WEEKLY STRATEGY
Perspectives

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Tuning into the 10-Year

"Here's the message from the bond market: keep your shirt on."
– Joy Wiltermuth, writing for MarketWatch, February 9, 2025

The Through Line: Equity markets are often the first place investors look for hints as to how a breaking news item will be perceived. Yet bond markets can serve as a more insightful gauge to measure an event's potential impact on economic outcomes. Watching the yield and price movements of intermediate-term bonds such as the U.S. 10-year Treasury note, for example, can offer keen insights into how impactful the nation's creditors believe various happenings may ultimately be.

Equities have more fun

President Donald Trump has had a busy first three weeks in office, serving up a banquet of new plans for businesses, consumers, foreign governments, legislators and markets to digest. After a few wobbly, knee-jerk reactions to specific proposals, equity markets seem to have settled into a somewhat steadier state. They now understand that each pronouncement is more likely written in pencil – not Sharpie – all in support of deal-making.

In the financial news flow, equity markets have historically received the lion's share of attention. In fact, before the great inflation of a few years ago, moves in fixed-income markets were often relegated to items in the far back sections – if they showed up at all. Central bank meetings might make front-page news, but coverage typically focused on their efforts to coax inflation *up* from near zero toward a goal of 2%. In short, it was tough to pique interest in a story that just wasn't happening.

The great reflation: bonds get some R-E-S-P-E-C-T

Much has changed in the last few years as the topic du jour became escalating inflation and the struggles of global central banks to get it back under control. Much of this recent focus has been concentrated on short rates because those are the "policy" levers that the U.S. Federal Reserve, the Bank of Canada and other central banks control with their rate-setting bodies. For many of the world's central banks, job one is price stability – a.k.a. creating reasonable and stable inflation and short-term rate calibrations are the primary tool they have to try to influence economic outcomes. (Note: in the U.S., in addition to price stability, the Federal Reserve has also been assigned a second mandate by Congress: keeping the labor market as close to full employment as possible.)

Central banks can raise short-term policy rates when inflation is too high in an effort to bring things into better balance. The influence is not direct and often happens with a lag, but higher interest rates can slow the economy just enough to allow inflation to moderate. Similarly, they can cut those same rates when growth or inflation is too low in an attempt to encourage price stability.

In contrast to the short rate arena where the central bankers play, market forces influence yields and prices on fixed income instruments with longer maturities. **Arguably these longer rates may matter more to the average citizen as many loans for longer-duration assets such as homes are tied to their levels.** We saw this divergent behavior in action beginning in the fall of 2023 as central banks began cutting short term policy rates, but 10-year yields moved up, carrying mortgage rates higher.

Intermediate Treasury Bond rates

According to the Securities Industry and Financial Markets Association, the total size of the U.S. Treasury market was over $28 trillion as of December 2024, making it the largest and most liquid sovereign debt market on the planet.[1] Within this large pool, the 10-year T-note plays a pivotal role in influencing everything from mortgage rates to corporate loans and bond rates.

As shown in chart 1 (page 3), the yield on the 10-year T-note was locked in a downtrend for the better part of 40 years. In fact, the rate on this instrument had not regularly traded above 5% since the early 2000s. The reflation of the post-pandemic period has changed that, however, and the downtrend has been decisively broken. Chart 2 illustrates both the volatility that the 10-year yield has recently experienced, and the attendant struggles stocks seem to have as yields vault up unexpectedly and/or approach 5%. Longer duration bonds also struggled during these bouts of higher yields, given the yield premium that buyers typically demand over and above shorter maturity bonds as a reward for tying up their capital for longer.

Why 10-year rates matter

In two recent interviews, President Trump's Treasury Secretary, Scott Bessent, noted that he and the **President are more focused on policies that will help push the 10-year yield back down than they are on influencing the Fed's short-term rate setting activities.** The level of U.S. economic growth and inflation heavily influence the yields on U.S. 10-year notes, but debt, deficits and fiscal policy also matter. That's why the new administration is pursuing policies to reduce the U.S. annual deficit (the amount that aggregate U.S. government spending exceeds revenue every year), currently running at over $1.8 trillion in annual overspending. The annual deficit adds to the mounting U.S. total debt – which is currently sitting at a non-wartime high of approximately $36 trillion or over 100% of GDP. (See Chart 3.)

