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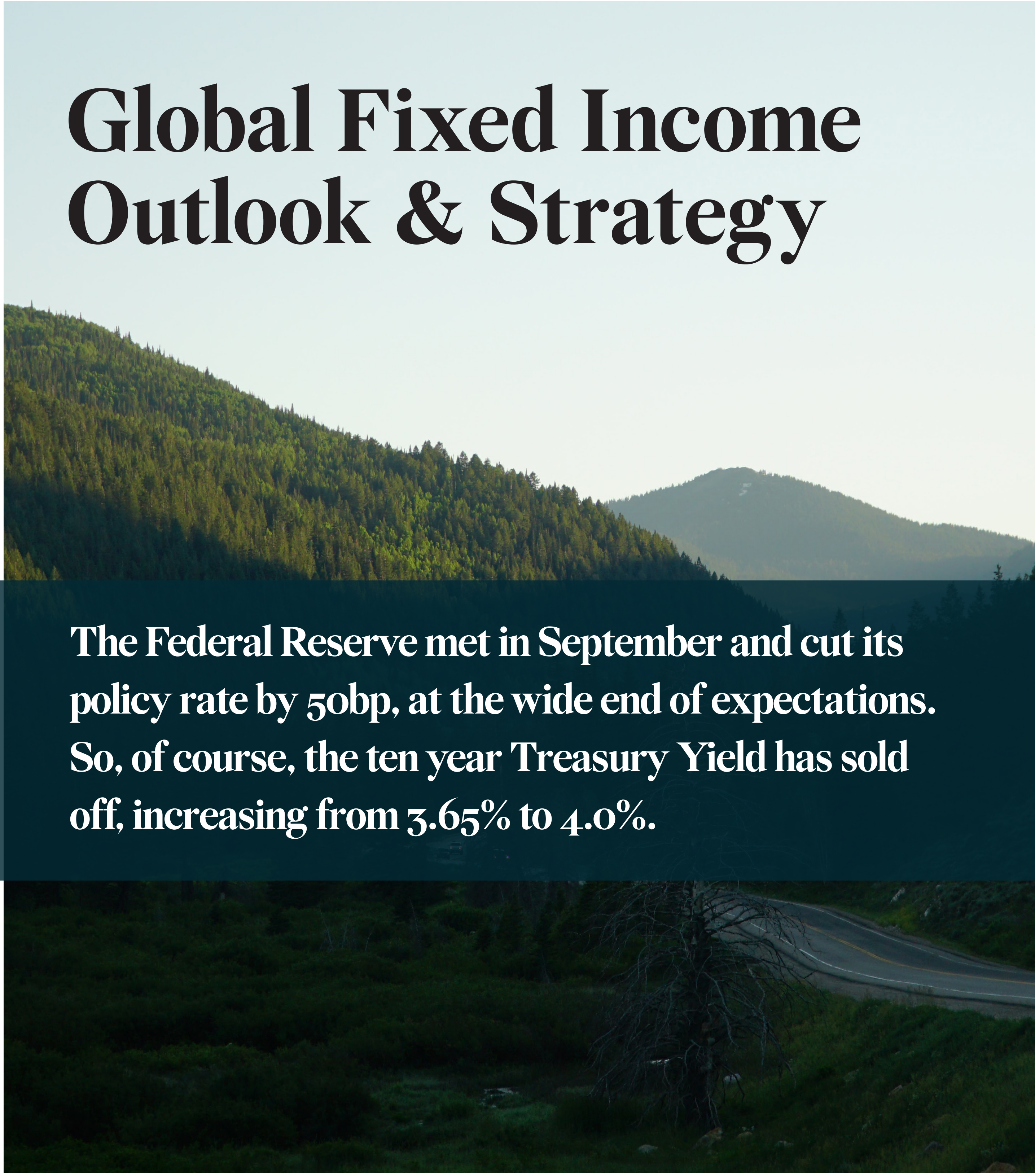
Global Fixed Income Outlook & Strategy



The Federal Reserve met in September and cut its policy rate by 50bp, at the wide end of expectations. So, of course, the ten year Treasury Yield has sold off, increasing from 3.65% to 4.0%.

Market Recap & Outlook

We have subscribed to a kind of unified theory of value for both the DXY dollar index and the ten-year yield this year. Both have been highly correlated with the market outlook for future policy rates, captured by the value of the December 2025 SOFR futures contract. When the macro data (inflation and employment) show a stronger economy, the contract falls, i.e., the expected policy rate at the end of 2025 may rise. When the economy appears weaker, the contract rises, i.e., the future policy rate declines.

Treasury yields are now higher because the September payroll report showed a robust 254,000 new jobs and the unemployment rate dropped to 4.1%. US economic exceptionalism apparently persists. As a result, market consensus about policy rates at the end of 2025 have risen from under 3.0% a month ago to 3.4% currently. This effectively has dropped two interest rate cuts from the future path of the Fed policy over the coming year. Yields and the dollar both climbed accordingly. Treasury yields are less about the cuts that just happened but rather about the future cuts that may not happen at all.

One important currency that is not in the DXY index is the Chinese Renminbi (RMB) for which we have recently witnessed dramatic change. On September 24, People's Bank of China (PBC) announced a host of interest rate cuts as well as providing at least RMB 800bn of liquidity to support equities. The media reported a further possible RMB 3 trillion in coming fiscal support for bank recapitalization, local government refinancing, and possibly direct consumption support. The CSI 300 rose 27% from its lows and futures increased after trading resumed at the conclusion of Golden Week. This was a positive for equity owners, except for the short and the underweight. We believe that China's quantitative easing policy may very well have a positive impact on the bond, stock, and housing markets.

The short-term outlook for Chinese yuan (CNY) is bullish as index and momentum purchases of equities demonstrate capital inflows. Longer term, lower interest rates and a massive expansion of the domestic money supply could potentially be CNY-bearish if Chinese capital controls prove ineffective. We believe that in due time, this will become more transparent. In the interim, the Chinese macro economic forecast is increasing GDP expectations by 50bps or more.

Our Strategy

In a month, we may know the outcome of the US Presidential election. Once the outcome has been determined, we believe that the USD will be bullish. If this is a contested election that we do not foresee, then for that scenario we believe that the USD would be bearish. We believe one possible explanation for the timing of the PBC for economic support is that it may strengthen the economy and sentiment around it ahead of a potential tariff shock. We believe an autumn of surprises is not yet over.

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Important Disclosures

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