WEEKLY STRATEGY
Perspectives

BMO Private Wealth

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Tracking the 10-year

"I used to think that if there was reincarnation, I wanted to come back as the president or the pope or as a .400 baseball hitter. But now I would like to come back as the bond market. You can intimidate everyone."
– James Carville

The Through Line: Global bond markets have been sending thought-provoking signals all year for those paying attention. They've hinted displeasure at mounting government deficits. They've waffled between optimism in stronger-than-expected growth to caution over the hit economies could take from accelerating trade wars. Decoding those messages is useful for all investors as yields on longer-dated sovereign debt can deliver more nuanced insight into an economy's long-term trajectory than shifts in central bank policy.

Bonds and central banks: it's complicated

After years of overarchingly low rates, divergent moves by key central banks in the last few years have attracted intense investor and political attention. Theory presumes that tweaking short rates translates cleanly into revved or reduced economic activity – but this is seldom the case. In the U.S., for example, a majority of private lending happens outside the banking system[i], making the transmission of rate decisions fitful at best. It's those "long and variable lags" that Federal Reserve officials and strategists are always referencing.

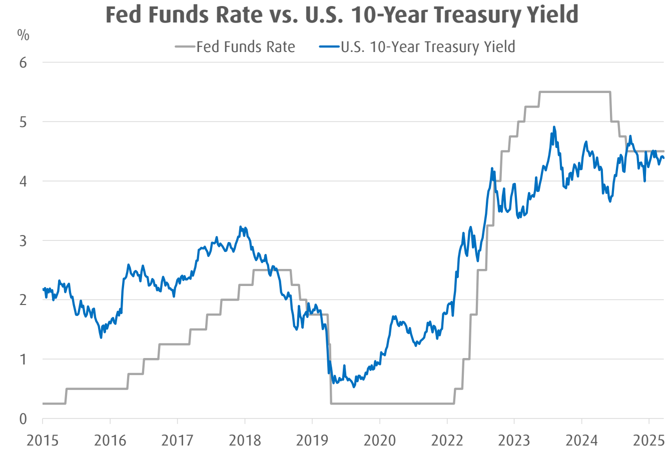
Central banks play a vital role: they help set a framework for inflation expectations. Bond markets also perform a key function as their reactions to geopolitical events, policy decisions and economic signs can be important early indicators of the state of the world economy. They touch virtually every corner of economic activity (being primary underwriters of much of that activity) and exert influence on interest rates. Watching price and yield movements in longer-dated bonds – those maturing 10, 20, or 30 years in the future – can be especially insightful. Investors in those maturities consider not only inflation but also growth and the ability of the underlying borrower to repay. The 10-year U.S. Treasury, for example, is often considered the bellwether maturity.

How central banks fit in

Most developed market countries (or trading blocs in the case of the EU) have a central bank whose primary charge is to ensure price stability – typically by attempting to influence inflation. The primary tool employed to move the needle is the setting of short-term "policy" rates. Rate increases should theoretically transfer through to higher lending costs, for example, and slow an overheating economy. **Unlike other central banks, the U.S. Federal Reserve has *two* mandates: price stability and full employment making its job a bit trickier** because those goals can sometimes be at odds with each other (e.g., raising rates to slow the economy could also lead to job losses and higher unemployment).

In the post-COVID era, central bank policy has diverged; some banks were quicker to start rising policy rates in response to the multi-decade spike in inflation. Once inflation had started to recede, others were quick off the blocks to bring policy rates back into more neutral territory where rates are neither restrictive/deflationary or stimulative/inflationary. The Bank of Canada, for example, had completed two rate cuts (50 basis points) before the Fed's rate-setting body, the Federal Open Market Committee, initiated its first cut, which happened in September of last year. After three reductions (100 basis points), the FOMC moved to the sidelines with the policy rate stuck at 4.50%. Meanwhile in Canada, the BoC kept cutting and eventually landed at 2.75%.

Fed Funds Rate vs. U.S. 10-Year Treasury Yield



Source: Bloomberg L.P. (2025); as of July 25, 2025.

Waiting it out on the sidelines

Throughout this year, pundits have been waiting for the impact of tariffs (already at rates four-to-five-times higher than they were on January 1, even though the final deals are not yet struck) to hit growth, inflation and/or hiring. Although a few signs have recently appeared in hard data, the U.S. economy has proven more spirited than most projected. The wait has kept the Fed on the sidelines – much to the obvious chagrin of President Donald Trump and his administration, who repeatedly call for cuts of up to 300 basis points aimed at lowering long-term borrowing costs of the U.S.