Neither President Trump nor Mr. Bessent can mandate 10-year rates lower, but they can promote policies – and encourage legislators to adopt moves – that increase revenue, decrease spending or some combination of the two. During his nomination hearings, Mr. Bessent suggested a "3-3-3" framework to focus on such policies. His proposal advocates GDP growth of 3% per year (via focusing on reducing impediments to growth such unnecessary regulatory constraints), wrestling the annual deficit down to 3% of GDP and increasing domestic energy production by 3 million barrels per day in the hopes of driving down consumer costs.

Market participants consider a wide variety of factors in determining the fair value for longer-term debt instruments, such as the:

- Sustainability of economic growth
- Likely path of long term inflation (up, down, stable)
- Potential variability in the trajectory of economic progress, particularly if impacted by changes in core policy such as taxation, the imposition of tariffs (and likelihood those tariffs may be met with retaliation) and regulatory changes

Fixed income investors have struggled in recent weeks to determine the best way to absorb fluid tariff and policy talk into their fixed income yield/price calculations. While tariffs are not new – indeed tariffs in a Trump administration are far from new – the lay of the land for Trump 2.0 is a bit different than it was during his first term. For example:

- Tariffs in 2018 were applied during a period of low inflation. **In 2025, consumers are hyper-sensitized to price increases, potentially severely restricting the ability to pass along increased levies.**
- On the other hand, U.S. **economic growth has remained sturdy for several years and shows no indication of slowing** – giving President Trump more maneuverability in pressing his case to apply reciprocal tariffs into a global trading system he views as unfair to U.S. interests.
- **One potential offset to the economy's sturdiness that bears close watching, however, is business reaction.** Mentions of corporate uncertainty in how to plan have skyrocketed in recent weeks – particularly notable during earnings calls in a broad swath of industries. If this uncertainty prompts delays in activity, holes could appear in the solid economic growth story.
- Potential productivity-enhancing technologies in the form of AI, cloud, robotics and other advances could bring welcome **advances in economic activity without stoking inflation** or to help offset inflationary pressures from tariffs.

It is well documented that President Trump views the equity markets as one barometer of success. **Given the level of debt and deficits, the bond market in aggregate (proxied by the 10-year yield) is also serving as an important feedback loop to calibrate the new administration and the legislative branch's ability to maneuver.** Bond investors have shown acute sensitivity to proposals, calculating the net impact each idea could have on growth, inflation and the fiscal landscape.

At the same time, fixed income investors have also been confronted with stubbornly persistent inflation readings and a Fed seemingly rooted to a "somewhat higher for a whole lot longer" mentality. This week's Consumer Price Index print, which showed core inflation above 3% (stronger than had been projected) quickly pushed 10-year yields above 4.6%. They were under 4.5% just last week. The Producer Price Index (widely viewed as inflation in the pipeline) also came in a touch hotter than expected, reinforcing both the stickiness of getting inflation back to the Fed's 2% target, and that body's insistence on being patient in continuing its rate cutting campaign.

Implications for investors

The staccato of rapid-fire announcements is not likely to let up any time soon, keeping both stock and bond investors on their toes. While earning season has shown a nice broadening in revenue and earnings growth across a wider array of companies, C suite consternation is building as the need to adapt quickly creates stress. **Chaos and uncertainty arising from tariff proposals can be powerful negotiating tactics.**

Yet they come at a cost: the longer the uncertainty remains, the greater the chance that growth trends in the U.S. and abroad could be negatively impacted. On the flip side, timely resolution – particularly if combined with regulatory relief, faster permitting, and the encouragement of more deals – could be beneficial.

Our House View remains that fair value on the 10-year is in the 4.25%-4.75% range. This week's hotter-than-hoped-for CPI report pushed yields quickly toward the upper end of that range. We expect yields, particularly at the intermediate- and longer-end of the curve to remain volatile and sensitive to both data and policy announcement as the year unfolds. Should the 10-year hold at current levels or move higher, we may recommend extending duration — both to lock in attractive yields, and to boost protection against any undue economic slowing and downward pressure on interest rates.

