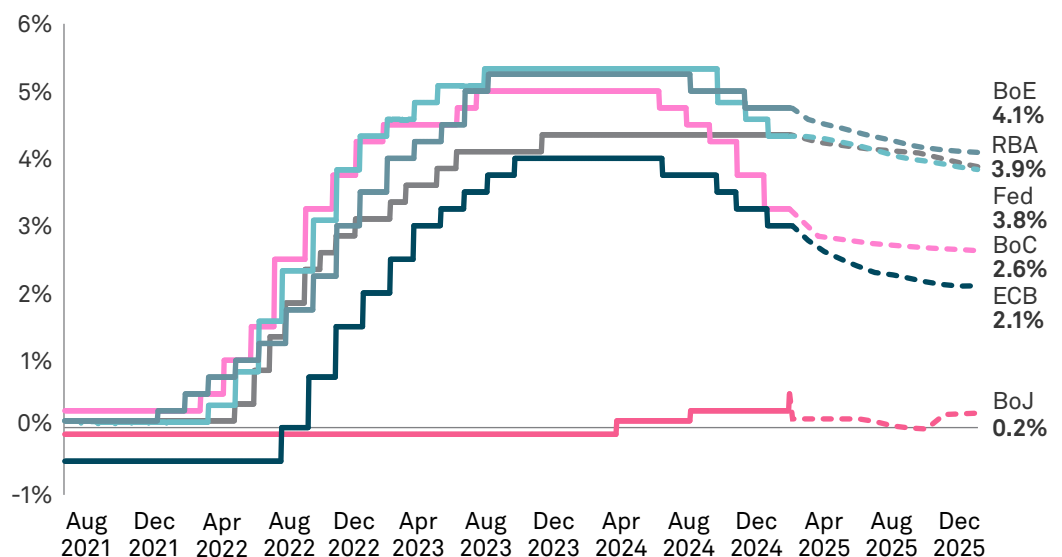
We believe an active, intermediate-term approach in fixed income has the potential to perform well for investor portfolios in 2025. Maintaining quality within bonds enables portfolios to seek attractive yield, while potentially providing downside risk mitigation.

Central banks are expected to decrease rates in 2025 and mostly remain steady through mid-year.

CENTRAL BANK FUTURE RATES

Central bank policy rates and market-implied rate trajectories

- ECB (ESTR futures)
- BoE (SONIA futures)
- Fed (Fed funds futures)
- BoJ (EuroYen futures)
- BoC (Corra futures)
- RBA (ASX futures)



Sources: BNY Investment Institute and Macrobond as of December 4, 2024. The chart is for illustrative purposes and not indicative of the past or future performance of any BNY offering. ECB = European Central Bank; ESTR = Euro Short Term Rate; BoE = Bank of England; SONIA = Sterling Overnight Index Average; Fed = Federal funds futures; BoJ = Bank of Japan; Euro Yen = Euro/Japanese Yen; BoC = Bank of Canada; Corra = Canadian Overnight Repo Rate Average; RBA = Reserve Bank of Australia; ASX = Australian Securities Exchange.

The stock-bond correlation recently turned positive, but we expect the relationship to normalize toward its more typical low or negative correlation as inflation expectations reset lower. This dynamic could help buffer multi-asset class portfolios from growth shocks.

We believe a [core plus strategy](#) may offer the potential for attractive yields with price appreciation through exposure to broadly diversified sectors across the fixed income landscape with an emphasis on high-quality bonds.

Meanwhile, global fixed income may also remain a compelling choice in 2025 for investors who want to diversify and mitigate risk from US rate volatility. There has long been a bias among US investors toward domestic bonds. However, as noted in our report, [Bonds without Borders](#), we see many potential opportunities and an array of interest rate exposures in global fixed income,

given that 60% of bond opportunities come from outside of the US.¹ This could be a particularly meaningful time to consider global fixed income, given it's likely that global central banks will lower rates more substantially than in the US. Investing in global fixed income, particularly on a hedged basis, can provide diversified sources of return to a domestic-only fixed income portfolio.

For a deeper investment discussion, see our full [2025 Market Outlook: Navigating a New Landscape](#).

¹ Source: FactSet, December 31, 2024.

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Past performance is not necessarily indicative of future results.

Bonds are subject to interest-rate, credit, liquidity, call and market risks, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. **Investing in foreign denominated and/or domiciled securities** involves special risks, including changes in currency exchange rates, political, economic, and social instability, limited company information, differing auditing and legal standards, and less market liquidity. These risks generally are greater with emerging market countries.

The 10-Year US Treasuries Average Yield represents a range of Treasury securities adjusted to the equivalent of a ten-year maturity. **Correlation** is a statistical measurement that indicates how the prices of two or more assets move in relation to each other.

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