Interesting thing about cutting short rates, though: there's no guarantee that longer rates will decline in tandem. When the Fed cut rates by 100 basis points last fall, for example, longer yields actually moved up by a similar amount. Longer bond yields (such as the U.S. 10-year Treasury) anchor many important types of credit like mortgages and autos.

Vigilantes at the ready

Fixed income investors are sometimes termed bond vigilantes. Since there's no bond market sheriff in town, they demand higher yields as a form of retaliatory justice, which polices the behavior of political leaders whose policies are deemed less than helpful for bond holdings. They carefully monitor factors that may impact growth (up or down), an entity's aggregate debt/ability to repay, or overt political intervention in the workings of the free market. So far, vigilantes have been watchful – not riotous – while sovereign governments increase stimulative spending, ramp outlays for defense, lower taxes, remove debt breaks, prep tariff responses, handle sticky inflation and put central banks under pressure. Other factors that may influence their thinking in the months ahead are outlined below.

What could push rates higher

- perkier-than-anticipated economic growth, especially if it leads to stronger wage growth amid a tight labor pool with no technology offset
- inflation that isn't seen as a one-time price increase – which tariffs may end up being – but is driven by factors perceived to have more staying power (e.g., wage/price spirals, a weaker dollar or price increases in key commodities)
- higher-than-expected deficits with little/no offset, which would drive a need to issue more longer-term debt
- increased scrutiny or discomfort with management of the maturity-date composition of government debt (e.g., too much in either the short or long term), and bond investors watching the quantity of lengthier maturities and sending distinct signals when they're displeased
- the Fed communicating a belief that the neutral rate is higher than the 3% markets are currently discounting
- the central bank cutting at the wrong time or for the wrong reasons (e.g., when growth and/or inflation are expected to accelerate; every easing cycle is different)

What could keep them lower/well-behaved

- limited impact of tariff price transmission
- markets move gradually to adjust to large deficits and increased debt issuances – these longer trends happen gradually
- tariff revenues that surprise to the upside, offsetting some portion of annual deficits
- increased reliance on short-term funding (issuing T-bills versus longer-dated bonds). Treasury Secretary Scott Bessent noted in a recent media interview that Treasury intends to continue funding its near-term needs in the Treasury bills market. Demand for bills will also likely include stablecoin issuers following the recent passage of the GENUIS act facilitating expansion of that industry
- the U.S. trade war may well prove deflationary as it siphons income from the economy into the coffers of both the U.S. and governments abroad (in the case of retaliatory levies)
- increased geopolitical tension and/or stock market volatility – U.S. fixed income remains a primary safe haven

Implications for investors

Watching bond markets react to key events can provide important insights to support or challenge an economic thesis. More than just monitoring central bank policy, bond market reactions provide well-informed insight into the health and sustainability of policy and economic events.

Even though central bank policy is an important starting point, long-term rates (with the U.S. 10-year yield for its centerpiece) play an integral role in financial markets – though they are often more difficult to forecast. Presuming that Fed rate cuts will lead to lower longer-term yields can be misleading.

Fed policy is currently restrictive and the neutral rate may end up more like 3% to 3.50% (compared to today's rate of 4.25% to 4.50%). But this does not mean a 10-year rate should be much lower unless economic expectations are less optimistic. It is also important to recall that the low rates of the last decade were not the long-term norm. Our expectation continues to call for 10-year yields between 4% and 4.5%.

In focus in North America

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

This week

U.S. Q2 GDP bests estimates but shows under-the-hood strain – The initial Q2 GDP print shows the U.S. economy expanding by 3.0%. This is a marked improvement from the 0.5% contraction in Q1 and better than the Bloomberg consensus forecast of 2.6%. Such a strong headline number elicited a Truth Social post from President Trump, who once again encouraged Fed Chair Jerome Powell to cut rates at Wednesday's FOMC meeting. After digging into the numbers, Federal Reserve officials may come to a different conclusion regarding the economy's strength: the underlying data appear far less positive than the headline figure implies. A key factor driving headline volatility in the first half of 2025 has been imports, which subtract from GDP in national accounting. Imports surged at an annualized rate of over 50% in Q1 ahead of anticipated tariffs, then dropped by more than 30% in Q2. **That swing mechanically inflated Q2 GDP and reflects trade policy front-running, not underlying demand.** Consumer spending and business investment both came in below expectations. The combination produced just 1.2% growth in final sales to private domestic purchasers for the quarter. That figure suggests private demand is growing at its slowest pace since Q4 2022. While the President believes the Q2 GDP headlines support his argument for a Fed rate cut, the actual justification would be economic weakness, not strength.