Chart 1

Chart 2

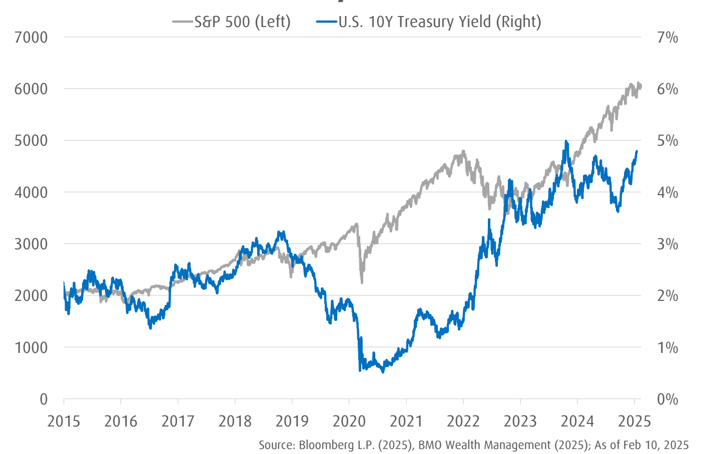
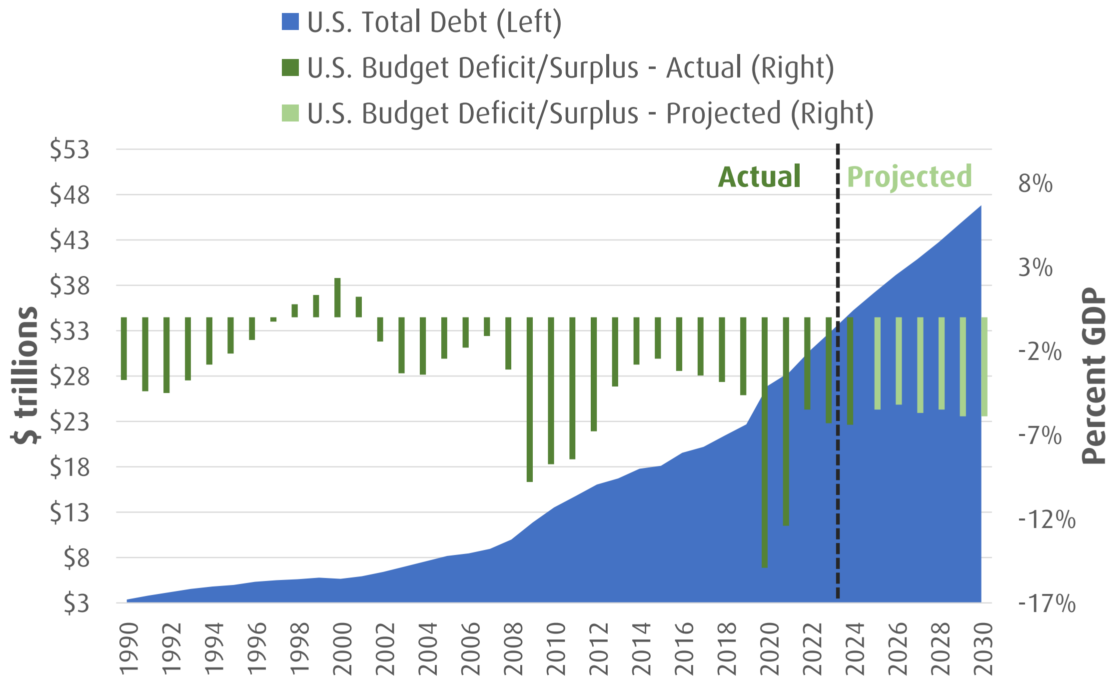


Chart 3



Source: : Federal Reserve (2025), U.S. Department of Treasury (2025), Congressional Budget Office (2025), BMO Wealth Management (2025); *CBO projections as of January 2025.

