

Flash Fixed Income

September 2025

Rate cuts won't help long-dated bonds

- The steepening of government bond curves reflects building term premium as investors demand compensation for uncertainty around inflation and monetary policy.
- We believe tariffs, immigration curbs and increasing tension between the Fed's dual policy objectives are the major factors driving long end US Treasury yields higher.
- We see higher long end yields as a non-trivial risk to the growth outlook, and with spreads well below medium-term averages we retain our preference for shorter, higher quality credit.

US Treasury (UST) yields have been volatile across 2025 as markets continually reassess concerns around tariffs, inflation and growth. Amid the price swings, the more durable trend for fixed income this year has been the steady re-inflation of "term premium" – the extra compensation investors demand for holding longer-term bonds rather than continually re-investing at shorter maturities.

While 10-year UST yields have bounced around this year – a high of 4.8% in January, a low of around 4% in April and multiple sharp direction changes inside that range – there has been an unambiguous rise in the difference between 10-year and 30-year yields (see Exhibit 1).

Exhibit 1: The US 10s-30s curve has steepened materially



Source: Bloomberg, 16 September 2025

We first highlighted the reemergence of term premium back in February as an underappreciated driver of rising government bond yields (**Flash Fixed Income: Is term premium back?**).

The best way to think about term premium is the compensation investors demand for holding duration (interest rate risk) beyond the roughly two-to-three-year period covered by short term rate expectations (i.e. the point beyond which central bank guidance and contemporary economic data become less useful in predicting the future).

In the quantitative easing (QE) period, central banks compressed term premium by buying long assets, supplying forward guidance, and credibly anchoring inflation expectations. Today, with a number of factors meaning uncertainty around the path for inflation and interest rates is higher, investors are once again demanding more compensation for holding duration.

Three macro factors driving long end yields higher

In our view, the rise in term premium is not just about "flow" factors such as heavy UST issuance or quantitative tightening.

Rather, we believe it is being rebuilt by three macro forces that are widening the range of projections for inflation and rates: a growth shock from tariff policy that is simultaneously inflationary, a supply shock from immigration curbs that tightens labour markets and sustains wage pressure, and a policy pivot toward more aggressive cuts even as inflation is

Credit market performance

	Total return YTD (%)	Total return last 30 days (%)	Yield (%)	Duration (yrs)
EUR IG	2.70	0.40	3.05	4.38
GBP IG	4.10	0.72	5.25	5.67
US IG	7.49	2.26	4.7	6.55
EUR HY	4.36	0.05	5.01	2.79
GBP HY	7.00	-0.07	8.09	2.92
US HY	7.08	1.52	6.63	3.00
EM HY	8.84	1.80	6.86	3.91
Euro Senior Banks	3.11	0.37	2.88	3.58
CoCo	7.99	0.84	5.58	3.39

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not fully damped, compounded by doubts over Federal Reserve (Fed) independence.

1. Tariffs

The market's fixation on tariffs rightly flags a growth headwind, but the second order effect is a wider distribution for inflation and policy. In the short-term tariffs generate inflation in core goods, (how much is uncertain but it is non-trivial), while weaker growth reduces demand and employment. The market cannot know which impact from tariffs will dominate. This combination also carries stagflationary risks as the Fed is forced to prioritise within its dual mandate of maximum employment and stable prices. For term premium, what matters is not the exact tariff rate but that the policy function becomes noisier: investors see a wider set of plausible inflation paths and a less certain Fed reaction to whichever path materialises.

2. Immigration

The US disinflation story has leaned heavily on labour supply normalisation. Prime age participation and immigration helped cool wage growth coming out of the Covid rehiring bonanza without producing a demand collapse. As we wrote in July, a deliberate curtailment of immigration could potentially reverse this effect (**Flash Fixed Income: Forget tariffs, watch the US labour market**). Wages are a slow moving component of core services; if they stick, so does underlying inflation. Ultimately the impact of immigration policy on inflation will take time to become known. It isn't a near term driver of monetary policy, but it could nudge up the Fed's estimate of the neutral rate. Thus, it is in longer-dated yields, rather than at the front end of the UST curve that investors require the additional compensation.