Canada's retail sales numbers influenced by tariff machinations – Canadian retail sales fell 1.1% in May. Weakness in autos (-3.6%), following months of strength on front-running, drove the headline drop, leaving sales ex-autos down just 0.2%. Some of that was due to a decline in gas-station spending (-1.4%), with sales ex-autos and gas flat. In a supplementary questionnaire, roughly a third of businesses said they were impacted by trade tensions (though that's down slightly from April) through price increases, higher costs and changing demand. On the bright side, the flash estimate for June points to a solid 1.6% gain, which could be the strongest month of the year. However, volumes could be a touch softer as goods prices ticked up in the month. While Canada and the U.S. work toward a trade deal, it's clear a bit of trade certainty would help support Canadian consumers and broader economic activity.

Tariff and trade update – Last Sunday, President Trump and European Commission President Ursula von der Leyen announced that the U.S. and E.U. had agreed to a new trade framework. Similar to the Japan trade deal announced last week, the framework imposes a 15% tariff on most goods shipped across the pond. President Trump highlighted several large commitments from Europe, including $750 billion in U.S. energy purchases over the next three years, $600 billion in U.S. investment, and significant defense equipment acquisitions. Structurally, the E.U. deal mirrors the Japanese agreement. While 15% is well above last year's average U.S. tariff rate of 2.2%, it is far better than the previously threatened 30% blanket tariff. At this time, Europe has shelved plans to impose retaliatory measures. For businesses and investors, certainty is the shiny object they have been chasing; these agreements help create a more predictable environment. However, **it is important to remember that these are framework agreements, not finalized deals.** For example, it is unclear how Europe would consume $750 billion in U.S. energy, or whether the U.S. could even supply that volume. There is also no visible enforcement mechanism to ensure the E.U. and Japan meet their targets. Japanese officials and President Trump have publicly disagreed on the nature of Japan's investment pledges. The Europeans reportedly believe that the 15% duty would apply even to goods like pharmaceutical products if new Section 232 tariffs are announced. Despite an improved trade picture relative to worst-case scenarios, uncertainty remains.

One consistent theme from Q2 earnings calls is that companies are initially absorbing much of the tariff burden. Proctor & Gamble (PG) is forecasting a $1 billion pre-tax tariff headwind for its new fiscal year. General Motors (GM) expects $4 to $5 billion in tariff-related costs in calendar 2025. Even though many firms have avoided discussing price hikes, PG said this week it will raise prices on about 25% of its U.S. products in response to tariffs. Kraft and Adidas made similar announcements during earnings calls, and Stellantis noted that the depletion of pre-tariff vehicle inventory is supporting higher pricing. While trade policy may now have more structure, it is far from certain. Yellow caution flags remain over the inflationary risk tariffs pose to both companies and consumers.

Canada's housing market stable yet subdued – Construction activity in Canada continues to push ahead valiantly. Normalized interest rates, immigration controls and aging millennials all suggest peak demand stress is passing. BMO Economics believes that sturdy rates of home building, stable home prices, income growth and some further downward movement in borrowing costs will restore affordability to pre-pandemic levels – faster for rentals than for ownership. Housing was a major pillar of the Liberal platform during the 2025 election. The *Globe and Mail* reported that Canadian housing stakeholders are fielding a flurry of calls from government officials seeking their advice on the creation of Build Canada Homes, a new federal entity that Prime Minister Mark Carney has said will get the government back in the business of homebuilding. Questions linger about how the new entity will function, and what its creation will mean for existing programs.

U.S. Fed stays on the sidelines – At its July meeting, the FOMC made no surprise moves and left policy rates where they've been since December 2024. Unchanged from the last meeting, the labor market is seen as solid; the unemployment rate is low; and inflation remains elevated. However, the pace of economic growth has moderated through the first half of 2025. The policy statement notes that the outlook for economic growth remains uncertain. In the press conference, Chair Powell said the full effects of tariffs have yet to be revealed. Currently, it is unknown whether the impact of tariffs will be short lived or persistent. Over the next few months, the central bank will receive a good amount of data, which will assist efforts to make an informed decision. But for now the Fed's policy stance is viewed as well positioned for future adjustments based on evolving risks. Two Fed governors, Christopher Waller and Michelle Bowman, dissented;

both preferred a 25-basis-point rate cut. This is the first time two governors have dissented from the majority view since 1993. Despite the lack of unanimity, Chair Powell said this month's FOMC meeting was constructive; members clearly explained and shared their views. Stocks retreated following the press conference where Chair Powell refused to provide the slightest nod toward a September rate cut.