In focus in North America

Jon Borchardt, Sr. Analyst
George Trapkov, CFA, VP and Portfolio Manager

This week

U.S. CPI prints hotter than expected – The January Consumer Price Inflation report came in above expectations, a signal that progress in getting inflation down toward the Fed's 2% target appears to have stalled. Headline inflation increased 3% year over year and core CPI, which excludes food and fuel, rose 3.3% – both exceeding consensus forecasts. **Inflationary pressures were broad based, with notable increases in used vehicle prices, motor vehicle insurance, travel services, shelter and once again eggs,** which surged 15.2% from December levels.

U.S. Fed speak – Chairman Jerome Powell spent two days on the Hill giving his bi-annual Humphrey-Hawkins testimony and answering questions from legislators on a broad variety of topics. The hotter-than-expected CPI print came on Chair Powell's second day of testimony, and he reiterated that if inflation remains sticky the Fed can maintain its current policy restraint for longer. **As a result, hopes for a summer rate cut quickly dissipated. Markets are now pricing in a rate cut no sooner than the fourth quarter,** and speculation has increased that the next move by the Federal Reserve could be a rate increase. BMO U.S. Wealth Management CIO Yung-Yu Ma, Ph. D, disagrees with the possibility of a rate increase, however, maintaining the view that two rate cuts are still possible in 2025. Further easing would likely be predicated on labor-market weakness rather than significant progress on inflation.

U.S. slaps tariffs on steel and aluminum – On February 10, President Trump signed an executive order setting a 25% tariff on steel and aluminum imports with the goal of encouraging investment in, and expansion of, domestic capacity. Currently, around 30% of steel and 50% of aluminum consumed in the U.S. is imported. These new tariffs will take effect March 12. Two-thirds of U.S. aluminum imports come from Canada where low-cost hydropower provides a competitive advantage in producing the energy-intensive metal. Most of the aluminum supplied by U.S. incorporated Alcoa, for example, comes from Canada. On the fourth quarter earnings call, the company's CEO told investors that a 25% tariff on aluminum imports "would represent a threat to U.S. industrial competitiveness" with the transportation industry most negatively impacted. Coca-Cola and Ford also discussed the impact of tariffs during their respective earnings calls. **Former U.S. Treasury Secretary Larry Summers pointed out that while the U.S. has approximately 150,000 steel workers, steel-consuming industries such as auto manufacturing and construction employ 900,000 and seven million workers, respectively.** It was this basic math that prompted President Trump to issue import exclusions during his first term.

Canada braces for U.S. tariffs on metals – Total steel and aluminum exports to the U.S. were C$35 billion in the past year, or roughly 1% of GDP. Quebec exported roughly C$14 billion of these products to the U.S. in the last year (mostly aluminum), or just under 2.5% of GDP, while Ontario's slightly larger dollar amount weighed in at just under 1.5% of GDP (mostly steel). The direct exposure across the rest of Canada is less pronounced.

Canada posts another strong employment report – Canadian employment rose by a sturdy 76,000 in January following the rollicking 91,000 advance in the prior month. Details were equally robust, with full-time jobs up a hearty 35,200 and total hours worked advancing a strong 0.9% month over month. This combination of cooling labour-force growth and still-strong job gains has helped bring the unemployment rate down to 6.6%, well below last November's 6.9% peak. For the Bank of Canada **there's not much here that cries out for further near-term rate relief,** but the clear and present trade risks will keep rate-cut hopes alive. The moderation in wages does give the BoC a bit more room to manoeuvre should a full-blown trade war erupt.

Next Week

Relatively light data week though the onslaught of earnings reports will continue. The mid-week release of FOMC January meeting minutes is likely to be put under the microscope given this week's hotter CPI and PPI reports.