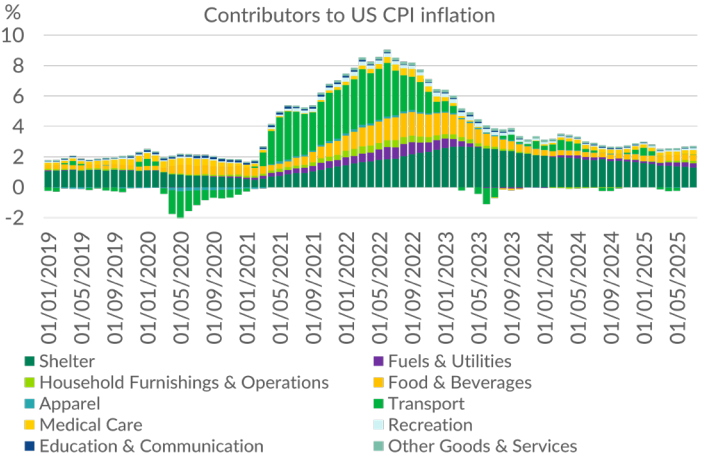
3. Fed's growth/inflation conflict

Finally, we need to look at how the present macro context is altering the Fed's communication and reaction function. Where both growth and inflation present risks to the economy, the Fed's dual mandate goals of stable prices and maximum employment come into conflict. While the Fed will not explicitly prioritise one or the other, we see the contours of its approach in its recent pivot to acknowledging the supremacy of growth risks. Signalling earlier and more numerous cuts while several inflation components remain not fully subdued puts downward pressure on front end UST yields and upward pressure on the long end. This is not a judgement on the wisdom of easing, it is an observation that tolerance for inflation appears higher when growth risks loom.

Fed independence matters

With stickiness in services, particularly housing, as well as food, the market views disinflation in the US as imperfect (see Exhibit 2). While these may follow the wider trend lower, we know that underlying inputs can create upside risks. Wages remain high even with evidence the labour market is cooling. Tariffs put price pressure on core goods. As the Fed is perceived to be prioritising growth risks over a complete inflation victory, long horizon investors demand more insurance against a drift up in trend inflation.

Exhibit 2: US disinflation is viewed as imperfect



Source: Bureau of Labor Statistics, 11 September 2025

Markets have benefited from decades of improved price stability since the advent of central bank independence. Economists generally agree that lower and more stable inflation is correlated with central bank independence. Doubts about that independence therefore create doubts about the path of inflation. The curve transmits that uncertainty by making the long end sticky, despite the Fed's dovish pivot.

President Trump has repeatedly called for the Fed to cut rates more aggressively. While rumours of the possibility of firing chair Jerome Powell have dissipated, and a recent attempt to remove Fed Governor Lisa Cook has also failed, there is clear political pressure on the institution. The Senate confirmed White House CEA chair Stephen Miran to the Fed board in a 48-47 vote, and he will keep his White House role. Dual-hatting blurs the line between the executive and a nominally independent central bank.

Rates dashboard

		Change (bp)			
	Current (%)	1w	1m	YTD	
US Treasury	2yr	3.50	-6	-26	-74
	10yr	4.03	-6	-31	-50
	30yr	4.65	-8	-29	-10
UK Gilt	2yr	3.96	5	0	-49
	10yr	4.64	2	-10	3
	30yr	5.45	-2	-16	28
German Bund	2yr	2.00	6	4	-8
	10yr	2.69	3	-7	33
	30yr	3.28	0	-6	68

		Change (bp)			
	Market projection	Current (%)	1w	1m	YTD
Base rate 4.50%	end-2025	3.64	-1	-17	-30
	end-2026	2.90	-1	-24	-106
Base rate 4.00%	end-2025	3.85	2	2	-28
	end-2026	3.57	2	-1	-42
Base rate 2.00%	end-2025	2.01	4	8	11
	end-2026	2.01	7	4	-5

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This is not to say the Fed is not well guarded from political interference; the courts have upheld its authority, removal protections are strong, and staggered overlapping terms reduce the impact one president can have. But even subtle questions about the Fed's ability to stick to its mandate under political pressure widen the monetary policy distribution. Independence is not a binary on/off; it is a credibility premium that tends to compress long end yields when it is regarded as high and decompress them when it is questioned.

Governments can't ignore long end

Term premium is rebuilding because investors are facing higher macro uncertainty and a weaker monetary policy anchor, but does this matter?

As governments bias issuance to the less costly front end and structural demand for long-dated bonds from insurers and pension schemes falls away, this part of the curve arguably becomes less relevant. However, governments should not entirely pivot to issuing shorter dated bills. Termed out debt gives some immunisation from yield shifts, while issuance focused at the front end makes refinancing and rising debt service costs an ongoing threat. The bond vigilantes will govern, not voters. But more broadly, significant portions of the rest of the economy's financing costs depend on long-dated government bond yields, from mortgages to long-dated corporate bonds. A higher premium on this debt will dampen activity, all else equal.

As fixed income investors we need to actively manage duration and be selective about where on the yield curve we think the best risk-reward is offered. While term premium has risen, for us the extra compensation is not compelling enough given the ongoing risks to the long end. With credit spreads well below their medium-term averages, the likelihood is they will gravitate wider in the coming months and thus our general preference for shorter maturities and higher credit quality remains. At this stage of the cycle, with yields still elevated, we feel we can build a fixed income portfolio at an attractive level of carry without reaching for too much duration or credit risk.

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