Canadian rate decision – For the third consecutive meeting the Bank of Canada held its key overnight lending rate unchanged at 2.75%. This decision was widely expected in light of sticky core inflation, a surprising pop in June jobs, and a lingering cloud of uncertainty on the tariff front. The tone of the statement and Governor Tiff Macklem's remarks suggest that the central bank is perfectly comfortable holding rates steady for now, which happens to be precisely in the mid-point of their estimated range of neutral rates (2.25% to 2.75%). Further rate cuts will depend on economic softness continuing and inflation pressures fading. Given that the bank already assumes a deep drop in Q2 economic activity (the full GDP report will be out in late August), we will likely need two friendly CPI reports ahead of the next rate decision in September to meaningfully increase the chances of a cut at that time.

Next week

A much lighter data week. Earnings roll on, Fed governors will be back on the talk circuit.

- **Monday 8/4 –** U.S. Factory orders
- **Tuesday 8/5 –** U.S. trade deficit, S&P final Services PMI, ISM services | Canada Balance of trade
- **Wednesday 8/6 –** Canada S&P Global Composite and Services PMIs
- **Thursday 8/7 –** U.S. Weekly unemployment claims, Productivity, Wholesale inventories
- **Friday 8/8 –** Canada Unemployment rate

Data scorecard as of July 30, 2025

Equity Market Total Returns						
	7/30/2025 Level	WTD	YTD	2024	2023	2022
S&P 500	6,363	-0.4%	9.0%	25.0%	26.3%	-18.1%
NASDAQ	21,130	0.1%	9.8%	29.6%	44.7%	-32.5%
DOW	44,461	-1.0%	5.5%	15.0%	16.2%	-6.9%
Russell 2000	2,232	-1.3%	0.8%	11.5%	16.9%	-20.5%
S&P/TSX	27,370	-0.4%	12.5%	21.7%	11.8%	-5.8%
MSCI EAFE	9,603	-1.9%	18.8%	3.8%	18.2%	-14.5%
MSCI EM	679	-0.4%	18.4%	7.5%	9.8%	-20.1%
Bond Market Total Returns						
		WTD	YTD	2024	2023	2022
Bloomberg U.S. Aggregate		0.1%	3.7%	1.3%	5.5%	-13.0%
Bloomberg U.S. Treasury		0.1%	3.3%	0.6%	4.1%	-12.5%
Bloomberg U.S. Corporate		0.1%	4.2%	2.1%	8.5%	-15.8%
Bloomberg U.S. High Yield		-0.1%	5.0%	8.2%	13.4%	-11.2%
Bloomberg 1-10 Year Munis		0.1%	2.2%	0.9%	4.5%	-4.7%
Bloomberg Canada Aggregate		0.3%	0.1%	4.0%	6.5%	-11.3%
Bloomberg Canada Treasury		0.3%	-0.3%	2.9%	5.0%	-9.9%
Bloomberg Canada Corporate		0.3%	2.0%	6.9%	8.2%	-9.5%
Government Bond Yields						
	7/30/2025	Last Month End	Last Quarter End	2024	2023	2022
U.S. 10-Year Treasury	4.37%	4.23%	4.23%	4.57%	3.88%	3.88%
Canada 10-Year Government	3.48%	3.27%	3.27%	3.23%	3.11%	3.30%
U.K. 10-Year Gilt	4.60%	4.49%	4.49%	4.56%	3.53%	3.66%
German 10-Year Bund	2.70%	2.61%	2.61%	2.36%	2.02%	2.57%
Japan 10-Year Government	1.56%	1.43%	1.43%	1.09%	0.61%	0.41%
Currencies & Real Assets						
	7/30/2025 Level	WTD	YTD	2024	2023	2022
USD Index	99.82	2.2%	-8.0%	7.1%	-2.1%	8.2%
CAD:USD	$0.72	-0.9%	4.0%	-7.9%	2.3%	-6.7%
Bitcoin	$117,143.62	0.0%	25.0%	120.5%	157.0%	-64.3%
Gold	$3,275.18	-1.9%	24.8%	27.2%	13.1%	-0.3%
Oil (WTI)	$70.00	7.4%	-2.4%	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. 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 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. 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.

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 Canada Aggregate Bond Index - Treasury is the treasury sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

Bloomberg Canada Aggregate Bond Index - Corporate is the Corporate sub-component of the Bloomberg Canada Aggregate Bond Index, which measures the investment grade, Canadian dollar-denominated, fixed-rate, taxable bond market.

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[i] https://www.sifma.org/resources/research/statistics/fact-book/