- **Monday 2/17** – U.S. Markets closed for Presidents' Day Holiday
- **Tuesday 2/18** – U.S. Empire State Manufacturing Indexes | Canada Inflation
- **Wednesday 2/19** – U.S. FOMC minutes from January 2025 meeting
- **Thursday 2/20** — U.S. Initial/Continuing Jobless Claims, Philly Fed Index, Leading Economic Indictors | Canada PPI
- **Friday 2/21** — U.S. flash Services and Manufacturing PMIs, Consumer Sentiment | Canada Retail Sales

Data scorecard as of February 12, 2025

Equity Market Total Returns						
	2/12/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	6,052	0.5%	3.0%	25.0%	26.3%	-18.1%
NASDAQ	19,650	0.7%	1.8%	29.6%	44.7%	-32.5%
DOW	44,369	0.2%	4.4%	15.0%	16.2%	-6.9%
Russell 2000	2,256	-1.0%	1.2%	11.5%	16.9%	-20.5%
S&P/TSX	25,563	0.5%	3.6%	21.7%	11.8%	-5.8%
MSCI EAFE	8,562	0.4%	5.9%	3.8%	18.2%	-14.5%
MSCI EM	594	0.2%	3.5%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Treasury		-0.7%	0.2%	0.6%	4.1%	-12.5%
Bloomberg U.S. Aggregate		-0.7%	0.2%	1.3%	5.5%	-13.0%
Bloomberg Canada Aggregate		-0.7%	0.4%	4.0%	6.5%	-11.3%
Bloomberg U.S. Corporate		-0.7%	0.3%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		-0.2%	1.2%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		-0.4%	0.7%	0.9%	4.5%	-4.7%
Government Bond Yields						
	2025-02-12	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.63%	4.54%	4.57%	4.6%	3.88%	3.88%
Canada 10-Year Government	3.18%	3.06%	3.23%	3.2%	3.11%	3.30%
U.K. 10-Year Gilt	4.54%	4.54%	4.56%	4.6%	3.53%	3.66%
German 10-Year Bund	2.48%	2.46%	2.36%	2.4%	2.02%	2.57%
Japan 10-Year Government	1.34%	1.24%	1.09%	1.1%	0.61%	0.41%
Currencies & Real Assets						
	2/12/2025 Level	WTD	YTD	2024	2023	2022
USD Index	107.94	-0.1%	-0.5%	7.1%	-2.1%	8.2%
CAD:USD	$0.70	-0.1%	0.5%	-7.9%	2.3%	-6.7%
Bitcoin	$97,663.11	1.7%	4.2%	120.5%	157.0%	-64.3%
Gold	$2,904.04	1.5%	10.7%	27.2%	13.1%	-0.3%
Oil (WTI)	$71.37	0.5%	-0.5%	0.1%	-10.7%	6.7%

Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index. Index definitions can be found at the end of this publication.

Index Definitions

Equity indices

S&P 500® Index is an index of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization.

NASDAQ Composite Index is a market-cap weighted index of the more than 3,000 common equities listed on the Nasdaq stock exchange.

Dow Jones Industrial Average ("DOW") is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq.

Russell 2000® Index (Russell 2000®) is an unmanaged index that measures the performance of the smallest 2000 U.S. companies in the Russell 3000® Index.

S&P/TSX Index is a capitalization-weighted equity index that tracks the performance of the largest companies listed on Canada's primary stock exchange, the Toronto Stock Exchange (TSX).

MSCI EAFE Index (Developed Markets —Europe, Australasia, and Far East Index) is a standard unmanaged foreign securities index representing major non-U.S. stock markets, as monitored by Morgan Stanley Capital International. The index captures large and mid-cap representation across 21 developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index is a market capitalization weighted index representative of the market structure of the emerging markets countries in Europe, Latin America, Africa, Middle East and Asia. Prior to January 1, 2002, the returns of the MSCI Emerging Markets Index were presented before application of withholding taxes.

Fixed income indices

Bloomberg U.S. Treasury Index is an unmanaged index that includes a broad range of U.S. Treasury obligations and is considered representative of U.S. Treasury bond performance overall.

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities and commercial mortgage-based securities.

Bloomberg Canada Aggregate Bond Index measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market. It includes treasuries, government-related, and corporate issuers.

Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers.

Bloomberg U.S. Corporate High Yield Index is an unmanaged index that covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+ or below.

Bloomberg 1-10 Year Blend Municipal Bond Index is a market value-weighted index which covers the short and intermediate components of the Bloomberg Capital Municipal Bond Index — an unmanaged, market value-weighted index which covers the U.S. investment-grade tax-exempt bond market.

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[i] US Treasury Securities Statistics - SIFMA - US Treasury Securities Statistics - SIFMA